

INTERNATIONAL CO-OPERATIVE ALLIANCE  
TECHNOLOGICAL EDUCATIONAL  
INSTITUTE OF WESTERN MACEDONIA

ICA International Research Conference

Local  
Society  
& Global  
Economy  
The Role of  
Co-operatives

Editors: Simeon Karafolas  
Roger Spear  
Yohanan Stryjan

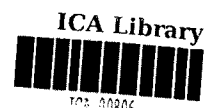
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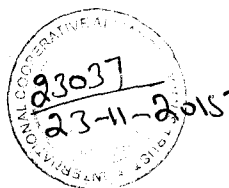
**Local Society  
&  
Global Economy:  
The Role of Co-operatives**

*Editors:*

*Simeon Karafolas, Roger Spear and Yohanan Stryjan*

Naoussa 2002

<b>ΕΚΔΟΤΙΚΟΣ ΟΜΙΛΟΣ ΙΩΝ</b>
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*Επεξεργασία Κειμένων και Σχεδίων:*

*Ατελιέ Γραφικών Εκδοτικού Ομίλου ΙΩΝ*

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### **Acknowledgments**

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### **Preface**

This set of papers is drawn from the most recent in a series of impressive research conferences organised by the European Section of the International Co-operative Alliance Research Committee. This meeting in Naoussa, Greece, was held in May, 2002, and hosted by the Technological Educational Institute of Western Macedonia.<sup>1</sup>

Research on co-operatives examines a field that has fascinated philosophers and thinkers since time immemorial – how can collective initiatives be set up and function effectively. Of course this field is much wider than co-operatives but co-operatives provide very rich seam for developing thinking on this important subject. And developing useful research in this area is becoming more and more pressing, as a series of associated pressures combine to challenge the effectiveness of existing initiatives,, provoking both degeneration and creative responses.

The current challenges are those faced by any enterprise in modern market economies – adaptation to ruthless competition in traditional markets as well as new public services markets (health, social care, recycling, transport, and utilities). But co-operatives face such pressures with distinct advantages and distinct disadvantages compared to their capitalist competitors. Learning about how to exploit these advantages and minimise the disadvantages is the job of researchers and managers and boards and co-op members alike. It is for this reason that all of these people are welcomed at our research conferences. But there is another vital dimension of co-operatives that demands the attention of researchers, practitioners and policy-makers. That is its role in civil societies – both as an economic force (for disadvantaged groups, to maintain choice for consumers, to exert pressure on prices and quality for consumers and producers) but also as a force in democratic society - generating social capital, in order to sustain the fabric of society.

---

<sup>1</sup> Previous meetings were held in

- Gavle, Sweden (2001)
- Oslo, Norway (2000)
- Berlin, Germany (1999)
- Cork, Ireland (1998)
- Bertinoro, nr Bologna, Italy (1997)
- Estonia (1996)

The themes of the book (and the conference) cover both these areas but with an attempt to locate the debate within a local/global perspective. This perspective is represented in the book's title: *Local Society and Global Economy: The Role of Co-operatives*. The aim of the conference was to investigate the mission of co-operatives in the local development within a new international environment. It is worth spending a few words examining why we regard this as so important:

Co-operatives have always constituted a vital link between local development on one hand, and processes in the surrounding economy and society on the other. Through co-operative organization, local produce came to be channeled to national and international (planned or market) economies and local credit societies were linked to financial markets. In much the same manner local initiatives in the social field now interact with national welfare systems.

The emergence and increasing integration of global systems pose new challenges for the co-operative movement. It is often claimed that the 'space of flows' engendered by the globalization process is threatening to supplant the traditional 'space of places' and marginalize local society. New ways for reconciling co-operatives' local mission with this new environment are called for. The new ways for linking the local with the global that new technologies open may be utilized from the bottom up. The strengthening of local society can be seen as a stepping stone to global involvement.

The presence of participants from 26 countries offered the opportunity to discuss many of these issues in market economies and ex-planned economies; the workshops allowed an exploration of conference sub-themes, and a comparative investigation of co-operatives' responses to these challenges in different environments.

This was the first time that an ICA Research conference has been held in South-Eastern Europe. Conference themes reflected some of South-Eastern Europe's specific problems, as well as drawing on its unique potential - particularly with regard to agricultural issues, credit unions, state's involvement, women's involvement in co-operatives, co-operative development in ex-planned economies in East-Europe.

### **Themes in the book**

The book offers a selection of papers presented at the conference. It is divided in eight sections discussing different co-operative themes and social economy issues.

- I. **Credit unions.** This proved to be a very strong theme with papers drawing on experiences from British and Irish credit unions on one hand, and the ex-planned economies and Latin America credit unions on the other hand. These contributions addressed a wide variety of issues including: education and training, modes of organization and adaptation strategies in the

changing economy; and strategic issues at different stages of sectoral development.

- II. Co-operative organization and management.** Again some extremely interesting papers, including: an important new theoretical contribution with empirical findings on why people participate in co-ops; a paper drawing on the excellent Japanese experience in the food marketing area; and a paper on strategy drawing on Quebecois experience.
- III. Co-operatives, the state and civil society.** This section appears quite diverse but there are common themes associated with how co-ops contribute to local society in a variety of fields. This is partly by way of generally enhancing local social fabric, and partly through providing specific facilities and services, in the fields of employment and integration, as well as in the provision of welfare services. However it also includes the importance of institutional factors, such as legal structures and the role of state institutions. Several papers addressed these issues drawing on experiences in Northern Ireland, Denmark, Poland, Hungary, and Sweden.
- IV. Paths in local development.** This section has two papers on different aspects of the role of co-operatives and social economy in economic transformations in rural areas based on Greek and Spanish cases.
- V. Agricultural co-operatives and transformation.** The three papers in this section focus on problems and possibilities of agricultural sectors in Southern Europe - they examine agricultural co-operatives, their restructuring in the context of transforming societies - examining the Bulgarian and Hungarian cases.
- VI. Solidarity and quality: wine and olive-oil co-operatives.** The five papers in this section address important issues of how apparently diverse traditional agricultural sectors address professionalisation and global market issues (such as niches and quality); this includes how co-operatives' distinctive characteristics (e.g. solidarity) influence outcomes. We were particularly pleased to have important contributions about wine co-ops from participants in South Africa, France and Portugal, and about olive oil co-ops from a strong representation from Spain,
- VII. Women and tourism co-operatives.** The two papers in this section generated considerable interest, since women's co-operatives and agro-tourism are becoming important for co-ops; these particular papers drew on experience in Greece.
- VIII. Economic models of co-operatives.** Finally, this area of study, which is a very well established field within co-op studies, provided both theoretical and empirical contributions to agricultural and rural development related to co-operatives.

As a whole these papers represent a most interesting contribution to thinking about co-operative development and management; at our conference, they certainly provided a lively source of discussion both in formal sessions and informally in the coffee and lunch breaks. We hope you gain as much utility from your own study of them, and find the exercise reading them as enjoyable as we did.

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## ***Part I. Credit Unions***

**NO STUDY, NO CREDIT UNION:  
AN IRISH PERSPECTIVE ON EDUCATION AND TRAINING IN  
CREDIT UNIONS**

**Noreen Byrne, Olive McCarthy & Michael Ward**

**Introduction**

Education, whether of a formal or informal nature, is generally seen as a fundamental element in the development of the individual and of society. This was recognised by the early philosophers (both Eastern and Western) who viewed education as a “significant medium which takes an imperfect human being closer to perfection and to a meaningful existence” Jeong-Kyu Lee (2001:161). Later educational theorists, such as Freire (1972, 1985) and Mezirow (1991), saw education as a primary force for independence and freedom of the individual and, in turn, of society. The early co-operative thinkers (such as Thompson, Owen, and the Rochdale pioneers) recognised the transformative and emancipatory nature of education well before educational theorists started to write about it in these terms. These, and later co-operative thinkers, viewed the purpose of co-operative education as being to raise the awareness of social and economic reality and of the individual’s ability, in communion with others, to change that reality for the better.

Education was at the heart of the formation of the Irish credit union movement. The motto ‘no study, no credit union’, first coined by the founders of the Irish credit union movement, is indicative of this. *Is this clear recognition of the importance of training and education as strong in the Irish credit union movement today? At a movement level it would appear so. One manifestation of this has been the support and significant funding provided by the movement to University College Cork for the development of the Diploma in Credit Union Studies and the BSc in Mutual and Credit Union Business.*

The focus of this paper is on the main users of credit union training and education, the credit unions. The paper starts with an introduction to the Irish credit union movement followed by a brief summary of the literature on the main concepts under discussion. The paper then presents the main findings of recent research into Irish credit union training and education and concludes with a general discussion of the key issues raised for credit unions and other co-operatives.

**The Irish credit union movement – past and present context**

The Irish credit union movement was founded in response to the difficult economic circumstances prevailing in Ireland of the 1950s. For many, access to



credit was limited and often only available through moneylenders who charged exorbitant interest rates, the cause of much economic and social hardship.

The Irish movement is now the strongest credit union movement in Europe with about 50% of the Irish population holding membership. There are 535 credit unions with a total of 2.6 million members and €7.9 billion in assets (ILCU, 2001).

Although, the movement has experienced steady and consistent growth and success over the last forty years, McCarthy, Briscoe & Ward (2000:118) highlight a number of challenges and concerns for credit unions, such as an ageing membership, greater demands for a broader service, increasing competition and the need to be differentiated from other financial institutions. Credit unions are not proactively responding to many of these challenges and concerns and often appear to be unsure about their identity and role in contemporary society.

One of the primary factors contributing to this may be that credit unions have achieved their *raison d'être*, where lack of access to credit is not now as significant a problem as it was forty years ago, as most people now have access to mainstream credit. Within this context, there is a danger of losing relevancy and being seen as just another financial institution. This is a familiar pattern of development in co-operatives and often means the decline of the co-operative or its gradual conversion into a conventional business. If this is not to be the fate of Irish credit unions, they must reassert their position as a relevant and necessary part of Irish society.

How can training and education help credit unions in their re-invention? The organisational learning literature argues that if organisations are to transform and reinvent themselves, they must become active rather than passive learners. Sadler-Smith, Spicer and Chaston (2001:143) describe active and passive learning as follows:

- Passive orientation: lower level, adaptive and incremental
- Active orientation: higher level, generative and transformational

Adaptive learning can be described as coping and dealing with current environment in new and better ways, whereas generative learning is seen as moving beyond adaptation by developing new ways of looking at the world (Senge, cited in Sadler-Smith, Spicer and Chaston, 2001:143). Are credit unions adaptive or generative learners?

According to O'Connor, McCarthy and Ward (2002:79) the main driving force behind credit union development and innovation has been to increase the efficiency of their current service rather than meeting the changing needs of members in an innovative way. Thus, credit union development to date would

indicate that they are adaptive learners. O'Connor, McCarthy and Ward pose the question;

“Rather than look at what banks and other financial institutions are doing, would credit unions’ interest be better served if they took time to identify what these financial institutions are not doing and at who they are excluding?” (O'Connor, McCarthy, Ward, 2002:79-80)

It could be said that adaptive development has worked well to date. However, three key issues arise; firstly, this form of development is based on the assumption of continuous growth; secondly, it focuses on the current rather than the future environment and thirdly, it encourages credit unions to imitate rather than distinguish themselves from other financial institutions.

The question is – how will the credit union move from an adaptive/incremental to a generative/transformational approach? Such a shift will require a corresponding shift in culture. From the primary author’s experience (AGMs(national and local), Chapter meeting and so on), credit union ‘people ‘ tend to be very defensive and resistant to any form of critical or reflective analysis. Such a lack of robust dialogue and debate creates a situation where credit union principles can become mere rhetoric and thus meaningless. To keep these principles alive requires open dialogue, analysis and debate. Our history books show us that once any system (state, movement or organisation) begins to discourage critical analysis, it has sealed its own demise.

Training and education will act as a central element in any shift in culture and learning orientation,. This study will present an overall picture of training and education in Irish credit unions. The focus of the study is the education of credit union activists rather than the general member. A brief introduction to the literature the main concepts under discussion follows;

### **Learning in organisations**

Within an organisational context, training differs from education in that training is concerned with the operational aspects whereas, education is more concerned with the strategic development of organisations and the personal development of its people. Both are essential to credit unions. Training and education should produce two forms of learning – individual learning and organisational learning. We will give a brief discussion of both below.

There are different types of individual learning. Mezirow (1991) discusses three types of learning that are based on Habermas’s (1971) work:

Instrumental learning which involves the gaining of technical knowledge. Examples from credit unions could include learning how to use computers, technical aspects of counter work, credit control procedures, loan procedures and so on. This form of learning will result in the acquisition of 'technical skills' (Katz, 1974).

Communicative learning which involves the gaining of social and human relations knowledge. This type of knowledge is sometimes more commonly known as 'people skills', such as communication, negotiation, management and so on. This results in the acquisition of 'human skills' (Katz, 1974).

Emancipatory learning which engages in critical self-reflection of our assumptions and beliefs in relation to ourselves and the world around us. This type of learning is 'transformative' in nature with the potential to act as a "means by which men and women deal critically and creatively with reality and discover how to participate in the transformation of their world" (Friere, cited in Mayo, 1995:16).

Adult and community education focuses on, or at least aspires towards, emancipatory learning whereas organisational training and education tradition tends to focus on instrumental and communicative learning (Tight, 2000). However, within the literature, there is some emphasis on emancipatory type learning, though it would seem to be more concerned with the emancipation or transformation of the organisation rather than any societal transformation. In the literature, such learning is referred to as conceptual or systems thinking. Katz (1974) indicates that conceptual skills are 'the why' of the things we do. Kim (1993:38) in a similar vein compares conceptual and operational learning where he refers to the former as 'know-why' and the latter as 'know-how'. With regard to systems thinking, Senge (1990:68) views it as a discipline for seeing wholes. The premise of a systems approach is that events within a system are connected and when changes are made to elements of that system, there are consequences and impacts for the rest of the system. Thus, a systems thinker has the ability to see the detail and the 'big picture' simultaneously.

However, systems thinking has been criticised as being too narrow in its focus, where it is based on an organisational rather than a societal framework (Panagiotidis & Edwards, 2001:135). Therefore, in the context of co-operative organisations, while a systems thinking approach is useful, it should be used within an emancipatory learning framework. Thus, let us now return to the broader approach of emancipatory learning.

It could be said that credit unions arose out of emancipatory learning, where the people within a community recognised the injustice and suffering caused by the lack of a fair financial system. They saw that this was not going to change and decided to solve the problem for themselves. Has this form of learning faded to

some extent within Irish credit unions and within the Irish movement itself? From superficial observation, it would appear so. One indication of this is that credit unions do not appear to have a clear purpose or direction at the present time.

If credit unions are to create a vision for the future, credit union learning must not only be emancipatory, it must also become collective in nature. There are three problems with learning being confined only to the individual. The first of these is that if the individual leaves the organisation, so also does their knowledge. Secondly, if learning is only confined to individuals and is not shared, organisations are less intelligent than they might otherwise be. According to Senge (1990:238) and others, collective thinking can be more intelligent and insightful than individual thinking. To illustrate his point, he cites Heisenberg, a famous scientist, who states that many of the theories of the great scientists (Pauli, Einstein, Bohr and others) arose out of collective thinking through the medium of conversations. Thirdly, organisations are collective in nature and in order to effect change, even minor change, requires the co-operation and understanding of many people.

Therefore, if organisations are to protect and develop their knowledge base, maximise their intelligence and transform themselves they need to encourage and support collective learning. Collective learning is not a new concept for credit unions: they were formed on this basis through a study group<sup>1</sup>. Some writers view collective or organisational learning as a panacea for the transformation and survival of organisations within an increasingly competitive marketplace.

Credit unions need to encourage all three types of learning, namely instrumental, communicative and emancipatory. However, within the current and future uncertain environment, Irish credit unions need to focus particularly on emancipatory learning and the building of conceptual and systems thinking skills. They must also ensure that learning is not only confined to a number of individuals but should maximise the learning of their whole organisation.

### **The research**

The research is based on interviews with over 800 credit union activists (both staff and volunteers)<sup>2</sup> in relation to their experiences and perceptions of credit union

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<sup>1</sup> Prior to formation, credit unions must set up a study group. This group has to rationalise the need for a credit union and then study for the practical setting up and running of the organisation. A similar idea, called 'Study Circles' forms an important part of co-operative formation and civil society developments in Finland (Briscoe & Ward, 2000).

<sup>2</sup> Credit unions are run by a voluntary board of directors which is responsible for the strategic development of the credit union, together with various sub-committees. A paid manager and staff deal with the day-to-day running of the credit union.

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If credit unions are to create a vision for the future, credit union learning must not only be emancipatory, it must also become collective in nature. There are three problems with learning being confined only to the individual. The first of these is that if the individual leaves the organisation, so also does their knowledge. Secondly, if learning is only confined to individuals and is not shared, organisations are less intelligent than they might otherwise be. According to Senge (1990:238) and others, collective thinking can be more intelligent and insightful than individual thinking. To illustrate his point, he cites Heisenberg, a famous scientist, who states that many of the theories of the great scientists (Pauli, Einstein, Bohr and others) arose out of collective thinking thorough the medium of conversations. Thirdly, organisations are collective in nature and in order to effect change, even minor change, requires the co-operation and understanding of many people.

Therefore, if organisations are to protect and develop their knowledge base, maximise their intelligence and transform themselves they need to encourage and support collective learning. Collective learning is not a new concept for credit unions: they were formed on this basis through a study group<sup>1</sup>. Some writers view collective or organisational learning as a panacea for the transformation and survival of organisations within an increasingly competitive marketplace.

Credit unions need to encourage all three types of learning, namely instrumental, communicative and emancipatory. However, within the current and future uncertain environment, Irish credit unions need to focus particularly on emancipatory learning and the building of conceptual and systems thinking skills. They must also ensure that learning is not only confined to a number of individuals but should maximise the learning of their whole organisation.

### **The research**

The research is based on interviews with over 800 credit union activists (both staff and volunteers)<sup>2</sup> in relation to their experiences and perceptions of credit union

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<sup>1</sup> Prior to formation, credit unions must set up a study group. This group has to rationalise the need for a credit union and then study for the practical setting up and running of the organisation. A similar idea, called 'Study Circles' forms an important part of co-operative formation and civil society developments in Finland (Briscoe & Ward, 2000).

<sup>2</sup> Credit unions are run by a voluntary board of directors which is responsible for the strategic development of the credit union, together with various sub-committees. A paid manager and staff deal with the day-to-day running of the credit union.

training and education<sup>3</sup>. These interviews were carried out by the students of the Diploma in Credit Union Studies as part of their final year dissertation. This research was collated into a recent report produced by the Centre for Co-operative Studies, UCC<sup>4</sup>. The report presents an overview of training and education in Irish credit unions rather than an in-depth analysis. Some of the main findings are presented in the next section.

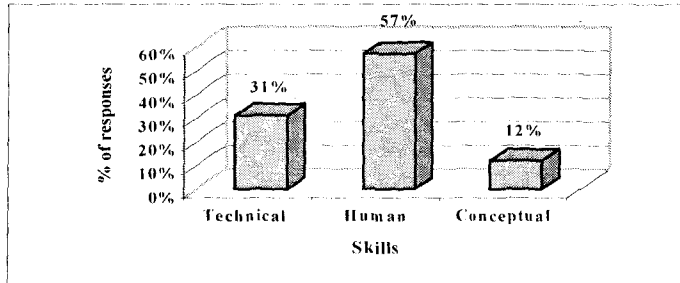
### **The findings**

The study examines the perceived skills of credit union activists, the level of participation in and the type of training and education currently provided and that desired for the future. Motivation to participate in training and education is also explored. The presentation of the findings concludes with a discussion of collective learning in credit unions.

### Skills

The skills level of the interviewees was examined using Katz's (1974) classification, (discussed earlier). The results are presented in figure 1.

**Figure 1 Skill type in the credit union**



<sup>3</sup> Training and education in this study means any training or education that is provided for credit unions. This may be specifically related to credit unions or it may be more general in nature, for example, presentation skills.

<sup>4</sup> Byrne N., O. McCarthy & M. Ward, *Training and Education in Irish Credit Unions*, Centre for Co-operative Studies, UCC, 2002

From this we can see that the skills of the interviewees are spread across the three levels (technical, human and conceptual) with the highest level of skill arising in the technical (31%) and human (57%) areas. It is not surprising that human skills are high in credit unions, as the nature of the work itself encourages and develops this type of skill. For many, especially at volunteer level, the democratic nature of the work is not familiar to them at first, resulting in a sharp learning curve in the early years of involvement. Perhaps, it is also not surprising that conceptual skills (12%) are low in credit unions. Irish credit unions have operated in a relatively stable environment for the past two decades or so and such stability does not encourage people to think in a conceptual way. However, the future environment in which credit unions will have to operate will be far more uncertain. Within such a context, credit unions need to improve their conceptual skills to a higher level, similar to the existing levels of social and human skills.

#### Level of participation

The research also examined the level of participation in credit union training and education by those interviewed. It was found that 57% of interviewees rarely, if ever, participate in training and education. However 43% attend training and education at least once a year. It should be highlighted that credit unions, with regard to the level of training and education, far surpass other co-operative movements in Ireland and also most other collective organisations such as political parties, trade union movements, farmers' organisations and so on.

#### Type of training and education

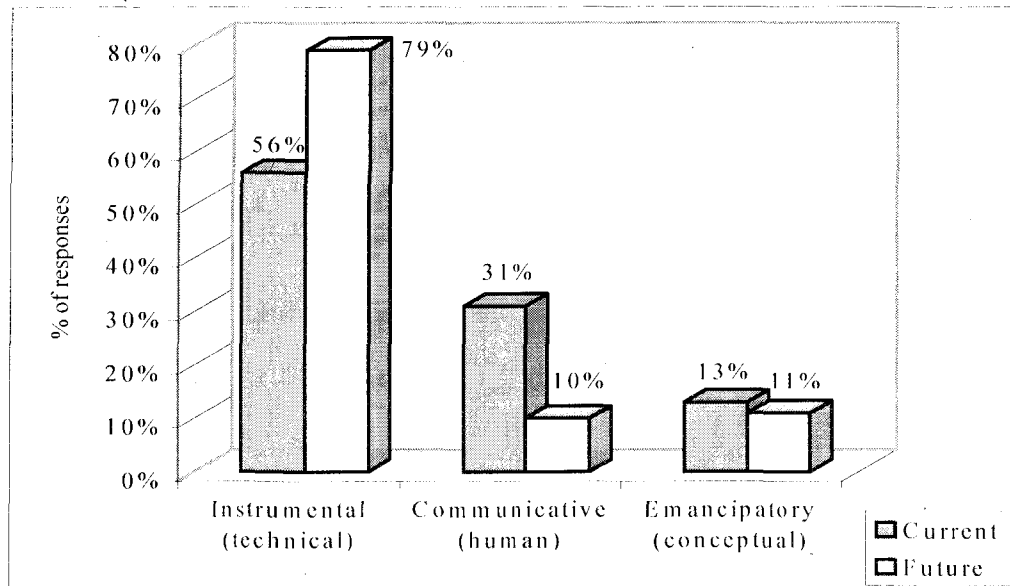
The type of training and education participated in was examined using Mezirow's (1991) learning domains (instrumental, communicative and emancipatory) which were discussed earlier in the paper.

It was found that the majority (over 87%) of training and education courses undertaken by credit union activists are contributors to instrumental and communicative forms of learning. The only credit union training and education which was found to contribute primarily to all three is the Diploma in Credit Union Studies and the BSc in Mutual and Credit Union Business (offered by University College Cork), and possibly any strategy courses (these comprise of only 13% of training and education attended by the interviewees in this study).

When the future type of training and education desired by the interviewees is compared with that actually attended we can see that requests for training and education which build technical skills are increasing (56% to 79%) whereas, those relating to human (10% down from 31%) and conceptual skills (11% down from 13%) are decreasing. This is presented diagrammatically in figure 2.



**Figure 2 Comparison of future desired training and education against that currently attended**



This does not bode well for credit unions. The primary problem is that credit unions are operating within an unstable and changing environment<sup>5</sup>. If this environment were stable, then credit unions could continue to develop along their current course and slowly evolve. This has been the method of development to date. Within a changing environment context, it is not enough to slowly evolve. Organisations must constantly evaluate everything they do, the outside environment and the role of the organisation within that environment. This process of reinvention will not come from the development of technical skills alone. Human skills (to bring people along) and conceptual skills (for reinvention) are crucial. This does not mean that technical skills are not necessary. But on a strategic level the technical needs of credit unions should not be viewed as important in themselves but only in relation to the long term sustainable growth of credit unions. Thus, it could be concluded that for the long term development of credit unions, there must be an increase in the human and conceptual skills base and not a decrease as figure 2 has indicated to be true.

<sup>5</sup> Some of the factors contributing to this are increasing competition from banks and building societies and also from new and potential credit providers. The regulatory environment is also changing and the competitive position of credit unions in the marketplace, is not only being questioned by competitors but also by national and EU legislators.

### Motivation Factors

The central motivating factor for volunteers in undertaking credit union training and education is their interest in the ethos and philosophy of the credit union. For staff, it also acts as a motivating factor but only after basic employee rights (satisfactory pay, work condition and so on) have been met<sup>6</sup>. At the centre of almost any discussion on organisational learning is the role of a strong and inspiring organisational vision. Therefore, if credit unions are to motivate their activists to partake in real learning, they must communicate a clear vision of what the credit union is, how it defines its role in contemporary society and how it views its future direction.

When the future and past motivation factors are compared it was found that certain motivators have increased in importance (local accessibility, career development, quality and relevance). This indicates that people are busier and want higher quality and more relevant courses. The main factor which has decreased in importance is interest in the credit union ethos and philosophy (down from 34% to 22%). This is a worrying factor for an organisation like a credit union, which is very much dependent on volunteers. As Sherry (1994) asserts, it is up to credit unions to inspire their activists to work and commit themselves to the organisation and to participate in training and education. He noted that the primary way of inspiring credit union activists is instilling in them the philosophy of credit unions.

### Collective learning in the credit union

As was indicated earlier, credit unions were formed on the basis of collective learning. However this type of learning appears to have faded to some extent in credit unions. One indication of this is that many of the interviewees complained about the limited sharing of knowledge and learning in credit unions. It was felt that those who attend courses do not share the information with others in the credit union. Many saw this as unfortunate because knowledge gained and not shared will have little impact on credit union operations or policy. In this situation, learning may be taking place at the individual level but not at the collective level. Such learning tends not to be applied, as credit unions like all organisations, are collective in nature and change of any kind requires the co-operation of many people.

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<sup>6</sup> The lack of encouragement and recognition from credit unions was a dominant theme throughout the study. If credit unions want their activists to take part in training and education, they must support them to do so. This recognition and support can come in many forms such as financial incentives, promotion, increased responsibility, involvement in strategy design and implementation and so on.

A significant number of interviewees (13%) thought that the credit union should use workshops or the former study group method as a future means of training and education delivery. The study group concept could provide a vehicle for the sharing of knowledge and collective learning. Perhaps, the credit union movement should seriously consider re-introducing the study group concept for established credit unions. The study group could be as fundamental to the transformation of Irish credit unions as it was to their development in the founding years.

### **Discussion and conclusions**

The findings indicate that Irish credit unions are still committed to training and education. However, there would appear to be a greater focus on the technical and operational aspects of the organisation. As was indicated earlier, credit unions are facing into an uncertain future. While they react to short and medium term issues, they appear to have less focus on the creation of a long-term vision for themselves or society.

What is the role of education in helping organisations to create that vision which ensures their long-term survival? Nora Herlihy (cited in Culloty 1990), a founder of the Irish credit union movement, felt that education had a central role to play. She was concerned about the reducing commitment to education in Irish co-operatives and felt that there was a danger that this would limit the resources of these organisations to form their vision. This research has indicated that credit unions are limiting the resources (emancipatory and collective learning) necessary for the credit union to form a true and inspiring vision for themselves and for future society.

All co-operatives, and not just credit unions, need to return to their emancipatory and collective learning roots. At the heart of this learning is thinking beyond the organisation and having a vision for a future society and then setting out to achieve that vision or at least contributing to it. There are many national and international groups that are genuinely working towards a better future society. However, many types of co-operatives do not appear to take part in these dialogues. This would not have been true in the earlier years of co-operation. Co-operatives should, along with other groups, be at the heart of any dialogue on the vision for a better society. Co-operatives are valuable contributors to such a debate – they are self-help organisations, work on the ground, have access to a huge percentage of the population, have credibility and have real power because of their dual social and economic role.

Co-operatives should not take on the concepts of emancipatory and collective learning and attempt to apply them without changing anything else in their organisations. These concepts would quickly become stale with little meaning and

impact. Co-operatives must first start by opening up a real debate about who they are, what their purpose and role is in contemporary society, what their vision is for a better society and how they can contribute to it. In their search for answers to these questions, they must enter into dialogue with other groups who are working towards a better society and, from this, true emancipatory and collective learning will follow.

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## **BRITISH CREDIT UNIONS AT THE CROSSROADS DRAFT**

**Ray Donnelly**

### **Introduction**

In 1998 HM Treasury appointed a Task Force to examine in what ways Banks and Building Societies could help credit unions to grow. This body produced a report published in November 1999 which recommended the establishment of a Central Services Organisation with wide ranging powers to assist in the rapid growth that all wished to see. Since then little or nothing has happened and this vacuum presents us with an appropriate opportunity to consider the problems of credit unions in England Scotland and Wales. At this time there is no guarantee that the credit union movement within mainland UK will have a future beyond the next ten or twenty years. Even if it does there is the possibility that it will always be marginal to the financial market. What steps might be taken in order to ensure that this is not the fate of the British Credit Union Movement ?

It has been assumed in all quarters within mainland UK that credit unions have a future and while they are slow to develop here, that given the necessary help they will indeed grow. To question such a belief might seem discourteous particularly as the questioner is a strong supporter of credit unions and all co-operatives but that is what is done in this piece. If the question of the future of credit unions within the mainland of the UK is not questioned there might not be a future for them here. Only by facing up to the reality of the position in which credit unions find themselves is there more than a fair probability that they will still be with us in twenty years. How has the Credit Union movement come to this position?

The answer is similar to that for two other important questions, first how have the supporting agencies and over indulgent governments allowed this to happen? Second how is it that the regulators of credit unions have turned a blind eye to incompetence, which could have resulted in financial loss to people who could not afford it.

Summarised the answer reads credit unions were and are perceived as “Good things” and that it would be wrong to do anything that would hinder the growth of the movement. Thus governments both local, regional, and national, continue to throw money at credit union development long after it has been demonstrated that such expenditure is a waste of scarce resources with little or no positive effect on credit union growth. Examples of this include at local level the formation of credit union development agencies, the first being in Strathclyde in 1984, and the funds voted by the Welsh Assembly and the Scottish Parliament for Credit Union

promotion in 2001. In total some tens of millions of pounds sterling have been wasted in this way. In towns such as Birmingham so much has been spent and so little achieved that the Council could have given a holiday to every citizen in areas of deprivation, and saved money.

As an example, because of this tautology the regulators turned a blind eye to credit unions which have failed to submit legally required forms concerning their finances not just for one year, but for periods of up to three years, thus endangering the funds of the members. In like fashion the actions of the trade bodies, The Association of British Credit Unions Limited and the Scottish League of credit Unions, amongst others, seem questionable. Their actions might be interpreted as promoting credit unions as a tool to finance their own existence rather than from any widely accepted plan for the development of a strong sustainable credit union movement. To be fair this might be a reflection of a past action but only time will tell.

Since 1958 when Hackney Credit Union opened, the British Credit Union Movement has grown to a size where there are now over 700 credit unions in England Scotland and Wales. Over 320,000 people are members of these credit unions that between then have over £214 million in assets. (1)

Credit unions are in the business of savings and loans, and at present can offer solely a share account and a loan account. They make on average loans of about £1000 per year to members. After 40 years they have made very little impact on the financial market place within mainland Britain. The reference to mainland Britain follows on from the much greater success of credit unions in Northern Ireland where they are much used. In Northern Ireland the Credit Union movement is divided on sectarian grounds, as is much else in that society. The much larger nationalist movement is part of the Irish League of Credit Unions and as such has no formal involvement with credit unions in England Wales and Scotland. The more recent flowering of the Protestant credit unions and their alliance in the Ulster Federation of Credit Unions has no contact with any mainland association. Many of trade bodies in mainland Britain are influenced to a greater or lesser extent by the Irish league. In a study conducted by Heriot-Watt University (2) into the relatively better growth record of credit unions in Scotland as against those in England and Wales the importance of the link between the peoples of Ireland and Scotland was cited as one of the **factors underpinning the differential in growth.**

### **What is the nature of the crossroads?**

Until now it has been assumed that credit unions in Britain will grow and that they will provide benefits to many people, particularly at the poorer end of society. It is time to question that belief. The Credit Union movement in Britain is at a

crossroads. It can progress, become larger, serving more people of modest means, or it can fade away, in so far as one can fade away from the obscurity in which it resides at present.

There are four factors which have brought the movement to the cross roads.

These factors are:-

- Conflict between social and economic objectives and the lack of focus that such conflict encourages,
- Government policy, and the social inclusion agenda,
- the relationship between credit unions of various types and the trade bodies.
- the personal animosity that has been generated by splits in the British Credit Union Movement

These are considered below.

#### Social versus Economic Objectives

The first to be considered is the question of whether credit unions are businesses with social objectives or whether they are social constructs which are not subject to the normal laws of the marketplace. At first sight this might seem a silly question but there are those who see credit unions purely as social constructs with nothing but social objectives and they hold prominent positions in some credit unions, and in both central and other layers of government.

Credit Unions grew out of the work of two or three nineteenth century co-operators Raiffeisen and in Germany and DesJardin in Canada. In England Scotland and Wales the Retail or Consumers Co-operative gained ground rather than the Credit Co-operative. Indeed consumers co-operatives formed on the model of the Rochdale Pioneers banned the granting of any credit at all. Both credit unions and retail co-operatives were founded as Social Enterprises. Credit Unions were in the same mould as The Consumer Co-operatives of Rochdale. They were democratic economic organisations that provided affordable credit to those who had hitherto been unable to obtain such credit.

The question of conflicting goals is not new for co-operatives. For one hundred years the question of objectives and conflict between them was a problem for the retail movement in Britain. Started in 1844 at Rochdale the founders had the goal of using the money created by the shop to finance "A home based colony of united interests." (3) By 1846 such ideals were abandoned, in reality if not in word, to be replaced by the goal of a high dividend rate.

Credit unions came to Britain in the 1950's. In Britain the conflict between economic and social goals within credit unions was irrelevant as they were too small to do anything to or for anybody. Then came the arrival of Mrs Thatcher in 1979.



Post 1979 Britain suffered considerable increases in levels of unemployment and subsequent poverty. This led to local authorities and some parts of central government to seek strategies to alleviate the resultant poverty. To many government agencies, investing in these strange creatures, credit unions, that purported to offer cheap loans to poor people seemed an ideal such strategy. The first credit union development agency was established in 1984 in Glasgow using funds from Section 10 of the Social Work Scotland Act of 1968. The agency was charged with creating credit unions in some of the most deprived areas of Western Europe. Here is the problem. One mans savings and loan institution for people of modest means i.e. an enterprise with a social purpose, but still an enterprise, becomes for others the organisational route by which poverty can be challenged. Unfortunately the two are not compatible and the resultant impact on British credit unions of this continued dilemma has been disastrous. Until that question is answered by all concerned, credit unions will always be marginalised in the mainland of Britain. An understanding of how credit unions work and prosper can indicate the way in which the answer lies. Credit unions which are successful are businesses with a social purpose

Following on from their European origins the Credit Union movement developed in Canada and America on the principles established. They continued to be Social Enterprises. They were member owned and controlled and provided essential services to their members at a price they could afford and which no other body was prepared to match. As one senior citizen from Chicago said to the writer many years ago "If it wasn't for the credit unions I would never have saved a penny." (4) Here is the nub of what credit unions are about and what they do well. They provide savings and loans to people of modest means and do so in a business like manner except that the members also own the business. The members also share in any profit at the end of the year in form of dividend. Credit unions are social enterprises of the purest kind. They pursue a social objective amongst other economic ones. The business is enterprising and seeks by its enterprise to assist its members improve the quality of their lives. In addition it is member owned and controlled and exists not for profit, not for charity but for service, the motto of the movement worldwide. The profit they do make which is necessary for the business to survive and advance is either ploughed back into the business or paid out as dividend to the members.

Members join credit unions for two simple economic reasons. First a place to save and second access to cheap credit.

Many parts of Great Britain are now deserts as far as financial institutions are concerned. The Retail Banks have withdrawn from all but the most central of places. Rural areas have been almost completely denuded of banks and many parts of the urban environment treated in the same way by other sectors, including the

Post Office and the Retail industry. As banks strive to lower costs and increase profits for their shareholders they have closed branch after branch. Despite the pleas of consumers and consumer watchdogs, this process continues unabated and indeed in the case of retail post offices is made worse day by day.

As institutions available and willing to take small savings disappear so people need an alternative place to deposit their savings. This has presented an opportunity to credit unions throughout the country. Some have grasped that opportunity others have not. The opportunity is not yet past but with developments in the area of a Universal Bank beginning to take shape the time is coming when the chance will have gone. This is of course if the Universal Bank ever gets off the ground, but that is a different story. The need for an organisation to take small savings is obvious. The problem is that there is no profit in setting out so to do. Only a social enterprise would get involved, and credit unions are such enterprises.

Access to cheap credit is seen by many as the prime reason people join credit unions. While for some that may be true it is not true for all. As indicated above a place to save is often just as important. This is reinforced by the lending profile of most credit unions. Very few have anywhere approaching their entire stock of money available for loan out on loan at any one time. Indeed for many credit unions liquidity rather than lack of it is the problem. It is not unusual for a credit union to have only a half to three-quarters of its funds out on loan to its members. Yet when the member needs to borrow the loan is cheap. For many credit union members credit rates of 12.68%APR, which is the maximum charged by credit unions must seem like free loans. Many will be used to paying much more to organisations such as The Provident Cheque Company and others. Rates in excess of 100% are not uncommon in that part of the market for loans. To be fair to the Provident Cheque Company at least it is there to lend.

In addition and largely unknown to members when they join the credit union they are insured against Death or invalidity by the union and at no charge to themselves. Their savings will be protected after July 1<sup>st</sup> 2002 when credit unions enter the Financial Services Compensation Scheme.

Despite the availability of money for loans at all times with the possible exception of Christmas, and the evidence of credit union members themselves that savings are the reason for joining, many inside and outside the credit union movement see things differently.

The importance of savings has always played second best in credit union mythology. Only over time as members began to build up savings did the dividend rate paid on savings come to the fore. For many members ease of access to savings and the possibility of creating an individual savings account is very important. This fact is supported by the fact that there are many members who have savings

accounts but who do not borrow. In industrial credit unions and particularly amongst women this is very prevalent. Many members do not want their statement sent to their home address as they see their credit union accounts as their own secret savings account, about which no one else knows. It provides a bit of independence where before none existed.

All of the above points to the idea that credit unions should have economic goals and social goals but that the economic must prevail if the social ones are to be met. At least that is what is indicated to some, but not to all, and hence the conflict.

After first becoming a member of a credit union a small percentage of members become active within the union. Not enough do so as all credit unions could do with more officers. Not all will admit to this problem but it is there none the less.

As members become more active in their credit unions they get the opportunity to become involved in the running of the union. As democratically controlled member owned co-operatives each member is encouraged, or at least should be encouraged, to play a full part in the running of the credit union. Thus credit unions help to enhance the social capital of an area, and in so doing enhance the quality of life of their members.

Why do members become officers? There are several reasons. For some, a belief in the idea of Co-operation, for others an opportunity to serve not available elsewhere and for yet more as an act of charity. It is with the third category that the problem arises.

These are good people with a firm belief in the goodness of credit unions, and the prayer of St Francis of Assisi, with which they start meetings. They see the credit union as a vehicle for helping people, and indeed they are right. What often follows on from this position is not so good. People who do not repay their loans are not chased up, or at least not quickly enough. Loans are not based on ability to repay but rather on need. One example amongst many will suffice. A Scottish Credit Union in its early days had a loan policy that stated each member was entitled to a loan of six times their savings after having saved for eight weeks. A large number of people saved one pound a week for eight weeks, demanded a loan of £48 and were never seen again. As most of them had drink problems it could be said that the members share capital flowed out of the credit union. The policy was changed and the credit union survived.

To some this approach to credit unions is known as the St. Vincent de Paul approach after the great charity of that name. These people are not as numerous as they once were and their unions are by and large at the smaller scale even of British Credit Unions. Others from outside share their views, concerning the Movement, and so the conflict of goals is intensified. The effect of this conflict is to inhibit focus on where the movement should be going. If the first question in

developing a strategy is “Where do we want to be?”, it is impossible to answer if the opinions are divided.

#### Governmental policy and the social inclusion agenda

The second element in bringing the movement to the crossroads is the activity of government.

It has been said of Tony Blair the Prime Minister that the only union he likes is a credit union. This probably relates more to his stand off approach to trade unions than to any fondness for, or involvement with a credit union. Be that as it may he is a powerful ally for any movement and his support is pivotal to any government action to hasten the growth of credit unions.

One of the recent developments in credit union growth has been the expenditure of significant sums in attempts to increase the rate at which they grow. Social Enterprise London has run a three year development programme with a total expenditure of millions of pounds. Further the Scottish Executive has earmarked £1.5 million for such developments over the period 2001- 2003. Each of the one hundred and forty credit unions in Scotland were entitled to apply for four thousand pounds during 2001. The only caveat was that the money could not be used for lending. This entitlement applied equally to large Industrial Credit Unions as it did to small community ones. As a result one of the Industrial credit unions took the money and used it for signage. One labour MSP put this generosity down to inexperienced ministers and civil servants “Not out of the top drawer.” Whatever the reason the money is being and will continue to be wasted.

In Wales the Welsh Assembly voted £2.5 million for Credit union development during the year 2000. The money will inter alia fund a further ABCUL field officer.

In Scotland the Credit Union Partnership formed to oversee the grants applied to itself for funding for the two trade bodies to carry out health checks on credit unions. The thought of conflict of interests never entered their collective head. Both ABCUL and the Scottish League play active roles on the Partnership board.

There is no evidence that this expenditure has or will increase the rate of growth in credit union membership and usage within the mainland of the UK. This is due to the fundamental contradiction between the aims of public bodies in relation to credit unions and those of the members of credit unions, as to their purpose. For government credit unions are a central part of the anti poverty agenda. To the members credit unions are a financial service.

There are those within the Credit Union movement who are content to see their movement taken over by public agencies knowing full well the purpose that those agencies will assign to these credit unions. Those that are happy to see the

movement hijacked in this way fall into three categories. First those that believe that credit unions are for the poor and as stated above their involvement in the movement is part of their charitable activities. These are good people who fail to understand that credit unions are not about curing poverty, but rather about giving people of modest means control over their financial lives. The second group are the poor souls whose lives are controlled by state agencies and for whom it is the norm for the state to provide everything. The thought that the state supported credit union is for them, is as natural as housing benefit, or the health service being free at the point of use.

The third group and that with most to lose are the legion of credit union workers whose livelihood depends upon the unthinking largesse of governments at all levels. No one can be blamed for fighting to keep their job and as such no blame can be assigned to the members of the Credit Union Development Workers Organisation, but in essence they are part of the anti-poverty workforce found throughout our country today. They get paid by the number of credit unions they establish. The quality of these unions is not of paramount importance, as the work of Paul Jones has demonstrated so ably.(5) They have little interest in the credit union succeeding, they need people to stay poor in order that they may continue to work. That is not to say that they in any way want people to stay poor. It is only to state the obvious that they are part of the poverty professionals who have had an undue influence on credit union growth in Britain. They are part of the government's plan for credit unions and curing poverty. It is a futile and damaging role to ascribe to credit unions.

Relationships between various types of credit union and the Trade Bodies.

It might be supposed that the needs of one type of credit union are identical with those of all other types, or that these needs are identical to those of their central organisations. This is not the case. The problems this causes are another element that brings us to the crossroads. They are considered below.

Problems between different types of credit union.

An examination of the annual returns for credit unions for the year 2000 reveals that in terms of the British movement two fissures are appearing.

First there is the continuing domination of employee credit unions as against the other common bonds, and second that even within the other common bonds, association and residential there is a skew between the large and the small. A third fissure, that of the difference in size between the Scottish credit unions and those in England and Wales is continuing.

**Table 1            Top twenty credit unions as % of British Movement**

Shares	52.6
Assets	53.9
Reserves	66.5
Members	32.2

Source AR20 2000

Of these large credit unions in terms of shares 15 are employee based, 3 have association common bonds and two hold residential bonds. The figures do not vary much in the other categories. There are only four which appear on all three lists and they are all employee based. The appearance of a small number of dominant credit unions poses dangers for the future of the movement.

Large credit unions need to offer their members other services than the basic savings and loan accounts they are allowed to do at present. They all employ staff and need to be able to charge fees on transactions in order to make ends meet. To small credit unions meeting in church halls such needs are remote. A two-tier credit union movement is developing as foreshadowed in the Treasury report referred to at the start of this article. (6)

How long large credit unions can allow their progress to be held back by small non professional credit unions is any ones guess but their patience will not last forever.

All indications are that the days of the small credit union are numbered and it would bode well for the movement if that fact was recognised and transfers of engagements ( mergers) encouraged and organised before they are forced on the Movement. This will begin later in 2002.

In comparing the list of the top twenty credit unions in 2000 with that in 1995 it is interesting to note how little change of membership there has been in this elite group. This suggests that there is a critical mass which when reached ensures a credit union's growth and development. Unfortunately very few credit unions meet that mass before time runs out and fatigue sets in. In case anyone thinks that running a small community credit union is easy let them try it for a week or two. They will learn the level of difficulty involved.

If the critical mass can be pinpointed it has to do with the volunteers giving over the running of the credit union to professional management and restricting themselves to policy and strategy.

Unfortunately even large credit unions have difficulty with this and they employ managers that tend to come from the original group of volunteers. They are not trained financial managers. This illustrates two points. First, running a credit union on payroll deduction and with only two products is easier than taking cash in a

community credit union, and second the interests of the director /volunteers are put before those of the members.

A further difference between large and small credit unions is found in relation to officers. All credit unions need volunteers to fill its committees, and it is much easier to find those officers from a large membership than a small one. Most credit unions will admit in private that they have difficulty in filling places on the various committees, but those difficulties will become as nothing when the FSA directive on suitably qualified persons becomes operative later this year. This will ensure the demise of small credit unions run by unqualified volunteers. The problem is that as yet within the Movement there is little planning for the necessary restructuring.

The Movement will need to face up to the sad fact that not all credit unions enjoy the same needs. To prosper there is a need to plan for that division on size that is coming. The further problem of division on common bond should not be ignored.

#### Problems between credit unions and central bodies

The central organisation requires money to prolong its life. A small credit union requires money to pay for insurance and has little to spare for an anxious central organisation which requires to charge fees for membership which are higher than can be afforded by many credit unions. They feel obliged to join because the central organisation acts as agent for the Credit Union National Association Mutual Insurance company or another insurer. This in turn provides cheaper insurance for credit unions than is available elsewhere. Whereas the credit union needs are related to serving their members the central organisation has needs which conflict with this simple task. As an example the needs of ABCUL include satisfying its major funding organisation which is CUNA in America as well as local authorities and central government which also provide funding. It is provided to help develop anti poverty credit unions. Here there is a conflict. The American funders want growth, so that the trade body can be supported by the indigenous movement. In order to achieve this ABCUL has to focus on the development of large Industrial credit unions. They do indeed contribute to the finances of ABCUL. However the majority of ABCUL members are small community credit unions.(84% at the end of the century.) They feel that they get very little out of ABCUL and in the words of one credit union officer "If you ever have trouble you never see ABCUL at all"(7) What ever the truth of this it is almost impossible for ABCUL to satisfy the demands put upon it. In such a situation is it any wonder that the central organisation seeks to protect its future by seeking money from whatever source it can get it. That money is used to pay staff wages and expenses and to provide some help to individual credit unions. The small credit unions would like to see that money coming to them rather than to a central organisation

of limited value in their eyes. The extent of this problem is demonstrated in Table 2 below

**Table 2 The Power of Industrial Credit Unions**

Top eight credit unions in Britain (all employee)  
As % of all British credit unions. (8)

Shares	37.8
Assets	38.9
Reserves	50.9
Members	20.4

In total Industrial credit unions account for some 50% of all credit union members in Britain and some 70.5% of the movements asset base. While they take most of the places on ABCUL committees and provide most of the, indigenous funds of ABCUL, the relationship between the two is not perfect. The problem here is size. Most large credit unions are far bigger than ABCUL and their officers feel, rightly or wrongly, that ABCUL does not provide much for them that they could not provide themselves either individually or collectively. They require Treasury functions yet those are not provided by ABCUL. They require marketing initiatives yet they are not provided by ABCUL. The Industrial Credit Unions now run their own annual get together. As noted earlier how long might it be before they feel that their progress is being held back by membership of ABCUL and act accordingly. The Nationwide Building Society was once the Co-operative Permanent Building Society until in 1968 it felt that association with the Co-operative Movement was limiting its growth. The central organisation has an almost Herculean task in convincing its members that it is doing the job they want, that of developing a strong broadly based credit union movement. Some of the best performing credit unions in Britain over the last ten years are not members of any trade association. Yet the community credit unions do not see this as a problem for ABCUL. Indeed they complain that ABCUL is only interested in corporate credit unions and not in forming small credit unions. Such is the level of this belief that Birmingham Credit Union Development Agency, one of the most costly and least successful agencies in Britain has threatened to advise all Birmingham credit Unions to withdraw from ABCUL and join the new Community Development Finance Institution. This would delight ABCUL as many potential problems would be removed. It is unlikely that the CDFI would be allowed to admit individual credit unions to membership. ABCUL has a difficult path to tread in this area.



Interestingly enough for students of Co-operation none of this is new. There are similar lessons from the history of the Retail or Consumers Co-operatives in Britain. Anyone who looks at the history of Retail Co-operative within the UK will find ample examples of all three problems faced by credit unions today. The conflict of economic and social goals from that sector is documented (9). It occurred within the first four years of the formation of the Rochdale Pioneers Society, and within 48 years it was settled once and for all. It is discussed in more detail below.

As to the role of government in the formation of co-operatives, all co-operators from any sector wished for was an even playing field. In Retail Co-operation they got such a level field until 1917. At that time the government was perceived as taking an anti-co-operative role rather than a supportive one, which led the congress of that year to take a decision to enter politics (10) with the formation of the Co-operative Party the next year.

Again the retail movement has examples of the clash in needs between the needs of a central body, and those of primary co-ops. They are plain for all to see, through the history of the CWS. The Co-operative Wholesale Society was established in 1865, and its sister organisation in Scotland formed in 1868, in order to serve the retail societies of that time. The two wholesales were by the early twentieth century the dominant forces in British Retail Co-operation. Today, as the merged wholesale, post 1973, it is British Retail Co-operation. Indeed it rejoices in the name "The Co-operative Group." While this is a relatively slow development it did not take the same time for a basic division in goal between the primary co-operatives and the secondary one to arise. This was over the fundamental problem of dividend.

Retail societies competed on dividend. Dividend was the virility symbol of independent retail societies. So great was this rivalry to have the highest possible dividend for the members that a pricing policy was adopted by retail co-operatives that denied the poor access to their shops. What is even sadder is that this was done consciously and knowingly. One part of the surplus that retail societies used to inflate their dividend was that which they received from the CWS. Unfortunately very soon after being founded the CWS decided that retention of profit was no bad idea to develop its business. In time the CWS came to have one factory for every day of the year. The demands for reinvestment in such a large business were used to justify their lack of dividend to retail societies. If however the CWS was brought into existence by the retail societies as it was, surely then its goal should have been to serve their interests above their own. Perhaps this might have been the idea behind the establishment of the secondary co-operative but that is not the way it turned out in practice. The needs of the secondary co-operative to survive and grow took priority over the reasons for its foundation.

## Personal Feuds

One final aspect of this split in loyalties is tied to personal feuds. Mention has been made in passing of the existence of various Trade Associations claiming to represent Credit Unions on a federal basis. In addition to the Association of British Credit Unions, which is the largest, and in Scotland the Scottish League of Credit Unions, there are several others. These include, The Association of Independent Credit Unions, and until recently, The National Federation of Credit Unions, which is now bankrupt. It is being reinvented as an organisation bearing the name ACE, and featuring the same people. These divisions within an already weak movement are testimony to the egos of those involved, and the ability to place a theology of credit union above the reality of life. In the beginning when credit unions began the slow process of inventing a national trade body there was no division and the Credit Union League of Great Britain was formed. The people who formed and manned that organisation can in some cases be found playing roles in the successor diversified trade bodies. CULGB evolved into ABCUL and is recognised by the World Council of Credit Unions in Madison Wisconsin as the only trade body for credit unions within mainland Britain.

At the same time as ABCUL was evolving out of CULGB, The National Federation was set up. The reason behind this split is rumoured to be the personal animosity between the Chief Executive of ABCUL and the founder of the Nat. Fed. It is interesting to note in passing the latter eventually sued the Nat Fed, won his case and brought them to the point of Bankruptcy. He then went on to form the Association of Independent Credit Unions, which seems a slight oxymoron.

In Scotland the trend to splitting was also evident when the Scottish League of Credit Unions was formed out of ABCUL with the basis of the split being supposedly philosophical. The Scottish League holds to philosophy that everything Irish is good and everything English is not so. They would seek to make responsibility for credit union regulation a devolved matter coming under the Scottish Parliament rather than London as at present. It is thus possible to see the development of the Scottish League as part of the Scottish renaissance occasioned by the birth of a Scottish Parliament. As they say in Glasgow "Aye Right"

While these are the major factors that have brought credit unions to the crossroads they have been added to by one recent development. On July 1<sup>st</sup> 2002 credit unions will join the Financial Services Compensation Scheme. This is bound to have a large impact on British Credit Unions. It has been said of community credit unions in Britain that they are a disaster looking for a time and a place to happen. This is due to the fact that member's shares were not protected in any way. When a credit union failed, the members only way of reimbursement of their share capital was to rely on other credit unions, or other financial institutions, making up the shortfall.

In nearly all cases of closure this has happened. Fortunately failure has been rare and in all but one case it has happened to small credit unions where others could fund the loss. The nearest to a “Millom” for the credit unions came with the closure of Camberwell credit Union in 2001

The Retail Movement in the UK had one small retail society close its door in the mid 1960’s. This was the Millom Co-operative Society Ltd.

The TV and other media reported the closure very widely and the next day the entire Retail Movement lost about £8.5 million in share withdrawals. When Millom was finally wound up members received £1.45 for every pound that they had in share capital. Millom had a cash flow problem not a solvency one. When Camberwell credit union closed its doors in 2000, the press and the media reported the matter but only in restricted circles. Camberwell was a large credit union by British standards and the scope for a run on shares at all credit unions was inescapable. Fortunately this did not happen. If a second established union was to get the way of Camberwell the outcome might not be so fortuitous as in this case.

This is not as much of a problem as it used to be. On July 1<sup>st</sup> 2002 credit unions will enter the Financial Services Compensation Scheme which will protect members share capital. Entry will bring with it however a cost. The cost will be a series of problems that few credit unions will solve. Primus inter pares is the problem of meeting the operating standards of the scheme. Only professional credit unions will be able to meet these standards.

It is the nexus of all these influences which produces the crossroads at which the movement now stands. Passing through and taking the right road will not be easy.

### **How did we get here?**

The growth of credit unions within Britain has been painfully slow. From the first credit union opening in 1958 only about 50 were in existence at the passing of the Credit Union Act in 1979. By the end of the millennium there were over 700 credit unions but the vast majority had very small membership. Total membership was close

on 325,000 persons. The complete figures for British Credit Unions are provided in Table 3 below

**Table 3            British Credit Unions in 2000**

Members	325058
Shares	£182,771,148
Assets	£214,976,982

Many have asked themselves the question “Why have British Credit Unions not emulated Irish Credit Unions and grown to a decent size ?”.

There are several reasons for this lack of emulation.

Included within them would be:-

- The different nature of the financial sectors
- The rural urban balance
- The quality of the leadership
- The temporal consideration

They are considered below.

#### The different nature of the financial sectors.

In the 1950's when the Irish Credit Union Movement began. banking was not the usual method of money transaction for the great majority of the Irish people. Ireland was not a society based on banking. Rural communities were without banks in many cases and in towns ordinary waged people would not be welcomed within the banking network. This created a gap in the market for savings and loans which was not being met by the banks. Ireland was in many ways at that time a cash economy. When working people wished to borrow there was always the “Gombeen Man” in every community. He would be delighted to lend money to you but at a very high rate of interest. Thus what was present was a vacuum for savings, money kept in cash and within the house, coupled with a need for loan finance at affordable rates of interest. This was and is an ideal combination for credit union development. Unfortunately these conditions did not apply in Britain in the last quarter of the twentieth century when credit unions were trying to grow. By that time Britain had become a banked society, anyone who wanted to save could do so without difficulty, and credit was widely available. Indeed it has been said that anyone in Britain could obtain credit, only the poorer you were the more expensive the credit became. While in the 1950's Britain had a majority of people without a bank account this had changed by the time of the passing of the credit union act in 1979. The majority of people had bank accounts and many also had credit cards. Store cards, charge cards and all the other attributes of a highly developed financial sector were available to nearly all. It was against this market that credit unions had to compete. It is a sad fact that this competition no matter how difficult was not embarked upon. Rather credit unions sought refuge in the margins of financial society. They sought out the role of the poor mans bank. Nothing has been harder to shake off, or has done and continues to do more damage to the credit union movement. In this way over infatuation with the Irish experience while understandable is not helpful

## The Rural Urban Balance

One obvious difference between Ireland and Britain during the nineteen fifties and seventies is that Ireland in the fifties was a rural society while Britain in the seventies was very much an urban country. This obvious difference which seems to have escaped many who feel that the Irish way is the best way has impacted on many other difference which have affected the variant rates of credit union growth. These areas such as access to finance and consumerism and the attitude of the Church are discussed elsewhere in this report.

One other area in which the Irish had an advantage was in the involvement of a quasi governmental organisation charged with doing something about rural unemployment. This organisation "Muntir na Tire" came to hear about credit unions and while not in themselves promoting them provided a network by which the news about credit unions could be spread rapidly throughout the land. Further although not promoting credit unions Muntir na Tire acted as a seal of approval which allowed other influential organisations such as the Catholic church to become supportive. This combination of factors supplemented the leadership of the embryo movement with a useful measure of support amongst those who could provide a supportive environment for credit union growth. This is very different from Britain in the 1970's. Urban economy

### Quality of leadership

One of the features of the Irish Credit Union Movement was the quality of leadership upon which it was able to draw. There are many examples of this but one of the most notable leaders was John Hume MP MEP first president of the Irish League of Credit Unions. Hume was himself part of a magnificent flowering of talent centred upon St Columbs School in Derry which produced apart from Hume, Seamus Heaney, like Hume a Nobel laureate, Phil Coulter and several others. This outpouring of talent was in the case of Hume laid at the service of the Credit Union Movement.

What distinguished Hume and his co leaders was their middle class background. While none of them would state as much themselves they were such in instinct and by profession . Hume was a teacher and others such as Nora Herlihy from commercial backgrounds. In the phrase of Jackson and Marsden in their book "Education and the Working Class" these people were the sunken middle class. In other words although they lived in modest circumstances their aspirations particularly for their children were akin to the attitudes of middle income people.

In contrast the leaders of the infant British Credit Union Movement were drawn from the immigrant communities of Ireland and the West Indies. This created a problem for credit unions within Britain and particularly within England. This explains to some extent the relatively slower growth of credit unions in

England as compared with their slightly faster growth in Scotland. Being of Irish extraction was far less of a handicap in Scotland than in England. In Scotland the first leaders were inspired by the success of the Irish Credit Union Movement and in many cases this inspiration continues

While the progenitors of the Movement in Scotland were not of the social standing within society that their Irish role models exhibited, they were drawn by and large from the skilled working class, being painters, bus drivers, taxi drivers and related jobs. In their study of why credit unions had grown faster in Scotland than in England and Wales Heriot-Watt University noted amongst other factors "The presence within a community of a sufficient number of adequately skilled and motivated individuals to promote and manage its affairs. Local people were prepared to take on management and policy making, making courageous decisions and move out of their comfort zones." (10)

In England and Wales the lead roles were performed by members drawn from the West Indian community and they were not as accepted as the Irish were in Scotland. This limited their opportunity to gain the credibility necessary to launch a national movement. When every day is a struggle against prejudice and impoverishment there is little time for growing a credit union let alone a national movement.

This is now changing. Leaders are now drawn from a much wider spectrum of society. They become involved with credit unions for a variety of purposes, not least as an ethical way of investing spare money for savings. This was most evident at the ABCUL AGM in Blackpool during March 2001. The proportion of immigrant or immigrant descendent people was almost nil. The accommodation was the Hilton Hotel rather than a University campus as in the earlier years. Delegates attending the Mass on Sunday morning amounted to less than 5% of the six hundred delegates. In the early years about one third of the two to three hundred delegates would have attended mass. While not scientific measures these three points taken together indicate a broadening of the appeal of credit unions in Britain.

#### The temporal Consideration

While the attitude of working people in Britain had for many years been neither a borrower nor a lender be, the influence of television and the consumer society had made a seismic shift in this outlook. By 1979 consumer credit in Britain was commensurate with most advanced western economies. Loans were advertised in all parts of the media and anyone who wanted credit had access to it. The only difficulty was that the poorer you were the more you paid in interest for the loan. This was very different in nature to Ireland in the 1950s.

There are many other indigenous factors which have contributed to growth rates lower than that of Ireland. At the peak of such considerations lies the role of the regulators. Good regulation is like good pruning and weeding in a garden, it makes things grow. Bad regulation produces a result wherein a garden arises in which "Things rank and gross in nature possess it merely." ( 11) The role of British Regulators is considered below.

#### The Role of the Regulators.

The role of the Regulators in Britain has done much to harm the growth of credit unions; the major problem has been a lack of consistency in how the unions were regulated. Indeed it has been said that the regime was one of no regulation (in fact if not in law.)

It is the failure to regulate credit unions properly, that has led to the situation of today where some credit unions are in poor shape. As noted above, in March 2000 stories began to appear about Camberwell Credit Union Ltd. By April 2001 this credit union, one of the longest surviving in Britain had been forced to close its doors, and members could not access their savings.

What has emerged from this problem concerns the dangers of a split Board of Directors, which was present at Camberwell, and suggestions of ineffective regulation by the Register of Friendly Societies. While the Registry will always claim that they never had enough staff to regulate credit unions they still seemed to adopt a cavalier attitude to their duties. Examples of this are legion and include a credit union not submitting its annual return (AR20) for three years while not attracting the attention of the regulators. Such a laissez faire attitude encourages credit unions to be sloppy and so problems build up.

As problems build up so volunteers leave and further problems develop. If they had been nipped in the bud and / or not allowed to develop in the first place then the movement would have been much stronger today.

Regulation can be divided into four temporal sets. They are

- Pre 1979
- The 1979 act
- Michael Bridgeman
- The opening of the flood gates

#### Pre 1979

Prior to 1970 there was little or no regulation of credit unions in the UK. They registered under the Friendly and Provident Societies act of 1965 and more or less did their own thing. Credit unions through CULGB (The Credit Union League of Great Britain) the predecessor of ABCUL pressed for a separate law for credit unions. This was passed in April 1979.

#### The 1979 Act

The act laid down the size of credit unions the rate of interest they could charge and what they could in interest. It made credit unions into very small savings and lending institutions During the period 1979 to 1984 about thirty credit unions were registered. Their performance caused some concerns with the Registry of Friendly Societies and the Registrar stopped registrations for some time.

#### Michael Bridgeman

At a meeting in 1984 Michael Bridgeman the then Registrar of Friendly Societies threatened to stop registrations for good and close down existing credit unions unless standards improved. The next registration did not come until January 1986. Bridgeman was the only registrar to date who has applied the law to credit unions. He issued 7 Section 19 orders, which effectively closed down the seven named credit unions, and he demanded that those that were left obeyed the law. It is a pity he moved on to be the Registrar of the Building Societies because he could have helped produce a strong credit union movement.

#### The Free for all

Following on from Bridgeman's transfer a different mood was found in the Registry. Now credit unions were a good thing and were registered without the demands of the previous regime. Gone were the demands for maps showing streets to be included within the common bond. In their place was an emphasis on social capital, linking with other local bodies. Whereas small credit unions were deemed favourable at the end of 1986 by the mid 1990s large common bonds were all the rage. Half of Glasgow was deemed acceptable when it was registered as the common Bond of Glasgow West Credit Union in 1999. Whether it was because of the governments pressure or because the Registry were understaffed, little was done to check out the suitability of the group to form a credit union. Their desire to do so was taken as proof of ability to do so. This generosity was added to by the lack of serious regulation of credit union returns. Further damage was caused by the desire of the trade bodies to keep all their problems to themselves, rather than inform the regulators. In such a way bad habits were inculcated to the detriment of the entire credit union movement.



All that can be said of the period of regulation by the Registry of Friendly Societies is that it is good that it is over. The Financial Services Authority has already indicated that they will not make the same mistakes. Regulation can be an effective tool in training a movement to be stronger. Unfortunately this is not the case in the case of British Credit Unions.

### **How do we move on from the crossroads?**

Living with Reality.

In essence if credit unions are to survive in Britain it will come about because they chose to live with reality. There are those in Britain within the Credit Union movement who have acted as though they believed that the law could be ignored. Further they have conducted their business as though the market could be ignored. This belief will disappear if credit unions are to survive.

What will be the nature of that real world? It will be one in which the regulatory authorities will become a serious element in shaping credit union development. Professional credit unions will survive and those that do not reach that standard will cease to exist. It will be a world, where the credit unions will be more focused. In such a world a much greater understanding of the market will be necessary in order to continue to grow and it will be a world where the Government will exit from the credit union scene. These issues are examined below.

- Regulation

When credit unions enter the Financial Services Compensation Scheme on the 1<sup>st</sup> of July this year, a whole new raft of regulation will descend upon and their officers. The FSA has already made it clear that credit unions will have to improve their level of performance and that they will be required to act in a much more professional way than before. The FSA has a method in mind that will ensure that over time many little credit unions will close themselves down or transfer their engagements to the larger professionally run ones. This process is already starting in areas where people are reading the runes. In other areas this is not the case. The method involves a combination of laying down standards for compliance and a level of bureaucracy, which will wear volunteers down. This will prevent the FSA having to use a heavy hand and attracting apobrium in public.

- There are credit unions and there are credit unions. The absence of focus.

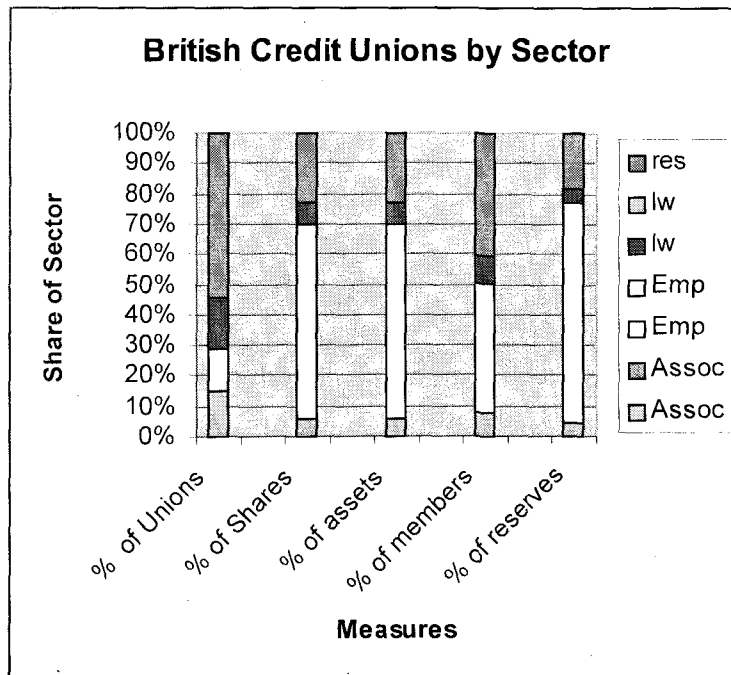
All the figures used below come from the annual returns of credit unions for the year 2000. What they reveal is a divided movement with a huge skew between the few large credit unions and the vast majority of small weak credit unions.

**Table 4 Credit unions in Britain by common bond.**

	% of members	% of Unions	% of Shares	% of assets
Assoc.	8.1	15.1	5.9	5.9
Em	42.1	13.8	64.2	64.3
lw	9.4	16.7	7	6.9
res	40.4	54.4	22.9	22.9
total	100	100	100	100

These figures are reflected in the chart below.

Chart 1



The dominance of the employee sector is plain for all to see. There are good reasons for this. Money is deducted from payroll, there is less bad debt, and all the members are in work. They can then build up the critical mass of savings that creates a credit union. When that mass is reached staff are employed and the credit union continues to grow. As a model for development it is very good. Table 5 and 6 below show how dominant are the few large credit unions.

**Table 5 and 6 Credit unions in Britain – Domination of the few**

Top 20 credit unions	% UK
Shares	53.1
Members	34

**Table 6**

Top 50 credit unions	%UK
Shares	70
Members	67.5

As there are over 700 registered credit unions in Britain, the problem lies with the other 650 or so that have to share the remaining 30% of share between them. Further it is this part of the movement which absorbs much of the time of the trade bodies which could otherwise be put to different tasks. Experience says that the chances of any of these credit unions within the 30% reaching the critical mass prior to take off are not great, that is at least if you believe in fact and experience. rather than in fairy tales.

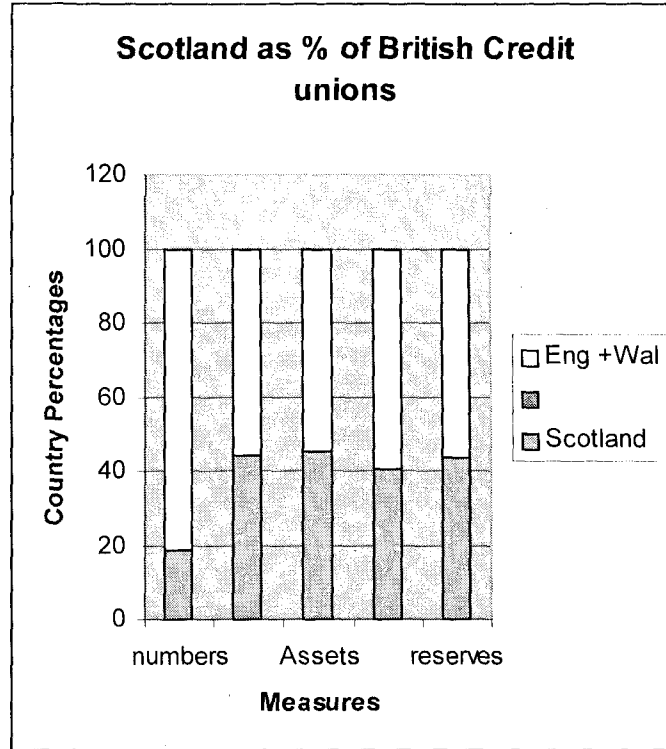
The third skew relates to the imbalance between the size of credit unions in Scotland as against those in England and Wales.

**Table 7 Scottish Credit Unions as a % of British Credit Unions.**

Number of C.U. s	18.9
Shares	44.3
Assets	45.2
Members	40.3
Reserves	43.6

This is shown graphically in Chart 2 below.

Chart 2



Scotland has less than ten percent of the population of England and Wales yet it accounts for over forty percent of the members of the entire British Movement. While the dominance of Scotland has been explained elsewhere (12) the fact that it continues illustrates more than anything that an absence of government policy is what is required for credit union growth. The dominance of Scotland is the dominance of the original community credit unions such as Dalmuir, Newarthill, Drumchapel, Mosshill, Johnstone and others, which have grown over time, as well as the advent of large industrial credit unions which occurred during the nineteen nineties. With the support of fertile soil the industrial credit unions in West central Scotland include the two biggest in Britain, Scotwest and Glasgow Council.

In 1985 the first piece of research on Credit Unions in England, Scotland & Wales was carried out. There were 49 unions in the study 35 from England and 14 from Scotland. The continued dominance of Scotland is shown by revisiting the 1985 study.

Of the 49 credit unions in the 1985 study, fourteen had stopped trading. That is over a quarter of the sample. On further investigation it transpired that all of these were located in England. None of the fourteen credit unions which had stopped

trading, were to be found in Scotland. Two years ago the Royal Bank of Scotland commissioned Heriot-Watt University to conduct a study into why credit unions in Scotland outperformed those in England and Wales.(13) One of the reasons given was that there was a stronger tradition of mutual and co-operative activity north of the border. Other reasons included the quality of the leadership, the support of outside bodies such as churches and the sheer connectivity of the unions that started. They all started in west central Scotland and were close enough to enable a sharing of experiences and of activities. The revisiting of the 1985 study reinforces the findings of this report and does so in a remarkable way. The survival rate is higher, the growth rate faster and the participation by the local communities much stronger. In 1985 all forty nine credit unions had 16,125 members between them. In 2002 the English credit unions, all twenty one that remain, have amassed a membership of 11098 with over half of that number being in three credit unions. The other 18 have about 5000 members between them. In Scotland the twelve have 40,599 members.

In share capital the English twenty one have £1.169m the Scots £29.334m. Perhaps it is something in the air or the Scottish water, which of course should be mutualised, but Co-operation really does work better in Scotland

From the point of view of the British Movement the danger of this split is that it gives life to the Scottish Credit Union League, the only serious rival to ABCUL as a trade body. Indeed the Scottish League might be justified in their criticisms of credit unions south of the border.

If these three fissures are considered together they give a picture of a movement that is not homogenous. The interests of one group of unions might run counter to that of another group, and the job of the trade bodies rendered almost impossible by the differences. ABCUL is often taken to task but it has an almost impossible task to perform.

As has been written about earlier there is no agreed consensus amongst credit union activists as to what the movement should be like today let alone in the future. The ACE, The Scottish League and many members of ABCUL support the idea of small local based poverty credit unions. Others including the main funder of ABCUL support the idea of a movement consisting of large employee based credit unions. Without a clear picture of the future no strategy can be evolved and thus no significant development achieved. Unless the three fissures discussed above can in some way be overcome then the chances of success for the movement are reduced.

- Professionally run Credit Unions

There are very few if any, credit unions in Britain that have their full complement of active officers. As the burden of standards and bureaucracy increases post July 1<sup>st</sup> then the pressure on these scarce officers will increase. Only in professionally managed credit unions will the job of a director or other officer be commensurate with a normal life. A glance at the Credit Union Guide from the FSA with its many chapters and appendices will confirm that view. (14)

Mention was made of the problems of leadership within the British Credit Union movement. The comparison with Ireland does not throw a favourable light on the British movement. As a consequence of the image of the poor man's bank the movement has not attracted the professional classes from which a more educated leadership might be found. As representatives of the movement on a national basis, trade bodies struggle to get the figureheads that might encourage more trust and enthusiasm amongst higher income groups. With the exception of the Police force Credit unions, much remains to be done in this area, if credit unions are to prosper. If you advertise yourself as the poor man's bank, or others do it for you, you cannot be surprised if people do not want to join. It is a sad fact in life that by and large people with a lower or no income do not possess the abilities of those who have a higher and steadier income.

If such people are to be recruited into the movement then a change of focus is necessary. Only by employing professionally trained financial workers and skilled marketeers will this problem be overcome. Again the struggle that retail societies have had over the years to attract directors of quality, can serve as an example of how difficult a problem this can be.

- A lack of product knowledge.

Credit union officers have in general no understanding of the market for savings and loans. They understand their local and immediate market but if they are to grow and survive they will have to come to understand why people in a wider setting save and borrow. To be fair some of the larger professionally managed credit unions are showing signs of such knowledge. Capital Credit Union in Edinburgh has developed a system of tiered interest rates, so that members wishing to borrow over £5000 can do so at a lower rate of interest. The normal rate of 12.68% is not competitive at such levels. This is also being introduced at other employee credit unions.

People want to borrow for economic and psycho/sociological reasons. There are distinct differences between groups as to borrowing. Lower income groups borrow small amounts over regular periods to finance life. Middle income groups borrow as part of a life style. It is this diversity that the officers must understand in

the market for Loans This market is vast but the reasons for accessing it are also countless. A special occasion, general living expenses, or the purchase of domestic equipment such as a new kitchen. All these requests require servicing but not necessarily at the same rate and in the same way.

All of the above internal problems need to be addressed if the movement is to prosper.

**External problems.**

Even if all the internal problems were to be solved life could still be difficult for British Credit Unions. These external problems include consideration of the basic divergence between credit union members and

their external supporters and promoters. Are Credit Unions primarily businesses or are they social constructs?

While to many the concept of credit unions as a social construct may seem funny there are those in Local Authorities and in Central Government who see them in exactly that light. This leads to two problems. First the perception of the credit union as the "Poor man's Bank" and second, the feeling that the government can hand over to credit unions the problem of financial social exclusion. The first has almost killed the credit union movement, the second is not possible. Credit Unions can and will help in this area, it is not possible for them to play even a major role in solving the problem. That is and will remain a responsibility of the government.

### **So where do the solutions lie?**

Solutions to all these problems can be found. They lie in the following areas:-

- An understanding of the business
- Professional staff
- Mergers
- The withdrawal of the government.

In any understanding of the business the needs of the member/customer must be paramount. Evidence from Ireland can be of great assistance in this area. Irish Credit unions grew quickly for many reasons but one of them was that they abandoned the ratio of savings to loans for personal loans. In Britain, no credit union has done this, you are still tied to three times your savings, if you want to borrow £1200 but have only £250 in savings then you cannot get the loan. This flies in the face of good business sense. The member will go elsewhere and the union will not earn interest on the money it has not been able to lend to the member. It is this rigidity that stops credit union growth.

If the movement is to prosper then it has to show much more understanding of the market place and develop the services that the members want. Evidence from Ireland shows that credit union members make use of other financial providers as well as the credit union. Thought must be given to the introduction of alternative products and services. There is evidence that this is beginning to happen within certain large credit unions.

It is not surprising that these developments are happening in credit unions that have paid staff. With the best will in the world volunteers have enough to do in running the credit union, complying with standards of the FSA and having a life, to give too much time to the consideration of new products. The staff employed at present, are largely drawn from the core group of volunteers and there is no guarantee that this is the correct path to follow. There is a difference between paid staff and professional staff. Each credit union as it grows will reach a point where they will require at least one professionally trained financial manager, if the members are to be served. At what point that recruitment becomes necessary, is a matter for each individual credit union and the directors thereof. Professional staff have to come and come quickly if the movement is to prosper.

After the 1<sup>st</sup> of July mergers between credit unions will become essential, if the movement is to grow. The FSA intend to impose standards on the movement that it has never met before and which many will find difficult. Already talks are underway between credit unions, but not nearly enough talks. As an example of this process, one small employee based credit union with a part time manager, is preparing to merge with a larger employee credit union. It is doing so as the directors feel that the burden of FSA regulation will be too great for the manager and directors. If this is the case for such a credit union, how much stronger is the case as applied to small community credit unions run entirely by volunteers. It is essential that if credit unions are to prosper that the number of unions is reduced dramatically. The nearest parallel is the merger of retail societies post the passing of another piece of legislation in 1964. This was the Resale Prices Maintenance Act of that year. At the beginning of the 1960s there were 813 Retail Societies in Britain, By 1970 there were just over 100.

The closure of many small credit unions will impact on the security and growth of the movement in three ways. First it will create better, safer, and bigger credit unions. Second it will enable the trade bodies to concentrate on the developmental needs of fewer credit unions and so perform better. Third it will improve the quality of service and product range that unions can offer. In addition the mergers will reinforce the trend to professional management that has been noted above.

The greatest help the external environment can give to credit unions and their development is for the Government to revisit its policy in relation to credit unions.



Millions of pounds have been spent on such development since 1981. Acts under which funds have been granted include The Social Work Scotland Act 1968 and Urban Regeneration Legislation for all the good this has done it would have been better to give all the "Poor" a holiday.

This is still going on. A small group in East Yorkshire have just received £2500 from a local government fund to start a credit union in the local economic development area, one of the poorest in England. Such a credit union has little chance of registration under the regulation of the FSA. In the Scottish Borders £36,000 was given to a study group who failed to get anywhere near registration.

What this intervention has achieved is the inculcation of the dependency model on small community credit unions, and the image of the "Poor man's Bank" so often commented upon and so damaging to the expansion of the Movement on a basis of sustainability.

All available evidence shows that government money either local or national has no impact on credit union growth. That is not to say governments cannot help credit union membership grow. Fiscal measures favouring credit union savings, or non budgetary measures such as those foreshadowed in the Treasury Task Force Report could prove useful. What must end is the stigma of the "Poor man's bank" with which previous government initiatives have saddled credit unions.

In conclusion if British Credit Unions are to survive and prosper then there will be far fewer of them, they will be much larger in size, based around an employer, and they will be professionally run. Further they will provide more services than they do at present and the movement will be in a period of long term sustainability. Each credit union will be financially viable and will support a strong trade body who will provide the services of a Central Services Organisation as recommended by The Treasury Task Force in 1999. If that is not the shape of the movement then it might not be a movement at all.

Finally there will be no government interference. All that credit union officers will demand will be a level playing field on which to compete with their non Co-operative rivals. Another parallel with the retail movement, it is a pity that so few of the credit unions supporters knew the history of the retail co-operatives. They could have saved themselves a lot of pain. A read of Arnold Bonnar's book *British Co-operation* would do all credit union officers a lot of good.<sup>(15)</sup> One of the issues that has arisen out of the study of British Co-operation is the extent to which each type of Co-operative feels different from the other types, keeps aloof, and has to reinvent the wheel. Perhaps the UK Co-operative Council is addressing this matter. In essence it has all been faced before and to some extent overcome.

If Credit Unions do pass the crossroads then the financial sector within the UK will be all the better.

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## **CREDIT UNION DEVELOPMENT IN REFORMING ECONOMIES: THE CONTRASTING CASES OF POLAND AND UKRAINE.**

**Charles Ferguson, Donal McKillop and Alex Sibbald**

### **Introduction**

Emerging from the shadows of the communist regime, the reforming countries of Central and Eastern Europe are rediscovering the importance of voluntary, co-operative, self-help organisations. Developing democratically run credit unions can, therefore, be seen as an integral component of a wider democratic transformation of society. Having endured for decades a situation where most voluntary organisations were disbanded as illegal and subversive to the communist authorities, the re-establishment of a non-profit 'third sector' - which can fill the vacuum between what the state and the market can do for citizens - is an important external indicator of democratic change.

However, the development of a strong, indigenous, non-profit co-operative sector, of which credit unions might be a significant component, is not without difficulty, since the legacy of the communist regime has created its own unique barriers to the adoption of self-help, voluntary principles. Besides the ideological remnants of communism, there are many practical economic and social barriers, including limited resources and inadequate legal structures, which also hinder the development of co-operative credit unions.

In this paper, the growth and development of credit unions in reform economies is examined, both in the context of credit unions as providers of basic financial services and also as important agents promoting greater social stability and democratisation. Besides identifying historical factors which inhibit credit union development, consideration also takes place of the key drivers of change supporting the growth of a credit union system. Poland and Ukraine are used as interesting case examples of the effort to establish credit unions in reform economies. Poland is held to be a 'model' case of sustainable credit union development whilst credit union development in Ukraine still faces major challenges. Exploring the reasons for the differential growth of credit unions and the credit union system in Poland and Ukraine will help uncover some of the key factors of influence affecting credit union development in other reform economies and thus provide a useful basis for a more generalised discussion of credit union development issues.

The opportunity is also taken in this paper to use these case study examples to evaluate an earlier typology of credit union development (Ferguson and McKillop 1997) in terms of the attributes described in the typology for credit union systems at different stages of development. As a check on the earlier typology, the evidence contained in the case studies would appear to confirm that the attributes identified are sustainable as descriptors of different stages of growth in credit union systems. The paper concludes with the caution that (as the cases of Poland and Ukraine show) there is however no universal guarantees of credit union development in reform economies especially where the influence of historically specific country conditions are so powerful.

### **Definitions**

An initial start point for considering credit union development lies with definitional issues. Credit unions are a particular type of co-operative institution. In that they are limited to serving the market for consumer credit and saving, credit unions as consumer co-operatives, are unique financial institutions. A credit union can be thought of as a 'purchasing' co-operative from the standpoint of its borrowing members, and a 'marketing' co-operative to its saving members (Taylor, 1971). Since it deals exclusively with its members, a credit union can claim to be the purest form of all co-operatives (Corteau, 1963). It cannot do business with the general public due to charter limitations based on serving a membership that is characterised by a common bond. The definition of a common bond is the subject of legal regulation and confers on credit unions a key defining characteristic. In addition, the common bond restriction on membership is assumed to reduce the cost of gathering credit information and in consequence minimises the exposure of individual credit unions to bad debt losses.

However, in exploring the wider aspects of co-operative organisation, the following definition provided by the International Labour Office (ILO) offers further insights,

“...a co-operative is to be understood as an association of persons based on a mutual contract (social contract, bye-laws), which may be somehow registered with the state and whose members have chosen the mutual goal of creating an enterprise with a democratic voting system, sharing also in the financial responsibilities and the risks involved in the process” ILO (1998)

A co-operative, in these terms, exists only to attain the economic and social goals of the people who comprise its membership. Although there may appear to be similarities between socialist co-operatives and autonomous co-operatives in a market economy, the differences in formation, ownership relations, goal setting

and functions mark them out as fundamentally different. Interestingly, in a socialist understanding there can only be co-operatives of producers and consumers, because trade and banking are the monopoly of the state, yet co-operatives in a market economy are particularly strong in the areas of trading, banking and transport, whereas co-operative production is the exception rather than the rule.

Genuine co-operatives are democratic organisations. Credit union members therefore enjoy equal rights to vote, that is 'one member, one vote' and have a right to participate in decision making, regardless of the amount of their savings or the volume of business undertaken. In credit union support organisations or associations, voting is deemed to be proportional or representational again in keeping with accepted democratic principles.

Credit union principles stress limited interest payments for the use of capital. Surplus monies arising out of its operation belong to the members. The distribution of any surplus may take a number of forms including allocation among members in proportion to their transactions; the development of common services to benefit all members; or the development of the business of the credit union. A key element is that any surplus should be distributed in a way that avoids one member gaining at another's expense and the distribution mechanism employed is under the democratic control of the membership.

In order to fulfil their dual economic and social role credit unions place emphasis on the importance of education. Thus, the economic, social, democratic and mutual self-help principles of credit unions are actively promoted through educational programmes for members, officers and the public in general. Awareness of the wise use of credit and the rights and responsibilities that go with membership are the main focus of educational programmes. Such educational investment is made to ensure that members understand the distinctive rationale that distinguishes the distinctive philosophy of credit union activities

Perhaps the most unique characteristic of a co-operative, which strongly distinguishes it from ordinary business organisations, is its 'subsidiary' nature. In other words, there is no profit motive in itself involved in the operation of a credit union. Rather it exists only to attain the economic and social goals of the people who comprise its membership (Corteau, 1963).

### **Typology of Credit Union Development**

In the typology developed by Ferguson and McKillop (1997) three discrete growth stages are identified for credit unions. These are nascent, transition and mature. Credit union industries in specific locations will potentially move from birth through adolescence to full development as a consequence of the growth in assets

and members. By offering a classification of credit union development, the typology simply aims to provide a useful heuristic device for analysing this path. Detailed in Table 1 are the three discrete growth stages identified for credit union industries. For each of the stages the main attributes associated with that particular stage are documented.

**Table 1 Stages of Credit Union Development**

<i>Attributes of a Nascent Industry</i>
Small asset size
Highly regulated
Tight common bond
Strong emphasis on voluntarism
Serve weak sections of society
Single savings and loans product
Requires sponsorship from wider credit union movement to take root
High commitment to traditional self-help ideals
<i>Attributes of a Transition Industry</i>
Large asset size
Shifts in regulatory framework
Adjustments to common bond
Shifts towards greater product diversification
Emphasis on growth and efficiency
Weakening of reliance on voluntarism
Recognition of need for greater effectiveness and professionalism of trade bodies
Development of central services
<i>Attributes of a Mature Industry</i>
Large asset size
Deregulation
Loose common bond
Competitive environment
Electronic technology environment
Well organised, progressive trade bodies
Professionalisation of management
Well developed central services
Diversification of products and services
Products and services based on market rate structures
Emphasis upon economic viability and long term sustainability
Rigorous financial management of operations
Well functioning deposit insurance mechanism

Credit unions in the nascent (birth) stage are wholly run by volunteers, get financial aid, and other forms of help, from government sponsors or other bodies. They are missionary in nature, with a tendency for zealous often inspirational

leadership. Legislation (or often the lack of it) severely controls and constrains credit union growth in nascent industries. However, over time, a nascent industry might develop through either a desire to establish larger credit unions, or by expanding the credit union philosophy through creating many new unions.

In the transition stage, the need to be efficient through economies of scale is to an extent forgone in favour of maintaining smallness as a credit union objective. Such unions inevitably hire paid employees, either full time or part-time. They also often have professional management, but retain volunteer directors. They may have more than a single product, and may offer a range of services

Maturity, the final stage of development, has a more business-like philosophy. Mature industries are characterised by large asset and member size, often achieved through a merger process. Professional staff operate multi-product services, which are often driven by state of the art information technology

### **Legacy of Communism**

Under the former communist regime, co-operatives did not concentrate on fulfilling the aims and needs of their members, but instead were used to pursue politically determined economic and social goals. Therefore, a powerful negative legacy has been left from socialist times throughout reform economies.

Before considering in more detail this legacy, it is worth pointing out that 'genuine co-operatives' - in terms of the definition offered earlier - existed in many reform economies from the mid 19<sup>th</sup> century, although the extent of development varied between different countries. World War I saw the demise of such co-operatives first in Russia then the Baltic States, and World War II saw the disbandment of co-operatives in several Central and Eastern European countries. In their place, 'socialist' co-operatives were established.

“Just like the State enterprises, co-operatives were incorporated into the central plan where the economic tasks were precisely defined, giving absolutely no chance to exceed the boundaries”  
ILO (1998)

Co-operatives in reform economies therefore suffered many deviations and deformations from the Western concept of a co-operative. They lacked a clear system of ownership and membership was often based upon coercion. Co-operatives were relegated to executors of government decisions and suffered from permanent government interference, being regarded as “schools for socialism”.

Although the official ideology of the socialist regime saw co-operatives as connected with capitalism, co-operatives nevertheless have always played a role in 'applied socialism' as a form of democratisation of social life and of the use of the market. Although a perversion of genuine co-operative principles, the socialist regime still found them a useful instrument;

'Qualities like adaptability and social neutrality even to adverse political conditions allowed co-operatives to continue under the social restrictions of socialism. They became a widely practised organisational form in Central and Eastern Europe which was used to integrate farmers and craftsmen into the political system of socialism. This process of integration became easier because of the socio-economic fundamentals of the co-operative concept which corresponded, at least to some extent (for example, regarding the solidarity aspect), to some socialist values. Therefore, socialist governments were able to instrumentalise co-operatives for their political, economic and social goals. ILO (1998)

As Davis (1996) points out, throughout reform economies, there is a widespread suspicion, scepticism and distrust of nonprofit organisations - particularly 'foundations'. State sponsored foundations introduced by communism often displaced earlier autonomous co-operatives in Central and Eastern Europe and this helps to explain the prevailing attitude of distrust. Under 'mandatory voluntarism' citizens 'were often expected to 'volunteer' their time to official state organisations and to contribute to officially sanctioned philanthropic endeavours' (Nikolov (1992)). Often these foundations established by the communist regime suffered from corruption, hence it is not difficult to understand the widespread scepticism towards such foundations by the general population of reform economies. The legacy of this perversion of the co-operative concept makes the rekindling of non-profit institutions based upon genuine co-operative principles difficult. Besides the perversion of the co-operative concept, the communist regime also created a strong dependency culture which mitigates against building self-help, voluntary co-operatives. The difficulties experienced by the reform process itself has led to some disillusionment with it amongst segments of reform economy populations since the basic security traditionally afforded to citizens has been undermined. Voluntary self help offers a way forward, but with no direct experience of its benefits there is a need to appreciate that institutions such as credit unions will not automatically take root. A fundamental prerequisite for the development of co-operatives in reform economies is that,



“.....there first has to be a readiness from the people themselves to practice self-help, active member participation and local autonomy, faith in their own strength and self-management”

Eisen and Hagedorn (1998)

The above mantra for credit union development can be usefully examined by considering in some detail the experience of credit union development in Ukraine and Poland.

### Poland and Ukraine

If the credit union system in Poland and Ukraine are placed in juxtaposition it can be seen that there are major differences between them. Using the typology alluded to earlier (Ferguson and McKillop 1997), the case can be made that Ukraine is still very much at the nascent stage of development, whilst Poland has gone beyond this and has reached the transition stage of development. Thus, in the case of Poland, credit union development has been progressive with the major elements of a sophisticated credit union system now in place. In Ukraine by contrast, the rate of development has been hindered by a number of structural and legal weaknesses and the credit union system is far less developed. Table 2 highlights the key features of the credit union system in both Poland and Ukraine.

**Table 2 Key Features of the Credit Union System in Poland and Ukraine**

	Poland	Ukraine
Number of Credit Unions	140	106
Number of Members	394,448	80,500
Penetration Rate	1.49%	0.24%
Savings (US\$)	\$239,541,298	\$3,076,639
Loans (US\$)	\$208,771,402	\$3,413,377
Reserves (US\$)	\$29,056,628	\$491,857
Assets (US\$)	\$289,477,188	\$3,808,998
National Association	Yes	Yes
Central Finance Facility	Yes	No
Stabilisation Fund	Yes	No
Insurance Company	Yes	No

Source: World Council of Credit Unions data, 2001

Poland has a population of approximately 38 million people and the GDP per capita is \$4,282 whereas Ukraine has a population nearer 50 million people and has a GDP per capita of \$486. Both Poland and Ukraine have benefited from assistance, for instance, from USAID funds. Between 1992 and 1999 Poland received \$3.9 million which was channelled into developing the ‘credit union

system' rather than strengthening the credit union base in Poland. The Polish credit union system is now the fourth largest financial network in Poland and displays features that make it comparable to most of the developed credit union systems found elsewhere in the world.

In order to support the promotion and strengthening of credit unions, Ukraine has, in broadly the same period, also received funds from USAID. First in 1993 with a small grant of \$300,000 to promote credit unions and train credit union organizers, and later with a grant of \$1.0 million for the period 1995 to 1999 to provide technical assistance, training, and other support to the fledgling movement. The credit union system in Ukraine has not prospered to the same extent as found in Poland. Although Ukrainian credit unions have demonstrated that they have found a viable niche in the financial market place, the credit union system is still 'small, undercapitalized, and lacks the structure and facilities to perform the tasks expected of it.' (DAI 2000)

The disparity in per capita GDP between Poland and Ukraine gives an indication of the deep seated problems experience by Ukraine as a transition economy. The volatility of post reform Ukraine demonstrates well the difficulties involved in the creation of a nascent credit union sector in an ex-communist society. With independence in 1991, Ukraine immediately experienced traumatic economic conditions. As part of the Soviet centralised system, the Ukrainian economy was more closely linked than those of the other Soviet republics which made Ukraine particularly dependent upon the Russian military-industrial complex. Post independence trauma was evidenced by a sharp decline in output of both industrial and consumer goods, which was compounded by a sharp fall in export demand for military goods. It has been estimated that the cumulative decline in gross domestic product between 1991 and 1994 was of the order of 85 percent. Inflation rose from 390 percent in 1991 to 10,255 percent in 1993 as the State budget deficit mounted ever higher. Monetary controls introduced in 1994 helped control inflation which, in 1995, fell from 21.2 percent in January to 4.8 percent in June that year. These difficulties associated with economic reforms are mirrored in the social predicaments endured by the citizens of Ukraine during the process of transformation.

Post independence statistical evidence suggests a considerable increase in the rate of poverty. It is estimated, for example, that by 1993 over three quarters of the population had official incomes below subsistence level. Even when the effects of the fairly prevalent black economy are taken into account, plus the extensive practice of home production of food on private plots of land, the overall view that the Ukrainian population has suffered impoverishment since independence can be safely maintained. Additionally, the traditional expectation amongst the citizens of Ukraine has been that the State is a provider guaranteeing at least a subsistence

level financial security. Indeed, Ukraine inherited one of the world's most elaborate welfare systems. In 1992, half the population received cash benefits such as retirement, disability, family supplements and student benefits - although it is now clear that Ukraine does not have the economic resources to maintain this level of social expenditure.

Changing this dependency culture demonstrated by its citizens towards the State is not going to occur overnight. The difficulties experienced by the reform process itself has led to some disillusionment with it amongst segments of the Ukrainian population since the basic security traditionally afforded to citizens has been undermined. It is clear that the previous totalitarian regime in Ukraine, which sought to control every aspect of economic and social life, leads to special challenges,

“.....a total dependency of the individual on society was created and every free space of self realisation and self responsible action was curtailed. At present, after the totalitarian centralistic societal and economic structures have broken down, an individual has to face enormous amount of liberties that they are not used to and which they have to learn to use. The centralist planning system had a tendency to kill the desire for individual action. Thus in its aftermath there is enormous insecurity. Co-operatives can act as institutions for a common learning of the mechanisms of the market. Co-operatives as voluntary communities of people with equal voting rights are a school of solidarity.”

Todev, Brazda and Schediwy (1993)

The economic and political pressures affecting Ukraine undoubtedly have been further compounded by the disastrous effects of the 1986 Chernobyl accident. Besides those who died, 130,000 people were resettled and nearly three million people were left with life threatening illnesses as a consequence of events at Chernobyl. To deal with the effects of the Chernobyl disaster has necessitated State provision of free medicine, subsidised food and early retirement. One sixth of the Ukrainian national budget is currently allocated to provide on going support for those affected by Chernobyl. Reluctance by the Ukrainian Government to cut public expenditure, particularly social expenditure, is perhaps understandable given the combined effects of Chernobyl and the hardships created by the economic reform process. The difficult conditions existing in Ukraine therefore obviously present particular challenges to the establishment of co-operative credit unions.

The difficult economic situation creates conditions where members and potential members of credit unions find it more difficult to save and are less able to manage debt, which will keep the natural growth of credit unions relatively slow. In

Ukraine, credit unions underwent a net loss of real assets, deposits, and value of loans in the 1997 to 1998 period because of the economic crisis. Growth has gradually returned to the movement, but at a slower pace. It should be noted however that in the adverse economic conditions in Germany in the late 1800s and in the United States during the Great Depression there was nevertheless a dramatic rise in strong credit union movements simply because they offered services that were denied by mainstream financial institutions to people of small means.

The structural weaknesses of the Ukrainian credit union movement are fairly apparent and act as potential brake on future development and growth. Weaknesses in the legal and regulatory environment underpin the structural weakness of Ukrainian credit unions. For instance, there is a lack of minimum requirements regarding start-up capital, ownership and operating standards. A weakly defined operating structure empowers them to operate under the law but does not specify their powers nor does it define their internal legal structure which would differentiate them from investment clubs or pyramid schemes. On the latter point, a large number of investment clubs or pyramid schemes operate in Ukraine under the banner of being 'credit unions,' thus undermining the credibility of those genuinely organized credit unions trying to operate under credit union principles. Finally, the absence of an adequate regulatory and supervisory structure for credit unions in Ukraine is a serious weakness which unless adequately rectified will hinder development.

Turning again to Poland, it can be stated that, although not without pain for the Polish people, the transition process in Poland has been much more successful than in Ukraine. By 1998 sound fiscal policy had reduced inflation from over 880% in 1990 to 8.9%. During the same period, the average monthly salary of Polish workers rose from 50 USD in 1990 to 350 USD in 1999. Compared to Ukraine, the success of Poland's macroeconomic reform and Poland's record to better engage in the reform process are evident. In part, the success of Polish credit unions is owed to a process of liberalization which started much earlier than the 1990s. Indeed, Poland took the lead in formulating a legislative framework for co-operatives that aimed to overcome many of the distortions that co-operatives experienced under the communist regime. For example, the Co-operative Law of 1982 was a real attempt to free co-operatives from the constraints of the central planning system and to give more weight to the primacy of their membership. Section 1 of this legislation attests to the desire to enshrine genuine co-operative principles in the governance of co-operatives in Poland,

'In its economic activities [the co-operative] is governed by the needs of its members and the demands of the central and local socio-economic problems,.....in order to improve the material

and cultural standards of living as well as the confidence of its members and to work towards the well being of the People's Republic of Poland ILO (1998)

In 1991, the autonomy of co-operatives was further enhanced by legislation which repressed the influence of non-economic and non-members influences. Additionally, this legislation gave co-operatives freedom to determine the use of 'profits' (surplus) and rectified the previous restriction which held that only 5 per cent of 'profit' could be placed into reserves. Specific legislation recognising credit unions in Poland was enacted in 1992 which, it should be noted, allowed for employee based credit unions only.

A further Credit Union Act, passed in 1995, rectified the limitations arising from the 1992 legislation and provided the platform for the further expansion of Polish credit unions by recognizing other forms of organizational common bond credit unions. Since the enactment of this legislation, there has been a major expansion of community credit unions based upon membership of the Catholic church. Other forms of community based credit unions - besides those based upon the Church - have also prospered.

The central role of the Solidarity trade union, based upon its opposition to the communist regime, as the key agent for driving social and economic change in Poland is acknowledged worldwide. Solidarity provided unwavering support for credit union development in Poland and openly encouraged its members to either create new credit unions or join existing ones. The emphasis by Solidarity on the establishment of employee based credit unions led to credit union development that in effect was subsidized owing to the Executory Order of the Council of Ministers 1993 which resulted in benefits such as free office space, utilities, telephone, payroll deductions for credit unions being established in the workplace. It is questionable whether Polish credit unions could have been as successful without this direct support. A major effect of this support has been to ensure that the credit union system in Poland is underpinned by a strong segment of employee based credit unions many of which no longer require workplace subsidies.

A crucial component of the 'chemistry of success' evident in the development of the Polish credit union system has been the quality of the leadership that emerged to guide the process of growth and development. Professor Adam Jediniski, a wealthy lawyer, has been Chair of NACSCU's Board since 1992 and he has played a key role in the development strategy of Polish credit unions. Similarly, Grzegorz Bierecki, a Solidarity political activist, has also played a decisive role in steering credit union development in Poland. Both men have provided stable and inspirational leadership based upon their own commitment and support of the ideals enshrined in the co-operative philosophy of member based credit unions.

Besides the original amalgam of features described so far, Poland provided a context which was favourable to credit union development across a wide range of cultural, social and economic dimensions. For instance, the religious values found in Poland underpin relationships based upon trust and 'people helping people' which made credit unions culturally very acceptable. Additionally, in the collective consciousness, especially amongst the older generation, there was an awareness of the savings and credit co-operatives that existed in Poland prior to the World War Two which again made acceptance of credit union ideals easier. As the banking sector in Poland had not served people well and most people distrusted banks, and as credit unions were increasingly able to offer attractive financial services, large sections of the population far preferred their services to those of banks. That this same favourable context is not replicated in Ukraine - where credit union regulation is lacking and where economic conditions are more adverse - means that there is little prospect of Ukraine achieving a similar level of credit union development in anything near the timescale found in Poland. Indeed it is extremely doubtful if, in the near future, other Reform economies could match the successful development and growth of Polish credit unions. In Poland it has proved easier for, *"the people themselves to practice self-help, active member participation and local autonomy, faith in their own strength and self-management"*

The role and function of sponsor organisations such as WOCCU and government agencies such as USAID have been crucial in triggering the potential that exists for credit union development in reform economies. The transference of technical skills from the wider credit union movement through training and education programmes have been important in adding to the favourable conditions for credit union development in Poland. Similarly, efforts to establish credit unions in Ukraine owes much to the tangible support by WOCCU funded by USAID, and the Canadian Co-operative Association

### **Historically Specific Factors and Credit Union Development**

World Credit Union Statistics provided in Table 3 provide a useful snapshot of credit union development in Europe and includes comparative data for the Soviet Union and some European reform countries including Ukraine and Poland.

**Table 3 Europe: Credit Union Statistics for Countries Affiliated to WOCCU, Year 2000**

Country	Credit Unions	Members	Penetration*	Savings (US\$)	Loans (US\$)	Reserves (US\$)	Assets (US\$)
Bulgaria	13	16,848	0.32%	945,843	607,044	76,560	1,042,551
Great Britain	483	265,166	0.68%	235,229,731	234,969,970	22,354,694	275,707,898
Ireland	535	2,600,000	102.46%	6,300,756,090	4,760,571,268	910,109,213	7,547,908,989
Latvia	15	9,533	0.59%	1,375,959	N/A	92,210	1,673,982
Lithuania	10	6,400	0.26%	3,185,675	2,202,950	N/A	3,823,400
Macedonia	3	586	0.04%	48,197	67,360	518,475	573,346
Moldova	206	20,968	0.70%	13,767	165,778	775,098	6,404,160
Poland	146	394,448	1.49%	239,541,298	208,771,402	29,056,628	289,477,188
Romania	4,304	1,571,928	10.27%	103,037,344	99,861,365	3,921,982	114,599,073
Russia	78	62,300	0.06%	7,164,376	6,472,193	212,899	8,386,251
Ukraine	106	80,500	0.24%	3,076,639	3,413,377	491,857	3,808,998
<b>TOTALS</b>	<b>5,899</b>	<b>5,028,677</b>	<b>2.19%</b>	<b>6,894,374,919</b>	<b>5,317,102,707</b>	<b>967,589,616</b>	<b>8,280,405,836</b>

\*The penetration rate is calculated by dividing the total number of reported credit union members by the economically active population

Source of data: World Council of credit Unions Statistical Report for Year 2000

No European country comes close to the success of the credit union system in Ireland. Interestingly, both Romania and Poland have achieved better penetration rates than Great Britain. The figures also indicate how much is still to be achieved where a country like Russia has a penetration rate of 0.06%. Differences between countries are of course historically specific and involve a unique amalgam of factors that will always tend to make credit union development uneven. Generally speaking, the key shared features of credit union systems in reform countries are their small asset size, their need for empowering regulation and recognition, a tight common bond, and a strong emphasis on voluntarism. Typically, such credit union systems require sponsorship from the wider credit union movement to take root. All such credit union systems depend on building a high commitment to self-help ideals if they are to achieve their mission of serving the weaker sections of society.

Indigenous factors associated with the historical legacy of communism and the trauma associated with economic reforms make credit union development no easy task in particular reform economies. Ukraine was used as an example. Yet there are examples, as shown in the case of Poland, where credit union development has flourished although the point has been made that this success will not be easily transferred to other reform countries. Despite the problems of diffusion of Poland's success it still provides a 'demonstration effect' of a reform country mastering its own destiny and building co-operative credit unions in support of a democratic way of life. Even as a model of what is possible, Poland's credit union

system provides a positive example which, in time, other reform countries hopefully can emulate.

In terms of refuting or confirming the attributes contained in the earlier development typology, we believe that these case studies broadly confirm the appropriateness of the development classification. However, the case studies provide insight into the complexities of credit union industry development and confirm that – despite the explanatory usefulness of the original typology - there is no universal, deterministic blueprint for credit union development. For instance, in nascent credit union industries the mix of empowering legislation, quality of leadership, commitment to self help, external sponsorship etc., is a dynamic one, the chemistry of which will be critically influenced by historically specific features in any given country.

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## CHANGING BRITISH CREDIT UNIONS: LEARNING LESSONS FROM LATIN AMERICA

Paul Jones

### **British credit unions – facing the challenge of change**

There has been considerable investment in the development of the British credit union movement. Since the late eighties, central and local government have spent millions of pounds of public money endeavouring to establish credit unions as prime vehicles for the delivery of financial services to low income groups (Jones 1999). 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. In Birmingham, for example, local government has funded a credit union development agency for fifteen years. Its annual Council grant of over £160,000 (2001 figures, increased to over £0.25 million with additional European funds) has resulted in Birmingham's 31 community or faith-based credit unions having, according to the latest Government figures, fewer than 6000 members and assets of under £2 million.

Research has identified the factors that have contributed to the slow growth of British credit unions to be poor legislation, disunited national trade associations and, most importantly, the lack of adequate institutional development models (Jones 1999). In the traditional British model, most credit unions were regarded primarily as socially oriented organisations. They were designed to be managed and run by volunteers and to offer a basic savings and loans service to members drawn from a relatively small catchment area. Consequently, the training offered by external development workers focused mainly on building the capacity of volunteers to manage a community initiative at a basic level. The 1999 research, *Towards Sustainable Credit Union Development*, pointed out the experience of credit union development elsewhere in the world where credit unions were seen much more as larger financial institutions able to serve a wider cross section-section of society, including those on low incomes and who had limited access to mainstream financial providers. The findings of the research indicated that British credit unions needed to change their focus and direction if they were develop the capacity to serve much larger number of the population. This change or focus involved adopting a more business-like and professional approach to credit union

development; an approach characterised by a clearer focus on economic goals and financial viability, professional management and competitive financial services. It was clear that this fundamental change in direction would demand a radical revision of traditional development and training programmes. The findings of the research left activists wanting to organise their credit unions according to a much more business-like model of development. The “*how*” to do this in practice was, however, not yet that clear.

### **Credit unions in Britain – can lessons be learnt from Latin America?**

It was Lucy Ito, vice-president of the World Council of Credit Unions, who first suggested that the British credit union movement may have something very important to learn from the Guatemalan credit union experience. In the 1980s, most Guatemalan credit unions were small and economically weak. However, in 1987, a process of credit union transformation began that resulted in the institutional and economic strengthening of a significant number of credit unions. From being small, relatively ineffective organisations, offering services primarily to the poor, these credit unions grew and were transformed into solvent, safe and effective financial institutions able to offer a wide range of financial services to a much larger cross-section the Guatemalan population.

Despite the evident social, economic and political differences between Guatemala of late 80’s and Britain of the new millennium, credit unions in both countries were established according to a similar model of development which prioritised social over economic goals (Jones 1999). As a result, both groups of credit unions suffered financial and institutional weaknesses and failed to make a significant impact within their respective financial markets. In both cases too, there was a long term dependence on external donor funding. In the British case, this was mainly in terms of financial support for premises, staff, training and organisational infrastructure. In Guatemala, external funds were used more to finance on-lending to members (a practice followed also by some British credit unions through the creation of externally funded loan guarantee schemes which facilitate lending to poorer, riskier members).

In Britain today, as in Guatemala in 1987, a fundamental change in the development of credit unions is seen to be necessary if they are to achieve their potential of making a “*positive contribution to increased access to financial services for low income groups, especially in deprived areas*” (HM Treasury 1999a). The HM Treasury’s Credit Union Task Force saw this change in terms of credit unions developing as broader-based, business orientated financial institutions with the policies, procedures and systems necessary to provide a wider range of services and to attract savings. This Task Force perspective mirrored the

recommendation of the HM Treasury's PAT 14 report that credit unions need to adopt a new transformational approach if they are to have the capacity to act as fully fledged financial institutions (HM Treasury 1999b).

Transforming British credit unions into modern, economically stable financial institutions is not, however, easy or straightforward. It depends on credit union volunteers and staff members beginning to think about credit union management and operation in a radically new way. It means replacing the traditional social welfare model of credit union development with a more professional, business and market oriented model. It was precisely this process of transformation that took place in Guatemala in the late 80's. It was this similarity of background that led Lucy Ito to suggest that British credit unions may have some hard lessons to learn from Guatemala about bringing about the change necessary to establish credit unions as fully fledged financial institutions.

This paper aims to examine and explore the process of transformation and change within Guatemalan credit unions in order to draw out some key lessons for the British movement.

### **The Guatemala Cooperative Strengthening Project**

From 1987 to 1994, the US Agency for International Development (USAID) contracted the World Council of Credit Unions (WOCCU) to undertake an institutional development programme aimed at stabilising and strengthening cooperative organisations and credit unions in Guatemala. The Guatemala Cooperative Strengthening Project (CPS) was a programme both of financial stabilisation and institutional reform. It aimed at both at strengthening credit unions as solvent and safe organisations and at modernising them so that they could compete effectively in a competitive market economy. Through a process of technical assistance and training, the policies, practices and disciplines of participating credit unions were upgraded in ways that were quite new to Guatemalan credit unions. The results were impressive. CSP credit unions made the transition from being inefficient and fragile organisations to becoming competent and sound financial institutions.

This process of transformation and change was neither easy, quick nor cheap. The whole programme took nearly eight years and cost \$5 million, of which \$3 million went in direct support to credit unions. It involved credit union directors and staff having to radically re-think the principles and practices of credit union management and implement fundamental reforms so that credit unions could operate as effective financial institutions within the difficult economic environment of the time. In place of the traditional credit union focus on providing credit for poor people, mainly with the support of external, international

donor funds, credit union directors and staff were presented with new business orientated objectives that spoke of responsiveness to market demands, profitability, credit risk analysis and capitalisation. Undoubtedly some credit union people did feel that something of their traditional socially-oriented credit union philosophy was being lost in the change to a market-driven, business approach to development. However, given the success of the project, CSP has now been recognised by Guatemalan credit unions as a major contribution to their effectiveness, soundness and sustainability. 20 credit unions participated in CSP and all experienced significant increases in membership, loans outstanding, deposit savings and retained earnings.

CSP was led by a management team of three people. A project director was appointed by WOCCU, an assistant director by USAID, the third team member was the CEO of The Guatemalan National Credit Union Federation (FENACOAC). There were three additional staff members responsible for marketing, finance and administration. It was an independent project and high quality staff were recruited to the team, all of whom had extensive financial knowledge and technical skills. The aim was to go for the best people that could be found within the private sector. The project worker responsible for organisational systems had worked for Price Waterhouse for 3 years, the marketing expert had worked for Sony and the finance person had a senior background in banking. Recruiting high quality staff was seen as essential to the success of the project. People were employed who fully understood the technical issues in the development of safe and sound financial institutions.

### **Modernising Guatemalan credit unions – the strategy**

The aim of CSP was to assist credit unions to develop into sustainable and safe financial institutions that could effectively respond to the needs of the rural, agricultural and micro-enterprise economy in Guatemala. Banks and mainstream financial institutions had shied away from serving micro entrepreneurs and poorer consumers. Credit unions, on the other hand, were local and based in rural and smaller communities. They were well placed to fill a market gap by making available an alternative financial service for smaller savers and borrowers.

However, a diagnostic analysis of Guatemalan credit unions prior to CSP had identified that Guatemalan credit unions were financially weak and insecure organisations. Not only did they lack the institutional capacity to serve a greater proportion of the population, many were near insolvent retaining large uncollectable delinquent loan balances on their books. One of the first tasks of the CSP project team was to investigate the factors lying behind this poor institutional development. At first, project workers assumed that credit union weaknesses were

a product of the external turbulent economic and political situation within Guatemala at the time. However, it soon became clear that the poor growth and economic vulnerability of credit unions was not primarily the result of external factors but rather a product of the internal organisation and financial structure of credit unions themselves. The first task of CSP was to clearly analyse how the traditional model of development was preventing credit unions becoming economically viable.

CSP identified that the traditional credit union model was based on the theory that the rural poor lacked the resources necessary to save and to fund their own borrowing and development (Richardson 2000b). Guatemalan credit unions had been established with a strong social ethos, often with the support of the Church or other welfare organisations. Their primary purpose had always been to provide low cost loans for poor people who were unable to access other financial institutions. They did not prioritise the mobilisation of member savings. In fact, the only savings that were captured were in the form of shares that could only be withdrawn on termination of credit union membership. These share savings earned minimal interest, often only 2-3% in an economy with 15% inflation. Their main purpose was to provide a basis for borrowers to obtain low cost credit and loans were granted, often quite mechanically, as a multiple of the member's share balance (usually 3 to one). These share savings were not attractive to people who wanted to save. The result was that Guatemalan credit unions were unable to mobilise the savings of members and, in order to fund the credit needs of the poor, were dependent on international donors providing external finance.

This model was regarded by CSP as inherently weak. Non-withdrawable shares did not attract savers. Low cost loans did not generate sufficient income to pay dividends or generate capital reserves. On-lending of donor money often was done in the absence of effective credit administration systems with the result that heavy loan losses were regularly sustained. This meant even lower earnings and lower levels of capital reserves. In addition, the traditional model was not characterised by rigorous accounting practices and, as a consequence, financial statements often overstated asset values. Long delinquent loans were not written out of the accounts and current delinquency was not accompanied by adequate provision for loan loss. Under-capitalised traditional model credit unions were particularly vulnerable when external donor funds were not forthcoming. When this happened, there was a chronic shortage of funds, loans had to be rationed to members with yet greater loss of income to the credit union.

The solution to this problem was to develop an alternative and modernised model of credit union organisation and structure that would address the weaknesses in the traditional model and strengthen credit unions as economically sound financial institutions. The strategy adopted by CSP, therefore, was to persuade credit union

directors and staff to adopt a radically changed approach to credit union organisation and financial structure. It aimed to replace the traditional social welfare model with a more professional, business and market orientated model of credit union development.

Following Richardson, Lennon and Branch (1993), the main elements of the new credit union model were:-

- attracting deposit savings – the central element of the new approach was the emphasis on attracting the savings of members, “*the project’s paradigm shift*” (Richardson 2000b). CSP encouraged the creation of new deposit accounts which could be withdrawn easily and which received a competitive rate of interest. CSP stressed that it was only by attracting savings, and thus amassing loanable funds, that credit unions would be able to free themselves from dependence on external, and necessarily uncertain, donor funds and become fully fledged financial intermediaries.
- market rate on loans – in order to pay a competitive rate of return on deposit savings, credit unions had to increase earnings which, CSP stressed, required the use of market rates in lending. This would prove to be a particular contentious issue within the programme as it meant that interest rates on small loans, mostly made to poor people, had to increase.
- capitalisation of earnings – when credit unions mobilise the savings of members, adequate capital and bad debt reserves become much more important in order to protect savings. In the traditional model, shares had been regarded as capital. CSP argued that shares were ultimately withdrawable albeit on termination of membership and, in fact, were regarded by members as secure deposits. CSP directed credit unions to maximise and retain earnings as capital reserves as a means of building institutional strength. CSP set the goal of retaining 10% of assets as capital reserves.
- repayment based credit analysis - CSP promoted the redesign of the administration of credit. Rather than loans being granted on a simple share to loan formula, they were to be based on the capacity of the member to repay, the available collateral or guarantee and the conditions attached to the loan made.
- marked-based, results orientated business planning - CSP approach to model credit union development was to focus clearly on economic goals. It argued, as central to the paradigm shift, that social goals could only be achieved through economic and business success.
- improved financial information reporting, control and evaluation. – CSP introduced rigorous monitoring and reporting disciplines and a system of peer evaluation through which the progress of credit unions was compared one with another.

## **Design of CPS**

In designing the programme, the CSP team found that it was essential to implement a whole package of reforms simultaneously. At the same time as instituting reforms to prevent losses and stabilise the credit union financially, it was important to put in place more proactive institutional reforms that improved managerial competence, competitiveness and business practice.

The design of CSP was based on five interrelated and interwoven components (Branch 1993), none of which could be implemented without the other four. These were financial stabilisation, institutional development, savings mobilisation, credit administration and external supervision and monitoring.

1. Financial stabilisation Financial stabilisation was the key incentive that attracted Guatemalan credit unions to buy into the whole package of CSP institutional reforms. Credit union directors and staff knew that their credit unions were under-capitalised and economically fragile due to historic loan losses and inadequate delinquent loan provision. The CSP stabilisation component offered credit unions an injection of financial resources to write off bad debts and to improve capital adequacy and solvency over a specific period of time. These financial resources were the “carrots” which persuaded credit unions to undertake the whole programme.

Financial stabilisation began with a rigorous identification of loan losses. Stabilisation funds were then allocated equal to the accumulated losses. However, funds were not allocated directly to the credit union. They were invested in a finance company in the name of the credit union and the interest accrued over time reinvested in the finance company until the conclusion of the stabilisation process. This accrued interest was used to write off bad debts and to build adequate reserves for future delinquent loans.

Participation in the stabilisation process was conditional on the credit union establishing and maintaining rigorous financial management disciplines. Credit unions were obliged, through a signed stabilisation-management agreement, to enforce delinquency and internal control policies, capital reserve standards, improved credit administration and the control of operating costs. In addition, the granting of stabilisation funds was conditional on participation in the institutional development component of CSP and meeting set financial and operational targets. Failure to maintain disciplines and meet targets meant expulsion from CSP. Technical assistance and training in establishing new financial and operational disciplines was given to staff members. Volunteer members of boards of directors were encouraged to share the vision of financial stability and economic growth.

2. Institutional development The institutional development component aimed to professionally modernise the business practices, policies and procedures of participating credit unions. Support in the form of advisory services, training, and marketing assistance was given to credit unions and grants were available for marketing programmes, upgrading buildings, facilities and information technology. Specific technical assistance and training was organised to upgrade the financial management and accounting competences, business and leadership skills of staff members. Within this, a clear focus was placed on developing strategy, market penetration and improving service delivery. The aim of the institutional development programme was to ensure that credit unions developed into modern, stable financial institutions able to offer a range of financial services to their members.

As with the stabilisation component, credit unions were obliged to meet certain agreed requirements and targets as a condition of continuing as participants in the institutional development programme. Compliance with these conditions was strictly monitored and the disbursement of finance remained a liability to the credit union until CSP were satisfied that the credit union had successfully completed its operating plan. These conditions covered establishing and updating credit procedures, pursuing a marketing plan, undertaking a financial audit, participating in training for directors, managers and staff, increasing share and deposit savings by a stated percentage and increasing membership by a stated number (Branch 1992). Non-compliance resulted in exclusion from CSP.

CSP stressed that external finance granted to credit unions had to be reported as extraordinary income and was not allowed to diminish efforts to become economically viable. With the same emphasis on self-sufficiency, finance for marketing was only given on condition that the credit union provided match funding from its own resources.

3. Savings mobilisation A central component of CSP design was the stress on aggressively pursuing the mobilisation of savings. The project team were insistent that this was the “driving force for internally generated growth” (Branch 1992, Richardson 2000b). Credit unions were discouraged from using credit or finance from external sources for on-lending to members. The maxim was: only funds that were saved were to be lent. Reliance on external finance, Richardson has argued, is the traditional weakness of micro finance programmes. It neither enables poor people to amass wealth through saving (Richardson 2000a) nor does it build the strength of the financial institution. CSP facilitated the creation of deposit savings accounts, which paid a competitive rate of return, and were attractive to savers.



4. Credit administration. CSP was designed to improve loan evaluation criteria, loan administration and delinquency control. A repayment based credit analysis approach to lending was introduced based on the member's character, commitment and capacity, collateral or guarantees and conditions of the loan.
5. External supervision and monitoring CSP facilitated the adoption of financial disciplines and enforced regular examination and monitoring within participating credit unions. CSP developed a new monitoring system called PEARLS which was used to analyse the financial structure and growth rates of credit unions (see section 12 below). PEARLS became a key management tool within the programme.

### **Implementing CSP**

The dynamics of implementing CSP were not easy. The project team were convinced that credit unions had to adopt a new business-oriented development model if they were going to succeed as successful financial institutions. However this meant convincing people to think about credit unions in quite a different way. As Richardson points out, "*the long difficult process of changing the way people think is by far the most difficult aspect of modernisation*" (Richardson 2000b). Through a process of education, training, persuasion, a constant focus on economic reality and the use of incentives CSP aimed at changing the mindset of the directors and staff of participating credit unions

One of the first issues to be tackled was the use of the funding. FENACOAC wanted to channel the external funding through to credit unions for on-lending in the traditional manner. The CSP team was clear that no external funds could be used for lending by CSP participating credit unions. All loanable funds had to be generated through aggressively pursuing deposit savings mobilisation (in fact \$1 million had been set aside in the original bid as a credit fund for on-lending by participating credit unions but it was never used). Through a process of discussion, FENACOAC was eventually convinced that savings mobilisation was the only effective way of building institutional strength.

An important element of CSP was that it was very hands on. CSP staff were recruited for specific specialisms whether in marketing, finance or organisational systems. They were not generalist credit union workers. They were all highly skilled, coming mainly from senior positions within the private sector. They spent a lot of time, individually and in small groups, with credit union staff. There was a lot of small group discussion in which issues were tackled in depth. Consequently, CSP was not a sequential programme of training. The team responded to the needs of credit union staff as these arose. There were seminars and technical

training workshops but 80% of the time was spent coaching and mentoring staff in individual credit unions. The resources available, 5 CSP staff for 20 credit unions over nearly a 8 year period, permitted this high level of one-to-one involvement.

CSP applied a methodology that integrated organisational diagnostics and planning, performance measures, funding, training and technical assistance. The CSP institutional development component began with a diagnostic of the market potential and economic viability of the credit union. This was a rigorous assessment of the credit union's market penetration, administration, savings mobilisation, credit assessment, delinquency, capitalisation, operational efficiency, policies and procedures. On the basis on this diagnostic assessment, a business development plan was drawn up aimed at strengthening the policies and procedures, service quality, management skills, accounting practices and credit union systems. The plan defined the development strategy of the credit union and the financial goals for the period. Participation in the institutional development component was subject to meeting the targets set in the development plan as defined in the legally binding institutional development agreement (*see section 7.2 above*)

The process of stabilisation was equally rigorous and was aimed at establishing permanent financial disciplines in the credit union. It began with the identification of losses. Funds were allocated and invested and the interest used on these to write off bad debts and restore reserves (*see section 7.1 above*). The legal representative of the credit union, its board members and the legal representative of CSP signed a legally binding financial stabilisation agreement in the presence of a solicitor. The credit union was obliged in the agreement to follow financial, administrative and management requirements as well as meet specific targets in regard to the growth of loans, deposit and share savings, members, capital reserves, investments and assets.

The demands of the institutional development and stabilisation agreements were not always accepted easily. Particularly contentious was the obligation to charge higher rates on loans. In order to maximise earnings to offset the higher cost of funds due to paying competitive interest rates on deposit savings, credit unions had to charge market rates (or a few percentage points below) on loans. This was difficult for the CSP team to sell to credit unions as it meant, in fact, charging poor people more for credit. "It was a constant struggle. We first managed to convince the credit unions to raise their rates to 1.5% per month", reported one of the CSP staff members, "and, after about a year, again increased those rates to 2% per month".

It also took a long time too for the CSP team to convince credit union managers for the need to build capital reserves. Credit unions had poor reserves as they

considered members' shares to be more than sufficient to cover any loss. CSP countered this by arguing that members regarded shares as "savings" and, if they were told that their shares were at risk, it was very likely that members would not invest in them at all. Today, Guatemalan credit unions actually treat members shares as though they were savings by provisioning monthly for the annual dividend rate. Eventually, credit unions hope to eliminate the difference between the interest rate paid on deposits and the dividend rate on shares, but as yet, there still exists a difference although much less than it was. CSP firmly stressed that all earnings had to be entirely capitalised, as part of the stabilisation agreement, until a ratio of 10% of assets was achieved.

The process of transforming credit unions into professional, viable market-oriented businesses came up against resistance constantly. The move away from what was seen as a social model of development was the big issue. Credit union staff and volunteers sometimes felt that the ethos and philosophy of credit unions were being lost in the pursuit of economic and financial goals. There was a perceived loss of identity too - "we are becoming just like banks" . Some felt the movement was being Americanised with all the import and feeling that arouses in Central America. Others felt that they were being forced to adopt just one business model of development and that they had little choice about it. Some felt that CSP was only interested in the bigger credit unions and were ready to let the smaller unsustainable ones collapse. There were issues too around perceived loss of control by volunteer boards. They were not used to employing highly skilled staff and were suspicious of CSP focus on the upgrading of the skills and abilities of managers. Overall, directors and staff found it difficult to cope with the paradox that, in order to achieve social goals more effectively credit unions had to develop a much clearer professional and business focus.

CSP staff moved the credit unions on mainly through persuasion, argument and a focus on economic reality. However, CSP did rely also on incentives, the "carrots". Participating credit unions were offered access to the stabilisation and institutional development programmes, including financial resources, if, and only if, they accepted, in a legal contract, the new model of credit union development and committed themselves to achieve set financial and organisational goals.

### **Process of gaining access to CSP**

Credit unions gained access to CSP through a evaluation process conducted by the CSP management team. In order to participate in CSP, credit unions had to meet defined and pre-existing operational and eligibility criteria. Entry into CSP was not automatic and not all credit unions that wanted to participate were able to do so. In Guatemala in 1987, about 25 of the 92 existing credit unions accounted for

about 80% of credit union assets (similarly, in Britain today, about 50 out of more 600 credit unions hold 80% of credit union assets). The CSP approach was to select the 21 strongest credit unions in the country and to ensure that these were stabilised and functioning as effective financial institutions. By establishing a strong core group of credit unions, the CSP idea was that they would eventually act, through the intermediacy of FENACOAC, as role models and mentors for smaller credit unions. Since CSP, there is evidence that this “*spill over effect*” has indeed been effective. FENACOAC has now in place definite operating criteria for all member credit unions wishing to remain part of the national association.

Credit unions wishing to participate in CSP had to submit a written request accompanied by a complete financial report of the credit union. This report included historical data on the past performance of the credit union including membership trends, loan portfolio management, delinquency and income generation. In addition, credit unions had to provide copies all written financial policies and procedures which affected savings and capital formation (Branch 1992).

The criteria by which credit unions were selected for CSP were are follows, they had to:-

- exhibit economic potential
- operate within a viable market area and demonstrate growth prospects This was assessed through a market and feasibility study prior to participation in CSP.
- have the disposition and desire to change. CSP regarded this as a critical element of success and applied to both directors and staff members.
- have the staff and resources to commit to a demanding development programme
- prepare an approved development plan
- increase loan interest rates to cover operating costs and the building of new reserves
- participate fully in the training and institutional development programmes.

In evaluating each credit union’s application, the CSP team also took into account:-

- the need for assistance – financial aid had to prevent the insolvency of the credit union and promote its development
- the causes lying behind the credit union’s need for assistance – these may have included poor management, inadequate credit administration polices and delinquency control. If fraud or embezzlement were involved a change in the management of the credit union was required.

- the effect that assistance would have on the members. Participation in the programme had to result in an enhanced public image and improved service for members.

The level of responsibility demanded by CSP from participating credit union directors and staff was at a much higher level than anything requested by public funding programmes in Britain. CSP was based on a clear understanding that directors and staff members accepted responsibility for the stabilisation and development of their credit unions. They had to sign legally-binding, formal stabilisation and institutional development agreements which personally obliged staff and directors to ensure that the credit union maintained financial disciplines and achieved identified financial and organisational targets. Regular monitoring and evaluation took place to ensure continued compliance. Ultimately, failure to maintain financial and organisational disciplines and meet set targets meant that the credit union lost access to the programme and its financial resources. Of the 21 credit unions selected to participate in CSP, however, only one credit union was expelled from the programme throughout the entire eight year period.

The decision of CSP to work with the 21 strongest credit unions was seen as an important aspect of the programme. CSP did organise some technical training sessions that were open to all credit unions but most of CSP time and commitment was spent with the selected CSP credit unions. These larger credit unions, even though they had staff, premises and existing policies and procedures, were, however, institutionally weak and in need of strengthening. CSP considered that, for the future development of the Guatemalan credit union movement time and resources had to be spent on credit unions that had a good chance of success. Their success, it was considered, would assist others to be successful in turn. Interestingly, many of the smaller credit unions were undisturbed by not being included in CSP. As one CSP staff member put it, *“they were so small that they really did not understand the issues. They did not care they were not in CSP”*.

### **Performance and impact**

CSP brought about a significant growth in credit union membership, assets, savings deposits, loans and capital reserves within the period of the programme. Overall it improved the professional image and economic stability of participating Guatemalan credit unions. By establishing new institutional policies, financial disciplines and a regular system of monitoring and examination of progress, CSP enabled credit unions to maintain growth subsequent to the programme. In the period 1987 to 1992, CSP credit unions increased capital reserves from 5% of assets to 9%, decreased loan delinquency from 19% to 9% and increased deposit savings by 589% in nominal terms. The following table illustrates the growth of CSP credit unions during the programme and for three years afterwards.

Following CSP, the 20 participating credit unions continued the process of modernisation with the support of FENACOAC and only occasional visits from WOCCU.

**Table 2 Financial Results for 20 CSP credit unions 1987 – 97 (Thousands or real 1997 dollars, except for total membership)**

Year	Total Assets	Loan portfolio	Savings Deposits	Member Shares	Capital Reserves	Net Earnings	Total membership (thousands)
1987	20,601	12,885	5,051	9,698	1,028	343	60
1988	22,994	14,305	5,691	10,470	1,255	494	65
1989	25,042	15,673	6,884	11,024	1,474	548	66
1990	21,168	11,629	7,224	8,284	1,397	444	72
1991	24,958	14,686	9,732	9,449	2,144	703	76
1992	30,053	17,482	14,368	10,502	2,695	559	80
1993	35,855	24,556	17,631	12,262	3,832	985	90
1994	45,703	29,838	25,009	13,748	4,934	1,405	104
1995	58,064	41,055	30,944	16,181	6,571	1,835	120
1996	71,081	47,504	39,355	18,440	8,265	2,019	174
1997	94,362	54,487	58,784	20,909	10,432	2,918	200

( taken from Richardson 2000b)

One of the most significant effects of the modernisation programme was the increase in savings deposits as a consequence of the policy of savings mobilisation. This resulted in credit unions increasingly freeing themselves from dependence on external funding and making advances in self-sustainable development. Among all CSP credit unions, external financing as a percentage of assets fell from 18% in 1987 to 6% in September 1992. A survey of seven CSP credit unions in 1992 confirmed that deposit savings had replaced external funding as the main credit union source of loanable funds (Boucher S., Barham B., Branch B.A., Cifuentes M., and Ronquillo A.1992). Increased deposit savings enabled credit unions to increase lending, and as this was conducted at market rates of return, credit unions were able to increase income and build capital reserves.

The new business model of credit union development had an impact on the membership profile of credit unions and their niche within Guatemalan financial markets. As confidence grew in credit unions as secure financial institutions, more middle-income and professional people became members. They were

attracted both by the competitive interest rates on deposit savings and by the possibility of obtaining larger loans which credit unions were now able to make by loosening the loan linkage to shares and by instituting capacity-to-pay lending policies. As Barham and Boucher (1994) discovered, the result was that credit unions offered much greater access to credit to many lower and middle-income people. In particular, small business entrepreneurs were better able to obtain capital for commercial opportunities. However, the drawback was that the poorest of members, with little assets, had greater difficulty in obtaining credit after CSP.

It was the new credit administration policies and practices that made it more difficult for the very poor to access loans as they had done in the past. Not only were loans more expensive, poorer classes of borrower found it more difficult to meet the more rigorous capacity-to-pay loan assessment criteria. Often they could not obtain a loan because of the lack of collateral or other repayment guarantees. This was a major issue within credit unions as they shifted to the new credit union development model. Credit unions were faced with the hard economic reality that they could not lend to poorer, riskier borrowers and be assured that they would earn sufficient income to cover costs and maximise capital reserves. In the past, of course, losses incurred through delinquent loans were covered by external donor funds. In 1987, in many credit unions, delinquency rates were 20-30% and sometimes even reached 60%. After CSP, it was the members' own money that provided loanable funds and potential loan losses had to be minimised drastically. This was a hard lesson for Guatemalan credit union directors and staff to face as they endeavoured to resolve the apparent clash of their economic and social goals.

However, this move away from serving poorer borrowers should not be overstated. Research demonstrated that CSP credit unions continued to provide small loans at lower costs to low-income members (Barham and Boucher 1994). The average loan size in 1991 was about 1700 quetzales which compared with 34,900 quetzales in banks. In fact, after CSP, many low income entrepreneurs, with very modest assets, were better served by credit unions through being able to access larger loans and receive interest on their savings. In their study of three CSP credit unions, Barham and Boucher found that modernised credit unions were able to fill a major niche by mobilising savings and making loans available to households engaged in small to medium-scale agricultural and commercial enterprises. The majority of these borrowers would have found bank loans too costly and, particularly as one fourth were illiterate, would have found bank administration very difficult to access. Barham and Boucher concluded that "*No other private or public financial institution provides a similar scale or scope of financial intermediation to this sector of the population*" (Barham and Boucher 1994). In the longer term, strengthened credit unions were able to introduce new low

transaction cost loan products aimed at the lower income market which in themselves were profitable to the credit union.

Low income borrowers still tended to invest money into shares to qualify for loans, whilst wealthier member tended to place money in deposits for market rate returns. The impact of the latter was that CSP credit unions experienced a rapid increase in savings during and after CSP. At the same time, a certain conservatism in lending, linked to higher interest rates charged on most loans, resulted in a reduced demand for loans. The result was excess liquidity and a falling loan to asset ratio over time; liquidity ratios were 63% in 1997 and 56% in 1992 in all CSP credit unions. In fact, Guatemalan credit unions are now cash rich and the current challenge is discover how to more effectively invest funds in the same communities from which those savings are mobilised.

### **Lessons for the British credit union movement**

Guatemala CSP was a new development for WOCCU and, also, for USAID and FENACOAC. When the CSP team first went to Guatemala, it had the general concept that credit unions needed to adopt a much more market-oriented and business approach, but it was less clear about what this meant in practice. A situation which is replicated in many British credit unions today. In Guatemala before CSO, there was no blueprint of a new model of credit union development and no means of assessing that model in operation. It was only through the CSP process that both the design of a new model and its implications in practice became clear and apparent. The following lessons arising out of the Guatemalan experience may usefully inform of the process of transformation of British credit unions into fully self-sustaining financial institutions.

- i. Institutional Diagnostic. CPS stressed the importance of conducting a thorough diagnostic or analysis of each credit union before implementing a development programme. The diagnostic enabled an assessment of the market and economic viability of the credit union and a rigorous analysis of reserve levels, delinquency, policies, procedures and operational efficiency. Guatemalan credit unions were often good at glossing over financial and institutional reality. They overestimated capital reserves, downplayed loan delinquency and had a blinkered view of their economic viability and potential. The team learnt the importance of ensuring that credit union directors and staff were honest with themselves about economic reality and that they faced into the issues as revealed in an in-depth analysis of the credit union's finances and operations.
- ii. Developing Economically Viable Credit Unions      The choice of working solely with credit unions that exhibited economic potential and financial



viability was seen by CSP as a strength of the programme. In Britain, with hundreds of small credit unions requiring strengthening such a policy may be seen by many as a weakness. However, for CSP, whose aim was the transformation of a national credit union movement, it was judged to be the best way forward. All participating credit unions had many of the basics already in place - staff, systems, premises and IT – albeit they were financially and institutionally weak. These credit unions offered the best opportunity of success. Many of the smaller credit unions were so financially weak they eventually closed or, as they failed to meet FENACOAC's basic operating standards, were expelled from the national association.

- iii. Radical Institutional Reform. Learning to communicate the message that credit unions needed to undergo radical institutional reform if they were to succeed as independent financial institutions was central to CSP. According to CSP staff, it took several years to convince Guatemalan staff of the need to implement fundamental changes to the financial structure and operation of credit unions. Communication meant a lot of hands-on coaching by people who were respected for their technical knowledge and expertise in finance, organisational systems and market analysis. It involved developing relationships and trust between CSP staff, FENACOAC and credit unions. For even though CSP set a clear direction, to which credit unions had to commit themselves in writing, this did not mean that changes could be imposed from above. Credit unions had to want the changes for themselves otherwise CSP advances would terminate with the conclusion of the project.
- iv. Safety and Soundness CSP learnt never to compromise on the safety and soundness of credit unions as financial institutions. For a development programme to succeed, it was essential to insist that credit unions had to adopt and maintain rigorous financial disciplines and operating standards in order to protect members' savings. For this reason, CSP would not compromise on not using external donor funding for on-lending. In fact, the funds in the budget, originally allocated for credit purposes, were never used. "*Money to lend is money that is saved*", became the motto of the project.
- v. Simultaneous Reforms CSP identified, as a central institutional element of development programmes, the need to implement a package of reforms simultaneously. This was regarded as of fundamental importance and explained the insistence on institutional reform for credit unions in receipt of stabilisation funding. Financial disciplines, credit procedures, marketing plans, improving quality of service, policies and procedures, establishing sound accounting practices and the setting up of a planning system all had to be undertaken as essential elements of the programme.

vi. New Credit Union Development Model. A key learning outcome of CSP was the detailed identification of the new credit union development model. Having this model allowed credit unions to better understand their purpose and rationale, and also to recognise key elements of successful credit union development. This model was based on the following principles:-

- *Credit union are first and foremost a business*
- *Credit unions are savings institutions*
- *Credit unions do not depend upon external subsidy*
- *Credit unions must build capital reserves;*
- *Credit unions must offer competitive interest rates on savings and charge near market rates on loans.*
- *Credit unions are professional financial institutions;*
- *Credit union employees must be capable, well-trained, and competitively paid*
- *Credit unions are for everyone (adapted from Richardson, Lennon and Branch 1993)*

The new credit union development model, as adapted for British credit unions, is outlined in Table 1.

vii. The PEARLS Monitoring System. Perhaps the most significant and most internationally recognised learning outcome of the Guatemalan project has been the development of the PEARLS monitoring system. Somewhat similar to the CAMEL System used in the United States, the PEARLS System was designed, through CSP, as a management tool capable of measuring key areas of credit union operations. It enabled managers to identify problems and find solutions for any institutional deficiency. PEARLS was originally designed, in Spanish as PEARLAS, each letter standing for:-

- P - Protección (Protection) – refers to the adequacy of loan loss provisions
- E - Estructura financiera (financial structure) – measures loans, assets, savings, shares and reserves as a proportion of total assets
- R – Rendimientos y costos (yields and costs) – measures rates of return
- L – Liquidez (liquidity) – measure liquid investments and reserves against withdrawal deposits
- A – Activos improductivos (non-earning assets) – measures loan delinquency and non earning assets
- S – Señales expansivas (signs of growth) – measures the growth rates of total assets, loans, deposits, shares, capital reserves and membership.

For each indicator the new credit union of development identifies target ratios by which individual credit unions measure institutional strength, economic viability

and growth. The Association of British Credit Unions (ABCUL) is currently piloting a version of PEARLS for use by British credit unions.

- viii. Internal Competition Finally, with the development of PEARLS, CSP discovered the need to instil internal competition as part of a development project. Each month, the project publicised 45 PEARLS ratios for all participating credit unions. At a monthly managers' meeting, these ratios were discussed and it was pointed out who was doing well and who was not doing well and why. The discussions focused on the issues each credit union was facing and identified action points for the next month.
- ix. Calibre of development team The calibre of the CSP team was a strength of the programme. WOCCU pitched this project at a much higher level than would normally be the case within public funded support programmes in Britain. It stressed the importance of employing people with huge financial knowledge and technical skills. It brought experts from the private sector and was ready to pay them appropriately.
- x. Available Resources CSP was a well resourced development programme linked to appropriate targets. Funds were not a problem and the financial arrangements were supportive of a flexible approach to the programme's development. In fact, USAID paid all the money in advance. This was unusual arrangement for USAID but it did allow CSP to invest funds and establish the stabilisation fund at favourable rates.
- xi. Serving Low Income Groups Some commentators have noted that as strengthened credit unions grew and attracted higher income earners, the poorest of households and smaller micro-enterprise businesses tended to find it more difficult to access CSP credit union financial products. Mushinski (1995) found, for example, that households with zero land and low asset levels had a low probability of obtaining a loan. Undoubtedly, this was a consequence of building a reputation as a prudent lender and achieving economic viability. However, strengthened credit unions were able eventually to introduce new low transaction cost loan products aimed at the lower income market which in themselves were profitable to the credit union. As in all credit union movements endeavouring to modernise, the question remains as to how credit unions can they continue to serve poorer members with low cost loans whilst modernising sufficiently to extend the involvement of wealthier households in savings and credit activities and achieve economic self-sufficiency (Jones 2001a)

### **Replicating CPS in the West Midlands**

The principles, policies and discipline of CSP are regarded by WOCCU as fundamental to effective credit union development programmes. Of course, there is no single recipe of development that works everywhere. WOCCU has implemented programmes based on the new model of development in a number of countries. In some it has worked well and in others it has not been as successful. What works often depends on the local context and differs from one country to the next. But the key CSP messages about the development of credit unions as stable, safe and viable financial institutions have been found to be applicable in Europe, in Asia and in Africa just as they were in Latin America.

ABCUL is currently planning to undertake a credit union strengthening project in the West Midlands based on the new credit union development model, the PEARLS monitoring system and CSP approach to the rigorous implementation of financial and organisational disciplines. This marks a radical departure from the capacity building and volunteer oriented approaches of the past. The project will work with credit unions that are able to demonstrate market potential and financial viability as new model credit unions. Technical expertise, human and financial resources will be directed into these credit unions dependent on a radical restructuring of credit union management and organisation and a fundamental review of policies, procedures and systems. Ongoing participation in the project will be equally dependent on meeting set institutional and financial targets.

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. However, this introduction of a more business disciplined and market-oriented approach is regarded by some in the credit union movement as an abandonment of traditional social goals and of the commitment to the poor. The Birmingham Credit Union Development Agency, for example, was recently quoted as being *“concerned that ABCUL’s call for the creation of stronger credit unions by encouraging mergers and extending ‘common bonds’ will undermine links with low-income groups”* (New Start 2002). ABCUL replied that *‘if a credit union wants to have social benefits it needs to get the business model right.’* ABCUL was merely reiterating the key lesson from Guatemala, that credit unions can only achieve social goals if they attend to their economic goals first

**Table 1 The New Credit Union Development Model**

Area	Traditional focus	New focus
<b>1 Ideology</b>		
Mentality	Social/business	Business/social
Attitude	Reactive	Entrepreneurial and competitive
Approach	Small is beautiful	Growth orientated
<b>2 Organisation</b>		
Activity	Diverse community activities	Specialisation in financial services
Policies and standards	Diverse, locally developed and often containing inconsistencies	Standardised according to FSA requirements
Membership	Lower income groups	Diverse income groups
Member service	Prioritises needs and convenience of credit union volunteers	Prioritises member service and responsive to member needs
Image and market presence	Poor and unnoticed	Professional and accessible
Products	Credit and savings	Savings, credit, budget accounts, insurance
Technology	Manual or outdated IT.	Modern Information Technology
Information	Inadequate and difficult to find	Transparent, easily available and clear
Formal complaints procedure	None	Clear procedure, made available to members, used to improve services
Compensation Scheme	None	Contributory scheme to ensure savings are safe
<b>3 Operating Environment</b>		
Credit union legislation	Outdated and restrictive	Modernised, permissive and designed for growth
Regulation	Inadequate – focused on registration rather than regulation	Recognises unique characteristics of credit unions as mutuals. Establishes prudent operating standards for all credit unions.
External environment	Isolated and lacking the active endorsement of other	Sponsored, supported by, and working in partnership, with key organisations and

	organisations and agencies.	agencies. (e.g. Housing Associations, energy companies, local authorities, large employers).
<b>4 Human resources</b>		
Governance	Volunteer Board	Corporate approach - volunteer board in partnership with the paid manager
Operational Staffing	Volunteers	Paid manager and employees
Technical knowledge	Insufficient	Well-trained
Business and financial experience	Inadequate	Competent and Professional
Staff remuneration	Inadequate	Competitive
Volunteer and staff turnover	High	Low
<b>5 Financial Structure</b>		
Financing	Grant dependent	Mobilisation of savings
Capital Reserves	Inadequate	Exceeding minimum regulatory requirements
Initial Investment	Inadequate	Adequately resourced and capitalised
<b>6 Savings</b>		
Savings mobilisation	Low priority	First priority
Dividend	None or below market rate	Competitive dividend rate. Variable rates paid on different types of savings accounts
<b>7 Credit</b>		
Administration	Inflexible policies and administration	Efficient record keeping and market-oriented approach to lending
Interest rates	One interest rate for all	Competitive to market rates, particularly in relation to larger loans
Credit analysis	Limited assessment, based on a multiple of member's savings	Based on affordability and capacity to repay as well as savings history
Credit checks	Never	If appropriate in relation to

Loan amounts	Restricted due to lack of funds	risk Within regulatory limits but flexible, based on risk
Guarantees (for secured loans)	Inadequate/not registered	Solid, convertible to cash, and registered
<b>8 Financial discipline</b>		
Accounting	In arrears and not balanced	Balanced and on time each month
Quarterly financial returns	Intermittent or late	Completed and submitted within prescribed deadline
Financial indicators	Diverse criteria	PEARLS Financial Monitoring System
Delinquency ratio calculation	Diverse calculations	Entire delinquent loan balance outstanding
Creation of bad debt provision	None or inadequate	Yearly write offs and 100% provision of net liability of debt more than 12 months in arrears. 35% provision for debts more than 3 months in arrears
Net income distribution	No dividend	Dividend after statutory transfer to reserves
Institution reserves	Inadequate	Reserve levels that meet FSA standards
Liquidity reserves	Not specifically allocated	Sufficient to meet operational needs and enable members' demands for unattached share withdrawals
Internal audit	Not effective, exists in name only	Active and effective. Compliments the boards work in improving services
Annual external audit	Inadequate	Professional and appropriately qualified accounting firm
Annual business plan / strategic plan	Inadequate/none	Prepared annually and controlled monthly
<b>9 Marketing</b>		
Premises	Inadequate, uninviting and often closed	New and well situated, comfortable. Open at regular times convenient to

Furniture and equipment	Old and worn out	members. Modern
Research	None/intermittent	Covering market area and used to inform marketing and business plans
Marketing plans	None/limited to promotions of publicity	Integrated with the business plan
Dress code	None	Professional

*adapted for the English credit union context from the WOCCU credit union development model (Jones 2001b)*

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## FROM THE MARGINS TO THE MAINSTREAM: A STUDY OF CREDIT UNION DEVELOPMENT IN BRITAIN

Lydia Plackett

### Introduction

Internationally credit unions have a much higher percentage share of the financial services market, in the USA for example, 25 per cent of the population are members of credit unions, and membership includes consumers from all sections of society. In Ireland 44 per cent of the population use credit unions as their prime financial provider. In Germany credit co-operatives have seen an increase in membership of 3.6 million over the past ten years, resulting in *'almost every fifth citizen'* being a member of a credit co-operative (Baumgärtler, 2001 p.28). In Korea, Seoul credit union has *40,000 members, US\$300 million in assets, employs about 15 staff and owns a four storey building that also contains a community centre and grocery co-op sponsored by the credit union* (Swoboda, 2001). In Cyprus *'about 64% and 58% of the housing and agricultural'* lending is financed by the co-operative credit sector which offers employment to 1850 people (Parnell, 1998). In 1998 Cassie Desjardins had 5,167,999 members, 13,562 elected officers, employed 41,180 staff, and had total assets of \$70,004 million CDN dollars (Goulet, 1999). Despite economic uncertainty during 2001, Australian credit union experienced healthy growth: loans grew by 7% to \$19 billion, deposits by 14% to \$20 billion, assets reached 24 billion and membership was sustained at 3.6 million (CUSCAL 2001 Annual Report). Credit Unions in Britain, however, have only made a limited impact on the financial services market, as the figures for 2002-2001 show, total membership reached just under 300,000 (an overall percentage penetration of the market of 0.004%), with a total sharing is £180,881.000 and loan balance is of £172,704.000 (ABCUL, 2001), the total workforce employed directly by credit unions is estimated at 188 people (Shakespeare, 2002). Linked to this lack of growth is another problem according to Jones *'that is the considerable amounts of public funding<sup>1</sup> that has been invested in the development and training of community credit unions with such little effect'*, (Jones, 1999 p.4)

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<sup>1</sup> Jones estimated that between £15-£20 million each year is spent on development agencies and workers to support community credit unions. Most of which have on average 150 members, grant 36 loans a year and are totally dependent on external grant funding.

The first British credit union was established in Wimbledon, in 1964; based on credit unions in Nova Scotia, an adaptation of the early Raiffeisen parish model of credit unions (Sammons, 1998). Common bonds were tightly drawn and based on close communal ties, membership was kept under two hundred so that the credit unions could be operated by volunteers, who were trained in simple accounting procedures by community educators. However, at the same time, Irish and Afro-Caribbean immigrants were also developing credit unions using methodologies imported from their home countries.

During the 1960s and 1970s Britain experienced rapid social and economic restructuring, and demand for unskilled labour and manual workers resulted in government-sponsored immigration from commonwealth countries to fill the labour gap. Migrants developed new communities in the industrialised cities, based on the cultures, values and traditions of the home country. Credit unions were one of those traditions. As an elder of an Afro-Caribbean credit union said to the writer, *“we set up our credit union so that we could each buy a house and once we had done that, we borrowed the money to renovate them. We didn't think about going to the bank for a loan - we didn't use banks at home – we used the credit union, that's why we set up the credit union”*. These credit unions were modelled on the Germanic approach developed by Schulze-Delitzsch and later refined by Filene in the USA; these credit unions focused on economic sustainability, financial stability, and ownership and control by the members.

It is evident that these two approaches to development are incompatible. The first depends on the patronage of the middle-class to train and develop volunteers. The second approach is on practical experience and first-hand knowledge of a vigorous international credit union industry, and promotes a member-focused, profit-orientated approach to running the business. The immigrant credit union activists had strong connections with their home credit unions that provided support for the fledgling credit unions, through the Irish League of Credit Unions (ILCU) and Credit Union National Association (CUNA). Anecdotal evidence suggests that the promoters of the first approach were not comfortable with the profit-led business focus of the second model. As a result, they chose not to affiliate with ABCUL and the World Council of Credit Unions; instead they set up a separate representative body, the National Federation of Community of Credit Unions (NFOCCU), and affiliated to the International Raiffeisen Union.

It is arguable that the fragmentation of the British movement can be attributed directly to the two opposing models of development. However, despite their differences, the two groups did agree that if the British movement were to prosper it needed a legal framework in which to operate. The Crowther Committee on Consumer Credit (1971) supported this view, arguing that the government should consider promoting credit unions as a means of providing people on low incomes

with a source of reasonably priced credit, and that to attract consumers credit unions had to be formally regulated. A working party was set up to consider the issue of legislation; this recommended that British law should be modelled on that of Northern Ireland. In 1979 the Credit Unions Act received the royal assent and by 1982 seventy-one credit unions had been registered. However, in the mid 1980s the number of new registrations slowed down. According to Clutton-Brock (1996), the Registry deliberately restricted registrations because the credit unions were inadequately managed, and it was not until the intervention of local authorities in the form of development worker support that registrations of new credit unions again began to increase.

Local authorities became interested in credit unions as a regeneration tool in the late 1980s. The British economy between 1990 and 1992 was dominated by recession and local authorities considered credit unions to have an important role in local economies; not least because credit plays an important role in economic regeneration.

- Firstly it can help safeguard savings - people often preferring to keep their savings intact and to use credit to purchase important items.
- Secondly, to take advantage of special offers, bargains in sales, for example, and provide a source of affordable for credit.
- Thirdly as a safe saving vehicle.
- Fourthly to even out demands on income when the needs arises to purchase expensive items.
- Fifthly to supplement income when it is inadequate to meet immediate commitments, in this situation credit is used in the anticipation of future income.

Thomas (1994) argues that credit used in this way can boost the local economy, Jones (1998) however, identified a different set of assumptions underpinning the movement, based on credit unions as a means of developing individual and community capacity. Jones called this the *Traditional or social* model of development, which may be characterised as follows:

- credit unions would always be small (only a couple of hundred members);
- credit unions would be run by volunteers supported by state-funded development workers;
- volunteers need only simple training to enable them to run a credit union regardless of their ability or background;
- common bonds are based on close communal ties;
- credit unions required only minimum start-up capital, because premises are provided by a sponsoring organisation;
- credit unions do not need to operate out of fully-equipped offices as, by definition, their trading is limited;

- credit unions are borrower dominated;
- trading activity focuses on loans, but to a limited extent, because dividends are limited - attracting sufficient savers to increase the available funds to grant loans is problematic;
- the 'poor persons bank';
- grant-dependant credit unions are the norm, as credit unions can not generate sufficient income from loans to pay for staff or proper premises; and
- that funding is filtered through development agencies, which retain overall control of resources (further weakening the autonomy and independence of the credit unions).

Jones challenged these assumptions arguing that this approach to development seriously hampers the ability of the British movement to achieve the potential seen in the rest of the world, not only because it fails to conceptualise credit unions as primary co-operatives offering financial services in a business-like way at a profit for their members. It is unattractive to the majority of consumers, who prefer a more professional approach to managing their finances. Jones argued that the traditional model had also lost the confidence of volunteers who reported being 'burnt out' and overwhelmed by the difficulties of running a financial institution under increasingly complex conditions.

It is unsurprising that this scenario should have developed given the historical background to the British movement, and the political conception of credit unions in the late 1970s. Hansard (1979) records that parliament envisaged credit unions as small-scale, voluntary organisations that would only provide simple saving and loan accounts for a few hundred members, most of whom would be on low incomes, and all would be bound together by a sense of inter-dependence through association with tenants groups, work or community activity. These restrictions were imposed, according to Hansard, to protect members' investments and to prevent credit unions developing into United States style 'atypical giant credit unions'. The underlying paternalistic ideology underpinning the movement is clearly demonstrated when the objectives of British credit unions are compared with those of the Canadian movement.

<b>British Credit Union Objectives:</b>	<b>Canadian Credit Union Objectives:</b>
<ol style="list-style-type: none"> <li>1. the promotion of thrift amongst members of the society by the accumulation of their savings.</li> <li>2. the creation of a source of credit for the benefit of the members at a fair and reasonable rate of interest.</li> <li>3. the use and control of the members' savings for their mutual benefit, and</li> <li>4. the training and education of members in the wise use of money.</li> </ol>	<ol style="list-style-type: none"> <li>1. to receive savings and invest them for profit;</li> <li>2. to grant credit to its members;</li> <li>3. to promote co-operation between the members of the credit union, between the members and the credit union and other co-operative bodies, and</li> <li>4. to further the development of knowledge in economic, social and co-operative systems.</li> </ol>

Traditional British credit union development mirrors the historical understanding of credit unions, and so it is only natural that the local authority approach to setting up credit unions would use community development techniques to engage local people. As the Association of Metropolitan Authorities (AMA) writes, *'community development is an exciting method through which individuals can develop their knowledge, skills and motivation, identify the common threads of problems which they experience in their lives, and work together collectively to tackle those problems'* (AMA, 1993 p.9). Community development, as it is understood in Britain, can be very successful as a means of developing individual skills and personal empowerment (Twelvetrees, 1989; Henderson & Thomas, 1990; Department of the Environment, 1995; McArthur, 2001). However, it appears to be less successful in developing robust community enterprises. The evidence points to a number of reasons for this. Firstly, community enterprises are generally under-funded - the majority of development investment funding going to third party agencies; secondly, community enterprises, including credit unions, need to be properly resourced with paid staff, well-appointed premises, and IT equipment, if the business is to operate successfully; thirdly, disadvantaged communities often lack the entrepreneurial skills needed to develop profit-making organisations; and fourthly, there is a tendency to underestimate the difficulties of translating the concept of an enterprise, such as a credit union, into fact. It is evident that to be successful credit unions, and other forms of community enterprise, need to be set up from day one as fully-functioning professional businesses, based on a well-researched and carefully calculated business plan that includes research into the intended market (Campbell, 1938; Midgley, 1986;

Keane and Ó Cinnéide, 1986; IRU, 1991; Wilson, 1996; Storey, 1994; McPherson, 1999; Levi 1998; Jones, 1998 & 2001). Donnelly *et al* also identified a fifth element in the process of developing successful credit unions, writing, '*it is only where local people have ownership of the process are credit unions successful*' (Donnelly *et al*, 199 p.4). Evidence of successful British credit unions can be found on the west coast of Scotland. For example, Scotwest, a work-based credit union, has 17,000 members and gives a 5% dividend on a simple saving account. Thus it would be wrong to think that the whole of the British movement is in decline. The cause for concern is the lack of growth in the community sector when measured against the substantial state investment in the movement, (between £15 million and £20 million in 1998 according to Jones). It was this lack of growth, combined with concern about the lack of sustainability of many community credit unions, that lead to Jones's groundbreaking research.

Following the publication of Jones's research in 1998 it was recognised by central government and many local authorities, that if credit unions were to ever make a significant impact in the areas of financial exclusion and economic regeneration, it was necessary to develop a new approach to their organisation and management and such a model should be based on the one recommended by Jones – the '*new model*', Hansard, (July 2001) and the Local Government Association (1999, 2001). This model recognises the need to set up credit unions as professional organisations, directed by capable and well respected community leaders, who are recruited from well-respected institutions and run by well- paid professional from well-equipped premises, that are accessible to members at least 9:00 a.m.–5:00 p.m. five days a week. Jones argues, that credit unions should only be set up following the successful outcome of a feasibility study that demonstrates these conditions can be meet. Funding for development, Jones argues, should go directly to the credit union rather than to third party agencies. Common bonds, Jones argues, should be based on economic realities rather than close communal ties, and the focus of operation should be directed at sound fiscal practice rather than the training and development of volunteers.

This model has subsequently been modified by further research undertaken by Jones (2001) into the development of rural credit unions, and the lessons drawn from the implementation and adaptation of the *new model* by ABCUL. Both Jones and ABCUL both have drawn heavily on the experience of the World Council of Credit Unions' (WOCCU) credit union strengthening projects throughout the world in refocusing the development of British credit unions. However, it is arguable that Jones's early work did not address all the questions relating to the poor performance of the British movement – it was just a starting point. There are other fundamental questions that, in the writer's opinion, must be addressed. These include:

1. Definition and agenda.
2. The role of Government.
3. Models of development, the common bond and understanding the concept of community.
4. The economic environment in which credit unions operate and develop
5. The competitive environment.
6. Organisation and management of credit unions.

### **Research methodology**

The research used an ethnographic approach and the methods included: action research, participant observation (the writer having access to reports, minutes of meetings, personal notes and diaries), focus groups, case studies and semi-structured interviews. The qualitative data was enhanced by quantitative data drawn from central government and local authority statistics.

### **The research**

The research investigated thirty-five case studies in urban, rural, and inner city areas of England and Wales. Of these thirty-five, eleven were feasibility studies that investigated the potential for the development of new credit unions that would serve whole boroughs or cities. In Leicester and Nottingham the studies investigated the potential for existing credit unions to merge or expand to serve the whole of the cities. The objectives of the feasibility studies included some or all of the following:

- to research the potential for sustainable credit union development in the area;
- to examine the impact that any new credit union(s) may have on existing credit unions;
- to raise awareness of the services offered by a credit union;
- to explore the potential for a range of sponsorships and partnerships to support the development of a credit union/s in the area;
- to assess the degree of interest in using the credit union of the local community and local employers;
- to assess the resources needed to set up a fully operational credit union in the area;
- to assess the availability of funding, benefits in kind etc., to support the development of a *new model* credit union;
- to produce a detailed action plan, identifying actions, time scales, costs human and material resources for establishing a sustainable credit union/s; and
- to outline the pre-registration requirements and targets.



Twenty-two studies were carried out in London, which formed part of a wider credit union strengthening project funded by the Single Regeneration Budget (SRB), as part of Social Enterprise London's integrated social and economic development work across thirty-three London boroughs. These studies examined all aspects of the operation and management of credit unions and the process became known as 'Health Checks', now being rolled out to credit unions nationally. It was during this project that the WOCCU PEARLS™ Monitoring system was first used. Developed by David Richardson, PEARLS™ is a management tool developed to help managers find sensible solutions to '*serious institutional deficiencies*' (Richardson, 2000). By standardising financial ratios and formulas, credit unions are able to evaluate their operations and measure themselves against similar organisations.

Two rural credit unions and one study group formed the basis of a two-year research project into the development of credit unions in rural England. The majority of research into the development of credit unions prior to this study had focused on urban areas.

The final four credit unions were part of a European Regional Development funded project. The credit unions, based in the Rhondda Valley, South Wales, had, with the support of the local council, made a successful bid to the European Social Fund for money to redevelop the credit unions as '*new model*' credit unions. The impact of directly funding the credit unions over a 2-year period was monitored.

### **Research findings**

These will be documented under each of the six headings and the findings will be supported by the literary review:

### **Definition and agenda**

It is evident from the literature that credit unions form a significant part of the international co-operative movement. British credit unions, however, have been divorced from the wider credit union family, arguably because their development has been in the control of external agencies, which have not understood, or are not familiar with, international co-operative principles. Although McPherson (1994) cautions against principles becoming '*iron-clad commandments*' (McPherson, 1994) it is difficult to equate grant-dependency and heavy reliance on the state with the principles of member economic participation, autonomy and independence. Strong co-operative movements are independent of the state, in the same way that '*enterprise controlled by capital is autonomous in their dealings with government*' (McPherson, 1994). It is time for British credit unions to

reclaim their co-operative heritage by working collectively to restructure and develop the movement, and integrating with the international movement through the adoption of the ICA International Identity Statement and adhering to the WCOCU International Operating Principles.

### **Recommendations**

- That all sectors of the British Co-operative movement actively promote the ICA Statement of Co-operative Identity and work towards implementing co-operative principles.
- That education and training for credit union staff and volunteers incorporates the ICA Statement of Co-operative identify and WOCCU International Operating Principles.
- That staff and directors are encouraged to attend WOCCU training and events.

It is evident from the research that the purpose of credit unions is to provide a vehicle for working people to accumulate capital (Wolfe, 1910; Desjardins, 1914; Cole, 1944, Bonner, 1960; Parnell, 1999). It is evident that a large proportion of the British movement has misunderstood this, and view co-operatives as a community development tool. Parnell (1999) writes, '*ultimately co-operatives are about economic power*' (Parnell, 1999 p.96). It is evident that credit unions must harness the economic power of their individual members, through savings, to give them creditworthiness, and collectively to give them economic power within the wider economy (Wolfe, 1910; Desjardins, 1914; Engelmann, 1970; Richardson *et al*, 1993; Blackburn, 1999).

### **Recommendations**

- that credit unions are developed with a focus on developing members' capital through targeted saving programmes that meet the needs of members;
- that regular payment of dividends becomes an integral part the annual strategic planning process of credit unions;
- that reserves are accumulated to:
- build the collective wealth of members;
- ensure the safety and soundness of credit unions; and
- provide a safety net in times of economic hardship for the community.
- that surpluses are used to enhance the social capital of members through job creation, education and training.

### **Role of government and support organisations**

It is evident from the research that government has a significant, but arms-length role to play in the development of credit unions, which should focus on ensuring that the social, economic, and legislative conditions are such that credit unions can flourish (MacPherson, 1994; IRU, 1991; WOCCU, 1993 & 2000).

### **Recommendations: the role of government**

That ABCUL continues to raise awareness amongst MPs, civil servants and other policy-makers, regarding the true role and purpose of credit unions as co-operative businesses able to offer full financial services provided the economic, social and legal conditions are favourable to their operation. These include:

- the removal of the legal limits on credit unions to set their own interest rates and dividend payments in line with the inherent risk of some loans and the conditions of the market.
- credit unions are allowed to own subsidiary businesses and set up second tier co-operatives to meet the collective needs of credit unions and the social and economic needs of their members.
- that government refocuses its promotion of credit unions from that of a vehicle for addressing social and financial exclusion to one of credit unions as sound financial businesses able to meet the needs of the financially excluded through economic success and stability.
- that the government actively supports the development of a CSO.
- that government develops an explicit strategy for tackling financial exclusion that sets out quite clearly the role government envisages for each sector: Banks, Building Societies, the Post Office, the Universal Bank, Community Development Financial Initiatives, etc. rather than creating a multiplicity of competing and overlapping initiatives and agendas that waste both time and resources.

### **The role of local authorities**

It is evident from the research that local authorities have proved to be important sponsors of credit unions. The majority of the large, successful and sustainable work-based credit unions developed with the support of local authorities. All of the feasibility studies demonstrated quite conclusively that the public sector is the major employer in the area; leading to the conclusion that engaging the support of public sector employers in the development of a credit union with a '*live or work*' common bond is essential if the credit union is to be financially sustainable. Jones (1998) and the LGA (1999) support this approach.

### **Recommendations for local authorities**

- Only support the development of credit unions following a period of intensive research (feasibility study).
- Sponsor credit unions directly rather than set up or support development agencies.
- Encourage good practice through the implementation of LGA guidelines for the development of sustainable credit unions.
- Relocate credit unions within economic development departments rather than within community development, trading standards or leisure departments.
- Refocus development on developing economically sustainable credit unions able to serve a wide common bond, create jobs and provide a full range of financial services for local people, particularly those on low to moderate incomes or living in social housing.
- Encourage credit unions to integrate with the local business community through engagement with local Chambers of Commerce and small business support groups.
- Support the development of work-based credit unions.
- Encourage and support vulnerable credit unions to merge with stronger credit unions, or to develop one strong credit union from a number of small vulnerable credit unions; thus protecting members' assets and the past investment of the authority in development. Encourage stronger credit unions to enlarge their common bonds rather than set up new credit unions.
- Ensure that council staff delegated to work with credit unions have the skills to support and develop an economically sound financial co-operative.
- Seek advice from ABCUL and the LGA before embarking on a credit union development programme.

### **The role of trade (apex) bodies**

It is evident from the research that successful co-operative industries are represented at local, regional, national, and international levels by well-organised apex bodies that speak on their behalf. It is also evident that the British movement has been significantly undermined by the multiplicity of voices claiming to speak on its behalf. It is also evident that ABCUL is increasingly recognised as the primary voice by policy-makers. However, the existence of the three other trade bodies and the National Association of Credit Union Workers undermines the movement's ability to present a united front - in consequence politicians and the population as a whole do not take the movement seriously.

It is apparent from the research that strong credit union movements collaborate and work collectively, looking to other co-operatives for advice and support rather

than to external agencies. Such movements are independent and autonomous, controlling their own development using their own resources. Internationally successful credit union movements collectively fund or individually pay for their own training, education, research and development, which is provided by the apex bodies, through regional and local networks.

It is evident from the research that the major factor in enabling credit unions internationally to develop into full service financial providers was credit unions working together to set up a CSO<sup>2</sup>. This facility enables credit unions to manage liquidity, get a greater return on invested funds, keep abreast of the market, and provide members with checking accounts, ATM access and BACs at a reasonable price. It is evident that British credit unions will not be able to participate in providing mainstream financial services until they have access to a CSO.

### **Recommendations**

- That credit unions actively work together to form one apex trade body.
- That credit unions prioritise setting up a CSO owned and controlled by credit unions.
- That Credit unions work in local collaboration thus reducing dependency on third party agencies.
- That Credit unions through the apex trade body set the quality standards for training, development and the organisation and management of credit unions.

### **Community and the common bond**

It is evident from the literary review and the original research that the subject of community is paradoxical. On the one hand the studies revealed a strong sense of community identity, on the other a sense of alienation, isolation and implosion, of people retreating to their own domains. Demographic changes brought about by industrial restructuring, with the resulting loss of traditional working-class support structures, has created a vacuum in communal life, that is proving difficult to fill. It is evident that people belong to more than one community, families are under pressure due to the demands of new working patterns; the place of work can be up

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<sup>2</sup> Mature credit union industries are supported by some form of central service organisation (CSO), this provides a range of services that include centralised liquidity management fund, centralised investment of surplus member deposits, marketing, research and development, business advice, centralised back office systems for ATMs, and other technical back office support. A CSO enables credit unions to offer members a full financial service whatever their size.

to fifty miles from home (people daily travelling between major cities to work); leisure is usually based around the home; and children frequently travel long distances to school. The feasibility studies identified the local authority, local businesses and networks of religious, voluntary and tenants organisations, as the most cohesive factors in an area. Thus it could be argued that there is no such thing as '*the community*' - rather a series of interlinking communities, which form the infrastructure for citizenry. Therefore, the common bond needs to link into and reflect the various communities of interest within a locality (WOCCU, 2000), such that credit unions can grow and develop according to the culture and environment in which they are based; thus shaping the businesses to meet local needs (MacPherson, 1994; Campbell, 1938; Aoki, 1949; Lewinsky, 1977; Savage, 1997; Isbister, 1998).

Nevertheless, it is important to recognise that where credit unions have developed out of a strong sense of oppression, such as the catholic community on the west coast of Scotland; or have a strong sense of working-class identity, they are most effective (Donnelly *et al*, 1999; Jones, 1999).

It is evident that top-down approaches to the development of credit unions are discredited as an imposition and patronising. To build '*community capacity*', resources need to be targeted at strengthening the local infrastructure, rather than developing individual social skills. The alienation of ordinary people due to the fear of crime and disillusionment with the systems of the state, are greater barriers to the development of credit unions than lack of skills within a neighbourhood.

It is apparent from the feasibility studies that some organisations, such as housing associations, the church, CISWO (in coal mining areas), and many voluntary organisations, are well regarded by people.

It is also apparent that the paradoxical nature of community brings into question the relevance of the common bond. If people have contradictory attitudes towards where they live and work, it is difficult to see why they should have less contradictory attitudes towards a credit union. Although, it is evident from the research that the common bond is still an important factor in relation to some people's choice of a financial supplier.

## **Recommendations**

- That locality-based credit unions are only developed where the infrastructure supporting local life is already well organised.
- That the directors of credit unions are drawn from within this infrastructure, thus local ownership and responsibility for the credit union lies with the organisations that make up the supporting infrastructure of the local society.

- That if local organisations are not willing or able to support the development of a credit union, one should not be set up.
- That common bonds should be based upon structural boundaries, rather than supposed close communal ties.
- That where people are clearly alienated from the state structures, other trusted support systems such as housing associations, religious bodies, and or employers are used as the framework for developing credit unions.
- That research should be carried out prior to development to assess active support for a credit union from local organisations.
- That credit unions are developed prioritising economic viability.

### **The economic environment**

It is evident from the research that credit unions are developed in response to industrial and social change brought about by technological developments and demographic change. The feasibility studies show how the decline of manufacturing and heavy industries, such as coal mining, steel production or car production, and the traditional working-class support systems, has contributed to the breakdown in traditional working-class community ties. This has created a vacuum in communities, which is proving difficult to address, and leads the writer to conclude that there is no longer a single community entity to which people can affiliate, although such ties, as Donnelly *et al* (1999) write, are essential to the development of strong credit unions.

In rural areas the decline in agricultural production and the demographic changes brought about by the migration of the middle-class to the 'countryside' has resulted in the gentrification of rural areas, which has resulted in significant changes in rural living conditions. It is evident from the rural research that rural credit unions have limited potential.

It is also evident from the research that changes in working patterns impact upon the ability of credit unions to attract sufficient volunteers to help run credit unions. On the one hand less secure contracts, more part-time work, and longer travelling to work time has impacted negatively on working conditions, but these factors have to be balanced against many improvements in working conditions. Parents have new parental rights, many people are entitled to longer holidays, the working week is shorter for many, and wages are protected through the minimum wage. People have higher expectations, and demand a better quality of life, making it less likely that people want to volunteer to run a demanding business in their spare time.

It is also evident from the research that credit unions are not exempt from wider economic issues. Changes in interest rates impact upon the competitiveness of

credit unions' products and services, and the value of their investments wherever they are held.

In an ever-deregulated market new financial providers are entering the field and undercutting the competition with the ability to provide products and services flexibly and at very low cost. Consumers can buy milk from the supermarket and access their bank account at the same till; building societies are banks and banks give mortgages. Credit unions operating in this market are facing stiff competition, especially as credit unions are not benefiting from such deregulation but have to deal with more stringent regulation and only minimal deregulation of the 1979 Act.

### Recommendations

- That prior to setting up a credit union an analysis of the economic situation is carried out. This should include an assessment of the impact of industrial change, the impact of demographic change in the area, changes in working conditions, and how these impact upon the ability of people to maintain their traditional communal ties. Credit unions should be developed to meet the existing and new demands of changes in technology and de-industrialisation.
- That recognition should be given to people's expectations in relation to how they use their spare time. It is evident from the feasibility studies that professionals and most tenants will only help set up credit unions if they can rely on paid professional staff to do the day-to-day work of the business, and that recruiting and retaining volunteers is problematic. It is therefore arguable that the current credit union structure, which requires up to 15 directors, between 3-6 credit committee members and 3 supervisors, plus additional volunteer cashiers, should be reviewed. The writer suggests that there should be more emphasis on professional staff, that the number of directors should be reduced to a maximum of 7 and that the credit committee should be abolished (Raiffeisen<sup>3</sup> was clear that it was the function of professional staff to grant loans not lay volunteers).
- That in an increasingly deregulated financial services industry a thorough study of the competitors to credit unions should be undertaken and the potential impact upon the viability of the credit union should be assessed. A

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<sup>3</sup> It may be interesting to note that Raiffeisen never envisaged credit unions without paid staff, he describes the book-keeper as the '*quasi-soul of the Union*', and it is the book-keeper (effectively the CEO) who runs the business on a day to day basis carrying out the decisions of the board, and granting loans in accordance with loan policy previously agreed by the directors (Engelmann, 1970)



credit union should only be developed if there is an identifiable market for its services. In Stafford for example ABCUL advised that the area was already well served by financial services, and the high rate of home ownership in the city provided the majority of people with access to easy to obtain and cheap credit.

- The assessment of the market should include an assessment of the potential membership and its profile. It is evident that where there is a high level of social housing in an area, the market is arguably greater for loans than in areas with higher levels of home ownership.

### **Competition**

It is evident from both the literature and the research that successful credit unions have a clear understanding of their position within the marketplace, and understanding of their members needs. Recognising that financial deregulation is a threat, such credit unions have confidence in, and commitment to, the products and services that they have to offer. Providing members with a professional and accessible service that provides the products and service that members want, directors ensure that managers run an efficient business that is able to perform well within the marketplace. It is also evident that such credit unions have a special relationship with their members, that is based on interdependence, ownership and respect. Such credit unions '*put members first*', always striving to meet *their* needs, constantly evaluating the competition and responding accordingly.

It is evident that the quality of the services, including the sense people have of the competence of the institution and the ease with which they can conduct their transactions, affect consumers' choice of financial institution, these include the sense people have of the competence of the institution and the ease with which they can conduct their transactions. Lepisto when researching consumers' choice of financial institutions found that accessibility of premises is as important as convenient opening hours, (Lepisto, 1993) and Lee *et al* identified that that face-to-face transactions are an important competitive advantage for credit unions (Lee & Kelly, 2001; Mercer, 1996).

The *human touch* does not mean that credit union members do not want access to ATM machines, telephone banking, or Internet banking - they do, but only for specific products (Lee & Kelly, 2001 ch.6); nor must the connection to, and relationships with, the community be undervalued as a competitive advantage (Julian, 1999). The common bond is an important cohesive force both to keep, and to attract new, members (Dacin, 1995; Julian, 1999).

It is also evident that savings must be integral to the package of services (Burger & Zellmer, 1995; Richardson, 2000); not only because having access to collateral builds up members' credit-worthiness, but savings provide the funds from which

the credit union makes loans, the income from which members are rewarded for their participation in the form of a dividend, thus encouraging more members to join the credit union.

It is apparent from the research that credit unions need a wide range of financial products and services if they are to meet the needs of members and earn sufficient income to run an effective business.

### **Recommendations**

- Credit unions must identify the products and services required by members and potential members and target products and services accordingly.
- Products and services must reflect the culture and values of the membership. For example: wedding plans, holiday products, home and life insurance products, and bill paying services. Such products must be integrated with insurance, savings and loans facilities. In effect credit unions need to produce integrated services that holistically meet the lifestyle needs of members.
- Burger & Zellmer (1995), Dacin (1995) and Swoboda (2001) all argue that people on low to moderate incomes are the prime users of credit unions. Whilst there is no conclusive evidence to demonstrate this in Britain, experience to date suggests that this is the case. Until such a time as new evidence or experience suggests otherwise, it is clear that credit unions should focus on attracting members from these income groups.
- Credit unions need to focus on providing a variety of savings packages that enable working people to build capital and develop creditworthiness'.
- Credit unions must maximise savings by buying in funds to lend to those who need low cost credit. Thus market-rate dividends must be built into the business plan to attract savers. Without savers credit unions cannot meet the borrowing needs of members.
- Loans must be linked to members' capacity to repay rather than the mechanistic '*multiple-of-shares*' that is the current credit union practice in Britain. Share-multiple lending does not meet the borrowing needs of the majority of members.
- The credit union must be supported by a sophisticated marketing campaign, and be able to provide financial education programmes, since low- to moderate-income members often lack financial expertise. Serving this group also takes more time and can be harder work than that serving more professional consumers (Burger & Zellmer, 1995).
- Credit unions need to concentrate on maintaining and promoting the core values that underpin the movement. That is high quality services, and treating all members all the same regardless of their status, with dignity and

respect. It is evident that these are central to credit unions gaining or retaining members (Lepisto, 1993; Fried *et al*, 1999; Lee & Kelly, 2000).

- Credit unions need to analysis how technology can assist in the delivery of services. This could be as simple as making good use of communication systems such as telephoning members to find out how content they are with the services they have received or to seek ways of improving that service.
- Credit unions need to be able to trade freely within the market. This means that restrictions such as the common bond requirement, limits on charges and payment of dividends, loan periods, and the opportunity to develop subsidiary businesses, should be removed. Credit unions should be able to develop according to the needs of members, the viability of the business, and in response to the challenges of the market.
- A CSO must be set up to meet the financial and technical needs of credit unions to allow them to compete effectively within a deregulated market.

### **Organisation and management**

The literature and research highlights the following challenges regarding the organisation and management of credit unions:

Credit unions, even those in the USA where they have reached a much higher penetration of the population than in Britain (25%), suffer from a general perception of poor competence. This has a significant impact on their development and must be addressed. It is apparent that the raising the quality of management and the skills levels of both volunteers and staff working in the movement is of paramount importance.

The need to employ professional staff from the start up of the business is well documented, although it is contested by commentators such as McArthur (2001). Findings of the feasibility studies, rural research, the Rhondda Cynon Taff ERDF Programme, and the growth in membership of 'new model' credit unions such as Tower Hamlets, Rochdale and Portsmouth, demonstrate that staff are able to build relationships and to provide a level of service to members unattainable by volunteers. It is also evident that directors are more effective once they are released from the day-to-day activities of running a credit union.

Managers must be recruited who have a high level of financial competence so that they can generate sufficient income to pay all expenses and to develop the credit union. The need to operate a profitable financial institution able to pay a dividend is enshrined within the WOCCU *Credit Union Operating Principles*. To support this, WOCCU has developed the PEARLS™ monitoring system. Use of this by management and directors to assess not only the safety and soundness of the business, but its areas of growth and stagnation need to be incorporated into

monthly management reports. Management of investments, liquidity, loan portfolio, delinquency, assets, capital, continual investment in the credit union by members, and build-up of reserves are the primary concerns of the manager.

The board of lay directors must be effective and able to competently direct the credit union and represent members' interests.

The need for the efficient use of technology, essential to delivering an efficient service, although the evidence is clear that technology *alone* does not give credit unions a competitive advantage (Rick, 1998; Greci *et al*, 1999; Lemmon *et al*, 1999; Lee *et al*, 2001). Competitive advantage comes from the quality of the relationship between the credit union and the member, and the quality of service provided by the business.

Credit unions require significant sponsorship and support in the form of capital and revenue funding. Overstreet & Rubin conclude that the sponsorship of US credit unions accounts for six per cent of their total operating (Overstreet & Rubin, 1991). The projected costs of setting up *new model* credit unions in the UK are between £250,000 - £300,000 over 5 years. New model credit unions in Rochdale and Portsmouth were supported in their development by their local authorities, which helped put funding packages together '*with money from the EU, Single Regeneration Budget, local housing associations as well as the local authority itself*' (LGA, 2001).

## **Recommendations**

- That professional staff are employed from the point at which the feasibility study recommends moving into stage two of development, so that the manager of a new credit union works with the steering group to set up and organise the business. Managers are required to have a high level of skills, and be suitably qualified, with personal qualities of commitment and leadership.
- That pay and conditions must be sufficiently attractive to encourage high quality employees to enter the industry.
- That directors are recruited who already have the skills and knowledge to run a business, thus avoiding the problems of '*micromanaging*' (Raiffeisen, 1850 translated by Englemann 1960; Stephenson, 1963; Hautaluoma, 1993; ABCUL, 1999; Parnell, 1999). It is evident that volunteers, who in reality prefer to be involved in the day-to-day organisation of the business rather than take responsibility for directing and strategic decision-making, direct unsuccessful credit unions.

- That the roles and responsibilities of directors and management are integrated and clearly delineated: directors directing policy, and management implementing it (Engelmann, 1960; Stephenson, 1963; Hautaluoma, 1993; ABCUL, 1999; Parnell, 1999; WOCCU, 2000).
- Training is developed for staff and volunteers that will enhance board/staff relations. It is evident that key to the success of management/board relations is:
  - both parties must trust and respect each other;
  - both parties must believe that the other is honest;
  - both parties must create an environment where it is possible to discuss mistakes and discuss negative information;
  - open interaction between elected members and management;
  - keeping to agreements, and
  - the understanding that everyone is working in the best interests of the credit union.
- That credit unions are managed in line with modern management techniques and practices, <sup>4</sup>designed to minimise customer complaints, reassure consumers that the products and services they receive are of an internationally recognised standard, and provide staff with a practical and sensible way of running the business so that at every level of operation quality is assured.
- That the quality of reporting to the directors by staff is enhanced through the implementation of the PEARLS<sup>TM</sup> monitoring system so that the strategic development of the credit union and policy decisions are informed by quality information and data provided by management.
- That training is developed for staff that will enhance financial management, bringing the industry in line with the standards of the financial services industry, i.e:
  - regularly monitor development against up-to-date business plans;
  - implement strict credit control and debt recovery systems;
  - have liquidity management plans, which are regularly reviewed and updated;
  - maintain a minimum capital reserve as laid down by the FSA; and
  - operate strict internal control systems that protect members' interests and ensure the safety and soundness of the business.
- Technology is employed where necessary to provide a better service to members. Managers must be fully acquainted with technology, and have

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<sup>4</sup> It is evident that the systems inherent in TQM are complementary to those of a modern co-operative

the ability to advise the directors on the most efficient and cost effective approach to using technology. It is evident that the key issue in developing a technology strategy is that meeting the needs of members is paramount. Efficient credit unions:

- use in-house data processing;
- utilise cost-effective lending technologies;
- offer ATM and debit cards but share the cost of these resources with other credit unions or through a CSO;
- connect to sponsors' email; and
- have information about the credit union on sponsors' web-page/email.
- The credit unions are set up and operate out of secure and well-appointed premises, preferably located in or near to the high street of the city or town, in the main shopping area or other most convenient locations for members.
- That credit unions are accessible six days a week at least 9:00 a.m. – 5:00 p. m.
- That development of a credit union only goes ahead if the resources are secured to underpin its development for up to six years.
- That members raise the initial capital required for registration.<sup>5</sup>
- That local authority funding for credit union development is directed at credit unions rather than third party agencies.
- That funding is directed to outputs related to the economic sustainability of the credit unions, rather than social development or training.

### Summary

Having investigated these six areas of credit union organisation and development 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; provided that they are understood to be vehicles for the development of collective and individual capital, that they are organised and managed as professional businesses, with sponsors who understand the purpose and function of the credit union, and that credit unions take ownership and full responsibility for the movement, including the development of a CSO without which the movement may not survive.

The study asked if credit unions are still relevant in a post-industrial society. Given the challenges that credit unions must overcome, not only to get started but also to trade economically, one would be forgiven for thinking *no*. However, it is clear that work-based credit unions are successful, and that in cities where *'new*

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<sup>5</sup> The FSA require version 1 credit unions to have 1,000 start-up capital and version two credit unions to have (£5,000).

*model'* credit unions are opening, people are joining in hundreds each month. Therefore, one may conclude that people want a local, friendly, accessible but professional service, which makes them feel like a real person.

The credit unions, which people are now joining in significant numbers, are different from those that have been developed over the past twenty years. They have professional staff, they are well sponsored and supported by local organisations; the directors are carefully selected by a monitoring committee that understands the needs of the business, and informs the members of the skills that they need to look for when electing directors and committee members. The local authority has an important role, but it is one based on developing a credit union that will serve thousands of members not a few hundred. The image of the '*new model'* credit union is bright and modern, open and accessible, but the secret of its success is that it is well-connected into local networks. Rhondda credit unions have over eighty supporting organisations and the society at large is proud to own the business.

It is evident that co-operative principles, properly applied and not used as an excuse for inefficient management, or applied so idealistically as to make them unworkable, have an important role in humanising society. However, just as the early co-operators found, co-operatives only work when they meet the needs of members and the communities in which they are based. The needs of people in the twenty-first century in Britain are fundamentally the same as the those of people in the nineteenth and twentieth century; security at home and work; solidarity within the systems in which they live, work and relax; a sense of significance or of belonging; and having a role and purpose in life. Co-operatives are able to nurture all of these human needs; how they do it necessitates working with and among the people the co-operative has set out to serve.

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***Part II.***  
***Essentials of Co-operative  
organization and management***

## WHAT MOTIVATES MEMBERS TO PARTICIPATE? A REWORKING OF A THEORETICAL MODEL AND SOME FINDINGS

Johnston Birchall and Richard Simmons

### Introduction

Recently, there has been a growing interest in the UK in the potential of the "mutual" form of ownership structure. Such has been the attention given to it among some leading commentators that it has been termed the "new mutualism" (Birchall, 2001). The demutualisation of much of the UK building society and mutual insurance sectors has focused attention on what we mean by mutual businesses, and on the costs and benefits of their conversion to investor-owned companies (Drake and Llewellyn, 2001). The search for an alternative to public ownership has led to a revived interest in non-profit and mutual forms, with an outpouring of reports from influential think-tanks wishing to influence UK government policy (Leadbeater and Christie, 1999; Westall, 2001). Mutual and non-profit alternatives for the delivery of public services are being advocated strongly (Mayo and Moore, 2001).

A new form of "public-interest company" is being promoted as a kind of "mutual" that achieves public aims while being protected from demutualisation (Public Management Foundation, 2001). Of course, the main argument for transfer of public services and utilities to private organisations is that this circumvents Treasury borrowing rules. But there is also a recognition that independent organisations may be more responsive to the needs of users, and can bring stakeholders directly into governance (Pollitt and Birchall, 1998). Some developments in the mutual sector have caught the imagination of policy analysts. The largest consumer co-operative (CWS, now Co-operative Group) has fought off demutualisation (Birchall, 2000) and the whole sector is embarking on a wide-ranging process of reform (Co-operative Commission, 2001). The development of the credit union sector is being seen as a key method of delivering the government's social inclusion agenda (Hargreaves, 1999). The development of football trusts has shown an exciting potential to reclaim the governance of football clubs by their supporters (Michie, 1999).

There has been some speculation about how the restructuring of utilities that are natural monopolies - such as water, rail transport and air traffic control - might be achieved through mutual forms in which investor-ownership is replaced by consumer-ownership (Birchall, 2002b; Westall and Mayo, 2001). This has been fuelled by four recent developments. First, there have been initiatives taken by water utilities in England and Wales, aimed at selling the infrastructure to consumers (Stones, 2001; Birchall, 2002a). Second, there is continuing uncertainty

over the eventual shape of the partially privatised and, to some extent, stakeholder-owned, UK air traffic control system. Third, there has been the dramatic collapse of Railtrack and the announcement by the government that it may be turned into a non-profit company. Lastly, a long-lasting and gruelling political struggle between London's central and local governments will shortly be decided, over whether to privatise the London Tube with a public-private partnership or to turn it into a non-profit company financed by bonds.

One question being asked more and more frequently of the co-operative or mutual alternatives being proposed is this - will people want to participate? A negative answer to this question has led to more than one proposal for mutualisation being turned down. For instance, recently the Scottish government decided against mutualisation for Scotland's water, on the ground that customers do not have sufficient incentive to become active members. While recognising the validity of the mutual model in a range of sectors, the government's White Paper rejected it as being inappropriate to the water industry, because customers do not have a "clear interest" (Scottish Parliament, 2001). Also, the water regulator, OFWAT, turned down a proposal to turn a regional water utility (Yorkshire Water) into a consumer mutual. One of the grounds was that customer members would not have enough interest in taking part in governance, and that it might be captured by a minority interest group. It might also provide weak incentives for, and checks on, management performance (OFWAT, 2000).

The existing mutual and co-operative sectors in the UK do not provide very good arguments for the willingness of members to participate. In the building society sector, member relations had been neglected until recent attempts to demutualise woke their boards up to the need to keep the loyalty of their members. Some, such as the regional society Britannia, are going further and developing an active membership strategy. However, the largest, national-level society, Nationwide, is resisting demands for independent member representatives on the board. Some of the 46 consumer co-operative societies are now promoting membership vigorously. The regional Oxford, Swindon and Gloucester Society, and the national Co-operative Group are leading the way, but the latter has had difficulty in finding enough volunteers to stand for its 47 area committees and has had to resort to co-opting people to fill empty places.

It is important that this issue be addressed urgently. Because of uncertainty about what motivates potential members, opportunities for mutualisation of public services and private utilities are being lost. Existing mutuals and co-ops are attempting embarking on potentially time-consuming and expensive attempts to foster active member participation, and they also need to know what motivates members. It is a key question not only in relation to the 'new mutualism' in the UK but in relation to all situations around the world where co-operative solutions are being proposed to a wide range of economic, social and environmental problems

(Birchall, 1997). We are expecting to provide some answers to this key question that will be applicable in most situations where people are being asked to participate in some organisation without being paid; co-operatives, voluntary organisations, non-profits, mutuals, and so on. Our first two years have been spent refining a theoretical model of motivation, and creating a large dataset of findings from face to face interviews with 400 people who are active in representing users in public housing and social care services. We also have a dataset from a comparison group of 80 non-participants that should tell us why some people refuse to participate. We have now begun to move into a second phase. In partnership with the UK Co-operative College, we are now analysing large datasets of self-completion questionnaires with co-operative activists, from one national-level and two regional consumer co-operatives (see the methodological appendix for details of how all these datasets were created).

### **Theoretical model of motivations**

At the Oslo conference in August 2000, we presented an early version of our theoretical model of what motivates people to participate. It was not intended to be an economic model, but a set of generalisations derived from a diverse range of literatures including political science, sociology and social psychology (Birchall and Simmons, 2001). Since then, the model has been refined much further. It now has five distinct stages:

Stage 1 - characteristics of each sector

Stage 2 - background conditions for participation

Stage 3 - measuring the motivations of participants, using the mutual incentives theory

Stage 4 - the dynamics of member participation

Stage 5 - the dynamics of organisational participation

#### Stage 1 - Characteristics of each sector

The first stage of the analysis is a new one that we have added in order to be able to note the effects that being in different sectors makes on motivations to participate. We cannot generalise about water consumers, railway travellers, shoppers at a village store, people investing their savings, or public service users without first identifying the specific characteristics of each sector. We identify four key variables:

- a. the degree of *continuity* of need (from occasional through intermittent to continuing);
- b. the degree of *intensity* of the need (on a hierarchy of needs from frivolous through important to life-saving);
- c. the degree of *financial involvement* of individual consumers (from no involvement, ie publicly funded, through means-tested to market-based); and
- d. the degree of *consumer competence* in assessing the quality of the product or service (from consumer-driven through to professionally dominated).

We can generalise that, other things being equal, the greater the continuity, intensity, financial involvement and consumer competence in a particular sector, the more likely people will be to participate. For instance, the National Health Service in the UK is professionally dominated, publicly funded, and the relationship of patients is often intermittent. Participation of patients has always proved difficult to organise. However, the intensity of their need makes up for this to some extent. Education has some continuity, with parents being involved over at least 12 years of a child's life. They are often intensely interested in the outcomes for a particular child, can assess the competence of teaching by its results. This compensates for lack of financial involvement (in state schooling). Council tenants also have a continuing involvement with their landlord, their home matters to them, and there is no mystery to housing management. However, where a high percentage of households have their rent paid fully by the benefits system, this may undermine their motivation to seek value for money in estate management. In water utilities there is a continuous need, but it is not a very intense one (except when the supply fails or the water quality goes down), nor will consumers be particularly interested in the technical questions of how it is supplied (though environmental concerns are growing among some consumers). They will, however, be interested in obtaining value for money as well as a voice in the running of a monopoly service, which they need, but from which they cannot exit. In transport, the main problem is that journeys are often occasional or intermittent, and so only season-ticket holders might expect to be involved as members. The technical questions of safety and timeliness are of great interest to travellers, their need is intense, and they are financially committed. Once people have made a decision about where to live and to work, they are locked into a monopoly-like situation in which they often have no choice about which route to travel.

What about sectors where mutuals or co-operatives are already operating? In financial services, we find that in some products, such as current bank accounts, pensions and life insurance, there is continuity, intensity and - by definition - financial involvement, and also a high level of customer uncertainty. It is no surprise that the mutual form has flourished and, despite demutualisation, continues to compete strongly against investor-owned businesses. One indication of the importance of consumer confidence is that the UK financial services regulator (the Financial Services Authority) has decided to insist that a consumer representative be appointed to the board of investor-owned insurance companies. When mutuality is excluded, it has in some form to be built back in. Another indicator is the strong financial performance of mutuals since demutualisation; there is evidence that customers have taken the windfall payment from demutualisation, then moved to one of the remaining mutuals.

In retail shopping, there is less obvious motivation for customer membership. The needs are continuous, intense and financially important, but customers are better able to choose between products, and there is, in the UK and most of Europe, intense competition between supermarket 'multiples'. Consumer co-ops will have to work hard to convince potential members that membership will improve the service better than will a strategy of 'shopping around' to get the best deal. The strategy of concentrating on small and medium-sized supermarkets in town centre and village locations is a sound one. The more dependent shoppers are on one store in a key location (either because they rely on public transport or because there are long distances to rival stores), the more likely they are to want to have a say in how the store and its parent company are run.

This first stage of the analysis gets us some way towards explaining motivations, but it produces some crude generalisations. For instance, farmers should be strongly motivated to participate, particularly in the UK where they face a severe economic crisis and loss of confidence in the industry. The fact that they have not produced a strong agricultural co-operative sector shows that there are more factors to be taken into account.

#### Stage 2: Background conditions for participation

The second stage of the analysis considers three background conditions for participation:

- a. prior member resources;
- b. opportunities to participate; and
- c. an organisational participation strategy.

First, the civic voluntarism model of citizen participation has found that the best predictor of whether people will participate in voluntary situations is the *resources* they bring to it. In particular, they bring "civic skills" derived from their involvement with institutions that have taught them how to participate. Not surprisingly, higher income and educational level correlate well with participation. Added to their resources, participators bring a psychological engagement with politics. Having free time is also important, but only when the decision to participate has already been made (Verba, Schlozmann and Brady, 1995). What this means for participation in mutuals is that, other things being equal, we should expect low participation levels in those mutuals whose members have lower incomes and educational levels, and have developed less of a "taste" for politics (credit unions, consumer co-ops?). In those whose members have more of these resources (life insurance mutuals and building societies?) participation should be higher. This was demonstrated recently when no less than three groups of Equitable Life members set up websites to deal with the insurer's financial crisis (Equitable specialises in pensions for people on high incomes). However, most



co-operatives are designed for lower income people, drawing on members' experience in trade unions and political parties (Pestoff, 1991). This means that broad generalisations about resources are not all that useful. But when managers of an existing co-op are preparing a participation strategy, or when co-op developers are planning a new co-op, member resources (or the lack of them) should be measured and taken into account. The UK Co-operative Group is currently doing this in relation to new area committee members, finding out what knowledge and skills they bring to the job, and then tailoring training to meet their individual needs.

Second, it is self-evident that *opportunities* are needed if there is to be participation. In many mutuals, the lack of publicity for annual meetings, of contested elections, of contact with members, have meant there has been almost no opportunity for participation. It is ironic that the vote for demutualisation has often been the first time members have been made aware of their status as owners. The large size of modern mutuals also restricts opportunities, since only a very small proportion of members can be involved at the top level. As a recent report on building society governance concludes, there is a need for federal structures designed to connect people up to large mutuals, and electoral college systems that reward active participation (Cook et al, 2001). In co-operatives more opportunities have been provided, but in Western Europe the merger of consumer co-ops into larger groupings (and sometimes their disappearance!) has greatly reduced the number of opportunities available for service on boards (see Pestoff, 1991).

Third, it follows that there has to be an organisational strategy for participation. It cannot be left to itself, in the way it could in the small-scale, locally based co-ops, friendly societies and building societies of the Victorian age. Managers have to be charged with setting up and staffing participatory structures such as area or regional committees or forums, with organising an information-rich environment in which members are listened to and their views collated, and with providing supports for participants such as training, office facilities, and expense budgets. Such a strategy is beginning to be developed in some UK consumer co-ops and building societies.

### Stage 3: Measuring the motivations of participants, using the 'mutual incentives' theory

So far, the analysis has been rather superficial. Stage three measures the motivations of participants. The idea that people need incentives to participate has been used successfully to explain membership of political parties (Whiteley and Seyd, 2002). The *mutual incentives theory* assumes that people are motivated by a complex mixture of both individual and collective incentives. Individual self-interest is easier to deal with, as it is the basis of exchange and rational choice

theories that provide some detailed generalisations. The term "collective" refers to a process by which individuals come to see their own aims and values in terms of a wider community, and so find it difficult to account for their motives entirely in terms of self-interest.

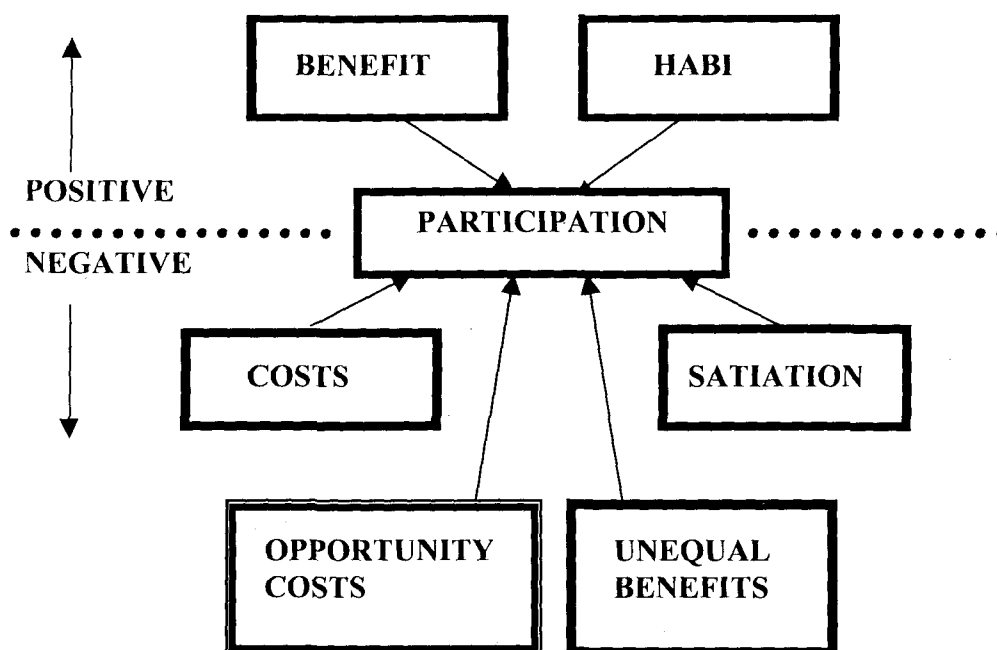


Figure 1: Individual Motivations

At the individual level, people calculate the costs and benefits of taking part (see figure 1). The costs to members are the opportunity-costs of giving their time and energy to this rather than to other activities, and the psychological costs of engagement; the risk that participation may not give the expected benefits, leading to frustration, anger or apathy (Homans, 1974). The literature on rational choice makes gloomy reading on this subject. Taking its starting point that people do not have a reasonable incentive to vote in elections, it attempts to find ways of overcoming this built-in disincentive in order to explain why so many people do, in practice, vote. There are two problems participants have to overcome: a temptation to free ride on other people's participation and a calculation that one's own participation will not have any noticeable effect on the outcome. There are several possible ways of minimising the "collective action" problem that results. First, participation may not be all that costly. Some types, such as voting, take little effort such as filling in a voting card. Second, in certain circumstances (such

as local rather than national political participation) a person's participation does have an effect. Third, participants may find that the "expressive" aspect, making one's views and feelings known, is itself a benefit (Whiteley and Seyd, 2002).

Benefits can be classified into external and internal. The external benefits include immediate benefits from taking part and longer term ones from maximising the return from the business. In terms of immediate benefits, it is often assumed that participants should not be paid, but attendance allowances and annual "honorariums" are often used for committee membership or officer duties, and expenses can be budgeted for. The longer-term benefits can be substantial, providing the members have real control over the business and over how surpluses are allocated. One of the main incentives for participation in consumer co-ops used to be that they declared an annual dividend on purchases; there was intense speculation among ordinary members about the rate, and much holding to account of directors when dividends were lower than expected (Birchall, 1994). The problem with proposals for the mutualisation of public services or utilities is that surpluses will either be ruled out as politically unacceptable, or be returned in lower prices in the future rather than cash payments. Members then face the collective action problem of not knowing how much their personal participation has counted.

Internal benefits include increased self-confidence, increased knowledge, a sense of personal efficacy, and enjoyment. Preliminary results from the current study show that these are very important, and, for activists, far outweigh the costs. Service on a forum or committee, even at a low level in the decision-making hierarchy, seems to have these effects, providing the quality of the relationship between the participant and the organisation's managers and board members is good. The terms of the relationship have to be made clear, time must be taken to build up trust, and the managers have to demonstrate their effectiveness in responding to the demands made by the participants.

One important non-material benefit is that participants enjoy taking part because the subject is an interesting one. Some subjects are more interesting than others; for instance, consumer co-operative shopping compared with running a water company. However, a management strategy can make most subjects more interesting to potential participants, and the sheer complexity of running a large business can be appealing. It also depends on what participants are being asked to do. Members of a utility mutual may be interested enough to read an annual report, or voting information from a candidate for the Board, or even to browse a website, even if they never serve on a committee. When people do join a decision-making group, providing it is seen to be effective they tend to find that their interest grows over time.

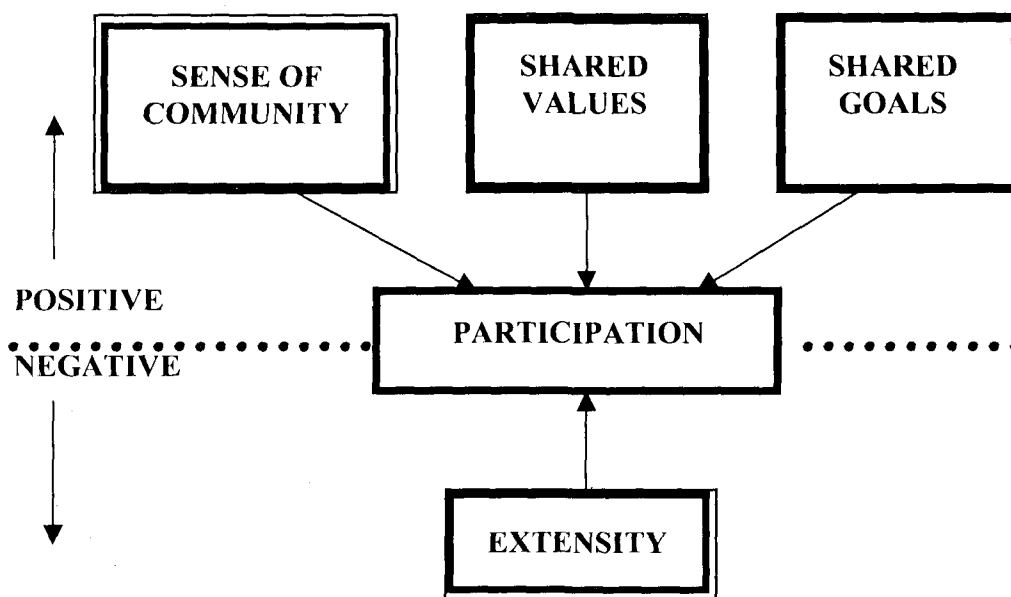


Figure 2: Collective Motivations

Participants often say they will participate even if they do not continue to receive these individual benefits. This seems contradictory, but they are saying they have collective incentives that outweigh the individual ones (see Figure 2). Following a suggestion made by Sorokin (1954), we distinguish three types: shared goals, shared beliefs, and a sense of community. The sharing of goals that one values highly is a major source of commitment. Through co-operation, people express mutual needs that translate into common goals. The sense of community motivates people because they care about other people who either live in the same area, or people who are like them in some respect (the elderly, the disabled, local commuters). Community is a major motivator on public housing estates in Britain, where residents either want to preserve or to rebuild it.

#### Stage 4: the Dynamics of Member Participation

The motivations of individuals are just one part of a more complex set of interactions. We start by setting out the 'Nature of the Opportunities to Participate', which is a summation of Stages 1 and 2 (see Figure 3). We then show how the opportunities and the initial motivations of individuals affect their initial decision to participate. The member's experience of participation then follows. This experience feeds back into motivations, weakening or strengthening them, changing the balance of individual and collective motivations, and so on. We also add in a variable we call 'Member participation style' that recognises that over time

a group of people develop their own styles (or if they think about it carefully, strategies). This is more relevant to self-sustaining member organisations than to mechanisms created by managers to engage with members. But even in the latter case members will, over time, work together to produce their own recognisable style of working. If the experience of participation is a bad one, then motivations will be affected, and eventually an individual will reopen the 'decision to participate' box. What we mean by this is that the decision will be revisited, and either participation will cease or will continue, subject perhaps to some new condition being attached. Some members, once they have started to take part, never reopen this question. Others reopen it regularly. Some may put a time limit on it - for instance, if the experience does not improve by a particular date, then participation will cease.

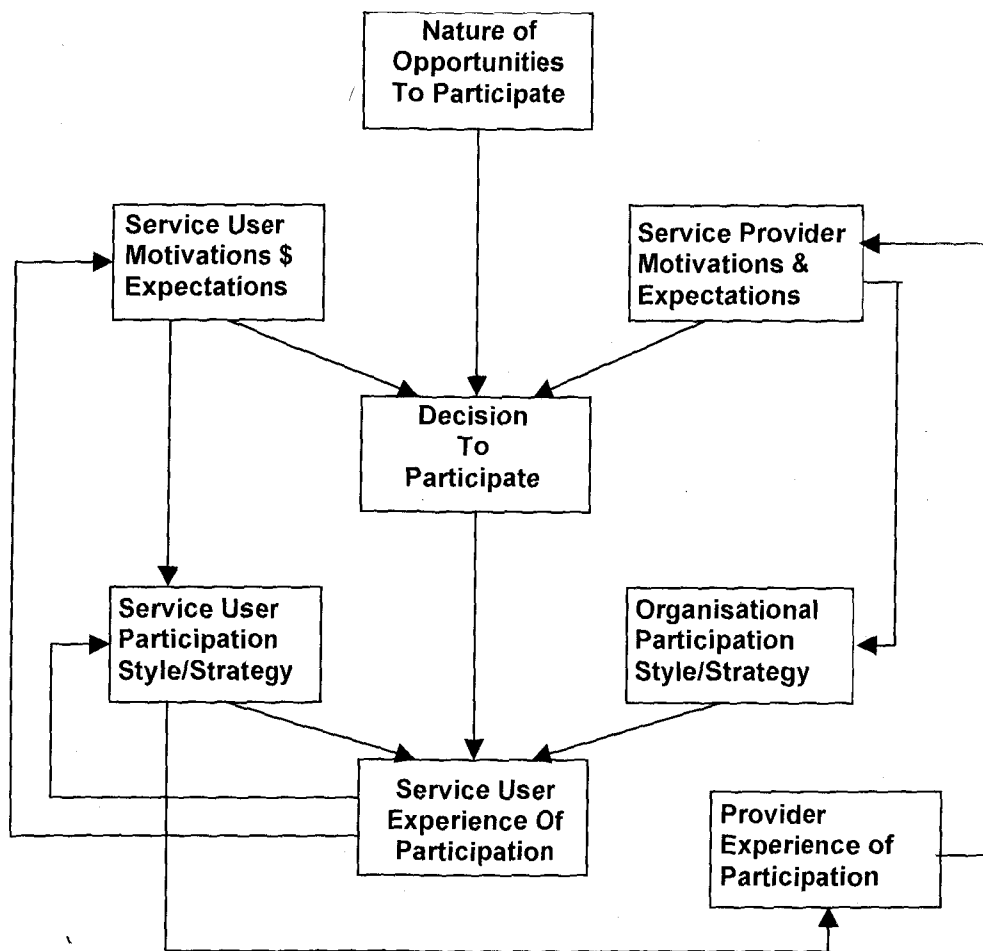


Figure 3: Dynamics of Participation

### Stage 5: The Dynamics of Organisational Participation

It is not just members who are participating, but also managers, front-line staff and board members. In the case of local authority service delivery, elected councillors may be involved. In some countries where co-operatives are highly regulated, government officials may also be involved. We call this, for want of a better term, 'organisational participation'. We bring into the model a set of boxes that exactly match those relating to members. So there are organisational motivations and expectations. There is an organisational style or strategy that affects how participation is experienced, and there is the experience of managers, board members and other participants of the same process. It might be thought that none of this matters very much, since managers are paid to take part, and it is also part of the duty of board members as governors. However, in practice the motivations, the experience and style adopted by these other participants all interact with those of the members, in complex ways. The use of detailed case studies in our research projects will help us to describe some of these interactions in detail, and to develop generalisations that we hope will provide insights into similar situations. Three local authority case studies will be available by September, and three consumer co-operative cases by November 2002.

### **Some interim findings - prior resources**

#### *A. Health*

A majority of respondents in reported themselves to be in good health, although unsurprisingly this figure was slightly higher for the sample of co-op members (88%) than for public service samples, which included care service users (77%). While those in good health might be expected to participate more, however, there is no evidence for this in our statistical data. Proportionally, the hours per month and the number of times respondents reported themselves to have participated in the last year were almost identical whether respondents were in good health or not. Hence, while some people in particularly poor health did state that this sometimes got in the way of their participation, health problems are a barrier which many participants seem to have managed to overcome.

#### *B. Income*

Around 55% of co-op participants, 65% of public services participants and 75% of non-participants had incomes of less than £10400 per annum (£200 per week). The corresponding figures for incomes of less than £20800 (£400 per week) were 85%, 90% and 95%. These figures are not in line with many studies of citizen participation, which show participation to be more likely amongst higher earners. However, these lower income levels may reflect some of the other characteristics of our samples.

Unsurprisingly, income level correlates with qualifications, with the better qualified on slightly higher incomes. Perhaps also unsurprisingly, those on lower incomes were more likely to report the different benefits of participation as being very significant to them. Interestingly however, these respondents were also more likely to say that without these benefits they would still participate. This indicates that they like to think they participate for collective reasons.

Income levels do not correlate with participation levels, either in the quantity or the range of activities undertaken by participants. In our study income does not therefore show up as an important resource in supporting participation.

### *C. Time*

We used three proxies for time resources: (i) current status, (ii) whether respondents had responsibility for the care of children, and (iii) whether they were currently taking any educational courses. With regard to status, 72% of co-op participants and 43% of public services participants described themselves as 'retired from paid work'. A further 20% or so in both samples were employed. Meanwhile, around 20% of public services participants gave their situation as being long term sick or disabled (29% in care services). The remainder in each sample were made up from people who were unemployed, looking after the home or full-time carers. Meanwhile, only 20% of participants had childcare responsibilities, and only 12% were taking courses. In addition to the large numbers of retired participants, these figures suggest that time resources are important in supporting participation. However, our data suggests caution in making this assumption. Once people are involved in the participation process, there is little difference in the participation levels and the range of activities undertaken by those respondents these proxy measures assume to be more 'time-rich' or those assumed to be 'time-poor'.

### *D. Qualifications*

77% of co-op participants and 64% of public services participants had attained some educational qualifications. This figure was slightly lower for non-participants (53%). Educational attainment appears to be quite an important indicator of differences amongst our samples. For example, amongst public services participants a greater proportion of those respondents with qualifications appear to participate for more than ten hours per month than those who hold none. A greater proportion of them have also had a formal role, and they are likely to participate in a wider range of ways, from communicating, publicity and mutual aid to committee and office bearer work. Educational achievement therefore appears to indicate a resource that helps to support these levels of participation.

### *E. Previous Experience*

69% of co-op participants and 57% of public services participants had previous experience of participating in similar organisations, of which 87% and 62% respectively were still members. In a similar pattern to respondents with educational qualifications, participants with previous experience are more active. They are slightly more likely to say they participate 'all the time', and for more hours per month than those who have not had previous experience. A greater proportion of them have also had a formal role, and are more likely to participate in committee and office bearer work, communicating on behalf of the group, publicity and mutual aid. Previous experience therefore appears to match educational achievement as a resource that helps to support these levels of participation. This is notwithstanding the fact that there is a substantial crossover between the two groups - a greater proportion of those with qualifications also report having previous experience of participation, and vice-versa.

### *F. Training*

This factor was investigated for public services participants only, as co-op participants were felt to have been participating for too short a period for it to have been widely applicable to them. Just 31% of the public services sample had received any training for the participation they were doing. Once again, a larger proportion of participants who have had training are more active. They are significantly more likely to say they participate for more than 10 hours per month than those who have not had training. In an identical pattern to that found for educational qualifications and previous experience, a greater proportion of them have also had a formal role and are more likely to participate in committee and office bearer work, communicating on behalf of the group, publicity and mutual aid. Training appears to match both qualifications and experience as a resource that helps to support these higher levels of participation.

### *G. Confidence*

Two aspects of participants' confidence were investigated:

- (i) Their confidence in their ability to participate effectively as a member of the group. 85% of co-op members and 93% of public services participants reported being either 'very confident' or 'quite confident' in this respect.
- (ii) Their confidence that they could personally make a difference to the group getting things done. Here, 71% of co-op members and 85% of public services participants reported being 'very confident' or 'quite confident'.



Participants tend to exhibit high levels of confidence. Both of the above indicators also have strong correlations with levels of participation. Those who report themselves to be very confident also report participating 'all the time' and for more hours per month. They are also more likely to have had a formal role, and to participate through committees, office bearer work, fundraising, communicating, and mutual aid. Those who were very confident of making a difference to the group getting things done were also more likely to participate in publicity and social events.

Participants with qualifications report feeling very confident about their ability to participate effectively, although the correlation with making a difference to the group getting things done was not significant. Previous experience in similar organisations did not correlate significantly with either indicator of confidence. However, participants who had received training were significantly more likely to report feeling more confident on both levels. This suggests that training is important.

### **Some interim findings on motivations to participate**

#### **(i) Individual Motivations**

##### *A. External Benefits*

'External' benefits include the following aspects:

- (i) Help to career
- (ii) Financial reward
- (iii) Others looking up to me
- (iv) Getting my own problems solved
- (v) Giving me a social life

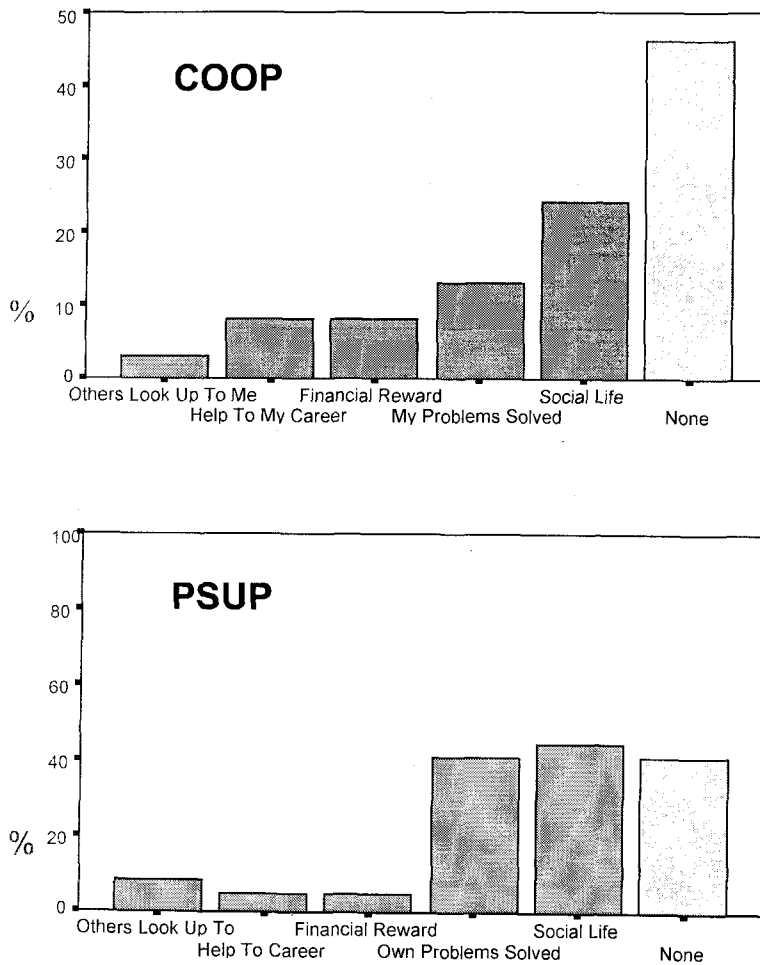


Figure 4: External Benefits

With regard to the first three of these factors, a very low level of positive responses were received (<10% in each case; See Figure 4). These factors are clearly not considered to be important by either public service participants (PSUP) or co-op members (COOP). However, public service participants were more likely to consider getting their own problems solved to be an important benefit. This would appear to indicate either a greater number of problems in public services, or that the problems are considered to be more important, or both. Things will become clearer once the case studies are complete, although at this stage it seems possible that this finding results from variations in the degree of intensity of public service users' needs. The external benefit considered to be most important by participants in both samples was 'giving me a social life'. For public service users,

this was an important factor for over 40%, demonstrating that groups should try to strike a balance between maintaining their 'task-focus' and ensuring social opportunities are available. Non-participants in public services were likely to consider the first two external benefits to be slightly more important than the participants did. They were also more likely to say that getting their own problems solved was important. However, perhaps surprisingly, their decision not to participate does not appear to be based on a lack of 'sociability' – just over 40% of them also considered 'giving me a social life' to be an important potential benefit of participation.

For all this discussion, however, over 40% of respondents in each sample of participants said 'none of the above'. For a large number of participants, external benefits therefore appear to have little or no bearing on their participation. To a certain extent this is confirmed by a further important finding of our research. 83% of public services participants and 78% of co-op members said that without any of the above benefits they would still participate. However, this does not necessarily mean that external benefits can be dismissed. For the other 50% or so in the public service participant sample, around 90% considered external benefits to be either 'very significant' or 'quite significant'. This figure was lower amongst co-op members (57%), but still indicates that where the above external benefits are considered important, their importance is significant to the majority of participants.

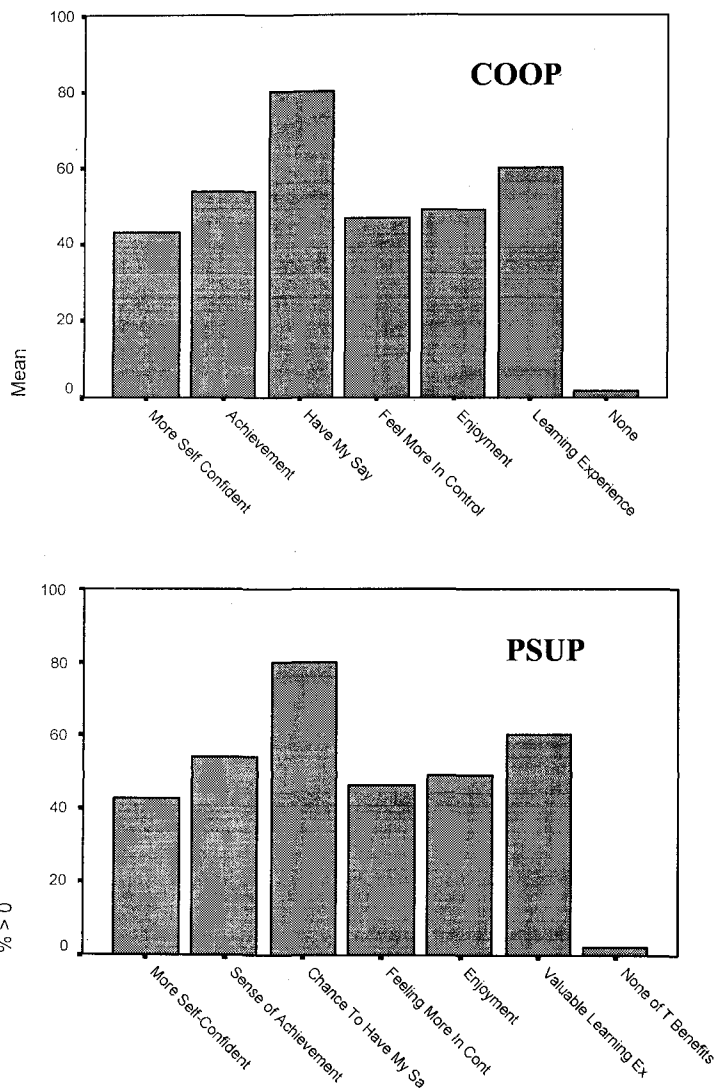
#### *B. Internal Benefits*

Internal benefits include the following aspects:

- (i) Feeling more self confident
- (ii) Sense of achievement
- (iii) A chance to have my say
- (iv) Feeling more in control
- (v) Enjoyment
- (vi) Learning experience

In general, larger proportions of respondents in both participant samples considered these factors to be important to them (see Figure 5). This is particularly noticeable in the public services participant sample, where each factor was identified as being important by at least 40% of respondents. Of these, the factor most commonly identified (at 80%) was 'a chance to have my say'. Key benefits of participation for many respondents therefore appear to be opportunity to contribute a consumer perspective to what still tend to be professionally-dominated services, or at least the 'catharsis' value of giving their own views. From our discussions with respondents, the need to speak up is sometimes felt to arise from a 'dissonance' in the perceptions of service users and professionals as to

one of our 'service sector' characteristics, the degree of users' competence in assessing the service. In the co-op sample the most commonly identified factor was 'a valuable learning experience'. In common with public services participants, this was identified as being an important benefit by just under 60% of respondents. There would appear to be a personal development angle to this finding. However, it also demonstrates the importance of knowledge and information as a resource. Many participants appear to be information-hungry, which indicates that either information is unavailable from any other source, or that the information otherwise available is considered to be inadequate.



**Figure 5: Internal Benefits**

The above factors are still strong in the non-participant sample, but significantly less so than for participants. Only 42% of these respondents identified 'a valuable learning experience' as an important benefit, while 67% considered 'a chance to have my say' to be important. In the other aspects, the proportion of non-participants' responses did not vary greatly from those of participants. This suggests that....

Very few respondents in any sample (including non-participants) said that none of the above internal benefits were important to them. Internal benefits therefore appear to have quite a large influence on participation. Moreover, around 90% of all participants also considered these benefits to be either 'very significant' or 'quite significant'. In the co-op sample this compares with a much smaller number of participants who considered 'external benefits' to be significant (89% v. 57%). This may be useful in informing participation development strategies, particularly around the three benefits identified by most respondents in this sample: 'a valuable learning experience', 'enjoyment' and 'a chance to have my say'. Even here, however, the idea of internal benefits acting on their own to influence participation is called into question by our finding that 77% of public services participants and 78% of co-op members say that they would still participate without these benefits.

### *C. Habit*

Data is only available from the public services participants on this factor, as the co-op participants were not felt to have been participating for a sufficiently long period to for it to be meaningful to them. 29% of public services participants said that their participation had become habitual, and 69% that it had not. These figures appear to suggest that it would be wrong to rely on a majority of members participating out of habit. However, a cluster analysis on our data (see below) has shown that there is one type of group member for whom participation may be more likely to become habitual.

### *D. Direct Costs*

Against the benefits of participation, respondents were also asked to identify which of the following costs affected them:

- (i) Financial costs (travel, childcare, etc)
- (ii) Being bored or uncomfortable
- (iii) Effort of gaining new skills and knowledge
- (iv) Meeting new people
- (v) Being unpopular with people outside the group
- (vi) Having to deal with criticism
- (vii) Other people free-riding on their efforts

In general, few of the respondents in either of our participant samples considered these factors to affect them (see Figure 6). Public services participants were slightly more likely to say that ‘dealing with criticism’ and ‘free riding’ affected them, but even here the numbers affected were less than 20%. Around 50% of respondents in each participant sample also said that none of the above costs affected them. Together these findings indicate one or both of two things. It could just be that the costs of participation are so low as to not bother participants. Yet in many groups there have been efforts to provide transport, creches and so on, or to cover the legitimate financial expenses of participants. Training has also been provided to reduce the effort required to gain skills and knowledge. It could therefore also be that such measures have been sufficient to reduce the level of costs to participants to negligible levels. Non-participants were only very slightly more likely to perceive that the above costs would affect them. Direct costs do not therefore appear to provide a significant barrier to participation. However, it is worth noting that around 60% of those respondents who did say that one or more of the above costs affected them also said that these costs were either ‘very significant’ or ‘quite significant’. It therefore seems that there is still more that can be done to reduce these costs where they apply.

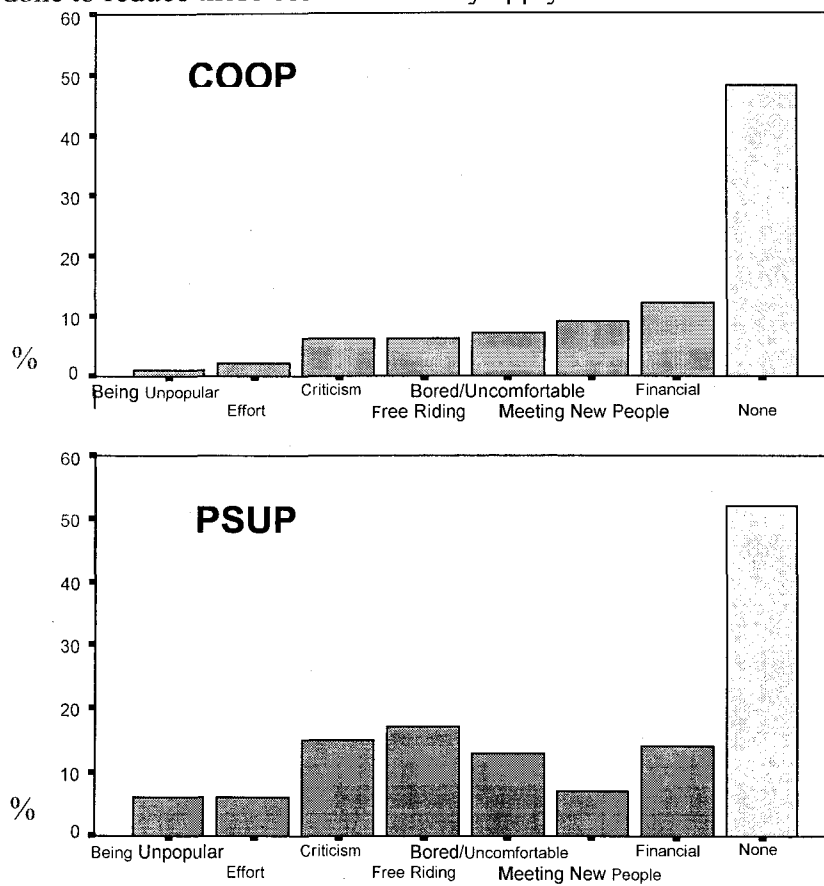


Figure 6: Direct Costs

### *Opportunity Costs*

The story here appears to be much the same as for direct costs. 11% of public services participants and 14% of co-op members said that opportunity costs stopped them from participating more. Perhaps unsurprisingly, this figure was slightly higher for non-participants at 22%, but overall opportunity costs do not appear to have particularly strong effects on participation.

### *E. Satiation*

Once again, data is only available from public services participants on this factor, because the co-op members were not felt to have been participating for a sufficiently long period to for it to be meaningful to them. Satiation does not seem to exert a particularly negative influence on participation. Only 15% of this sample believed that any of the benefits from their participation had become less valuable to them. Of these the benefit that was most likely to have become less valuable was 'getting my own problems solved' (21%). This is interesting, as the suggestion that the concerns of some participants move on from a narrow focus on their own problems to a wider focus over time is backed up by comments made to us by a number of respondents.

### *F. Individual or Group?*

Overwhelmingly, participants want to get benefits for the group as a whole, as opposed to individual benefits. Only 2% of public service participants and 1% of co-op members said they wanted to get individual benefits from their participation. The corresponding figures are 78% and 51% for the group or co-operative as a whole. 19% of public services participants and 45% of co-op members said both individual and group benefits were important. These findings confirm one of the underlying messages in the above findings for individual motivations, that the pursuit of individual benefits is often secondary to a wider set of concerns.

### (ii) Collective Motivations

#### *A. Scale of Collective Motivations*

Our studies used a 30-point attitude scale to measure collective motivations. This scale was found to be internally reliable ( $\text{Alpha} = .7649$ ). More work is being done to investigate the potential of this scale. However, crude scores show that the public services participants sample appear to demonstrate the strongest collective motivations, followed by the co-op participants, followed by the non-participant sample (see Figure 7; lower scores indicate stronger collective motivations).

	Mean	Median	Mode
PSU Participants	2.32	2.33	2.27
Co-op Participants	2.50	2.59	2.34*
PSU Non-participants	2.70	2.70	2.4*

\* Multiple modes were found. The smallest values are shown.

Figure 7: Collective Motivation Scores For Each Of Our Three Samples

These findings show that both sets of participants score more highly on collective motivations than non-participants. This finding is important, if not unexpected. The findings also show that our public services participants scored more highly than our co-op participant sample. To a certain extent, these findings are also what we would have expected. In contrast with many of their counterparts in public services, co-op participants are currently participating at a less intense level and have been participating for just a short time. Both of these factors are significantly correlated with collective motivation scores.

The above scale provides a crude measure for motivations which needs to be explained more fully. We can commence this explanation with a more detailed look at each of the theoretical components underpinning the scale. Items were nominally assigned to our three categories: sense of community, sense of duty and shared goals.

*B. Sense of Community*

	COOP			PSUP			PSUNP		
	+ve %	Neutral %	+ve %	+ve %	Neutral %	+ve %	+ve %	Neutral %	+ve %
SOC1	82	18	0	<b>94</b>	4	1	79	14	7
SOC2	75	<b>18</b>	7	<b>88</b>	9	3	<b>80</b>	6	<b>14</b>
SOC3	43	<b>35</b>	22	<b>81</b>	10	8	36	33	<b>30</b>
SOC4	58	<b>22</b>	20	<b>76</b>	11	12	50	23	<b>27</b>
SOC5	59	<b>30</b>	11	<b>84</b>	8	8	62	26	12
SOC6	81	14	5	<b>80</b>	14	6	65	21	<b>14</b>
SOC7	40	<b>42</b>	18	<b>60</b>	22	18	37	24	<b>39</b>
SOC8	54	<b>33</b>	10	<b>66</b>	10	24	62	17	<b>21</b>
SOC9	NA	NA	NA	<b>77</b>	12	11	66	21	13
SOC10	67	<b>25</b>	7	<b>92</b>	5	3	87	7	6

Figure 8: Orientation Of Response To Sense Of Community Items



Figure 8 shows the orientation of the responses from co-op participants, public services participants and non-participants respectively to ten attitude statements relating to sense of community. The overall orientation for all three groups in relation to most sense of community items is positive, indicating that a relatively strong sense of community is felt by all groups. However, figures have been highlighted in three columns to demonstrate something of an emerging pattern. First, more public service user participants tend to give positive responses to sense of community items. Second, responses from co-op participants tend to be more neutral than those for the other two samples. Finally, public service user non-participants (PSUNP) tend to be more likely to respond negatively to a majority of these items. This is a pattern which is repeated for all three of our categories of mutual motivations, which helps to explain the scores in Figure 7. The latter finding also shows that the variation between our three samples is not limited to just one or two of our categories of collective motivations.

The above tables also show that both sets of participants are less likely to give negative responses to sense of community items. Beyond this, the fact that co-op participants are less likely to give positive responses than PSU participants, and more likely to give neutral responses, can be interpreted as their not yet having had sufficient positive feedback from their participation. This may be because the short duration of their participation has so far resulted in too few 'feedback loops', or because the experience of participation has not been sufficiently positive. If, over time, more positive feedback is received, it might be expected that many of the 'neutrals' will move to a positive orientation in this group. If not, it is also possible that some neutrals will switch to a more negative orientation. As this latter orientation appears to be a characteristic associated with non-participants, it seems likely that a number of participants could be lost in this way.

### C. Sense of Duty

	COOP			PSUP			PSUNP		
	+ve	Neutral	-ve	+ve	Neutral	-ve	+ve	Neutral	-ve
SOD1	73	23	4	62	20	18	50	21	<b>29</b>
SOD2	73	<b>25</b>	2	<b>86</b>	8	6	53	26	<b>20</b>
SOD3	54	<b>28</b>	17	<b>71</b>	10	19	36	23	<b>41</b>
SOD4	43	<b>30</b>	27	51	16	33	40	10	<b>50</b>
SOD5	49	12	38	<b>80</b>	7	13	72	11	17
SOD6	44	<b>28</b>	27	<b>55</b>	20	25	43	19	<b>39</b>
SOD7	78	18	4	<b>77</b>	11	12	66	17	<b>17</b>
SOD8	Na	Na	na	94	3	3	90	9	1
SOD9	43	12	45	35	11	54	39	18	42
SOD10	18	11	71	<b>61</b>	16	23	38	13	49

Figure 9: Orientation Of Response To Sense Of Duty Items

The above broad trend in responses is also discernible here in our three samples. Hence, in general, public service user participants tend to give positive responses, co-op participants tend to be more neutral, and non-participants tend to be more likely to respond negatively. However, the overall orientation for sense of duty does not appear to be as strongly positive as it is for sense of community. Some items have attracted negative responses even from participants. In some other items there appears to be less variation between the three samples. These findings appear to reflect the nature of this category. The sense of duty items reflect the extent to which 'shared values' are found in the community. While some respondents may be relatively polarised in some of these values, it appears there may be other values to which respondents' attitudes are more universal. These findings will help to inform the next revision of the scale.

#### D. Shared Goals

	COOP			PSUP			PSUNP		
	+ve	Neutral	-ve	+ve	Neutral	-ve	+ve	Neutral	-ve
SG1	64	<b>26</b>	10	59	19	22	67	13	<b>20</b>
SG2	35	<b>35</b>	29	<b>59</b>	18	22	46	19	<b>34</b>
SG3	27	<b>26</b>	47	<b>71</b>	13	16	37	7	<b>56</b>
SG4	48	<b>41</b>	11	<b>83</b>	8	9	55	24	<b>21</b>
SG5	23	<b>54</b>	23	<b>68</b>	15	17	45	23	<b>32</b>
SG6	26	<b>58</b>	16	<b>69</b>	14	17	48	27	<b>25</b>
SG7	50	12	38	<b>79</b>	6	15	73	7	20
SG8	39	<b>47</b>	14	<b>71</b>	21	8	57	28	15
SG9	58	<b>35</b>	7	<b>87</b>	6	6	58	24	<b>18</b>
SG10	54	24	22	<b>59</b>	11	30	29	10	<b>61</b>

Figure 10: Orientation Of Response To Shared Goals Items

The trend we have picked up in both of the above categories is clearly visible in these figures. This was to be expected. The sense of shared goals is linked to the idea of successful group working. PSU participants, who are generally of longer standing and participate more intensely than co-op participants, have a longer track record and deeper understanding on which to judge this success. Co-op participants may simply not have yet had time to make a similarly firm judgement. This interpretation is supported by one item where co-op participants are particularly negative. This item (SG3) shows that respondents did not consider themselves to have enough information. As we noted earlier, people tend to be information-hungry, particularly at the outset of their participation. This is an important need that can usually be serviced easily by the organisers of participation. The fact that non-participants are more likely to be negative is also telling. Their more negative perceptions may result from seeing few successes that

they attribute to the participation of others. In response, groups may benefit from publicising their successes more effectively if they are to change such perceptions and encourage more people to participate. This was something which was widely recognised by respondents in our discussions with them.

#### E. Factor Analysis

Dividing the 30-point scale in the above ways allows us to draw on the theoretical heritage of the model. However, factor analysis was also used on the public service user participants sample to divide the data from this scale. Following Kaiser's criterion, eight factors were retained. Using item loadings on these factors, it has been possible to characterise these factors in the following ways:

Factor	Eigenvalue	Factor 'Name'	Linked To
1	5.07	Group Process	Shared Goals
2	2.62	Community Identity	Sense of Community
3	1.77	Community Representation	Sense of Community
4	1.56	Inadequacy	Shared Goals
5	1.46	Group Outcomes	Shared Goals
6	1.28	Internalized Norms	Shared Values
7	1.14	Social Trust	Sense of Community
8	1.08	Obligation	Shared Values

Figure 11: Factor Analysis on Collective Motivations

(Method: Principal Components Analysis with Varimax Rotation)

Each factor has been linked back to the three theoretical categories. This has resulted of a further subdivision of sense of community into three factors, sense of duty/shared values into two factors and shared goals into three factors. These findings will aid further theoretical development. However, on their own, factors do not themselves all lead to internally reliable scales. This means that collective motivations are still best considered on the original 30-point scale.

#### F. Cluster Analysis

A K-means cluster analysis was performed on the data from public service user participants. This clustered our respondents according to their collective motivations. Five clear clusters of participants were found. Cluster membership was then cross-tabulated with participants' other responses to generate a more detailed picture of their characteristics. One cluster (N=50) consist of 'marginal' participants. They are not very active and usually of short standing with the group. Their main activity is attending meetings, but they are more likely to say they feel

bored and uncomfortable in these. Their scores on collective motivations also tend to be lower than that found in other clusters of more active participants.

We have been able to characterise four different types of activist from our other clusters. We have called the first type 'campaigners' (N=70). These participants are very active and very confident in their participation. They tend to be office bearers in their groups, regularly taking part in committees and taking responsibility for communicating on behalf of the group. They also tend to be more interested in politics, and to have a negative view of the role of authorities. Campaigners exhibit very strong collective motivations, being more likely to 'strongly agree' with all but four of the items on the 30-point scale.

The second type are characterised as 'footsoldiers' (N=30). These participants are much more likely to have no educational qualifications. Their participation is generally of shorter standing than campaigners, but they are only slightly less active. However, the nature of their participation is quite different. Footsoldiers are more likely to undertake some of the group's support functions, such as *fundraising and delivering leaflets, rather than strategic functions such as office-bearer and committee work*. They score highly on sense of duty items and community identity, but low on social trust. Trust tends instead to be invested in the group, which is considered to know best how to improve services.

In contrast with the first two types, the third type (N=85) tend to be 'thinkers' rather than 'doers'. We have termed these participants 'scrutineers'. They are more likely to have educational qualifications, and to be interested in participation as a learning experience. However, they are not as active as either of the above clusters of participants. Scrutineers score quite low on sense of duty items – they are clearly there on their own terms. As thinkers they may also tend to see the 'shades of grey'. They are therefore more likely to consider that the group is trying to take on too many problems or problems that are too difficult to solve. This may act to prevent them from becoming more active themselves, but they are generally supportive of the group and its more active members.

Finally, the fourth type is the most numerous (N=139). These participants are guided particularly by internalised norms. They score averagely high on most other aspects of collective motivations. Participation has also become habitual for a larger proportion of this cluster, many of whom are long-standing participants. Participation from this group is mature and stable: they are 'habitual participants'.

## **Conclusion**

The next stage of the research project will explore stage 4 and stage 5 of the model - the dynamics of member participation and wider 'organisational' participation. In the case of public services, organisational participation includes politicians,

managers, and front-line staff, In the case of co-operatives, it includes board members, managers and member relations officers. Already we have enough material for detailed case studies of the interactions of active service user representatives with other stakeholders in two types of setting (public housing and social care), in three local authorities (two Scottish authorities and one London borough). This gives us six sector case studies, within three local authority cases. Then, from around July 2002, in partnership with the UK Co-operative College and as part of our second ESRC grant, we explore the dynamics of stakeholder interactions within the Co-operative Group. If we obtain more funding, we can then extend this to the two regional co-operatives for which we will already have questionnaire data.

The question of why people participate is too important to be left to the kind of everyday common sense that we all possess. Our knowledge has to be made systematic, and then we have to make sure that the lessons learned will be disseminated effectively to those who are responsible for fostering member participation. This applies not just to co-operatives but to all organisations that have stakeholder representation built into them: mutuals, public service delivery agencies, non-profits, and some ethical investor-owned businesses. More generally still, it applies to local governments that want actively to engage with their citizens. We believe that our theoretical model will continue to grow in complexity, and be applicable in a wide variety of settings. It should help us better to understand the potential - and the limitations - of member participation.

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## **CO-OPERATIVE SUPPLY CHAIN SEEN FROM FOOD SYSTEM APPROACH**

**Akira Kurimoto**

### **Introduction**

Traditionally, co-operatives dealing with supply of food have been analyzed by the separate disciplines; agricultural processing/marketing co-ops by agricultural economics and food engineering, while retailers/consumer co-ops by commercial and consumer behavior studies. However, the increased vertical integration in food production/distribution and the advent of supply chain management partly invalidate such separate approaches. So, more integrated approach is needed to analyze the whole supply chain. The food system (food chain) approach captures all the process from food production / distribution to consumption / waste disposal as a 'system'. It involves actors working at all stages; farmers (upstream), food manufacturers and wholesalers (midstream), food retailers and food service providers (downstream), consumers and garbage recyclers/incinerators (lake). This approach seeks to analyze the behavior of these actors and interaction among them, including regulations and technologies affecting the system.

The food system had evolved to involve new actors; food manufacturers, supermarkets and convenience stores, fast food chains etc. As a result the added values had shifted from primary industries to the second and notably the third industries headed by large-scale retailers and food service chains. The consumer's choice had been largely expanded but the enlarged distance from farm to table generated some serious problems.

The food system approach can provide more holistic view of food-related industries and position the co-op's food businesses in the whole food chain. Thus it may help suggest the ways for more coordinated product development/marketing and cost reduction. Agricultural Co-ops have played the pivotal role in marketing green groceries but now challenged by the newcomer commercial operators and foreign competition under the liberalization/deregulation measures. Some co-ops are entering the food processing and introducing the direct marketing with major retailers/restaurants to reduce costs and add values. Consumer co-ops have promoted the direct transaction between producers and consumers, thus bringing both parties closer for developing the safer products. Facing the consumer's food scare on BSE and GMOs, they are striving to build in the traceability in the food chain from farm to table.

### **What is a Food System Approach?**

Where and how is food produced, processed and distributed to the table? There has been no field of academic enquiries to answer this question systematically. Until 1960's the agriculture and the food were placed side by side where produce harvested at farms had been usually delivered home without processing and cooked at home kitchens. But the distance between them has been expanded to the extent our dietary life cannot exist without functioning of a variety of actors involved in food processing and distribution. Now our table is full of processed food and cooked meals or we can enjoy dining out and fast food. For both producers and consumers the processes in-between are seen as black boxes.

The Food System Approach was developed in order to investigate into such black boxes and make the holistic view of the food chain. Prof. Masao Takahashi, Nihon University, proposed to initiate this approach in 1994. The Food System Research Association was set up by academics in the fields of agricultural economics, food economics/engineering, commerce/marketing, nutrition/health studies and practitioners in the related industries in 1996.

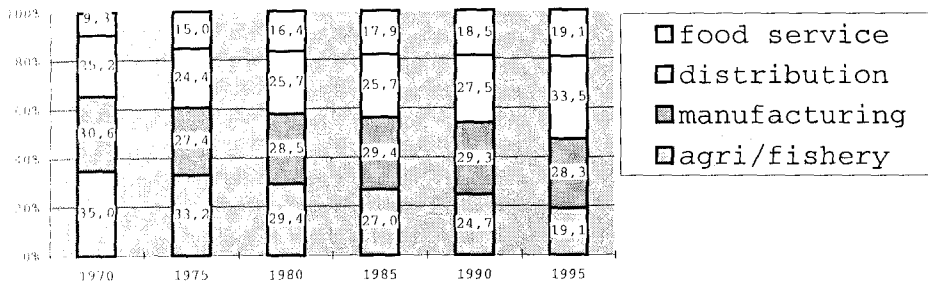
The Food System is defined as a concept to grasp all the processes from food production to consumption as a comprehensive system, including economic actors' behavior and interaction among them (Hiromi Tokoyama, 1999). Takahashi used similes and metaphors on the involved actors in explaining his approach; farmers (upstream), food manufacturers and wholesalers (midstream), food retailers and food service providers (downstream), consumers and garbage recyclers/incinerators (lake). He insists to take a holistic view from objective standpoint, not prioritizing any specific actor. It is not one-sided downstream but we can sail upstream if we take information flow (i.e. Quick Response, Efficient Consumer Response etc.) and recycling (composts brought back to organic farms etc.) into consideration. This approach also involves external factors such as regulations and technologies affecting the system. In view of the recent food scare on BSE and increased concerns on labeling, fodders manufacturers and printing industry might be included as actors.

### **Outline of Food System**

The outline of Food System in Japan can be shown both in monetary and employment terms. The total expenditure on food amounted to ¥80.4 trillion in 1995 according to the inter-industry tables. This figure accounts for 17% of the GDP. Figure 1 shows how this amount was distributed to the industries; agriculture/fishery, food manufacturing, food distribution and food services. In other word it shows how much of values were added in each stage to the raw materials produced by the primary industry. In 1995, the proportion belonging to agriculture/fishery was only 19.1% including imported food while the forward stages earned 80.9%.

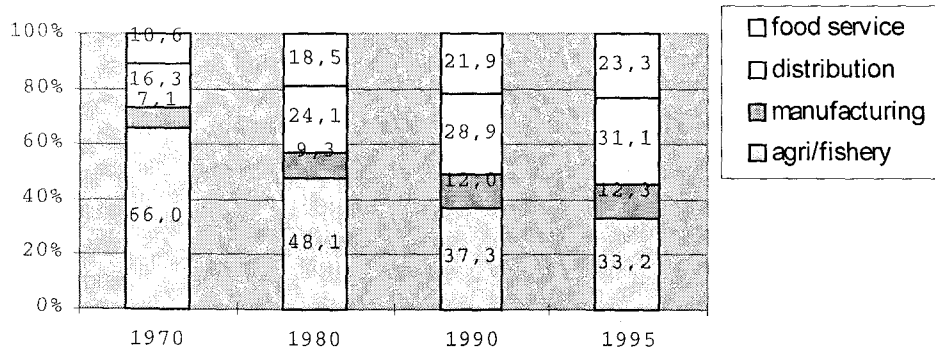


**Figure 1. Composition of Food Expenditure by Actors**

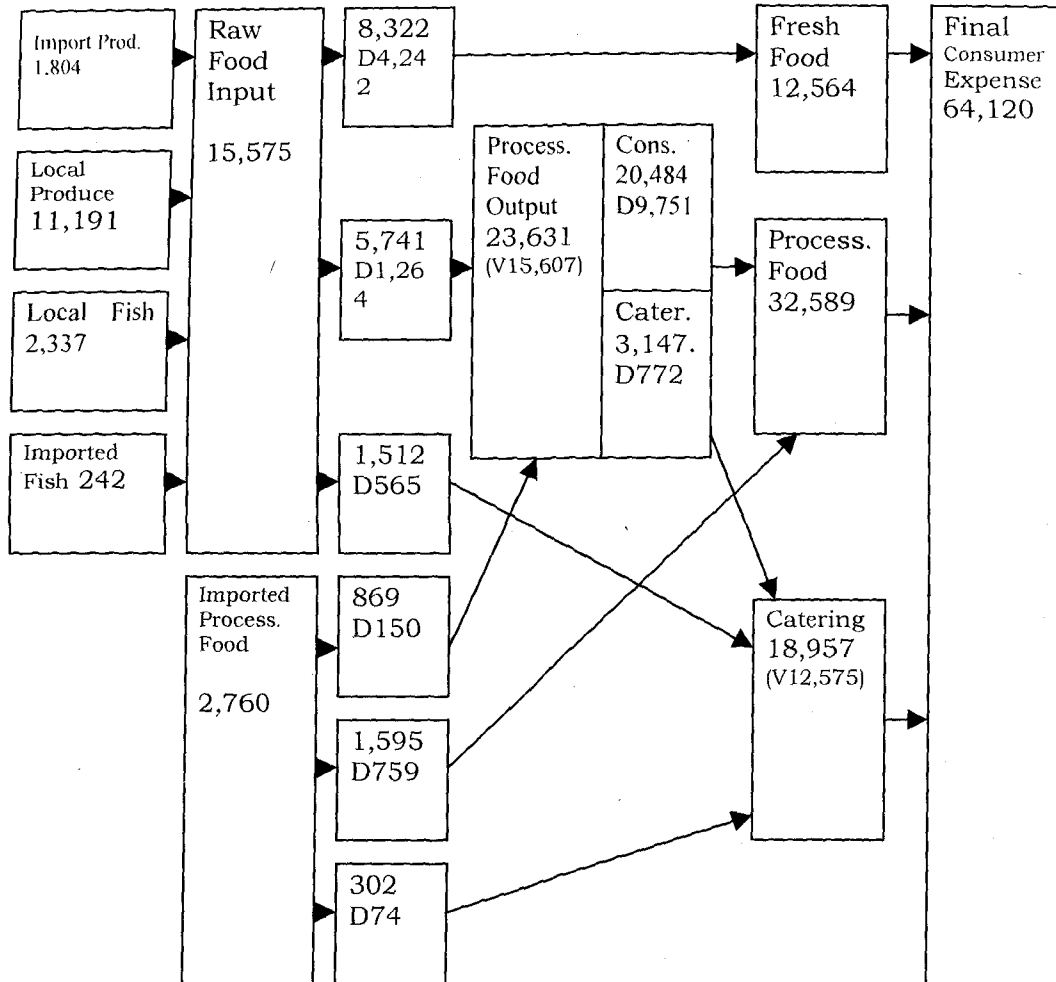


The declining share of the primary industry can be seen from the employment term as well. Figure 2 shows the proportion of workforce in the primary industry dropped from two thirds to one third while the second and third industries increased their share. Figure 3 indicates the flow chart how the values were added in each stage of Food System from the inter-industry analysis. It shows all the distribution costs accounted for 27.4% of final consumer expenditures while the added values for processing and cooking amounted to 44%.

**Figure 2. Composition of Employees by Actors**



**Figure 3. Flow Chart of Food System in 1990 (\billion)**



D: Distribution Costs, V: Value Added

Source: Annual Statistics on Food Industry

All these statistics imply the Food System is being deepened in that food is delivered to consumers through multiple echelons of industries, each of which has made substantial growth. Accordingly the mode of final consumption has shifted from fresh food to processed food and ready meals, accounting for 20%, 50.5% and 29.5% respectively. Such evolution has been led by the extended division of labor on food. First, the self-sufficient agriculture was supplemented by food distribution businesses who bridged separated producers and consumers. The emergence of processed food opened the door for further evolution, diversifying the product categories and enabling longer preservation and distant transportation. And food services grew to respond to the need of outsourcing cooking housework.

Thus, the evolution of Food System brought the multiplication of channels and competition among them, which provided consumers with expanded choice in terms of food items and buying channels.

At the same time, the widened distance between farms and tables generated some negative byproducts. Producers have lost direct feedback from consumers by concentrating on the high yield products, without knowing how they were accepted. They might not care about consumer health, often using a large amount of chemical inputs. Consumers have lost the knowledge on how the products were grown, processed and distributed. They were handicapped by asymmetric information in terms of quantity and comprehension. They cannot know the contents of products, which were processed in highly sophisticated technology. Even they might lose the cooking know-how handed down over generations or judgment on food deterioration by their own nose and tongue, too much relying on 'Best if used by' labeling.

### **Performance of Food System**

Thus, the evolution of Food System has both positive and negative aspects. How we can evaluate the Food System? There are some criteria against which the performance is measured. The contribution to the enriched dietary life of consumers would be the ultimate goal, but the other criteria would include the higher productivity of industries, and the food safety and the environmental conservation. The Food System approach seeks to grasp the food chain from consumer's viewpoints, rather than supply side approach of agronomics. So it involves consumer sovereignty vision. We have to see if consumer needs are feed backed from downstream to upstream and rightly responded, thereby consumer satisfaction is enhanced. Generally speaking, consumers enjoy the choice of diversified food both in product assortments (fresh/processed/frozen food, delicatessen etc.) and eating opportunities (fast food and slow food, home cooking and dining out etc). But consumer needs are not formed completely independent; they are often capricious or influenced by what the system itself provides. Consumer judgment might be even misled. Recently consumers were shocked by news revealing a number of fraudulent labeling of meat both in origin and feeding methods. These events badly hurt the credibility of product information on labeling and consumer's distrust to meat packers was culminated. The deficiency of Food System in securing the honest labeling was revealed.

On the other hand, the Food System has achieved higher productivity as a whole; during a quarter of a century from 1970 to 1995, the output of the final food products or the consumer expenditure of food has grown by 82% in real term (adjusted by CPI) while employment has shrunk by 22%. All the industries raised productivity but to the varied extents; the labor productivity of primary industry

remained one fourth of the second industry. The primary industry could not enhance its scale of operation nor competitiveness against foreign counterparts in spite of mechanization while the second and third industries made the major innovations, introducing new products and formats.

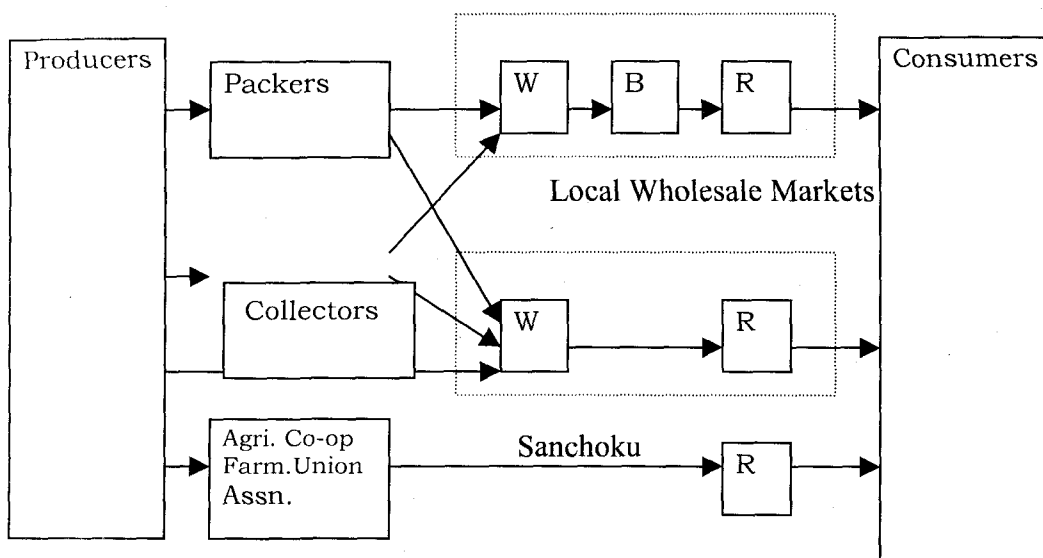
As far as the food safety and the environmental conservation are concerned, it was demonstrated the Food System had serious deficiency; it could not prevent BSE, FMD and a variety of food poisoning. Now the urgent necessity to establish a system ensuring traceability in every stage of food chain is widely accepted to regain consumer confidence, but without doubt its full enforcement involves high costs and time. The safety of GMOs for human bodies and environment has been a subject of hot debates. But the incidents of mingling of not-authorized GM food showed the existence of numerous loopholes. Again who will undertake the IP handling and bear its costs requires a systematic approach. In addition, we have just started recognizing the huge economic losses generated in processing, storing, transportation, cooking and damping of food and its impact on environment. The loss rates of food at home and at food services amounted to 8% and 5% respectively, according to MAFF survey in 2000. In this field the Food System approach is expected to play the vital role.

### **Food System of Vegetables; Structure and Change**

I shall apply the Food System approach to vegetables: partly it can help international comparison as it has not been so heavily regulated by the state, partly it is a field where both agricultural and consumer co-ops have been playing important roles in its renovation.

The traditional food system of vegetables had been characterized by the structure with a large number of small-scale producers/greengrocers on one hand and the concentration to the large-scale wholesale markets on the other hand. The farmers had produced a variety of vegetables at the small farm in the suburbs and marketed them through marketing co-ops. Most of vegetables had been sold by greengrocers both in the cities and villages. Both ends were connected by wholesale markets located in rural and urban cities. The brought in produce had been auctioned in the wholesale markets and distributed to retailers by brokers. Figure 4 shows the traditional distribution channels of vegetables.

**Figure 4. Traditional Distribution Channel of Vegetables**  
Major Wholesale Markets



W: Wholesalers, B: Brokers, R: Retailers

Under the Agriculture Basic Law of 1962 seeking to achieve higher productivity in parallel with rapid economic expansion, the government made substantial investment in the infrastructure for selective expansion of vegetable production to encourage the formation of large-scale growing areas of specialized items, mainly targeted to the wholesale markets. As a result, a number of vegetable growing areas were created in many parts of the country. Higher yield per ha largely contributed to higher output in 1960's and 70's. In these areas emerged large-scale farmers specialized in vegetable cultivation on the year-round basis. The marketing groups for each item were formed by specialized farmers within agricultural co-ops, aiming at reducing costs, realizing the favorable prices, thus maximizing net incomes. These groups formulated plans for production/marketing, organized training for improving cultivation skills, consulted with wholesale markets and served as main collectors with related functions of inspecting, sorting, packaging, transporting and so on. They undertook joint buying of agricultural inputs (seeds, fertilizers, chemicals, packaging materials etc.) and ran pick up/sorting facilities. Their marketing volume reached ca. 6.5 million tons p.a., which is estimated to occupy 45% of all marketed vegetables.

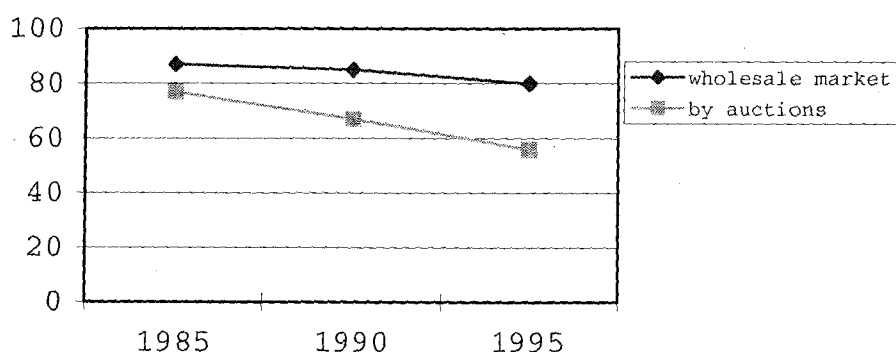
However, aging farming population and increasing side-business farms have weakened the production capacity. The numbers of vegetable growers decreased by 20.4% during 1990-1995. Especially smaller farms with less than 1 ha

decreased by 22.3% while larger farms with more than 2 ha increased by 10.1% (See Table 1). But small farms still occupied 86.6% in 1995. The proportion of 65+ of growers increased from 21.1% to 28.5% in the same period. It is notable a large part of production depends on the aged and female farmers. Although entrepreneurial farmers cultivating dozens of ha by leasing land and hiring labor emerged, they could not offset the decreasing subsistent family farms and often tended to compete with agricultural co-ops by making direct marketing/contractual production tying up with major food manufacturers and restaurant chains.

Table 1. Number of vegetable growers and its proportion

□	less than 1ha	1 to 2 ha	2ha and more	total
1990	537,747	45,318	23,155	606,220
1995	417,644	39,160	25,486	482,290
90/95	0.777	0.864	1.101	0.796
1990	88.7%	7.5%	3.8%	100.0%
1995	86.6%	8.1%	5.3%	100.0%

Figure 5. Vegetable Transaction thru Wholesale Markets



Since 1980's, drastic changes have taken place in the distribution channels of vegetables; wholesale markets based on auctions reduced their share while emerging supermarkets and food service providers started to exercise a bargaining power over packaging and pricing. The transaction method shifted even faster from open auctions to bilateral negotiations. (See Figure 5) The large-scale retailers required procuring a large quantity of vegetables with stable quality at the lower price. Such needs could not be met by auctions where quantities and prices were inevitably subject to fluctuation. So, they chose the closed buying channels and transaction methods by which they can control the supply of vegetables. They used brokers as their buying agents who negotiated prices and other terms with the

wholesalers who were commissioned to act as selling agents for producers. The food service providers and food manufacturers also required specified or organically grown vegetables, and preferred to fix the quality/standards, quantities and prices in the long-term. Such vegetables could not be easily handled by the wholesale markets. So the closed distribution channels were created between farmers/agricultural co-ops and users, bypassing the wholesale markets. Some trading firms such as Mitsubishi Corp. and Dole Food Co. are promoting the vertical integration, organizing farmers for contractual cultivation and supplying vegetables to the large-scale buyers. Their trading pattern is based on the prefixed price and stable collection of produce.

In the latter half of 1990's the Japanese market was challenged by rapidly increasing imported vegetables from China and other neighboring countries. For instance, the importation volume of leek jumped by 25 times over 5 years while the income of the Japanese growers dropped by 30%. This happened partly because of strong yen, but more important factor was the product development and importation by Japanese firms who made the contractual cultivation of vegetables introducing seeds and quality control aiming at lower price. Japan introduced a temporary safeguard measures against China for leek, Shiitake mushroom and rush (Tatami mat) based on WTO Agreement in 2001 but finally gave up the formal enforcement facing a strong retaliatory duties placed on Japanese cars and electronic devises. So, the problem remained unsolved and will be spread to other items.

### **Agricultural Co-op's Shift to Direct Marketing**

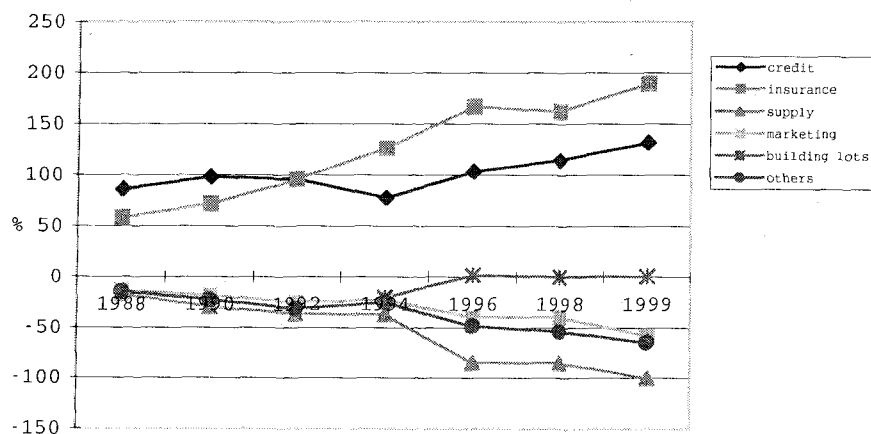
Facing such challenges, the agricultural co-ops had to reconsider their marketing strategy. Traditionally they had been working as collectors/packers of vegetables, consigning sales of produce to the wholesale markets which found buyers based on auctions. It was intended to cut off the buying power of the large-scale buyers. But now they are diversifying the marketing channels; while the wholesale markets still remains the major channel for the time being, the direct transaction with buyers is increasing. To do so, they have to make negotiation with buyers, drive sales promotion, conduct the related functions such as consumer packaging, processing and transportation, take risks and so on. They are also involved in promoting their own brands or supplying private labels to supermarket chains.

At the same time agricultural co-ops had entered in the ongoing functions of processing, whole selling and retailing. The processing plants for pickles, cans, juice and so on were set up at local, regional and national levels to add values to the raw materials. They are mostly run by subsidiary companies of agricultural co-ops, but now some workers co-ops are being set up by farmers' wives to add values and create employment by processing the local specialties and selling them at farmer's markets.

The National Federation of Agricultural Co-ops (Zenno) set up 3 Fresh Food Centers to supply produce directly to consumer co-ops and supermarket chains in the large metropolitan areas (Tokyo and Osaka). These Centers are the major channels to cater to the large-scale buyers, taking over the function of wholesale markets.

The retail shops were also built in the rural area to supply agricultural input and daily necessities including petrol. Originally they were franchised as A Co-op chain, but recently transformed as a joint stock company by Zenno to improve their profitability. Now, A Co-op chain has 1,371 shops, more than half of which are running in red. There has been a structural problem of multi-purpose agricultural co-ops; the deficits of supply and marketing divisions have been offset by the profits earned by banking and insurance divisions. This gap has not been shrunk, even expanded in 90's (See Figure 6). It is often argued the loss making operations should be either abandoned or restructured as subsidiary companies. In fact, the number of subsidiary companies in which agricultural co-ops owned more than 50% of shares increased since 1995, and reached to 497 in 1999. Most of them deal with processing, marketing and retailing.

**Figure 6. Expanded Gap in Net Profit Contribution in Agricultural Co-ops**



Against such background I'd like to introduce one of the success stories. Kanra Tomioka Agricultural Co-op is located ca.100 kilometers northwest of Tokyo, in the typical under populated area specialized in cultivation of Konnyaku potatoes and silkworm raising, both of which had lost foreign competition decades ago. In the last decade the agricultural production has shrunk by \ 7 billion, 2,500 farmers moved out of agriculture and nearly 1,000 ha of farmland were abandoned. Thus,



the agriculture was in the brink of collapse. The mountainous topography and the aging population made it difficult to build large-scale growing areas.

After trial and error, Co-op decided to diversify range of products; shifting from monoculture to relaying production of a variety of vegetables all year round taking geographical advantages of vertically stretching land (150 to 840 meters above sea level). To this end Co-op strengthened the farm guidance to help farmer's production by proposing the farming patterns based on database on individual farmers and giving a wide range of technical supports through its agriculturists. This function combined with other functions facilitated the planned production and sales; farmers made reservation of planted areas while Co-op supplied necessary inputs (seeds, fertilizers etc.) and assisted in marketing the products. Co-op also promoted 'morning harvested vegetables' which were picked and packed at dawn, refrigerated and transported to shops in Tokyo in early morning so that they were displayed on shelves before store opening time. These vegetables became a strong attraction in those shops, as consumer would pay the higher price for the freshest.

This Co-op diversified marketing channels to make full use of local recourses and ensure farmers a higher net income; i.e. farmers markets, shops in shop, comprehensive contractual transaction and ordinary wholesale markets. Firstly, farmers markets are located in the operating rural area, targeting mainly local residents and tourists. They depend on newcomers (farmer's wives, U-turns etc.) who can grow small quantity, often assisted by support staff. So they serve as training centers for those who enter in agriculture with a small start-up capital. Secondly, the shops in shop are special corners located in the department stores/supermarkets in the Tokyo metropolitan area, for which Co-op pays a fixed rate of sales as commission. Retailers sell the vegetables while producers fix selling price. Now there are 20 shops in shop. It was introduced as a showcase in large cities to grasp consumer trends. This type of operation is borne by female and aged farmers whose names are displayed on the produce. Thirdly, the comprehensive contractual transaction has been developed as the major channel of direct marketing, accounting for 70% of total sales. The Co-op commits itself to the stable supply of vegetables to seven supermarket chains and consumer co-ops throughout the year, and collaborates to develop retailers' own brands. It intends to develop the long-term partnership with retailers based on mutual trust, rather than pursuing the short-term gains through the fluctuating price in the market. This type of operation is borne by full-time farmers. Finally, the wholesale market is a channel for the professional large-scale farmers with a high production capacity. This channel is also used to balance supply and demand. Thus the Co-op has playing the pivotal role in coordinating supply, marketing and farm guidance and providing multi-channels to meet the diverse capacity and requirement of producers on the basis of equity, rather than equality.

### **Consumer Co-op's Sanchoku (Direct Transaction with farmers)**

Consumer co-ops have occupied a unique position in the Food System; they are both consumer organizations and retailers, but even approach to the manufacturing function through developing own brand products. They have also played a pioneering role in developing new channels for food distribution; joint buying through Han groups. Now they are running several channels; store operation, joint buying, direct home delivery and e-commerce. In addition, they have a self-enlightening mechanism as democratically organized consumers; consumers learn various issues on food safety and express their views, which in turn give the social impact to establish the better food system. In fact their massive campaigns for strengthening food safety administration largely contributed to change the public opinions and the government policy on this problem.

But the most notable contribution to the Food System is made by Sanchoku, which literally means a direct transaction between farmers and consumers. In 1970's consumers started Sanchoku since they were not satisfied with the existing channels of supplying produce; they could not see who produces, how produce were grown/processed and so on. The background was the growing concerns to food safety and the transforming distribution system. The modernization of agriculture and food processing resulted in the enlarged distance between consumers and producers and brought the excessive use of chemicals (pesticides, fertilizers and food/fodder additives) in the process of production, manufacturing and distribution. In addition, the wholesale markets became too centralized, often hampering rational distribution of local products. Their commercialized behavior rejected non-standardized vegetables. So various types of out-of-market distribution emerged in this period. Under such circumstances, consumers formed the buying clubs to buy directly from farmers with mixed objectives; to secure food safety, to restore the direct link with farmers, to form new production-distribution system, to promote local production and consumption, to reduce the distribution costs by simplifying complex system and so on. They concluded contracts on the terms of production, including use of chemicals, method of cultivation and so on. As such, consumers had taken initiatives and the most active groups have grown to consumer co-ops while farmers committed to Sanchoku had to often fight with agricultural co-ops, which had concentrated to consignment sales to the wholesale markets.

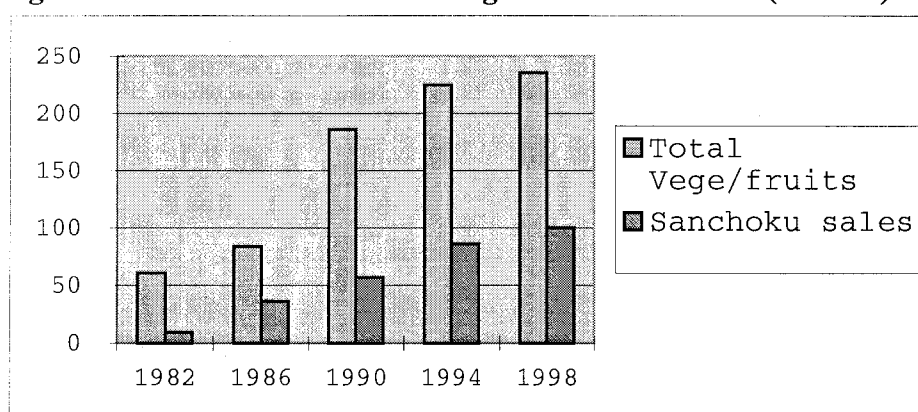
The driving force of Sanchoku was primarily consumers who wished to restore agriculture supplying the safer products. To this end, they have taken active parts in the development process and exchange programs with farmers. Consumer co-ops also sought to establish their own brand in the field of vegetables as a competitive edge against supermarket chains. In order to differentiate with the wholesale markets they tied up with producer groups who grow vegetables in

accordance with their specifications. These practices were studied and Kyoto Co-op formulated Sanchoku Principles in 1983;

- Who produces should be clear.
- How produce and animals are grown should be clear.
- There should be exchanges between consumers and producers.

Such principles were accepted by many consumer co-ops and Sanchoku practices had prevailed throughout the country. The JCCU has conducted the National Survey on Sanchoku every 4<sup>th</sup> year, which showed the percentage of Sanchoku products in the turnover of vegetables/fruits has increased from 30.6% in 1990 to 42.5% in 1998.

**Figure7: Growth of Sanchoku in Vegetables/Fruits Sales (\ billion)**



In conducting Sanchoku, consumer co-ops had to tackle with inherent problems; how to adjust quantities and how to decide prices. Unlike industrial products, the output of produce largely depends on weather. In case of overproduction, the producers find it difficult to sell the redundant vegetables grown based on the co-op's specification. In the opposite case the co-op cannot supply the required quantity. It is especially problematic in case of joint buying where sold-out situation is basically unacceptable although it often happens in store operation. To solve this problem, many consumer co-ops had multiplied the source of products to disperse risks. On the other hand, the producers' networks were created among farmers groups both at national and regional levels to upgrade the adjustment functions and make proposals to consumer co-ops to improve Sanchoku system. But the recent events demonstrated this problem was not wholly solved. Pricing is also problematic since there is a clear clash of interests between consumers and producers. So both parties had to fix prices based on the market price or compensation of production costs. In the latter case the price of Sanchoku products tends to be higher than the ordinary products, partly to cover the extra costs of production/distribution and partly to offset risks.

Sanchoku has evolved to be the mainstay of consumer co-op's produce business. In this process, many co-ops have developed the specification formats and the verification system, while they have made efforts to rationalize logistics to reduce costs and maintain freshness. The ecological consideration was also introduced through reduced use of chemicals in farming and recycling of garbage as composts. Taking these practices into account, the JCCU's Committee on Sanchoku Business worked out the Sanchoku Standards in 2001;

- Promote multifaceted member participation based on member's voices
- Clarify production sites, producers and production/distribution methods
- Establish verification system by keeping records and inspection
- Build partnership with producers based on independence and equality
- Promote sustainable production and environmentally friendly business

Now Sanchoku is facing new challenges. Looking at the success of co-operative Sanchoku, private supermarket chains also introduced it to attract consumers. They bought produce directly from farms but their product policies largely varied from one company to another; some had the differentiated criteria for safety, freshness and so on while others took just name. Even specialized Sanchoku operators emerged. They followed the co-op system in conducting business; collecting order sheets, delivering ordered produces to individual consumers or groups. So, co-ops had to renovate Sanchoku system.

More serious problem is a series of false labeling disclosed by consumer co-ops in February-March. Some meat packers including agricultural co-ops did betrayed consumers' trust by labeling the false information on the place of origin, feeding/growing methods and date of package. Zenno's subsidiary packer supplied CoopNet Federation with imported chickens grown with antibiotics instead of domestic medicine-free ones as specified by contracts. Tamagawa Agricultural Co-op had breached Sanchoku contract with Toto Consumer Co-op by mingling pork acquired from the other source for 11 years. These events happened partly because suppliers had to respond to the sharply increased demands for pork and chicken as a result of the outbreak of BSE, but there have been long-standing practices of false labeling and mingling of varied grades of meat in the meat packing industry. These events gave a negative impact on Sanchoku system and consumer co-ops as a whole. The involved consumer co-ops had suspended or cancelled the transaction and reimbursed the money to consumers. Such labeling scandals were widely covered by mass media and drove the government to strengthen the regulation on food labeling. No doubt producers/packers are to be blamed for dishonest conducts. At the same time it was shown the problem of matching demand and supply has not yet solved. It is necessary to make the clear rules of verification for securing honest labeling and adjustments for solving shortage of supply problems.

## **Conclusion**

As seen, the Food System is neither static nor complete, rather it always involves dynamic and evolving processes. The globalized economy and the breakthrough in information/biological technologies have accelerated the speed of change in the Food System. Since co-operatives are playing various functions as producers, manufacturers, wholesalers, retailers, consumers and recyclers, they have special responsibility to promote food security, food safety and ecology conservation. To this end co-ops have to demonstrate their capacity as integrating agents and take initiatives to establish the better Food System. The Food System Approach has to help them to identify the problems/bottlenecks and propose the solutions.

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## **CO-OP STRATEGY AND CO-OP PERSONALITY: AN ATTEMPT TO DEVELOP A THEORY BASED ON ITS PERSONALITY**

**Michel Lafleur**

### **Introduction**

The center of my research problematic is that of the development, the improvement of the conditions of life of all by a sensible use of our rare resources. The general problematic begins with the report in the effect that the application of the current entrepreneurial logic give opposite results to this sensible objective of a optimal use of our rare resources. From this report, organization which we associated to the concept of sustainable development propose entrepreneuriales solutions to take up the challenge of development. We saw in previous works how these organization, including cooperatives, put up in the front a vision and policies traced on the model of the sustainable development.

This general problematic is translated by a specific problematic of strategy suited for the cooperative by basing itself on its unique personality. In link with its need to fit into a dynamics of competitive market, the cooperative possesses unique elements which no other type o businesses can, in theory, take advantage of. My research question is read as follows: *"How the unique cooperative principles can be integrated into the strategic management of the cooperative and become elements of value creation perceived and valued by the citizen / consumer?"*

To take up the challenge of this frame of strategic analysis, we positioned ourselves in a constructivist paradigm, with a exploratory type of question, we adopted a grounded theory methodological approach for our analysis and we selected a case study as our strategy of investigation. For the data collection techniques, we are using interviews, semi-structured interview, observation, participative observation, focus-groups and documentary analysis.

### ***Cooperative and strategy : lack of models***

Mastering the strategy is the central task of the work of the administrator. « One of the most important tasks which is devolved to the manager consists of the determination of the strategy of his or her organization – or at least in the supervision of the processes by which other persons and himself elaborate a strategy.» For the researcher, any study on strategy should allow him or her to explain the success of a organization. The result of its researches will have to

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<sup>1</sup> MINTZBERG, Henry, *The management: journey in the center of organizations*, Publishing(Editions) of organization, on 1999, page 47

allow the researcher to propose a modelisation of the various elements allowing the decision-taking leading a organization towards success.

Bathing in its debuts in a predictable environment and in a context of relatively low competition of the 50s, the strategy was synonym of internal process of budgeting and financial control of the organization. During the 60s and 70s, with the arrival of a wilder competition, the concept of strategy take a marketing perspective to make the connection between the organization and the needs of its market. With the turbulence of the 80s, the way we looked at strategy was then completely modify due to a less previsibility of the external environment. The first models of strategic analysis are proposed, including the matrix of the strengths-weaknesses-opportunities-threats, coupling external and internal environment. At the same time, generic strategies are developed, notably by *consulting group Boston*. The researchers also state problems between the structure of the organization and its hierarchical levels in strategic decision-making. Finally, with a greater competition, a less and less predictable environment and the complexity of the new realities linked to the globalization bring the concept of strategic management, where the manager has to think and act at the same time. We see more the manager like the captain of a ship who, in front of an agitated sea, has, in the same moment, to analyze the currents, the winds and the waves, extrapolate the force and the direction while deciding on the ideal route to follow. No time to call a two days meeting to decide on the direction to be taken, the storm is raging.

If the strategy evolved with the changeable realities of companies, few researchers bent over the different realities according to the types of organizations and particularly according to the realities of the cooperative. Most researchers who studied strategy and cooperatives tried, from the existing theories, to put by "force" the cooperative in the models of strategic economic planning developed for the traditional organization, to estimate the forces and the weaknesses of the cooperative personality in relation with the existing models.

From existing literature, few studies on the strategy tried, from the cooperative differences, to propose framework, methods or tools of analysis adapted to the reality of cooperatives. For the manager of cooperative, tools at his or her disposal never reflected completely the reality of a collective organization turned to the maximisation of the relation of use. Many manager of cooperative are asking for ways to really put the cooperative difference into their strategy in a pro-active way.

The present work has for object a first proposition of tools and strategic method appropriate for the cooperative. The point of view at the base of this work is to take the cooperative particularities as the central element of the strategic analysis and its role on value creation in a entrepreneurial and développemental dynamics.

### **Approaches for the strategic analysis**

In a general way, two general ideas appear from researches in strategy. A first vision states a more formal strategic method based on an detailed analysis of the sector and on an obtaining a durable competitive advantage by a series of deliberated actions. Porter insists on the importance of this analysis, without rejecting however formally the more emergent methods, but underlines that even if the administrator uses such a method, this one must be based all the same on a rigorous analysis in term of competition, sustainable advantage and value creation that must lead companies towards the choice between three generic strategies: advantage based on overall cost leadership, advantage based on differentiation or advantage based on focus. He underlines that in spite of the importance of the training schools or the core competencies point of view, those only give positive results if they proceeded by a rigorous analysis of the market. According to him, the organizations which had success in this period of high turbulence and uncertainty had a formal strategy that they followed. This first block is of positivist inspiration, has for premise a very rational internal process and one faith in a certain previsibility of the external environment.

Another vision, than the researches of Mintzberg summarize, sees the strategy and the management as not being only a linear, thoughtful, formal and structured process. The work of the administrator cannot be resumed at the traditional PODC and to elaborated strategic plans elaborated in closed meeting by some experts of the question. The winning strategies would rather be shaped by the administrator by touching the material, by multiple daily decisions, by appealing both to his or her tacit knowledge and to its "got feeling" that in its explicit models depending on the situation. The image of the potter summarizes better the work in strategy than the solitary expert behind its computer. We shift then from a vision of strategic economic planning to a vision of strategic thought. The constructivist paradigm, evaluative approaches or interprétative are often used by the researchers of this block.

In the light of these two major currents, we note two variables to analyze them. On one hand, there is the question of what: on what elements one base themselves in strategy. At this point, there is a continuum where we find on one side researchers concentrating on what takes place in the external environment of the organization and tries to foresee the tendencies to adjust the organization. On the other side, there is a series of researchers who are concentrating themselves on the internal competencies of the organization and try to find the adequate market. Some will suggest to try to modify the external environment to pull in a maximum profit for the internal competencies of the organization.

On the other hand, there is the question of how: by which processes and who is participating in the development of the strategy. So, several researchers bend over



the internal factors of the development of the strategy. Of a side, they insist on a linear process appealing to experts and of the other one end, there is a process where a multitude of actors of various hierarchical levels of the organization participates in the form of collective and continuous learning in the development and in the implementation of the strategy.

Naturally, several researches are made between these variables. These currents and all the variables studied also are influence by the type of organization (multinational or small and medium size) as well as the sector (manufacturer, services, etc.). Finally, it is important not to put all the schools of thought in strategy in opposition. As underlines by Mintzberg, the understanding of the definition of the strategy itself need a plurality of definitions

### **Approaches in the construction of theory in strategy**

For Porter, the central question a theory in strategy must answer is: «*Why a organization have success or not*». In an article on the elaboration of a theory on the strategy, Porter proposes four basics elements necessary for the creation of theories in strategy. In the first place, there are two approaches in the conception of a theory; that is an approach by models, often mathematical, and frameworks. Secondly, to have a valid theory in strategy, it has to explain the chain of causality of the decisions and the strategic analyses leading to the success. Thirdly, the theory must also be able to explain the success of a firm no matter the time period. Finally, the theory must determine how this theorization can be tested empirically.

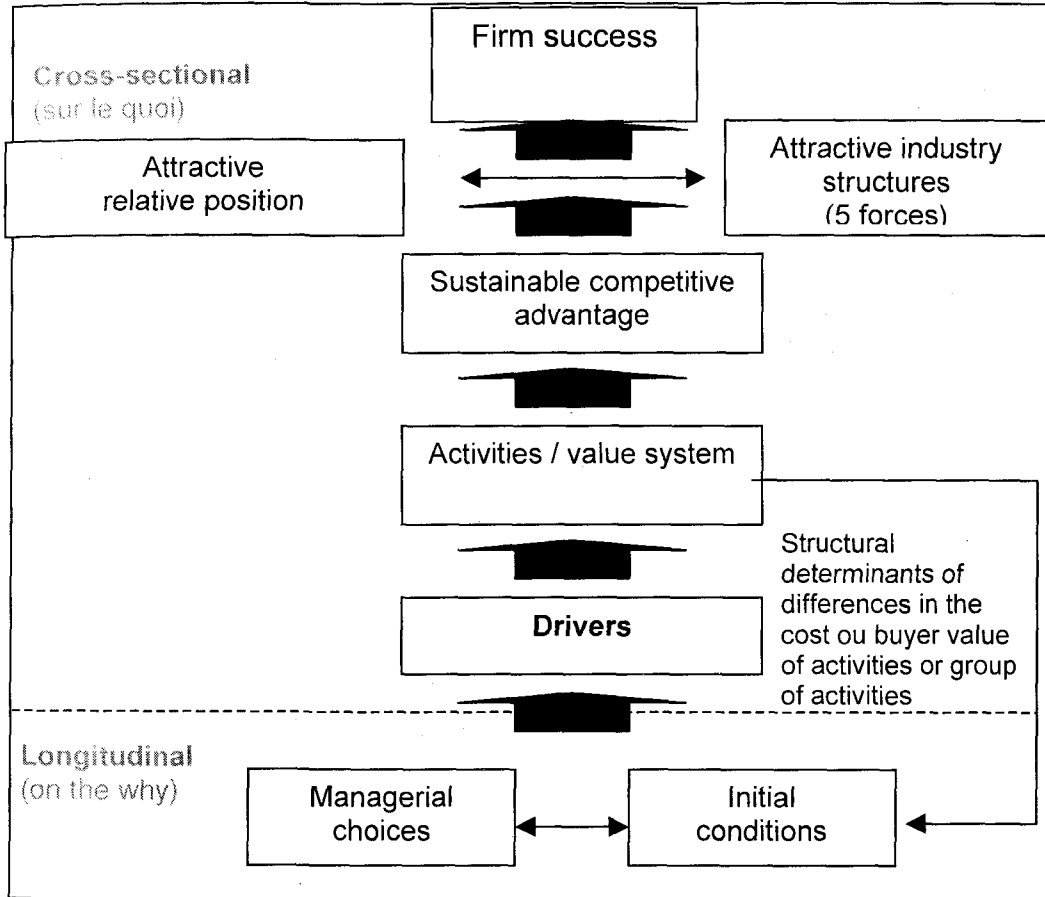
### ***Towards a theory of the strategy***<sup>2</sup>

To explain the competitive success of the firm, Porter advance that a theory of the strategy has to connect the environmental circumstances and the behavior of the firm to the results of the market. Porter proposes his own diagram:

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<sup>2</sup> PORTER, Michael E. *Towards a dynamic theory of strategy*, dans fundamental issues in strategy, in RUNELT, R. et al. *Fundamental issues in strategy*, Havard business school, 1994, pages 423 à 461

**Table 1 The determiners of the success in the different sectors.**



For Porter, it is very important to understand that the strategy is not a race to occupy a desirable position, but a problem more in nuances in which several positions can be chosen or create.

The contribution of these diagram is to have allowed to move further back farther in the chain of causality in what Porter calls the cross-sectional problem. What makes that certain industries and certain positions inside this one, are more attractive than the others? What makes that certain competitors are favored or disadvantaged? What specific activities and drivers determine the superior positions? By answering these questions, we have to confront the question of the causality.

However, there is also a longitudinal problem: why certain firms managed to obtain a favorable position with regard to drivers in the value chain ? Why certain companies manage to obtain advantages of costs by the advantage of scale? Why

some companies moved quickly or late and how it led to an advantage? To answer these questions, Porter proposes two answers:

- Initial conditions: companies have reputations, skills and activities in place as being a resultant of their history.
- Management choices: who are choices independent from their initial conditions. These management choices, which are made in a context of uncertainty with regard to future, define the concept of competition (position) of its configuration of activities, and its consequent investments in term of assets and know-how.

The explanation of the strategic choices can result from these two elements. The skills and the position of market which a firm possesses at the present time are the result of its past choices with regard to the way is configured the activities and on the consequent skills to be created or to be acquired. The fact of having good skills, knowledge etc. is not sufficient, they need to have the right ones. The companies which are successful are notably recognized to be capable of turning to good account their imagination to define a new position, by their capacity to find a new value on which to build its strategy no matter the position of departure they had at the beginning.

### **The strategic analysis of cooperatives**

For the researches on the strategy of cooperatives, the major current tries to adapt the concepts of the traditional organization to the cooperative formula (Côté, Spear, Tremblay, D'Amboise, Sauffroy, etc.). The external environment of the cooperative is seen as fixed and not modifiable, consistently, the strategies of adaptation proposed aim at the adaptation of the cooperative personality to the "imperatives" of the capitalist and global environment. The researches are inspired by a prescriptive approach and strongly influenced by the models of the positioning and planning schools.

On the other side, we find a series of prescriptive publications which, contrary to the first current, put the strategy emphasis on the co-operative doctrine as an intern fixed environment, and aim, in a way, at modifying the external environment. This current proposes a series of cooperative results which a management centered on the cooperative doctrine should bring. But the strategies to arrive at those results are not investigated.

In a general way, most researches on cooperatives pay their attention on an internal adaptation of the cooperative to face a non-cooperative external environment. This adaptation can concern the dynamics of activity reports and the membership relations or the activities relations of the cooperative dynamics to

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<sup>3</sup> GLADWIN, Thamoas N. *Plaidoyer en faveur d'un développement durable*, [http://www.lesechos.com/formations/strategie/articles/article\\_12\\_3.htm](http://www.lesechos.com/formations/strategie/articles/article_12_3.htm), 2000

explain its success. Few authors have, therefore, dedicated themselves recently to try to understand the success, past, present or future, of the cooperative from its cooperative particularities and how these could become elements of value creation perceived and valued by. It is the objective of our research. To be made, we targeted a review of literature of case to encircle better certain particular strategic elements of cooperatives and others similar organization. Afterward, different case studies has allows us to test and to improve our first modelization of strategic analysis based on the cooperative personality.

### ***New conceptions***

Like we have formulated in our problematic, there is, in our knowledge, no theory or model of strategy adapted to the cooperative based on his cooperative personality. In a basic analysis bridging the study of the external and internal environments, we developed a series of model stemming from the literature and from our case studies to propose a first model of cooperative strategy based on its distinctions.

### ***The analysis of the external environment: strategy and development***

In our analysis of the crisis of development both at the birth of the cooperative and today, the cooperative is a vehicle to increase the quality of life. There are many examples where the results of growth of traditional companies and development are contradictory. Furthermore, every person interested by the linkage between traditional companies and sustainable development is confronted with this not concordance between results of company and result of development. Consistently, we believe the researcher must open up the traditional owes widen vision of businesses and extend beyond the traditionally economic sphere of the research on the corporate management.

To answer this situation, our conception of the external environment of the cooperative strategy incorporate three concepts of analysis. We use the frame of the sustainable development proposed by Thomas Galwin<sup>5</sup>, the frame of local development of Paul Prévost<sup>7</sup>, and that of the traditional economic analysis of five forces of Michael Porter's economic view of businesses<sup>8</sup>. These elements of our abstract frame give to the strategic analysis a wider reach and contains all the elements of the development (economic, environmental, economic, local)

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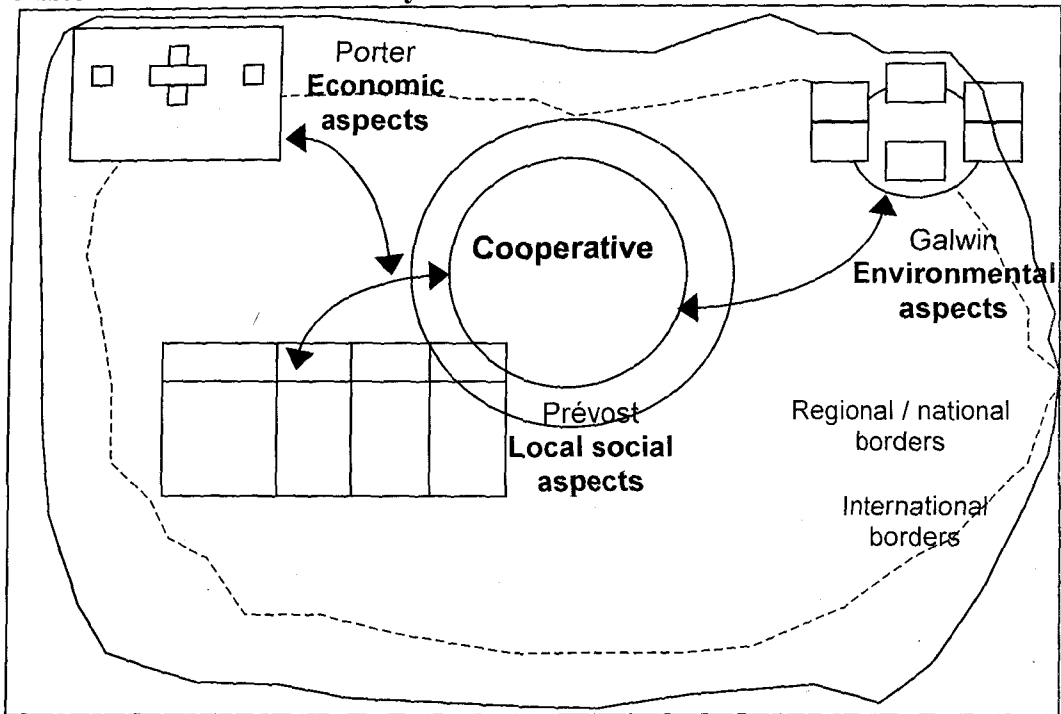
<sup>4</sup> GLADWIN, Thomas N. *Plaidoyer en faveur d'un développement durable*,  
[http://www.lesechos.com/formations/strategie/articles/article\\_12\\_3.htm](http://www.lesechos.com/formations/strategie/articles/article_12_3.htm), 2000

<sup>5</sup> PRÉVOST, Paul, *Les dimensions et processus du développement des collectivités locales*,  
IRECUS, IREC 01-05, Université de Sherbrooke, 2001

<sup>6</sup> PORTER, Michael, *L'avantage concurrentiel*, Dunod, Paris, 1999

necessities for a use of the cooperative challenges which we shall see in the analysis of the internal environment of the cooperative.

**Table 2 Elements for the analysis of the external environment**



Those elements for the analysis of the external environment of the cooperative, want to be has dynamic answer to its nature and to the development imperatives of the present time.

***Strategy and internal cooperative challenges***

In this first element of study of the external environment, we developed another model on the internal strategic study of the cooperative. In the center of this model, it finds the objective of value creation developed by Porter surrounded by the cooperative particularities, whom we have named cooperative challenges.

Considering the particularities of cooperatives management and the results of our work with the three “caisses populaires Desjardins” where we did our cases study, we proposed eight challenges unique to the cooperative formula which have an influence in term of its strategy.

- **Challenge of the participation (CP):** the structural dimension is different in a cooperative. By the principle "one member = one vote", by the constitution of a general assembly as the supreme decisional level, by the periodic election of the administrator, by the values of self-help, solidarity and personal and mutual responsibilities, the democratic powers and duties of the members of the cooperative are well established. Those particularities commands the challenge of a participate strategic process to insure a unique contribution of members to the cooperative.
- **Challenge of the sectorial business intercooperation (CSI):** from the structural point of view, the groupings of cooperatives, in union or in confederacy according to their sector, invert the traditional hierarchical structure and the traditional strategic vision of the strategic business units (SBU). It is the cooperatives at the base who are the owners of the head office, and not the opposite as to the traditional companies with SBU. With this inverted hierarchy, cooperatives are doing sectorial business intercooperation with the aim of controlling a new organization to offer themselves a series of services, improve their costs, realize economies of scale, etc.
- **Challenge of the investment and the capitalization (CIC):** by the cooperative principles of the limited payment on the invested capital, the inalienable reserve and the necessity of being a member-user to sit on the board of directors, the cooperative offer particular challenge for its choices of investment and capitalization. The investment and the capitalization is mainly in the hands of the members of the cooperative, restringing the potential sources for capital investment. Therefore, the cooperative is keeping the decision making on the relation of use and not on the relation of profit. This constrain cooperatives to draw its necessary capital for its starting up, for its development and for its capitalization mainly in the hand of the members straight from their assets and their shares of the financial surplus. By doing so, the cooperative is facing the challenge of paying well the investments (in money or by value of use) while maintaining an adequate internal investment for the development of the cooperative.
- **Challenge of the service/product (CSP):** cooperatives are created with the aim of answering a need or a service. The central challenge thus is for the cooperative, in a competitive and not cooperative environment, to offer a product or a service according to needs and requirements of the members and the future members to a competitive price; it is the origin of the cooperative. However, the product or the service of the cooperative goes beyond the traditional equation of quality/price. Even if this one remains an basic element, the cooperative has to exploit other elements of its performance in term of cooperative plusvalue (local development, education, democracy, "disciplinary prefect" of the market, etc.). The cooperative personality has to

generate a series of distinctive elements of the co-operative product or service so that the current and future member perceives a tangible and valued advantage there.

- **Challenge of the segmentation (CS):** the principle of the opened door sees to it that the cooperative, of consumers especially, cannot refuse the entry to anyone who wants to participate in the cooperative project. So, the cooperative must offer its products or services to all. Therefore, the cooperative often face not segmented market. Desjardins, for example, cannot decide to drop a part of his poorer members to only target his richest members or to search for members outside its natural community. So, the cooperative face this challenge to be able to answer the same basic need to a vast range of members who can ask for different ways to buy the product or the service from the same cooperative. As the cooperative still has no choice of a segment of precise market, it will have to be able of diversified its provision of a service or product to answer the requirements differentiated by her members.
- **Challenge of the value of use (CVU)** the dynamics of cooperatives management aims at maximizing the users value for a precise need of the cooperative members and not a maximal return on the investment of a shareholder in a vast range of branches of industry. The member invests for a maximization of its users value and not a financial return on his or her investment. The users value is usually relatively narrow and stable, from this point of view: it is connected to member's work, to member's consumption or to the member's production. So, to workers' cooperative, the members will not decide to delocalize their cooperative to take advantage of lower conditions somewhere else to improve their profit. A milk producers cooperative will not buy some less expensive milk coming from the South, and Desjardins cannot operate a caisse populaire outside its community with the simple objective of maximal profitability. The cooperative is thus, in a sense, "limited" and "captive" of the needs of its members. Consistently, the strategic analysis will rest not on a maximum profitability, but on a maximisation of the relation of the value of use. The economic planning and the strategic objectives are, consequently, very different from the traditional organization. The cooperative will thus try to develop by containing all the products and the services connected with a need, what would push cooperatives towards a vertical development to maximize its users value.
- **Challenge of the local development (CLD):** the first objective of a cooperative is to give better products and services to its members. But by realizing this objective, cooperatives individually and collectively also have to participate in a harmonious development of their community. In the same sense, the more its community is healthy, the more the cooperative has chances of being healthy too. Therefore, cooperatives are logically dedicated to the

development of their community because their members arise from it and because they have to live essentially on its relations with its community. The cooperative is thus "condemned" to have a local dynamics because it is the result expected from the work of cooperatives and because it is necessary so that the cooperative can insure, partially, its survival. This does not exclude an international dynamics, but the cooperative has invariably and at any time a local dynamics.

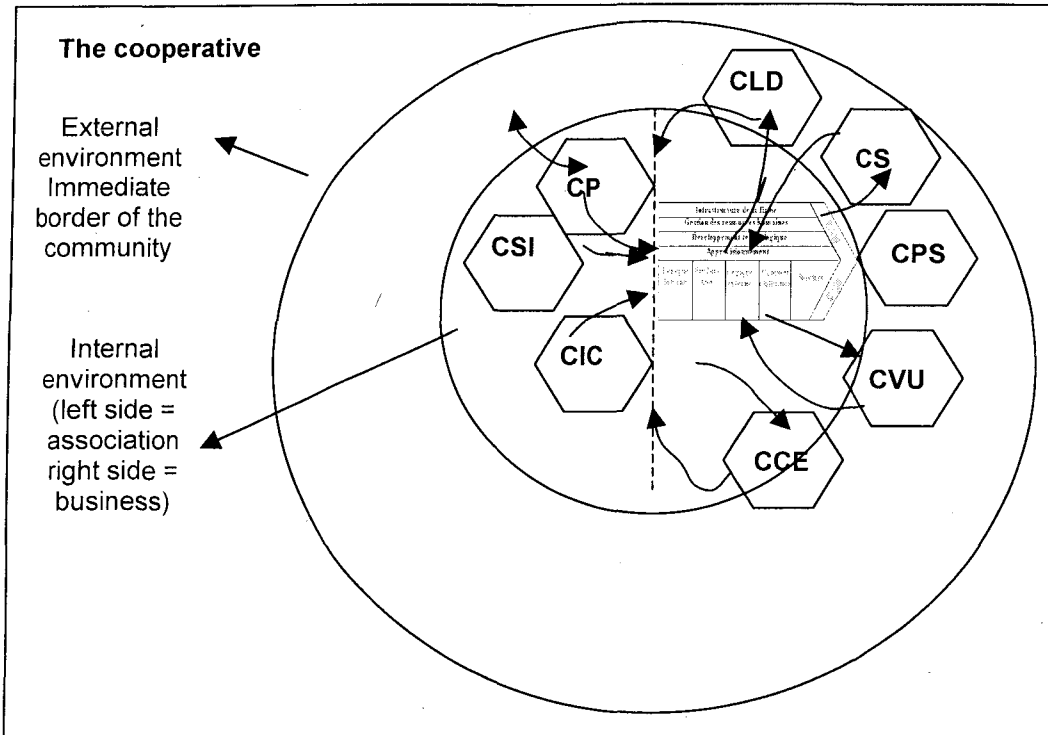
- **Challenge of the cooperative education (CCE):** soaking in an ocean of companies of market economy where the indication of success amounts in the return on investment, the cooperative which also has to perform at this level, but it also has to exploit its success in one wider perspective. Part of the cooperative plusvalue is in its democracy, its durability, its long rang objectives, etc. Therefore, cooperative inevitably has to make the education of its members and its community so that they will consider not only his its short term economic results, but also its wider results at the développemantal, democratic level, etc. This education has to be made so that all the different cooperative results becomes as many elements occurring positively in the decision of purchase of the consumers, workers or producers.

This first part of our reflection proposes eight challenges of strategic management which the cooperative particularities to be taken in account by the administrators and managers of cooperative. These challenges must be seen as a more practical transposition of the cooperative particularities in term of management input from the traditional particularities of the cooperative personality, as indicates it the table 2.

To better illustrate the strategic dynamics of the cooperative, we put Porter's value creation framework in the business part of the cooperative, and we associate our challenge of service/product. Our first three cooperative challenges are situated in the association part of the cooperative while the others challenges are situated in the immediate border of the cooperative.



**Table 3-Framework of strategic analysis for the management of the cooperative**



**Cooperative challenges and strategic results**

In our objective to understand the elements which lead to the success of a cooperative, this first strategic internal frame is not sufficient. Our case studies in three caisses populaires Desjardins allowed us to elaborate a table of analysis inspired by the vision of the result-based management. In theory, this table should allow to analyze better and to better place the strategic results from the point of view of the cooperative and from the point of view of the member. Every cooperative challenges must produce beneficial results on these two elements. So, to analyze his strategy from the cooperative differences, an administrator or manager could estimate the results of every challenge as follows:

**Table 4 Strategic results for every cooperative challenge**

<i>Challenge</i>	Results (effects) for the la cooperative	Results (effects) For the actual and futur member
<i>of participation (CF)</i>	Is closer to its members to serve them better; Benefit from the positive implication of the members; Obtains a greater development of customer loyalty of its members.	Feels listened to; Obtains very satisfactory products and feels responsible for its cooperative.
<i>of sectorial business interco-operation (CSI)</i>	Benefit from the force of the number to improve the performances with a vision of the base.	Have access to several products / services, to competitive price and according to its local particularities.
<i>of investment and capitalization (CIC)</i>	Give an added value in term of individual, collective discount and in term of capitalization (inalienable reserve) while assuring its autonomy and by keeping a local dynamic.	Sees its discount as an element of added value in its purchases; Is aware of the added value which brings his or her cooperative financially solid.
<i>of product/ service (CPS)</i>	Give a quality product / service to the members.	Perceives the product or the service of the cooperative as being the most competitive (price, service, added value).
<i>of segmentation (CS)</i>	Develop vertical strategies of development; Every type of members makes the cooperative financially sound.	Every member benefits from the contribution of the other members; Has access a range widened by products / services answering its needs.
<i>of the value of use (CVU)</i>	Offer a range of profitable product/service which covers all sector needs of its various segments of member.	Find a product adapted to its needs; Find all the range of products answering its needs.
<i>of local development (CLD)</i>	Participate to the progress of its community and progress with it.	Value the local projects of development; Make the link with its purchases for the cooperative and the increase of its local life quality.
<i>of cooperative education (CCE)</i>	Is different by the education and the promotion of the relevant cooperative differences	Perceives the value of its purchases to the cooperative in his/her community; Consider the cooperative added value in its decisions of purchase.

However, to understand indeed the success of the strategies of the cooperative, this table is not sufficient.

***Cooperative challenges, strategic results and strategic actions***

To understand the success of a cooperative, it is necessary to be able of going at the source of the strategic results. If the cooperative challenges and the strategic

results allow us to better seize the effects and the impacts of the decisions and the daily actions within the cooperative, they do not give us of information onto these actions and daily decisions. Further to the interviews, we elaborated another frame clarifying certain actions that the people we interviewed realized or suggested to make that we associated to our cooperative challenges and strategic results. We name these actions "strategic actions" which allow to reach the strategic results for the cooperative.

**Table 5 Strategic actions for every cooperative challenge**

<b>Challenge</b>	<b>Strategic actions f or the cooperative (caisse populaire in this case)</b>
<i>of participation (CF)</i>	The caisse presents several scenarios of discount to the AGA The caisse has formal canals of communication with its members The members of the CA and the employees are sensors of strategic information; The members of the CA come from every geographic sector The members of the CA are implied in the caisse The members of the CA are involved in the community
<i>of sectorial business interco-operation (CSI)</i>	The caisse possesses a vast range of products and services; The caisse possesses one or several local investment funds; The caisse has access to sector-based experts; The caisse is a part of a grouping of caisses to manage better its local investment fund and the associated risks
<i>of investment and capitalization (CIC)</i>	The caisse has the capacity to produce excesses The caisse was capable of give back surplus in the past (financial health) The caisse always reinvested its surplus to improve its capitalization ratio
<i>of product/ service (CPS)</i>	The caisse proposes a set of financial products The caisse possesses the employees well formed to propose good products adapted to the various segments of member.
<i>of segmentation (CS)</i>	The caisse makes an specialized offer for all their type of members; The caisse is capable, by these products, to development of customer loyalty of the members; The caisse as the physical place reflects a feeling of "being at home"; The caisse answers to the hesitation of someone of "to put all of their eggs in the same basket".
<i>of the value of use (CVU)</i>	The caisse possesses a staff formed like advisor The caisse integrates positively new technologies The caisse sees itself in the future as a cooperative of services specialized.
<i>of local development (CLD)</i>	The top management of the caisse is involved in its community; The members of the CA are involved in their community; The members of the CA and the employees are sensors of strategic information; The caisse offers products and manages its risks with partnerships with the other organisations / caisse.
<i>of cooperative education (CCE)</i>	The caisse makes a follow-up of sponsor The caisse transforms its coop plusvalue as center its added value

The analysis of our data also highlighted two types of elements which come to color the cooperative challenges. So, we add to our model two series of elements which influence all challenges.

#### **Environment elements (EM)**

- History of the cooperative
- Type of community: strong / weak membership; the economic activity, etc.
- Type of competition: strong, average, weak
- Type of member: individual or businesses

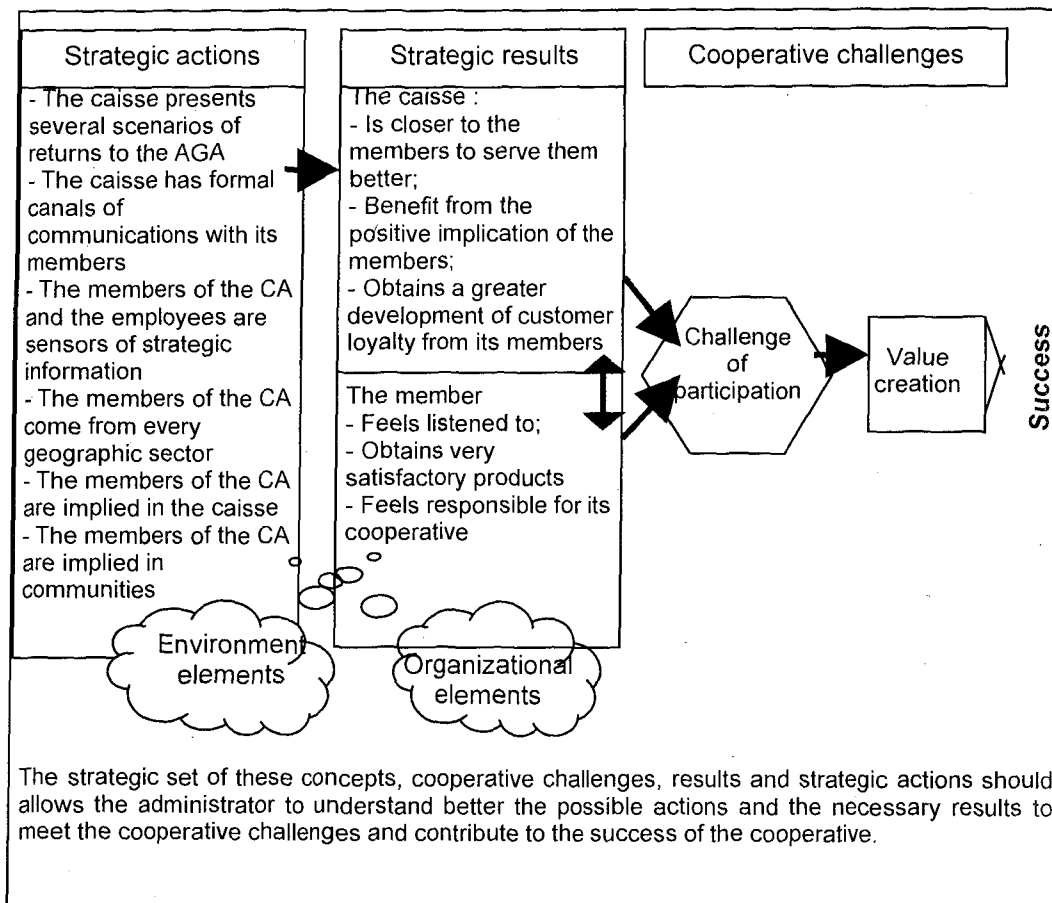
#### **Organizational elements (OE)**

- The strategic objectives of the movement vs the strategic objectives of the cooperative: need of complementarity and difference.
  - General public products
  - Specific products of local development
    - From the business plan of the movement to the business plan of the local cooperative; importance of the mission
    - The importance of the implication

For example, for the elements of the environment, a caisse which has a history strongly anchored in its community and/or which is within a community having a strong feeling of belonging to its environment and/or which works in a region where there is a prosperous economic activity, where the competition is weak and where the caisse receives so many members of individual type as corporate are elements which assure to the caisse an ease to meet the cooperative challenges.

The following table illustrates the progress, for the challenge of participation, between strategic actions, strategic results, cooperative challenge and value creation. All challenges can be viewed like the next table.

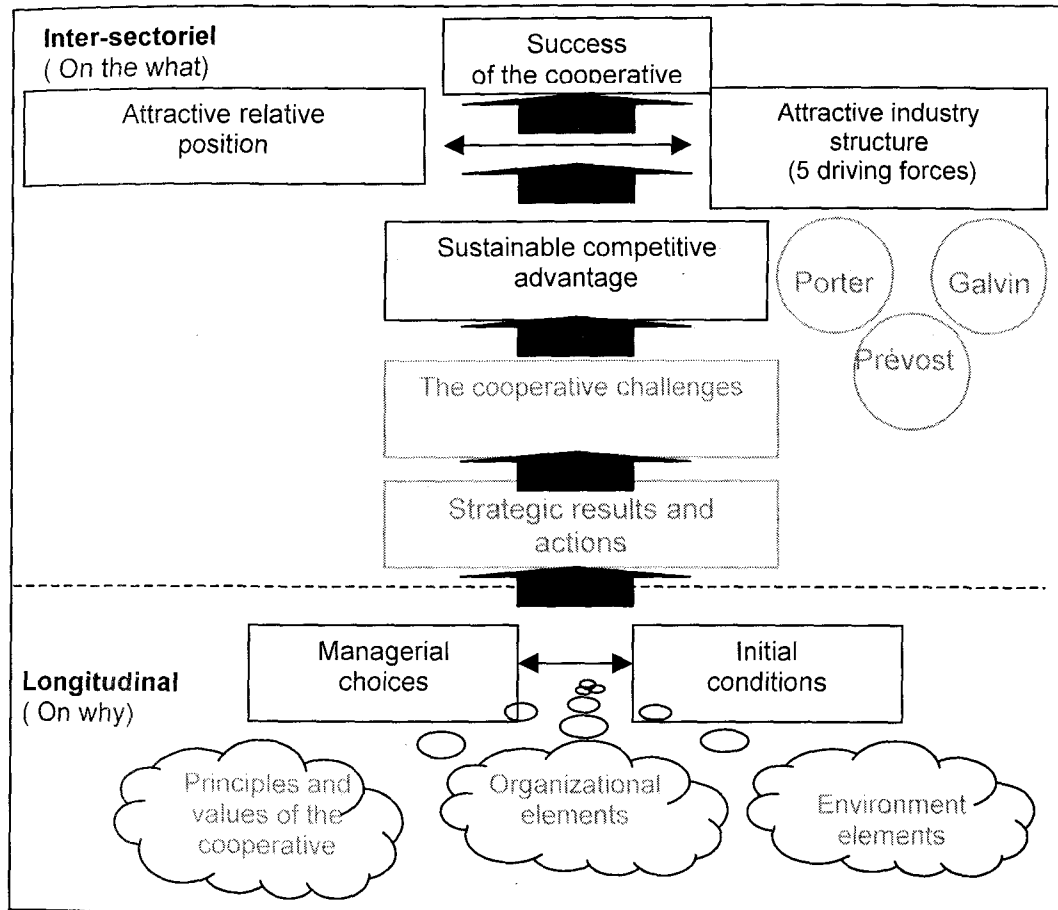
**Table 6 Illustration of the strategic dynamics for the challenge of the participation**



***Theory and strategy of the cooperative from their distinctive elements***

In link with the premises of the theorization advanced by Porter, the results of our case studies demonstrate that the concepts and tools developed are relevant to understand indeed the cooperative peculiarities under the magnifying glass of the strategy and that these turns out relevant to theorize, as illustrates it the following table:

**Table 7 The determiners of the success in the different sectors.**



### Conclusion

The objective of our work was to make a first proposition of tools as well as a strategic method appropriate for the cooperative. Our proposition thus offers a new reading of the cooperative particularities in term of cooperative challenges, results and actions. These first tools allow, on one hand, to the researchers to analyze the strategies of cooperatives according to their appropriate particularities, and on the other hand, can allow the actors of cooperatives to better view the range of their possible strategies think better and to decide.

In link with the propositions of Porter on the formulation of strategy, our tools answer the various criteria, the use of framework inter connected explaining the chain of causality of the decisions and the strategic analyses adapting itself to any time period to explain the success according to the cooperative personality. Finally, our framework will have to clarify how this theorization can be tested empirically.

Naturally, these elements and their links between them are a first proposition stemming from a method of theorization anchored from a number limited by case. Our results thus remain to be tested to acquire a greater scientific robustness. We thus concentrate our efforts in this objective.

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## SUCCESS FACTORS IN UK RETAIL COOPERATIVES

Roger Spear, Mike Aiken and Terry Newholm

### Introduction

The UK retail co-op sector has been marked by some interesting developments in the last 20 years. Firstly the Co-op Bank rethought and modernised its co-operative image, branding itself as an ethical bank (see Wilkinson, A and Balmer, J.M.T. (1996)). Secondly decades of decline, the largest retail society CWS, has stabilised its market share, invested in value based co-operative training of management, seen off a hostile bid to privatise it, and amalgamated with the other very large society to form the largest society in Europe. Thirdly led by Oxford, Swindon and Gloucester (a strong regional society) there has been a highly innovative orientation to membership and democracy (see Spear, 2000). Fourthly the government commissioned a high level report on the co-op sector, which has resulted in a substantial number of measures to strengthen the sector, including its leadership at national level. Thus the retail sector is currently in a better position, economically, democratically, ethically, and politically than it has been for many years. These significant features have not been universally adopted across the retail sector, and there is still considerable debate on ethical marketing, member benefits and democracy, as well as on economic/business strategies; but at least these debates are being held within strengthened and strengthening structures.

Measuring success is problematic (see for example Spear and Voets, 1995), and in all the cases reported on in this paper the researchers have taken self reported success as sufficient criteria for inclusion in the study. The book *In Search of Excellence* by Peters and Waterman was one the world-wide best-sellers of the eighties, and it still remains a landmark in literature about enterprise "success". In the book, the authors identified 62 American enterprises as being excellent, 36 of which were classified as 'excellent in every respect' (Peters and Waterman, 1982). The criteria for excellence were six measures of long-term superiority, three of which were measures of growth and long-term wealth creation and three were measures of return on capital and sales.

The excellent enterprises were distinguished by the following eight characteristic features:

1. A bias for action
2. Close to the customer

3. Autonomy and entrepreneurship
4. Productivity through people
5. Hands-on, value driven
6. Stick to the knitting
7. Simple form, lean staff
8. Simultaneous loose-tight properties.

Since the publication of 'In Search of Excellence' there have been several different, sometimes contradictory, types of criticism:

1. Questioning of the book's conceptual rigour and research methodology. Carroll (1983) stated his criticism of the research in the following remarks: "More disturbing than research based heavily on secondary sources, non-excellent companies, and unfortunate anecdotes are the unsupported generalisations that litter the chapter dealing with the eight attributes of excellent companies". In addition Lammers (1988) questioned the direction of causality: "Peters and Waterman see the culture of excellent company as the cause of its success, but in my opinion a case can also be made in defence of the thesis that the causality is the other way around: perhaps a strong, home-grown culture is not the cause, but rather the effect of the company's success".
2. The second type of criticism is based on the argument that subsequent research conducted in the same way as the authors of 'In Search of Excellence' produced different results. Two years after the publication of the book at least 14 of the excellent companies had lost their excellence (Business Week 1984). Furthermore a survey among successful British and Japanese companies competing in UK markets provided mixed support for the characteristics of excellent companies (Saunders and Wong 1985).
3. Thirdly it is argued that 'In Search of Excellence' did not differ significantly from other more established theories of management and organisation. Thus Lammers (1988) argued that: 'The 'excellent' type of organisation (as discovered by Peters and Waterman), ..., is quite similar to Mintzberg's 'missionary form', Ouchi's 'type J', and Touraine's 'representative' organisation, and can be seen as a subtype of Burns and Stalker's 'organic organisation'.

Perhaps a more fundamental critique is implied (and stated) in Mintzberg's approach. He developed the concept of the 'missionary type' of organisation, referred to above, as *one of several possible structures* ('configurations') for an organisation to cope with its situation. His theoretical contributions about the relation between the structure of an organisation and its effectiveness, culminating in first five, later six 'configurations' has received wide recognition (Mintzberg, 1983). Thus Mintzberg argues against the idea of 'one best way of management'; supporting the view that there is no simple, clear-cut relation between the structure of an organisation and its effectiveness; this locates him in the tradition of contingency theory.

Nonetheless as an intuitive “theory in action” the P&W criteria for success provide one benchmark for assessing the significance of the empirical findings from the co-operative cases studied.

Brazda and Schediwy, 1989, document common trends across European consumer co-op movements. Referring to their chapter on the UK, it is interesting to note: there has been a continual decline in market share, which has been arrested recently to a certain extent; there is still no national society, but the business of CRS declined so drastically that it has merged with CWS, that change and the report of the Co-op Commission, particularly on the role of the Co-operative Retail Trading Group (CRTG), together with strengthening of regional societies offers interesting prospects for consumer co-operation in the UK.

The research approach adopted in this study: the survey identified areas of co-operative business which were reported by the co-op societies surveyed (Davis and Donaldson, 2000) as having exceptional performance. The surveyed societies were asked to give reasons for their choices, and the suggested criteria were:

- a. financial evidence of growth in revenue,
- b. strong organisational values, and management skills, and c) co-operative values and evidence of co-operative difference.

Thus the reasons cover business and co-operative values; and preliminary evidence suggested that there was considerable diversity in these case studies, across the full spectrum of business to co-operative values.

Two cases were identified in each co-operative retail sector, and both were researched to provide good comparative information (except for the pharmacy sector, where only one case was studied). These 9 case studies in 5 retail sectors are reported on in the next section.

In theoretical terms there are certain characteristics of co-operatives that give an inherent advantage (see Spear, 2000). Thus one of the interesting dimensions of this study is the extent to which such co-op advantages underlying success. Closely related to this is the idea that co-operative principles and values could, if properly operationalised within a business be a major source of success.

However reviews of the literature indicate that there are several different sets of co-op values that might inform success. For example two typical sets of values are:

- strongly espoused modern/ethical values (e.g. the Co-op Bank)
- vs. traditional implicit member benefit values
- (up front co-op values vs. in your boots co-op values).

It may be that certain sectors would be more predisposed to one rather than the other as a basis for success. Similarly taking this line or argument further, from a

marketing perspective (drawing on courses developed by Blomqvist and Spear) it has been possible to develop several distinct co-operative images.

#### Co-operative Images

- Value for Money
- Valued Customer
- Profit Overt (ours = yours)
- Altruism with Attitude (we care)
- Anchor in a Chaotic World (Good Value, Good Products, Good Advice)

Where possible the study explores the extent to which these different images informed successful practices.

#### **Findings from the Case Studies**

Initially the findings are reported by sector, examining similarities and differences.

##### ***Dairy produce***

Dairy 1 and Dairy 2 were based in regional co-operative societies. The dairies were involved in door step deliveries, shop deliveries, and in the case of Dairy 2 with a production facility. The reasons for both these cases being selected were exceptional business results. The factors sustaining the success of these co-ops are as follows:

1. Both dairies were strong players in the local market (well-known name for many years, strong co-operative area.) This position gave both economies of scale, and a protected market since dominant supplier position leads to high market entry costs; [home delivery sector was in decline, but shop delivery was increaing.]
2. Both dairies had developed well-managed businesses.
  - a. This included good quality service (right throughout various customer contact points, from call centre to delivery); based on training and quality approaches; good staff and high degree of staff stability.
  - b. Investment and cost control: to improve profitability (closing production capability, expanding wholesaling, and the geographic base; and investment in new technology). For Dairy 2: continual investment, included a new dairy in 1982.
  - c. Business performance: "In percentage terms our bottom line is as good or better than the major companies like Express."
3. These factors helped develop strong customer loyalty, but in the case of Dairy 2, this was also due to a strong regional identity, and a high membership base (members were more loyal). Business and customer loyalty together helped create

a loyalty/success dynamic: “it is a co-operative and it is a business so the benefit comes to the members because it is a successful business.”

4. The business performance was further enhanced through economic co-operation between co-ops to get economies of scale. This helped with national contracts for shops through the CMTA (co-op milk trade association); and group purchasing of packaging.

5. Regarding the Co-op ethos – this appeared unimportant for Dairy 1. While for Dairy 2 - business is a little removed from the co-op, running more as a dairy business. Co-op branding is only on some packaging.

### **Summary**

The key factors in the success of both these co-op divisions are:

- a strong local player,
- well-managed business
- both generating customer loyalty.
- business performance enhanced by economic co-operation between co-ops.

Thus rather than overt co-op values being evident, the success of the co-operative seemed to be based on traditional member based business values: delivering good quality product/service. In terms of co-operative image (see above) this combines: valued customer, with value for money.

### ***Non-food produce***

Non-food produce (NFP) includes furniture, carpets, clothing, toys and electrical goods – but not all stores take the full range. These cases are from 2 regional societies (NFP1 and NFP2). A key feature of NFP2’s performance is their major programme of store refurbishment, which has led to increased sales.

1. Both co-op societies were effective players in the local market – this being characterised by good use of local knowledge in marketing, and store location, etc.

This has involved moving away from national co-op society promotional strategies to select schemes that match the local competition better; and varying the marketing channels to match local conditions (from press advertising to leaflets).

Similarly they used local knowledge of suppliers to keep development and refurbishment costs down.

2. Both stores had developed well-managed businesses.

In NFP1 this included being very responsive to changing markets – such as the shifting importance of shopping centres in the town with other retail outlets opening, or changing retail patterns.

This involves continually getting the balance of space and turnover correct; changing store locations; as one manager said: “One thing is we don’t let problems lie...”

For NFP2, good marketing means: “... regular meetings with the management executive as well as meetings of all senior managers in non- food... where we discuss promotional activities – [based flexibly on the CWS<sup>1</sup> promotional calendar for the year] - and we can react quickly, because we are local, make decisions...” Local intelligence is regarded as particularly important: “we also give store managers a big say and input into promotions, advertising, they know their market.”

In NFP2 the Chief Executive is particularly close to the market: visits to competitor’s stores by staff (including the chief executive) are undertaken to check the range offered on certain product lines compared to the co-operative’s. And: “we have a customer feedback form ...”

Both societies promote the co-op brand, NFP2 particularly strongly: maintaining the brand and their distinctive logo on all stores and promotions: “We think the co-op brand is an asset. It is a strong brand. We should take advantage of that.” ..”But many societies haven’t invested in their stores and so the perception has become ‘old’ and ‘dated’ and ‘not cheap’.”

Similarly for NFP1, when considering investment in store locations and good quality refurbishments, attention to different customer profiles requires a differentiated marketing approach - for example locating small local shops near the traditional customer (council housing, old people’s homes); drawing in “the upwardly mobile young people who care about what we are, our ethical stance, the Co-op Bank...”

NFP2 has had a major programme of investment in stores: “The business plan recognised the need for investment in staff, stores, and training and the result is we are now doing well.” The results: in non-food, a 25-100% sales growth, over a period of time. This investment has been combined with cost control as a vital way to accrue money in order to invest in new stores.

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<sup>1</sup> CWS is the Co-operative Wholesale Society that took over the CRS (Co-operative Retail Society) in 2001, to become the largest co-op retail society in Western Europe. It owns the Co-operative Bank, and the Co-operative Insurance Society. It is also the major player behind the CRTG, the Co-operative Retail Trading Group, which provides a joint buying service to co-op societies in food, and more recently in other sectors, too.

NFP1 have a clear business strategy: “Our approach is to run a low cost margin, keep the cost base down, maintain volume. ...”

Similarly for NFP2: “I think there are 3 strands to what we are doing. I’ve been here just over 5 years.. first it is getting the right type of business, to get the retail side right, that has to be a priority. ... We have a sound financial footing and we have that now and we want to build on that. Second is creating a distinctive difference. Third is the membership - there must be a genuine reason for being a member and we’re working on that.”

The NFP1 approach to staffing is: “growing our own”....”It’s also crucial to have the right people in the right positions...” - This is not always easy where staff mobility and turnover are significant.”

NFP2 invest in training at all levels, and induction - with a staff induction roadshow whereby new staff are made aware of the wider business. They have a high degree of staff loyalty. This also indicates commitment. And there are staff benefits to reward some of the loyalty demonstrated by staff.

NFP2 have a very clear idea of delivering a quality customer service: customer comments indicate that the product knowledge of staff plays an important role in what is liked and appreciated. Their ‘quality’ approach for both customers and staff is to free time for front line customer service, the aim being to minimise paperwork for frontline staff. “It’s these people in the front line who are the ambassadors for the Society. If we don’t tell them what we are all about then customers/members won’t know what we’re about.”

4. The business performance has improved through economic co-operation between co-ops to get economies of scale.

In NFP1: “on electrical goods we’ve held our own but the margins are very low. The prices are ridiculous, the competition is intense. The issue was: should we pool buying power, trying to get together with other societies? ..We agreed to change our product range with XXZ (larger co-op society).....we don’t have enough critical mass alone. On furniture - it worked. We have had a strong performance on furniture.”

For NFP2 co-operation also applies to marketing: it ties in with CWS national promotional campaigns by promoting local society offers at the same time.

“CRTG has helped because we can now compete in food on price. Our food division is showing healthy sales increases.” But they use that facility flexibly: “we have the option of taking up those deals, but we also do deals with certain suppliers ourselves.” But they are not part of CRTG for non-food at present, which is still in its early stages of development.



5. Regarding the Co-op ethos: in NFP1 this involved pushing a number of co-operative features: member benefits through the dividend, the dividend card (for cross-selling), as well as the democratic side: “We’re obviously there to give benefits to our members, give value to members, to keep the democratic side of the society alive, we’ve worked hard at the democratic side of the Society.”...

However the co-op brand is seen as attractive, and promoted consistently by both societies (see above). Promoting the co-op brand is seamlessly linked with co-operative education in NFP2.

In NFP2 member benefits are emphasised (rather than democracy). They target members first for promotions and cross-selling. They also want to draw in new members through promotions and a system of discounts only available to members.

But there are, in addition, social benefits: outings and trips organised for members via the Member Relations Department and some people have joined especially to take advantage of the discounts available on these trips.

An ethical stance has been developed by NFP2 to provide community benefits. They have a unique scheme whereby the Society pledges all of its profits from tobacco sales will be donated to charity. This is a scheme which is unique in the UK and possibly the world. Another ethical dimension is in their sales approach, which could be termed “ethical selling”: “say in holidays - we are closely linked to the CWS Travel Care Theme, we’re not hooked to a particular holiday company - the same with funerals, we aim to not oversell a coffin arrangement they don’t need. The aim is not to con them and sell them something they don’t want. In electrical and furniture we get exceptional comments on the cards saying how staff have helped them. It is more like helping the people to choose. That makes a noticeable difference to what customers receive elsewhere. I see it as an ethos that runs through the business...”

Although NFP2 recognises the effectiveness of Oxford, Swindon, and Gloucester in developing member democracy, the balance between democratic involvement and professional management is a delicate one. The important thing, stressed earlier, is to get the retail side of the business right. “...to get the retail side right, that has to be a priority. If we don’t do that, it doesn’t matter what type of ethos we have got - we haven’t got a business!”

Clearly this view is inextricably linked with board performance: “our board today is more on the ball than they have ever been, because of the Corporate Code of Governance..” and “Director training is on a regular basis.”

## **Summary**

The key, according to the chief executive of NFP2, is "... to show you are a local organisation- and for members, show they cannot get these benefits anywhere else. I don't think you can get this by a national co-op. You need niche retailing on a regional basis - but with nationally managed buying power." This approach also typifies that of NFP2.

Both societies have a place for co-operative values, and to a certain extent the co-operative difference is integrated into business strategy, but in other ways, it seems to be something which is an added extra rather than deeply embedded within strategy.

## ***Travel***

There are two cases examined here: one is part of a strong regional society (T1), the other, part of a national society (T2).

T1, the regional society measure themselves, especially in terms of growth, against the travel industry rather than other parts of the Co-operative Society.

"When you consider there are seven-and-half thousand travel agents, we've got thirty five of them yet we've got over two percent of Thompsons national business. We are certainly more productive per outlet than any other travel outlet."

Additionally they consider themselves successful on factors such as continuing profitability, staff retention, customer care (for which they receive awards), marketing and staff training.

T2, the national society measures success on the usual 'key measures': growth of sales volume, growth in profitability and return on capital employed. It has, for instance, 300 outlets nationwide and this represents a growth from 230 in early 1998 (including managed partnerships).

1. The regional society (T1) was a strong player in the local market.

Perhaps the most significant management decision, by T1, was one to expand. A little over ten years ago the travel section was confined to the Society's department store. It was clear that the travel industry was consolidating around a small number of increasingly large travel agents. A decision was taken to expand geographically to achieve a dominant position with respect to travel from their regional airport. The business now has 35 branches in the catchment area and is negotiating three further leases.

This has allowed the Co-operative to take a 24% share of this market and be the largest agent in the region. Because of this position they have been able to compete effectively on price and added benefits. The manager considered that there has been a cycle where price and benefits alternatively have been uppermost among the customers concerns. Currently he thought price to be most important.

One of their newest outlets illustrates how the benefits of geographical dominance has allowed the Co-operative to added value to the travel product. The travel centre is located in shop units around a large central area, which has a bandstand and is designed to suggest a holiday atmosphere. The travel business puts on all sorts of events including music and tea dances to make booking a holiday a wider and more pleasurable experience.

## 2. Both had developed well-managed businesses.

For the regional T1 this means: “doing the simple things extremely well - we are perfectionists - if you look at this year alone we’ve virtually taken twenty years of trading apart, looked at everything we do and put it back together again and if we thought it needed fixing we changed it.” Being critical of their own performance and responding to it was reported as an important factor in business success.

A deliberately interactive management structure has resulted in a number of innovations, for instance:

- they had been the first among travel agents to offer discounting;
- in the last three years a ‘familiarisation programme’ has been instituted by which all sales staff have been regularly sent to experience a resort to which customers go;
- there are now facilities for customers (and/or their children) to view videos that include entertainment ones and others of their prospective destination;
- they have set up ‘Paddington’, a travel management intranet;
- ‘floor walkers’ whose job it is to engage potential customers browsing brochures will bring free coffee and tea to tables in the centre of the shop.

A member of staff interviewed said she thought they do feel that the management values their opinions.

A recent innovation is an internet site and a small but expanding call centre based at the headquarters. However growth in this business would inevitably bring them into competition with the national and global operators. Their policy of constantly reviewing and seeking improvement to their product, therefore, will become more important than the geographical dominance that has sustained them in the past decade.

T2 has good management information arising from good management systems.

In addition to the feedback form for customers, noted above, T2 have management systems that enable them to spot and quickly respond to difficulties and opportunities. For instance 'Lets do it better' meetings between staff are aimed at highlighting poor practices. Recently, for example, staff used this opportunity to complain about aspects of the 'mystery shopper' system. On investigation a consultant's methods and practices were found to be poor and changes were instituted.

Because of the feedback from customers the newly launched flagship stores include crèches with bouncy castles and videos. They had also found that different tiers of insurance policy upset customers. An offer of better insurance indicated the previous standard to be inadequate and they now have only one policy.

T2 has also been innovative - they operate telephone holiday clubs for organisations including the Co-operative Bank. Call centres, 'T2 online' and digital TV capabilities have grown considerably. For instance they have a 23,000 sq ft call centre. All these new services will be differentiated on the basis of open and honest delivery.

a. This well-managed business included good quality service:

T1 have won awards for their service, and have been very innovative (see above); also the manager interviewed added that their all round approach is characterised by: "honesty (and bluntness) - in the way we approach discussions with suppliers, the way we approach our staff and the way we approach problems with customers."

For T2, a customer-focussed open and honest offer has been crucial to their success:

"Really since we've determined our strategy and gone with it, as in marketed the co-operative values and built our business position on it, we've grown market share. For example we launched our 'Travellers Right to Know' in February '98 and the business has grown significantly since '98, through '99 and through this year." As part of this initiative staff and customers may refer to 'tell it like it is' gazetteers that contain selected reports about resorts and holidays on offer. The reports are said to be selected on their informative quality rather than whether they are complementary to the resort.

The co-operative monitors the success of this openness policy through a number of independently administered measures:

- Customer service questionnaires
- 'Mystery shopping' where independent investigators book holidays with T2
- Complaint ratios
- Customer holiday reports

- Customer (potential customer and competitor's customer) focus groups

These research measures show eight out of ten clients are satisfied with the service, and the co-operative scores highly on 'knowledge' of the holidays offered. Much store was placed on the independence of the national society from the major holiday providers. Most travel shops are linked to a travel provider and these holidays are sold in preference to competitors. T2 additionally aims to answer customer's ethical concerns about holidays through the use of an environmental consultant.

On the basis of this success the national society is engaged in a £20m rebranding of its T2 outlets around the differentiating notion of 'open honest impartial advice to customers' including an ethical dimension. The rebranding deliberately retains the co-operative dimension in both the logo, which is similar to the Co-operative Bank's, and the use of 'Co-operative' as a secondary heading.

T2 also competes on price by offering a discount of £10 against a competitor's holiday offer.

A strong customer focus culture was cited by the T2 manager - 'a customer focus culture', focused business goals and getting staff on board with the strong business proposition. She cautioned "don't claim more than you can deliver". With regard to customer orientation she said: "profit is of course important but there is a real understanding in the business that you don't get profit unless the customer is happy."

- a. Good management included good staff relations

T1: Good staff relations were cited as important. "I'd hate to think we had a 'them and us' and I'm almost certain we don't." Considerable care is taken with new staff and, for instance, their line manager will take them for a drink and give particular care to settling them in. A significant number of the mostly young female staff leave to have children and return to work at the Travel Centre. Some respect for management seemed to be generated by noting that when the sales space was very busy the managers could sometimes be seen working with the customers.

The travel department has, the manager thought, led the way in the Co-operative in a culture of constant review and positive staff relations. Although all staff are required to be members of the Co-operative neither the manager nor the staff member thought that this was instrumental in good staff relations.

All staff are required to train to NVQ level 2 'Customer Care' and have the option to take level 3 and introduction to management skills courses. The business has 'Investors in People'.

Similarly for T2: the manager: “Lots of opportunities for people to contribute to the business. Lots of opportunities for people to feed back to us if they don’t like something ..that’s the route to making sure you have staff who want to work with you ... to achieve the business objectives.” To this end she said: “We try not to be hierarchical”. For instance the head of operations holds ‘lets-do-it-better-circles’ once every eight weeks. Anybody can, and do, apply to join one.

Motivation of staff is mostly through the honesty policy. “Staff are quite proud of selling what the customer needs and wants rather than what the parent tour operator is telling them they ought to sell”. Staff are proud “because this is morally and ethically right”.

Staff do visit and report back on resorts but on average only once every two years. However, staff turnover level is just over 20% whereas the industry norm is 40%.

There is a high demand for able sales staff as the travel industry grows. T2 has mostly in-house training, increasingly for new entrants, but they encourages staff to take NVQs.

3. These factors helped develop strong customer loyalty

4. The business performance was enhanced to a limited extent through economic co-operation between co-ops:

T2 has a managed service partnership (like a franchise including training and branding) with other smaller co-operatives in ten regions. This improves the national society buying power and the national coverage.

5. Co-op ethos

For T1, this doesn’t seem at all important. The Co-operative has traded in the area for 120 years and has a membership of some 30,000. It takes an active part in the local community rather than the wider regional area in which the travel business trades. This is very much at a Co-operative rather than travel department level. The manager saw the membership and its committees as mostly separate from the general business management of the society. “The society takes care of all of that” he said.

In terms of the travel centre business the manager thought that membership was becoming less important. He pointed out that nearly ten times as many holidays were booked in the previous year as the Co-operative has members. Members get no special treatment.

For T2, there is a more positive approach: management encourages branches to be involved in local community and financial support is available for this. Staff are, however, not generally members of the national society. Members can have a

special holiday package (for instance discounts special rates on car hire) and receive a dividend if they book directly.

However it appears that a theme of “ethical selling” has emerged in both cases, implicitly in T1 but overtly in T2, with their emphasis on open honest impartial advice to customers.

### **Summary**

Geographical dominance has served the T1 co-operative well in the recent past. If the manager’s assessment of the market alternating between price consciousness and customer benefits is correct, then their customer care innovations are not consistently of prime importance. In a clearly changing market the constant review and willingness to adapt must be their most valuable asset.

T2 seem clear that their open and honest approach has underpinned their success. It has done so both by motivating staff and managers and by giving a clear business offer to the customer. However, there are also many feedback mechanisms that have influenced the co-operative’s business practices and clearly informed the changes they have made. As the manager argued, these seem inseparable.

### ***Funeral Services***

The two cases researched are based in strong regional societies.

F1 Funeral Service sees itself as successful and innovative. Market share, based on death rates, has been increasing. The co-operative has expanded by acquisition. Some of the reasons for their general success are discussed below but the establishment of a website and the success in generating immediate media coverage are key examples of innovation.

For F2, the primary reason for success had been the bereavement care services:

1. The local market is clearly important since: for F1, 90% of trade is generated by word-of-mouth. Placing advertisements in the media is costly and largely ineffective. The establishment of a website was seen as a low cost way of delivering added customer benefits with considerable public relations spin-offs.
2. Both F1 and F2 had developed well-managed businesses.

The F1 management team go (irregularly) to visit all trade areas and discuss matters with staff, however trivial. In this case: “Perception is reality, that’s the ethos so that even if everything they are saying is rubbish there’s obviously a problem somewhere in communication so it gives us a chance to address it.”

F1 Managers are encouraged to be innovative, as for example in the case of the website trial, and there is a good staff suggestions scheme. Staff are recompensed for good ideas that may relate to any area of the business. A panel of judges including members from all levels in the business reviews staff suggestions.

F2 had introduced improved management practices; and a refurbishment of outlets was almost complete. The manager gave two examples of raising standards. Before her arrival there had been no means of identifying a body through the funeral process. This poor management system could lead to mistakes. Processes for recording had been instituted. The monument production division had been poorly organised and had produced poor quality work and made mistakes. Since this has been reorganised, sales of monuments have risen. Other new management systems are discussed below.

For F1 a major innovation has been the launch of the internet site in January 2000, with relatively low start-up costs. It is not primarily intended that people should buy on-line. Some customers have gone 60% towards a purchase and then “feel the need to see a funeral director”. It is primarily used as an ‘after service’ where customers can review products in their own home subsequent to arranging the service. In this way “the internet is there to complement our existing funeral directors”. Arranging a funeral is “the worst time of your life” and customers end up saying “Just give me the basics”. However, the internet gives a chance to reflect on your decisions and this offers better customer care. “You can sit there and browse coffins without feeling guilty”.

In terms of column inches in newspaper the “PR has been phenomenal” and far more cost effective than a conventional advertisement. There has also been radio and TV coverage. Additionally the website gives feedback on customer browsing “it’s an interesting way of doing cheap market research”. The amount of interest in, say, new products can be measured.

F2 also has a developing internet site and the funeral service has a presence.

But for F2 the major innovation is their Bereavement Aftercare Services. The manager has established that only 4.6% of their commissions resulted from direct advertising in the local media. Four years ago part of this budget was diverted to establish a bereavement service. A qualified staff member was employed to offer free counselling to the bereaved regardless of which funeral director they engaged. The service has grown to include:

- 24hr bereavement support telephone line staffed by volunteers;
- One-to-one counselling for the bereaved (currently with 48 people);
- bereavement support groups (eight, the first of which is now developing into a self-supporting social contact group);



- group counselling to the support groups;
- bereavement awareness training to staff in nursing homes studying NVQ 2/3 for care assistants;
- funeral in bereavement support training out of the regional area; and,
- community care programmes in nursing homes.

“The majority of funeral directors, once the funeral has taken place, apart from chasing the bill, that’s it. We don’t - we support before, during and after” Clients of competitors use this free service and the co-operative gets referrals to the service from ministers, doctors and other practitioners, health centres and hospitals. One health care centre now has accommodation for the co-operative’s counselling support team. “All this is getting the name of the caring co-op out to the community”

Some have been sceptical of the co-operative’s motives, the bereavement counsellor estimated between 5 and 10%, but the majority of people appreciated and approved of the services.

The approach was piloted four years ago and has now grown to employ three qualified counsellors and six others with various qualifications. Most are part-time staff. Counselling services are now also delivered within other departments of the co-operative. Because of demand they are beginning to charge for training services.

These services brought many more contacts than the co-operative would otherwise have and referrals and prepayments for funerals have risen. The manager said she felt the increase in market share was primarily a result of the additional free services.

a. A well managed business included: good quality service

Good staff development – F1 co-operative has a dedicated training manager and most staff are qualified. “I think.. that is our defining difference that the majority, if not all, have a professional qualification.”

The F2 funeral service has, ‘Investors in People’. “Training is a very important aspect because if staff aren’t comfortable with the role they have to play and they don’t have the product knowledge then it’s not going to help them; it’s not going to help us.” Management staff hold the Funeral Diploma, the embalmers hold BIE diploma and about a third have NVQ 2/3 in Care.

A client questionnaire provides feedback on their performance.

Service at F2 branches had been poorly decorated with a small reception and dark corridors to small dark consultation rooms. The receptions were now larger, more open and well decorated. “We’ve changed it so that it’s warm and comforting and relaxing.”

3. The business performance was further enhanced through economic co-operation between co-ops

The F1 website includes 36 Co-operative funeral service outlets and 104 independent funeral directors. However, most of the apparently independent businesses are acquisitions. The Funeral Shop wanted to co-operate with all other funeral services whether co-operative or independent. However, the response to an invitation to join the site was poor. The manager is presenting his ideas at the UKCC funeral directors association. About the co-operatives he said "This [the web] is a good place where we could join together and do some things together" rather than what he considered as the confusion of co-operatives and their funeral services.

In spite of the advantages of clarity for consumers and ease of location through established search engines, the marketing manager now considers it is unlikely that there will now be such a national website.

The F2 funeral service has assisted another Co-operative Society to set up a similar bereavement support service. This assistance was free because they are a co-operative. Other co-operatives have exchanged ideas about management systems.

5. Regarding the Co-op ethos:

All funeral suppliers for F1 are local but there is no other direct relation to the community. The business is management led but members are kept apprised of developments. "We've had the odd bit of feedback that says this is good, this is bad, there's a hole here, could you do this, which has been taken on board from members meetings. It's not specifically invited but you don't need to with a co-op because the members drive the feedback up anyway."

In F2 there are clear benefits to the community in the bereavement services. There are also spin-offs for membership - in one case members of a bereavement group took out membership of the co-operative. Members are given discount on masonry purchases.

## **Summary**

In the F1 case the nature and degree of success was not made clear. It seems the case that the regional society is trying to be an innovative co-operative and has some mechanisms in place to promote this. There was some reluctance to be specific about the success of the funeral service (reasons given but not recorded). The success of the website was clearly set out and explained. In order for this to

prove a longer-term asset it seems that innovation to attract further media attention will be necessary. The benefit to customers has yet to prove itself.

Clearly in F2, better management services have been introduced to improve the service at a basic level and this has been essential to the revival of the business. However, the extended bereavement services have combined a co-operative principle with an appropriate marketing initiative. Whilst the manager admitted that they could not compete on price with the very small funeral directors operating with exceptionally low overheads, they were able to offer an exemplary service. They had for instance gained all major hospital contracts in the area. In the last of these they had been told that the bereavement services had been a significant factor in gaining the contract. The range of the funeral service now successfully offered establishes the co-operative in the minds of the public and other professionals as the leader in the field. "People are realising that we are professionals."

### *Pharmacies*

A possible threat to all UK community pharmacies is the current discussion about abolishing Retail Price Maintenance. This would enable supermarkets to undercut the price of medicines. This section is based on data on one group of pharmacies that are part of a strong regional society.

1. The pharmacy is a strong player in the local market. They own 25% of the pharmacies in the area and several of them are in unopposed situations in villages.

This position is strengthened through the small scale and geographical compactness of their operation. They can already get discounts on supplies, but compactness gives them managerial, trading, and financial advantages (low distribution costs).

And the position is further enhanced through the pharmacy being very well networked with other pharmacists in the region, giving advantages of local knowledge and information. They operate an unofficial, locum agency for independent pharmacies. This is run on a commercial basis. It builds on one of the strengths of the Regional Society, which over many years has reinvested in the community, including some small communities which other people thought weren't worth bothering with.

2. The pharmacy has developed a well-managed businesses.

a. This included a good quality service

Professional values of pharmacists places a high value on ethics and confidentiality, and a high level of education and training to sustain it. This is effectively combined with a closely integrated and hands on management approach. The most senior person in the Pharmacy Department can be found working, at least some days in the week alongside the most junior of pharmacy assistants facing the same situations.

b. Investment and cost control.

Strong prudent financial performance over the years has borne fruit: “we own the shops - we own 90% of the shops we work in. We pay 90% of a commercial rent (as an internal rent to the regional co-op society). That’s an advantage for us. We also have the finance to buy new businesses so we can act quickly.” This has also allowed them to invest to develop a highly integrated business, a pharmacy warehouse and distribution service, and that has cost and efficiency advantages.

“We also have a distribution service - we can deliver to nursing homes, doctors and some housebound people.”

There has always been a great deal of support at board level for the pharmacy business. This and the investment performance have led to an increased number of pharmacies from 4 to 23 during the last 20 years. This is part of a general approach by the regional society: since it: “has got resources and uses those to invest in its infrastructure, upgrade its stores, invest in IT.”

3. It is considered that these factors have not developed customer loyalty, rather the pharmacies have a captive market in many areas; the pharmacies recognise it is important not to abuse this position, and provide the kind of service which will reflect well on the whole regional society.

4. The business performance is enhanced through economic co-operation between co-ops – low cost supplies come through an association of independent pharmacies.

5. Regarding the Co-op ethos

The co-operative ethos links substantially with pharmacy values which are embedded strongly in the operation of the business. Professional values play an important part in a responsible business attitude, in what is a rather special business operating on the boundary of the person being served being a ‘customer or patient.’ This professional ethos may be as important for the rest of the operations in the regional society as it is for the pharmacies.

They have found ways of delivering a co-operative advantage despite government restrictions: prescription items cannot be included in the usual Society's dividend, however "we have a Health Care Fund. This was a fund set up seven years ago - it was a means of returning to the community profit we aren't allowed to give back on dividend. We can't offer a dividend on prescription items, instead it gives out £1,000 per branch per annum into community projects involved in health care. This year we gave £23,000 back. We support Multiple Sclerosis Groups, Alzheimer Society, a deaf network, equipment for doctor's surgeries, health promotion work in schools, special schools for equipment. On these things we can demonstrate the co-operative advantage."

The philosophy of a strong regional society brings together business, community and member interests: "to provide benefits for the society's customers, members and communities it serves across the widest possible range of services." For some rural communities in particular the regional co-operative can offer a very wide range of services.

### **Summary**

The co-operative enjoys a dominant market position in the region. It plays to this well by developing a role in local pharmacy networks, which adds to its knowledge and understanding of pharmacy in the region. An integrated management structure and training mean a quality responsive service. A warehouse and distribution network ensures the co-op can deliver medicines extremely efficiently and cheaply locally. The community approach is reinforced by the Health Care Fund.

### **Conclusions**

There are a wide range of reasons identified as important for success in the different co-operative sectors studied. Many of these (parts of items 1-3) are associated with good business practices in any sector, and good management, no matter what type of business structure used.

1 a strong player in the local market.

Close and responsive to the market

2 well-managed businesses.

a deliberately interactive management structure leading to innovations,  
good management information arising from good management systems.

good quality service:

a strong customer focus culture

good staff relations  
investment and cost control

3. These factors helped develop strong customer loyalty
4. co-operation between co-ops
5. Co-op ethos

However there are some interesting themes which seem to derive from inherent co-operative advantage. These include: dominant player in a region or community, good customer/member relations, good staff relations (together with investment in both these areas); co-operation between co-ops has played an important role in several cases; there also seems to be an emerging advantage associated with “ethical selling”; several cases have invested in community relations with economic advantage.

Different emphases are placed on values underlying the co-operative images promoted (see section 1); and it is clear that there is a spectrum of successful co-operative strategies ranging from good quality service based on customer focus, and value for money to strategies which whilst adhering to similar strategies also emphasise community and ethical values. However there are also cases where the co-operative ethos does not play an important role, though it is encouraging that these are a minority of cases studied.

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***Part III. Co-operatives,  
the State and Civil Society***



## **PARTICIPATIVE DEMOCRACY, THE SOCIAL ECONOMY AND POLITICAL DEVELOPMENT IN NORTHERN IRELAND**

**Arthur Williamson and Cathal McCall**

### **Introduction**

For nearly 30 years during the period 1972-1999 Northern Ireland was under direct rule from Westminster following the events of 1972 when the devolved parliament at Stormont near Belfast was prorogued. This period of direct rule is spoken of as a time of 'democratic deficit' when the absence of normal politics enabled the voluntary and community sector to participate increasingly in the governance of the region. The sector developed close relations with public decision-makers and administrators and extended its traditional role of working at the coal-face of service delivery to becoming an integral part of the policy-making process.

The European Union (EU) has been pivotal to the success of the Northern Ireland voluntary and community sector in establishing itself at the table of governance and indeed its funding programmes made possible an explosive growth in the sector during the 1990s. In particular, the EU funding programme known as the 'Peace Programme' was remarkable for the substantial role it assigned to the sector in the innovative mechanisms of District Partnerships and Intermediary Funding Bodies that were established for its implementation. This participation in governance is continuing post-2000 with the implementation of the new £900m EU regional aid package (incorporating the Peace Programme) for Northern Ireland that runs from 2000 to 2006. Consequently, the sector in Northern Ireland can be said to enjoy influence and involvement in governance that is unequalled by its counterparts in the rest of the United Kingdom.

The foundational settlement for a new pattern of government in Northern Ireland (and new institutional relations between the United Kingdom and the Republic of Ireland) is the Good Friday (Belfast) Agreement (1998). The institutional configuration agreed in this settlement includes a parliament, the Northern Ireland Assembly; a Multi-Party Executive; a Cross-Border Ministerial Council and implementation bodies; a British-Irish Council; and a 'consultative' Civic Forum. This paradigm shift in the governance of the region presents the voluntary and community sector with formidable challenges. The voluntary and community sector is becoming accustomed to participation in the 'consultative' Civic Forum that was established to provide a formal voice for participative democracy in the Multi-Party Agreement.

Almost one third (18 seats) of the 60 seats in the proposed Civic Forum have been reserved for voluntary and community sector participants. This compares with the

business sector (7 seats), the trade union sector (7 seats), the churches (5 seats), cultural traditions etc. (4 seats), the farming/agriculture/fishery sector (3 seats), arts/sports (4 seats), universities (2 seats), victims (2 seats), and community relations (2 seats). The First and Deputy First Ministers allocate the remaining 6 seats<sup>3</sup>.

Northern Ireland, in a state of constitutional and administrative flux, can be seen as a laboratory to test new concepts like social partnership and new models of transterritorial governance designed to respond to an economic, political, social and cultural complexity that may have surpassed the capabilities of modern nation-state government. Social partnership and transterritorial governance are especially suited to a region like Northern Ireland where a conflict based on territory, economics and culture has inhibited the formation of a stable government (McCall, 1999).

The research on which this paper is based was carried out shortly before the Civic Forum was established. Two prospective parallel research projects were undertaken. The project which being presented today was designed to elicit the views of representative leaders of the voluntary and community sector in Northern Ireland concerning this important political and institutional development. The other piece of research concerned the views of elected members of the recently established Northern Ireland Assembly concerning the Civil Forum. The findings from that enquiry were published in the journal *Governance* in July 2001 (McCall and Williamson 2001).

### **The Social Economy in Northern Ireland**

Because of the particular focus of this conference some brief comments on the role of the social economy in Northern Ireland may be of interest. It has often been noted that significant parts of the voluntary and community sector remain outside the field of vision of public policy (Horton Smith, 1997) and in most developed countries this has been the case with regard to the social economy. There are welcome signs of change, however. Recently, however, in Scotland and the Irish Republic, two of Northern Ireland's nearest neighbours, the social economy and its actual and potential contribution to public policy has attracted attention at governmental level. Indeed in both Scotland and the Irish Republic there have been significant policy measures to assist the social economy. In Scotland in 1999 the Government's Social Inclusion Network established a special group *The Wider Social Economy and Social Investment (Scotland)* with a remit to foster the growth of the social economy. In the Republic of Ireland in 2000 the government indicated its commitment to the social economy with the establishment of a fund of £IR 42 million to be administered by the Department of Enterprise and Employment. Furthermore, since 1996 the Irish League of Credit Unions has

funded a social economy training programme. Social economy research in the United Kingdom has recently been promoted by the work of Lloyd et al (1998) in their study *Local Enterprises in Enterprising Localities: Best Practice in Area Based Policy in the United Kingdom*, a study of over 30 local initiatives and by the writings of Leach and Unsworth of Manchester Metropolitan University.

In Northern Ireland there is widespread concern about the likely impact of the looming end of generous funding from the European Union in the form of Objective One funding and Peace II (the EU's programme the Support of Peace and Reconciliation). These funds have been highly significant in sustaining the voluntary and community sector during the 1990s. In 2000 the Northern Ireland All-Party Executive commissioned a major study of the social economy in Northern Ireland and of the measures that would be required to promote it. Their report is an important baseline document for people interested in the social economy aspects of voluntary action in Northern Ireland. Stutt and colleagues report that the social economy in Northern Ireland is a large and diverse sector that has largely been ignored by public policy (Stutt et. al. 2001). In many areas it is more fully developed than in other parts of the United Kingdom and Ireland. However, the report notes that, although the social economy is a distinctive and important sector, it is one for which there are:

- No public policies
- No support mechanisms
- No forum for discussing development and challenges.

The importance of the social economy in Northern Ireland goes far beyond the number of jobs that it provides. Stutt has pointed out that social economy organisations are distinctive not only in terms of *what they do* but also in terms of *how they do it*. Among the suggested advantages are: their flexibility, closeness to communities, focus on disadvantaged areas and groups, emphasis on participative management and consultative processes. To these might be added their contribution to bridging social capital and the fact that social economy organisations create incomes, wealth and employment in disadvantaged areas and for disadvantaged communities. They draw on volunteering and attract donations thus securing resources that would not otherwise be available.

In Northern Ireland's deeply divided society the social economy has a further and very important role. This arises from the fact that the social economy operates largely on a cross community basis and creates employment and income, particularly in disadvantaged and often divided communities. There are very few institutions in society in Northern Ireland that bridge the deep community gulf and it is of interest that the social economy is one of these.

Although the size of the social economy is notoriously difficult to assess Stutt and colleagues estimate that it accounts for approximately 5% of the employee jobs in

Northern Ireland (and from 30,000 to 48,000 jobs). This means that it provides employment equivalent to the construction sector or the tourism industry and is larger than some other sectors whose significance has long been recognised, such as textiles and apparel or agriculture forestry and fishing. Its significance is enhanced because much of the employment is in disadvantaged areas or communities.

The following table ( see Appendix) provides some estimates of social economy activity in Northern Ireland. The prospects for the future of the social economy rest largely with the Northern Ireland Executive and the public policy measures that it may take to remove obstacles to its growth and development and to foster its development.

### **Participative democracy and the inauguration of the Civic Forum**

The fluidity of Northern Ireland's position, in terms of governance and democracy, make it an important case study to consider by people who are interested in the development of a model of democracy to suit the shift from traditional, centralized nation-state government to a new transterritorial form of global-national-local governance.

Drawing on the experience of the voluntary and community sector in Northern Ireland, this paper examines the prospective views of voluntary and community leaders in relation to the concept of participative democracy and to the proposal for a Civic Forum as a component part of institutional change for Northern Ireland. The primary sources for the research are interviews with leaders of the voluntary and community sector in Northern Ireland. Those selected for interview included directors of central umbrella organizations (the Northern Ireland Council for Voluntary Action, Disability Action and the Rural Community Network), a major grant giving trust with close and extensive links with community groups (the Northern Ireland Voluntary Trust), one of the two main organizations working in the criminal justice field (Extern), and the director of a locally-based council for voluntary action in a locality that is deeply divided by sectarian politics. Further interviews were arranged with government officials and with political analysts. Press reports relating to the Civic Forum and voluntary action were analysed.

### **Participative democracy in context**

The idea of participative democracy involves the active participation of citizens in public life rather than their detached involvement through representatives (BARBER, 1984, p. 151). It is a model of democracy that is most commonly associated with ancient Athens. There citizens participated directly in public

affairs, involving themselves in the creation of the rules and regulations of their city-state rather than being the passive subjects of political authority.

Participative democracy, it is suggested, was able to function in city-states because they were small and because they excluded whole swathes of society (HELD, 1995, pp. 6-8). Highly differentiated, emancipated, modern industrial society has made the application of the participative model of democracy impractical (BUDGE, 1996). Developments in democratic practice to suit the changing conditions of modern society involved the evolution of a system characterized by rules, procedures and institutions. Instead of participating directly in the new institutions citizens were represented by elected officials. Liberal democrats were able to secure their key concerns of authority and individual liberty through representative institutions. In liberal democratic societies participative democracy concerns of active citizenship and civic virtue were, to a large extent, displaced by a regard for authority and for the pursuit of individual interests (HELD, 1995, pp. 9-10). This lack of democratic participation, combined with increasingly ineffectual mechanisms of democratic control, makes further development in democratic practice essential if democracy is to keep pace with changes in contemporary society and continue to have meaning.

In Northern Ireland, one problem for advocates of an increase in democratic participation to coincide with the establishment of representative democracy there concerns the democratic credentials of participants, particularly the voluntary and community sector, given their performance during the period of direct rule. The close-knit relationship that developed between voluntary and community participants and the appropriate department, or quango, or British minister, during direct rule has been described by Richard Jay as often representing: 'the mirror image of the bureaucratic state; locked together in an ever-more-complex web of backroom lobbying, personnel exchanges, network-building, grant applications and monitoring exercises' (JAY, 1995, p. 69). To some observers, leaders of the voluntary and community sector appear to be so integrated into the public policy decision-making process that, far from being the 'ordinary citizens' championed by participative democracy, they have become specialists or professional lobbyists. However, voluntary participants may respond to such criticism of their democratic legitimacy by claiming that their work widens and improves democracy through providing access to decision-making fora for 'active citizens'.

In addition to an assessment of voluntary and community sector behaviour, any assessment of the democratic legitimacy of participation also requires an examination of the preferences of citizens. Participative democracy will resonate with the 'fullest expression of democracy' if it was arrived at by citizens 'acting in a fair and reasonable way' (MEEHAN, 1996, p. 28). This 'fullest expression of democracy' involves civil participation in political and economic institutions

whose functions include agenda-setting, deliberation, legislation and policy implementation. It should also entail a review procedure to allow the easy adaptation of the institutional system to changing conditions (BARBER, 1984, p. 151; HELD, 1996, p. 271). However, 'acting in a fair and reasonable way' alludes to the possibility that participative democracy may be vulnerable to political and/or paramilitary exploitation. For this 'fullest expression of democracy' to ring true, citizens' preferences must prevail over political and/or paramilitary exploitation.

Possible pathologies of participation include increased fanaticism, intolerance and conflict (STOKES, 1998, pp. 123-39). Indeed, in a region like Northern Ireland, which already suffers from a deeply entrenched ethnic and political conflict, increased participation may exacerbate these pathologies. After the cessation of paramilitary violence in 1994, the manifestation of fanaticism, intolerance and disruption was transferred from the low-level violent conflict to conflict over the sectarian marching issue. Marches, or attempts to march, through Catholic populated districts by lodges of the Protestant Orange Order, the Apprentice Boys or the Royal Black Preceptory led to conflict between members and supporters of these region-wide groups and members and supporters of local Catholic residents groups. At times these march-related conflicts became so inflamed that they threatened to return the region to violent conflict and destroy any prospects for democracy. Political and/or paramilitary interests have the potential to exploit democratic participation by grassroots associations. Political and/or paramilitary interests, undermining the democratic legitimacy of the participative exercise, may even displace citizen preferences.

In Northern Ireland, building democracy from the local community level up clearly faces as many problems, if not more, than building from the political class level down (COCHRANE, 1986, pp. 72-5). However, the view that political apathy produces healthy democracy (LIPSET, 1963), though perhaps tempting in the perennial upheaval of the Northern Ireland political conflict, is also untenable. Participative democracy offers 'the best guarantee against the tyranny of the "elected autocracy"' (LUCAS, 1976, p. 144). Following on from this, it could be argued that during the nearly 30 years of direct rule period that commenced in 1972 the participation of the voluntary and community sector has offered some buffer against an unelected autocracy emanating from Westminster.

### **The Northern Ireland experience of participation and partnership**

'Inclusiveness' is the touchstone of participative democracy with an emphasis on the inclusion of marginalized voices in the policy and decision-making processes. In the early 1970s, community associations began to emerge mainly, though not

exclusively, in disadvantaged Catholic areas of Belfast and Derry. These associations campaigned vigorously on behalf of the people in their localities and lobbied energetically and vociferously for resources. Their leaders often emerged as representatives of these communities; some became significant, if unelected, figures in their localities. However, the direct rule administration was reticent about the philosophy of inclusion at that time. The authorities in London became concerned about this emerging field of voluntary action because some community associations and residents' groups were considered to be amenable to subversive political and paramilitary interests. The problem was compounded by the durability of the low-level violent conflict and by the emergence of Sinn Fein as an electoral force after the 1981 Hunger Strike, when ten Republican prisoners starved themselves to death in protest at the loss of 'special category' political status.

#### *From exclusion to partnership*

In 1985 the UK government announced a new policy of political or security vetting in Northern Ireland. Vetting was intended to prevent funding reaching any community association that was known by the security services to be under the influence of paramilitaries. It was bitterly resented by community activists from both the Republican and the Loyalist communities. Many community leaders from across the political and sectarian divide co-operated and made common cause in their protests as they campaigned together against vetting through the Northern Ireland Council for Voluntary Action (NICVA).

In the early 1990s this policy of exclusion and proscription of some community associations gave way to a new policy of inclusion and partnership. The precise reasons for this change of approach are not in the public domain but it is likely that the objective of engaging previously excluded 'marginalized voices' was shaped by broader political objectives and was intended to lay the foundation for the paramilitary cessations of violence. In 1993 the Secretary of State, Patrick Mayhew, launched the *Strategy for the Support of the Voluntary Sector and for Community Development in Northern Ireland* (DHSS, 1993). This document, which was a policy first for Northern Ireland and provided a model for New Labour's Compacts of the late 1990s (NICHOLAS DEAKIN, personal communication to Arthur Williamson, 01 June, 1999), sets out a statement of principles and a strategic framework to guide the relationship of government departments with the voluntary and community sector. The previous policy of vetting was replaced by a new affirmative and co-operative approach, which emphasized the responsibility of government departments to 'encourage, promote and support an independent, vigorous and cost-effective voluntary sector' (DHSS, 1993). With regard to community development the Strategy broke new ground

when it recognized and endorsed the value of community development and of community groups in Northern Ireland.

#### *The European Union's Peace Programme*

In the Autumn of 1994 Republican and Loyalist paramilitary organizations announced cessations of violence. The EU responded quickly by launching its Peace Programme which gave prominence to promoting social inclusion attempting to 'embed' peace' and engaging community groups in a local development process. During the first three years of the Peace Programme, community associations employed more than 1,100 community development workers. Under this special Community Initiative to support Northern Ireland's fragile peace, community groups and voluntary organizations became the beneficiaries of an EU 'funding avalanche'. The programme provided £234 million in 1995-7, with the UK and Irish governments adding £78 million in matching funds. An additional £88 million was made available in 1998 and a further £70 million in 1999.

The Peace Programme placed special emphasis on developing innovative measures to include civil society organizations both in the shaping and in the delivery of the programme. NICVA worked closely with the UK government and with Brussels in shaping the programme's principles and measures. Two important delivery mechanisms that were central to the Peace Programme were District Partnerships and Intermediary Funding Bodies (IFBs). Each of these provided an arena for the voluntary and community sector to shape policy and to be closely involved in its implementation.

In 1996 District Partnerships were established in each of the 26 local government areas and were responsible for the delivery of 14.7 per cent of the Peace Programme. Priority areas included employment; urban and rural regeneration; social inclusion; and productive investment and industrial development. The Partnerships were coordinated by the Northern Ireland Partnership Board, a tripartite body comprised of representatives of the community and voluntary sector (one third) as well as of local government (one third), business and the trades unions (one third). The composition of the District Partnerships mirrored that of the Partnership Board. Partnerships became established bodies at local level throughout Northern Ireland and provided a forum for representatives of the voluntary and community sector to work together with local government councillors and other local interests. On a pluralistic and inclusive basis people from the different sectors of local civil society were able to engage in a deliberative, policy-making and grant-making process. Participative and deliberative democracy co-existed with representative democracy at this local level. It is widely believed that such a continental approach to public



administration, with its German emphasis on subsidiarity and its French stress on the involvement of the social partners, has much to offer divided societies like Northern Ireland (WILLIAMSON, SCOTT and HALFPENNY, 2000).

The 8 IFBs established by the Peace Programme were charged with the delivery of 43.5 per cent of the funding in five priority areas including: the development of the Irish border region; employment; urban and rural regeneration; social inclusion; and productive investment and industrial development. Voluntary bodies like Co-operation Ireland, the Northern Ireland Voluntary Trust (NIVT), Youthnet and the Combat Poverty Agency (based in Dublin) functioned as IFBs which assessed projects for funding and distributed funds to successful applicants (McCALL and WILLIAMSON, 2000). The engagement of these Third Sector organizations with the European Union is an important example of global-national-local governance and illustrates the development of policy in Brussels toward the inclusion of Third Sector organizations in the formulation and delivery of its programmes during the late 1990s.

### **The challenge of a civic forum for the voluntary and community sector**

#### *Origin, form and function*

The Civic Forum is provided for in the Multi-Party Agreement and is legislatively established by the Northern Ireland Act (1998). It has the potential to further enhance participative democracy in Northern Ireland. The Agreement states that the Civic Forum 'will act as a consultative mechanism on social, economic and cultural issues' (GOVERNMENT OF THE UNITED KINGDOM AND THE GOVERNMENT OF IRELAND 1998). This broad remit appears to anticipate that the Civic Forum may develop to become an important interface between representative and participative manifestations of democracy in Northern Ireland. The leaders of the voluntary and community sector envisaged the proposed Civic Forum as a mechanism that would enable the sector to engage formally with Northern Ireland's new constitutional arrangements and administrative structures in a participative, and perhaps even a deliberative, capacity (INTERVIEWS, 19-27 August, 1999).

The Women's Coalition, one of the smaller parties involved in the Multi-Party negotiations (1996-8), secured the inclusion of the 'consultative Civic Forum' in the Agreement by engaging the support of the Irish Taoiseach (Prime Minister) Bertie Ahern (IRISH TIMES, 27 March 1999). The Coalition also received the support of the Secretary of State for Northern Ireland, Dr Mo Mowlam, when its negotiators argued for the inclusion of a 'Civic Forum' drafting paragraph towards the end of the exhausting negotiating session that produced the Agreement (CONFIDENTIAL INTERVIEW WITH A SENIOR OFFICIAL IN THE

NORTHERN IRELAND OFFICE, 18.6.1999).

The design and remit of the proposed Civic Forum bears similarities to the Republic of Ireland's National Economic and Social Forum (NESF) which has been a leading example of democratic innovation along participation and social partnership lines. The NESF was established in 1993 with the aim of developing economic and social policy in order to tackle social exclusion, unemployment and inequality (NESF, 1997). Its principal innovative feature is its social partnership design. Of its membership, one third is drawn from each of three groupings: the Oireachtas; the employer/trade union sector; and the third (voluntary) strand. The social partnership approach of the NESF has enabled the voluntary sector in the Republic of Ireland to participate in policy making, although the degree of participation and influence is, as yet, unclear (CATHERINE BRENNAN in presentation of research to Centre for Voluntary Action Studies (CVAS)/Association of Voluntary Action and Research Ireland (AVARI) Research Forum, 2 June 1999).

The Civic Forum also represents an innovation in democratic practice because it has the potential to be a public arena for broadening and deepening discourse and deliberation on issues that affect the citizenry. Discourse in politically representative fora in Northern Ireland since 1974, such as the Northern Ireland Assembly (1982-6) and the Northern Ireland Forum (1996-8), was perennially polarized by a preoccupation with the contested nature of government in Northern Ireland and the question of territorial sovereignty. In contrast, a participative forum was seen as having the potential to broaden discourse and deliberation by simply offering an alternative construct to the established representative Assembly. Avila Kilmurray, Director of the Northern Ireland Voluntary Trust, believed that 'because the Civic Forum members will not have to look over their shoulders to an electing constituency it is likely that they will engage in somewhat more lateral thinking' (INTERVIEW, 27 August 1999).

The discourse of the Civic Forum has a focus on Northern Ireland's profound economic and social problems that are the stuff of 'normal' politics. Furthermore, the involvement of the component parts of civil society, not least the voluntary and community sector, deepens that discourse and deliberation by bringing together incumbent voices from those sections of society that have, hitherto, been marginalized. Niall Fitzduff, Director of the Rural Community Network, considered that the diversity of input has the potential to produce a useful breadth of dialogue. Nevertheless, he believed that the different cultures of debate in the business, trade union and voluntary sectors etc. would inhibit the achievement of a uniformity of understanding between the sectors in the Civic Forum. In the Republic of Ireland the NESF has attempted to deal with this problem by giving the Chair clear and strong terms of reference (INTERVIEW, 24 August 1999).

However, there is an inherent contradiction in giving quasi-autocratic powers to the Chair of a participatory democratic institution.

The possibilities for a sea-change in the way in which Northern Ireland's social and economic problems are understood and tackled by a new political dispensation that is amenable to recommendations from the Civic Forum was highlighted by Monica Wilson, (Director of Disability Action) who suggested that the functions of the Civic Forum should relate to 'policy development' and 'systems change'. Systems change refers to a 'softening' of interfaces between institutions and their users. A participative institution like a civic forum has the potential to offer user insight on institutional inflexibility problems and to propose ways of doing things differently with the aim of improving the relationship between institutions and the citizen. The potential capability of the Civic Forum to build unlikely alliances and networks may enhance the possibility of eliciting the unique perspectives required in a changing situation (INTERVIEW, 26 August 1999).

Niall Fitzduff considered that the proposed Civic Forum should be a guarantor of principles of equality, targeting social need etc. as well as providing a space where marginalized voices, that do not translate into votes, can be heard (INTERVIEW, 24 August 1999). However, Liz Law, (Northern Ireland Council for Voluntary Action), cautioned against high expectations for the Civic Forum lest they should lead to disappointment: 'It [the Civic Forum] has to be realistic and realize what it can do and what the Assembly can do' (INTERVIEW, 23 August 1999). Edwin Graham, (director of the Lurgan Council for Voluntary Action), considered that the Civic Forum had the potential to become a 'wider sounding mechanism for the Assembly'. He added that, while Assembly members enact legislation, 'if the reports of the Civic Forum are properly presented to them and the paper work is sufficiently robust then it would be very difficult for the Assembly to fly in the face of the Civic Forum all of the time' (INTERVIEW, 20 August 1999).

#### *Undemocratic participation?*

Richard Jay (1995) has argued that the voluntary and community sector may be perceived as having become so integrated into the policy-making network during the period of direct rule as to have forfeited the credentials of participative democracy. Certainly the high level of expertise within the sector sets it apart from the 'ordinary citizen' who is the source of democratic legitimacy.

Some respondents recognized that participation by the voluntary and community sector in governance may be perceived as undemocratic. Liz Law of NICVA expressed the view that one of the charges laid against the sector in the past was that 'we didn't articulate what our values were; what the ethos was; what we saw as good practice; how our way of working could be valuable; why it was more

participative' (INTERVIEW, 23 August 1999). Monica Wilson warned that 'the danger of being "inside" is that you lose your principle, that you collude'. However, she believed that participation is a game that can and needs to be played without necessarily losing the ideals of democratic participation: 'We [Disability Action] think that it is possible both to take the food and bite the hand. The only way to change public policy is to try and build local alliances and maximize effectiveness by taking the best of what is on offer' (INTERVIEW, 26 August 1999).

### *Inclusion and effectiveness*

A potential problem for the effectiveness of the Civic Forum lies in the strong emphasis placed on the inclusion of many marginalized voices. The then Deputy First Minister (Designate), Seamus Mallon, asserted that the Forum would be 'no mere talking shop or gathering of the great and the good' (in remarks to the NICVA Annual Conference and AGM on 24 June 1999). The 'great and the good' is understood to refer to eminent people from the business, trade union or voluntary sectors with a history of participation in governance during the period of direct rule. The implication was that, in deciding on the membership of the Civic Forum, 'the great and the good' may be passed over in favour of 'ordinary citizens' and, three years on, this is what many consider to have taken place. This has raised a question mark about the resolve of the architects of the Forum to maximize its effectiveness as an institution of governance. Niall Fitzduff cautioned that 'if you lose the inclusion of the people out there then you have lost the Civic Forum' (INTERVIEW, 24 August 1999). However, some pro-participationists believe that the Civic Forum could become a 'tokenist' institution, stifled by the inclusion of as many marginalized voices as possible without regard to analytical and communicative skills possessed by the members (CONFIDENTIAL INTERVIEW WITH A SENIOR OFFICIAL IN THE NORTHERN IRELAND OFFICE, 18 June 1999).

Bill Lockhart, Director of Extern, believed that 'in theory' the Civic Forum should be inclusive but agreed with the view that in practice, strict adherence to the principle of inclusion might result in tokenism. He argued that an 'outreach mechanism' to draw in people with no previous experience of participation but who may have a lot to offer is a potential solution to the inclusion versus effectiveness conundrum (INTERVIEW, 19 August 1999).

The allocation of 18 seats to the voluntary and community sector and 7 each to the business and trade union sectors may be perceived to be another potential problem for the effectiveness of the proposed Civic Forum. Leaders in the business and trade union sectors were aggrieved at their smaller allocation and may take the Forum less seriously than they might have done had sectoral representation been

more balanced (BELFAST TELEGRAPH, 23 February 1999). Indeed, some political analysts saw early signs of the leaders of the business and trade union sectors losing interest (DEMOCRATIC DIALOGUE, 1999, p. 15). They cite the *Department of Economic Development's Strategy 2010 document that was drawn up by the public sector in conjunction with the business and trade union sectors*. The document proposes the establishment of an economic development forum to monitor and adjust the strategy (DED, 1999). If the business and trade union sectors participate alongside the public sector as equal partners in an economic development forum, they may come to regard that forum as their primary interface with political representatives. Such a development would have obvious detrimental implications for the effectiveness of the Civic Forum. Nevertheless, the respondents from the voluntary sector were unanimous in their view that the sectoral balance of the Civic Forum was broadly the right one (INTERVIEWS, 19-27 August 1999).

Bill Lockhart maintained that the range of representation proposed for the Civic Forum would be the key to its effectiveness and how seriously it would be taken by political decision-makers: 'If it has a wide range of people discussing and debating, trying to come to a view and putting that on paper then I would hope that a minister would use it as a guide in policy- and decision-making. The voluntary sector has a definite role to play, which is beyond pure service provision. There is a level of expertise in the sector, which should be used on broad social issues. It should have a role to play in influencing government (INTERVIEW, 19 August 1999). However, Liz Law believed that it would have been simpler to base the composition of the Civic Forum on these three main sectors alone: 'the simpler it would have been, the more equitable it would have been. The increase in the sectors that are named and the sub-sectors within the voluntary and community sector militates against equality and makes people think representationally when they are not representatives as such' (INTERVIEW, 23 August 1999).

### *Representation and participation*

Inclusiveness and sectoral (im)balance were among the issues that preoccupied the leaders of the voluntary and community sector with an interest in making the proposed Civic Forum as effective as possible.

One respondent recognized an ongoing tension between democratic representatives and democratic participants: 'the politicians would have seen the voluntary sector having a louder voice [during direct rule] than would normally be the case'. A new political dispensation has in fact brought new challenges for political representatives: 'Civic Forum members will have to recognize that politicians are having to learn their role so it has to be a two-way thing in terms of developing trust and an understanding of the different roles' (INTERVIEW, 23

August 1999). Avila Kilmurray viewed the proposed Civic Forum as a 'first step in the process of exploring the possibility of creating an interface for the engagement of sectors in society that is apart from the formal political structures but can work with those political structures' (INTERVIEW, 27 August 1999).

The experience of working together with elected representatives, with business and trades union interests in the District Partnerships set up to help administer the Peace Programme imbued some voluntary participants, as well as some political representatives with an awareness of the need for interdependence and the need to find a balance between representative and participative forms of democracy. For Avila Kilmurray, 'the Civic Forum had the potential to locate in the political sphere some of the knowledge base of the District Partnerships, which were seen as somewhat apart from politics' (INTERVIEW, 27 August 1999). Monica Wilson believed that an effective Civic Forum would be a potential interface that could help realize a democratic balance by facilitating the development of themes of multiple interest where people see the commonalities so that those who are marginalized become empowered players (INTERVIEW, 26 August 1999).

### **Conclusion**

The increasingly global-national-local nature of politics necessitates further development in democratic theory and practice. Civic fora in transterritorial institutional systems of governance offer a means of building on the successive enfranchisements of the modern era. They have the potential to strengthen new forms of democracy by enabling marginalized participants from civil society to have a voice. Northern Ireland's communal alienation and exclusivism provide difficult obstacles to achieving the inclusivist goal of a Civic Forum (JAY, 1995, p. 70). However, through such a vehicle Northern Ireland society may begin to overcome the stranglehold of alienation and exclusivism. In the eloquent words of Benjamin Barber, 'human freedom will be found not in the caverns of private solitude but in the noisy assemblies where women and men meet daily and discover in each other's talk the consolation of a common humanity' (BARBER, 1984, p. 311).

### **Acknowledgement**

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## Notes

1. Apart from a brief period of less than five months in 1974 when a local power-sharing administration functioned.
2. Officially designated as the Special Support Programme for Peace and Reconciliation for Northern Ireland and the Border Counties of the Republic of Ireland.
3. There are also be voluntary and community sub-sectoral groups concerned with older people, youth, women, people with disabilities, ethnic minorities, carers, families and children, community development, community health, community education and the environment (REPORT OF THE FIRST AND DEPUTY FIRST MINISTER (DESIGNATE) TO THE ASSEMBLY, 15 February 1999).
4. In this article, references made to the 'nation-state' also encompasses the concept of the 'national state'. Strictly speaking, the state is a 'national state' when its centralized, autonomous and differentiated structures uphold legitimate authority within a boundary that contains multiple regions. However, a nation-state exists only where the citizenry share a common code of national identity expressed in language, religion, myth and custom. The majority of modern European states are quintessentially national states, while only a small minority, ostensibly the Republic of Ireland and Sweden, could satisfactorily qualify as nation-states.
5. See note on below 'Respondents' for details.
6. In parallel with these developments, the European Union's LEADER I (1992-1994) and LEADER II (1995-2001) programmes provided opportunities for joint working by rural development representatives of community groups, civil servants from the Department of Agriculture and local government staff and councillors. The funding for LEADER II is £14 million. Across rural Northern Ireland LEADER's innovative programmes and projects engaged 15 LEADER groups incorporating many hundreds of representatives of local communities in planning for their communities. On the urban scene Area Partnerships were established in Belfast in the mid-1990s under the Making Belfast Work banner. These brought local 'civil society' interests into contact with statutory agencies in a formal way. However, there is considerable dissatisfaction with the slow rate of development of these partnerships and with the reluctance of the Belfast Development Office to share information with them and, in their view, to 'take them seriously as equal partners'.

Further evidence of the collaborative relationship between the third sector and government is the Joint Government/Voluntary and Community Sector Forum for Northern Ireland, established in 1998, which meets twice each year. This body brings together representatives of the voluntary and community sector (12 drawn from a panel of 24) with civil servants from a range of relevant government departments.

## **Respondents**

Respondents include leaders of the voluntary and community sector from both urban and rural areas, from across a broad spectrum of organisational fields including disability, criminal justice, and community relations. Respondents also include the directors of two region-wide umbrella organisations and one local umbrella organisation. The interviews were tape recorded and respondents gave their agreement to their views being reported in the context of the present article.

Niall Fitzduff, interviewed on 24 August 1999, is director of the Rural Community Network (RCN). Based in Cookstown, County Tyrone, the Network is a membership organisation representing some 450 rural associations and groups from across Northern Ireland. RCN is one of four regional organisations which have been given the task of developing a mechanism to select 18 representatives from the voluntary and community sector to sit on the Civic Forum.

Edwin Graham, interviewed on 20 August 1999, is director of Lurgan Council for Voluntary Action based in Lurgan, County Armagh, a community deeply divided on ethnic and political lines and characterised by significant areas of deprivation and disadvantage. The Council is an independent voluntary organisation established in 1994 by local community and voluntary groups to promote community development. It provides a range of services to the voluntary and community sector, has promoted the development of a number of voluntary organisations in addition to providing information and support and is closely in touch with a wide range of community groups and grass roots voluntary organisations.

Avila Kilmurray, interviewed on 27 August 1999, is the director of The Northern Ireland Voluntary Trust. Established in 1979, the Trust is Northern Ireland's community foundation and is an IFB under the EU's Peace Programme. Under this programme it awarded almost £6 million to around 500 community based projects in 1997/8. It also undertakes a wide range of development and related policy work.

Liz Law, interviewed on 23 August 1999, is a senior staff member of the Northern Ireland Council for Voluntary Action (NICVA), the main umbrella organisation for voluntary, community and charitable associations and organisations in Northern Ireland. NICVA provides information, support, training and representation for its 600 members and works with government and with the EU on policy in relation to the development of policy relating to voluntary action.

Bill Lockart, interviewed on 19 August 1999, is director of Extern, a major voluntary organisation working in the criminal justice field. Established in the mid 1970s, Extern employs about 150 staff and operates more than 20 projects providing preventative and restorative services to people affected by crime and



social exclusion. He is a member of the Governments review committee established under the Multi-Party Agreement to consider the need for change in Northern Irelands criminal justice system.

Monica Wilson, interviewed on 26 August 1999, is the director of Disability Action, the leading intermediary membership organisation for disabled people in Northern Ireland. With 150 organisational members it has some 90 staff and a turnover of more than £3 million per annum. Among the services it provides for disabled people are: an information and advice service; a driving school and assessment centre; a prevocational training and employment service and a community development programme. It also engages in advocacy and lobbying about disability rights.

John Woods, interviewed on 23 July 1999, was, until mid-1999, the director of New Agenda. Based in Belfast, New Agenda was established in 1997 as a network of voluntary sector leaders and academics. An offshoot of the Belfast politics and policy think-tank, Democratic Dialogue, its members worked together in the run up to the Multi-Party Agreement. Following the signing of the Agreement it continued to facilitate discussion of proposals for the Civil Forum.

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## **Appendix**

### **The Social Economy in Northern Ireland**

#### *Community enterprises in Northern Ireland (196 surveyed)*

- 1,089 jobs had been created
- there were 939 volunteers
- 5,339 people were members of these organisations
- turnover, 1997-98 was a total of £14.4 million.

#### *Northern Ireland Federation of Housing Associations*

- 41 Registered Housing Associations
- 20000 units of rented accommodation
- £42.5 million generated in service and rental income
- £118.3 million net assets
- 1500 people employed and over 500 volunteers.

#### *The Community and Voluntary Sector in Northern Ireland*

- 5,000 organisations
- 33500 employees
- 79000 volunteers
- £514 annual turnover -less than 1% of which comes from business contribution and only 8% from public/fund raising.

#### *Co-operative Retail Sector*

- 1350 are employed throughout 31 outlets
- total investment of £100 million sterling in the local economy since 1991.

#### *Irish League of Credit Unions*

- 536 Credit Unions throughout Ireland
- membership of 2.2. million
- savings of £3.3 billion
- assets of £3.9 billion
- 183 credit unions in Northern Ireland with an estimated 700 paid staff and 4000 volunteers
- 500,000 members of credit unions in Northern Ireland (1/3 of the population).

Sources: NICDA/NICVA, 2000

## VISIONS OF CO-OPERATIVES RESTORATION IN POLAND

Zofia Chyra – Rolićz

After the second world's war, under the communists power co-operative movement had been reoriented from full democratic, economic and social movement into the pillar of new political order in the central planned economy [1]. At the beginning of the new time some co-operative branches with long tradition like banking, housing, peasant's supply and marketing and others were liquidated by the authoritatively political decision. Co-operatives had existed under the strong control of communist and peasant's parties nomenclatura and its had built very big and large bureaucratic structures of its territorial and branches of activity's unions. There were the good paid jobs for thousands of parties' functionaries, and also the place of asylum for these, which were not enough suitable candidates for higher political carrier. All co-operative branches had worked under the regime of central planned economy with very thin margin for individual decisions and collective management of co-operators. The sector of co-operative economy had received large area of activity. At first in early 50.ties – it had served as a tool for collectivisation of individual peasants craftsmen and artisans, also preparing new patterns in supply of goods for inhabitants of towns and villages. Workers industrial co-ops and co-ops of disabled persons had very good possibility of growing, supported by governmental policy leading towards the professional vivacity of different groups of society and economical boom of undeveloped countryside. Next – at 70.ties co-operatives had received monopolistic positions in housing and supply of food, dairy in towns and in countryside. These important decisions had been made outside the co-operators meetings, in the shadow of party's cabinets. In these circumstances democratic co-operative spirit had quickly disappeared.

During the political turning – points in 1956/57 and 1980 – 1981 co – operators (rather older, remembering time before the real socialism) had asked for renovation liquidated branches and co – operative traditions, especially the democratic, voluntary spirit, management and social control in this sector of national economy. They organised many meetings, articulated arguments, preparing memorials to the government. The results were rather in organisational area then in general situation of movement. Nobody didn't vote against the political dependency of co – operative movement in the central planning economy. The restoration of liquidated branches, mainly banking and housing, also the renovation of three separately organisations for agricultural co – operatives (supply, dairy and horticulture) were the more important victory of these times.

The idea of restoration co-operative movement had appeared in early 80ties in Poland between co-operators and scientists (mainly economists and sociologists) closed to political opposition against socialist central planning economy [2]. In this time this idea was connected with the preparation of the new co-operative law, so called 3S (Solidarity – Self – help and - financing), acted from October 1982. This direction of reorientation co-operatives' activity had gone towards free market economy as an island different orientation in the time of central planning socialist economy. It had composed the origin of new economical relations in the socialist reality. From this point of view this co-operative laws had been strongly attacked by conservative state and communist party bureaucracy.

The next step towards free market in Polish economy was done during 80ties. For co-operators it meant a little more autonomy in the basic decisions – the possibility of choosing the co-operative union for association.

The following step was made at the end of 80ties, when the big political change of future way of development was decided. The political opposition (“Solidarity” movement) exalted the different perspective of developing – political and economic pluralism leading to free market rivalry as a remedy for long lasting indigence of goods [3,4]. The big change of political and economical system was decided by citizens' votes at the parliamentary election 4 June 1989. It would conduct to the dismantling of central planed economy and to establishing whole conglomeration of independent enterprises, which would have equal rights and full of rights in economic activity. This situation opened the question concerning the place of co-operatives in approaching changes and future role in the national economy.

During the first Congress of Polish Co-operatives in December 1989 delegates from co-ops discussed about the reorientation co-operative activity from realisation the national plans of economic and social development towards every day interests of its members, clients, citizens. In fact, it was rather the vision of small co-ops serving for its members' needs, than the large scope units. The director of Co-operative Research Institute in this time - prof. Stanisław Nowacki [5], so described five mains urgent directions of Polish co-operatives' restoring:

- Co-operative's property should constitute the constant part of the new social and economic state's system. In consequence, it would be necessary to change the relationship between three levels of property in the state (national, social, and private estate). Co-operative property – from his point of view – wasn't identical with private property, because it was common used property of members, even more effectively than national. He underlined that in future transforming the co-operative property should be one among the whole system of different equal types of property: national, communal, self – governed and private. The superior

criterion of developing should be only the economic efficiency, not political plans and decisions. In fact, he believed in better order, management and efficiency in co-ops and expected the co-operative's expansion to other areas of economy. He saw the co-operative forms of property and common activity as an alternative of privatisation the national property as the better way serving for its members and society.

-According mentioned above rations, **social free market economy** was appeared as the great for future developing of co-ops. It was not only a mirage of good wishes thinking but the good working in practice patterns of high developed countries.

-Co-operatives could developed only like full democratic and self – managed movement, accepted by society because of economical reasons and social benefits.

- Co-operatives needed the completely **new economic and financial system**, protecting co-ops in conditions of strong market competition. In contemporary Polish condition it meant the valorisation of members' shares bringing them the real value.

Co-operative also needed the **modern system of management and organisation** for coming time. The unification of organisational structures hadn't seen for him the good solution. He voted for differentiate of co-ops' types and its unions and associations according real needs and challenges.

The discussion during this Congress shown big gap between very traditional mentality of co-operative's high functionaries, acting in central planned economy, waiting for instructions and challenges of the time of transformation. There were presented also votes of delegates demanded preparing the new co-operative law. The realisation of the mentioned above issue was the main goal of future law and organisational changes decided by co –operators.

During this political turning – point leaders of co-operatives, traced their origin back to nomenclatura, were disoriented and not be able to make the quickly necessary changes by own forces.

Finally the restoration of co-operatives in the III Republic of Poland has begun by the new government of "Solidarity" with Prime Minister Tadeusz Mazowiecki by the Act of 20 January 1990. Its general idea was oriented to breaking old bureaucratic structure of co-operative' organisation and to create a new full voluntary co-ops, restoring a private property of its members as an essential value of new co-operative movement and new democratic society [2]. As prof. Jerzy Klier noticed [3] co-operatives with its over 150 years' tradition, were the field for an experiment with "shock therapy" in Polish economy, reorienting after almost a half of century into free market. According prof. Klier's idea, the Ministry of

Finance Mr Balcerowicz and his crew thought, that testing the liberal model of transformation would be more easy in co-operatives. At the beginning of transformation new political leaders had prefer this solution, thinking that – what was not important in that time – it would not create so big resistance like in state sector of national economy, giving job for millions workers. It seem [3] for them more easy to do, because there were two options between co-operators and opposition's leaders. One had recognised and appreciated old co-operative traditional like from the end of XIX century, which had developed at the margin of free market, acting self – help functions. It was the main reason for transforming socialist co-operatives. This point of view was more popular among part of economical leaders from new political forces – “Solidarity” and a group of co-operators, appreciated social functions and flexibility of co-ops. Another part of new leaders had seen co – operatives only like an unreformed relict of real socialism, which was appropriated for destroying. In spite of that big co-operative estate was seen as very easy and rich field for privatisation, giving floor for growing up the new Polish middle class. These reasons determined the general political solution accepted for transforming socialist co-operatives. Mentioned above liquidation of old organisational structure had accompanied strong and aggressive campaign against co-operatives in press and TV.

Very quickly it brought big loss in co-operative property and great collapse its role in the national economy. The crisis of co-operative's idea has been deepened in 90ties.

Co – operators (management staffs, members and employees of co-ops) very quickly at 1990 tried to organise themselves for depending the good meaning of the co-operative's idea, common property, places of work and jobs. There were proofs of establishing special committees for support this kind of voices in Warsaw and at countrywide.

It was also even more – the proof of organising the co-operative political party (Union of Free Co-operators) undertaken in spring 1990 by ing. Michał Sandowicz. This leader wrote a whole program of wide activity with very smart tittle –“Co-operative way toward new Poland” [6]. At the beginning of Polish transformation the leader proposed co-operative activity as a certain medicine for almost all great public problems in general spirit of social consensus and common work in different type of co-operative, in towns and countryside. He saw the possibility of future developing in banking, trade, housing, small industry and crafts, dairy and agriculture. In fact, he drew a large place for social free market economy, realised in many co-operative enterprises He also tried to find the balance between the state and co-operatives on the field of democracy and freedom of economic activity. This program was very close to old pan co-operative ideas from the end of XIX and beginning of XX describes by Sidney and



Beatrice Webb and Charles Gide. It was also the vision of "Co-operative's Republic" showed by Polish philosopher Edward Abramowski (1868 – 1918) [7]. Unfortunately, Union of Free Co-operators didn't joint many members and funds, didn't win the election to the Parliament and very quickly collapsed and disappeared from our politic life. Now so interesting program is completely forgotten and nobody tried to continue this way during last decade.

Co – operators had possibility to present their opinion during the long lasting discussion concerning preparation the new co-operative law. At last it was rather next bid change of the old one than the new law. In spite of pressure done by new political forces liberal oriented, co-operators voted had and depended full independence of co-operative organisations and management bodies of this movement.

The new shape of co-operative's law, voted in 1994 after long lasting political struggle at the parliament as a compromise of different options, came back to the definition of co-operative, which was used in the II Republic, between two world's wars. This definition designates as a full voluntary association of equal members in their rights, duties and benefits. Mentioned above law removed also the traditional meaning of co-operative property as the private estate of its members – owners of members' shares. The social activity of co-ops was also underlined, but not obligatory.

According this law, co-operators kept full democratic mode of election their representative management bodies – the Congress and National Co-operative Council). These bodies were elected full democratic only among members of all kinds of co-ops in countrywide. This very expected event opened the floor for the new wave of discussion concerning the future. Prof. Zbigniew Madej presented the new strategy of Polish co-operatives developing [8]. In this time he believed that co-operatives would play the important role in establishing of new political and economical system. It would exist like a bridge between free market of liberal economy and government policy of interventionism for supporting weaken groups of society. This vision came back to the Polish tradition of the II Republic. He underlined the real success of co-operative movement changing the rapacious capitalism in XIX and XX centuries for better. In contemporary situation of a half of 90.ties in Poland he saw the great value of co-operatives in privatisation of state property leading to the new society of small owners, more reach than hitherto society of users. According that, he noticed the great request for new co-operative thoughts and researches supporting co-operators in difficult choices of transition. Looking at the urgent co-operatives problems – he indicated needs of restoration organisations of management and self help, unions of primary co-ops for common economic activity and applied of modern management's methods.

New wide vision of co-operatives' restoration was drawn in the new politic reality during the next Congress of Polish Co-operatives in May 1995 [9] and was repeated once more at the II Congress in November 1999 [10]. There was the large scope, complex vision of economical activity on free market's competition and also program of co- operative education of young generation and training co-ops members and staffs, supporting co-operative idea in Poland. Co-operators recognised the weakness of their estate and meaning, very danger for future. They asked the government and politicians for warrant of free activity in future among different enterprises. They voted for special policy of state's intervention, supporting co-operatives as a part of new social policy, which lack has been evident. Characteristically, they didn't asked for bigger privileges, but only for equal conditions in law and financial, comparing with foreigner capitals.

The near perspective of European integration has appeared in co-operative's programs in the middle of 90.ties. They recognised it as a good perspective, underlining their old tradition of international co-operation and potential possibility to create collaboration in future. The integration has been seen as a chance for modernisation (in area of know – how technology, equipment and management) Polish co-ops towards win the free market competition. In the same time co-operators reminded the role of co-operative movement in keeping the national Polish tradition in united Europe.

Co-operators discussed among them in the circle of good convinced peoples. They invited politicians from mains left – oriented parties for their congress and tried to arrange co-operative lobbying against proofs of changing co-ops in joint stock – companies.

Right – oriented political forces, mainly Union of Freedom and Electoral Action "Solidarity" tried to open easy possibility of transforming co-ops into different kind of companies by special act, which was brought to the Parliament in 1997. Authors of this project explained that it would give better contacts with foreigner investors, preferring to have relations with rather narrow group of owners that bigger group of independent co-operators with many small shares and using its rights in auditory body. In fact, it wasn't the new idea of restoration Polish co-operatives, rather the next proof of privatisation co-operative's property (protected by Co-operative law in this time as a private property) according this new law. This project floated the continuity of economical activity of enterprises and changing it from co-ops into companies only by decision of members voted in general assembly in one day! Fathers of this concept used false arguments about better management and efficiency in companies than in co-ops. This project, discussed in the Parliament involved big movement of protest in co-ops in countryside. Co-operators organised committees for saving their enterprises in many regions and in Warsaw. Under the pressure of so spontaneous protests, the

National Co-operative Council announced its attitude against this proof of becoming the owners by narrow group of businessmen [11].

The struggle of shape of co-operatives, described in the projects of new Co-operative law, had place during the former the Parliament's term of office in 1997 – 2001. Once more it was the rivalry between tendency of independence and proofs of extending certain groups of interests' authority over co-ops. In fact the line of both tendencies was agree with the political orientations – left or right. Some ideas supported by right or central oriented politicians, mainly from Union of Freedom, went out towards expectations of co-operators and peoples looking for possibility of creating jobs for themselves in small enterprises.

Unfortunately much impoverishing co-operatives hadn't enough own forces for realisation mentioned above programs, prepared inside this movement. There is continuously a big gap between co-operators' expectations and lack of clear defined social policy of state [12]. State policy until now doesn't include these programs in strategies of national – wide and local development. Co –operators, under authorisation of the National Co-operative Council try to organise meeting with representatives of governmental and local authorities, presenting them wide co-operative possibilities in solving many economical social problems in their regions. Results of these actions aren't noticeable quickly. Co-ops have weakened with flow of time. Statistic data published at the beginning of this year, shows not overcome tendency of collapsing and liquidation of co-ops in many branches, especially in countryside [13]. Co-operators look with hope towards UE funds.

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# ON THE DYNAMICS BETWEEN THE PUBLIC SECTOR AND THE SOCIAL ECONOMY IN DENMARK – ORGANISATIONAL PATTERNS AND STYLES OF LEADERSHIP

Gurli Jakobsen

## Introduction

When describing the *social economy* of a society at the level of organisations and statistics, one would normally include *cooperatives, mutual societies, and associations*. In the case of Denmark, this classification is doubtful in two respects. First, including cooperatives among the organisations of the social economy will almost always be met with a questioning. In the general opinion at this time in history, co-operatives are basically big commercial enterprises within consumer goods, and agro-industry. They are not normally seen as a part of the organisational picture of present day third sector activities. The social side to cooperatives does not seem to be present in people's mind - as any more than a historical reminiscence. This applies to the mutual societies as well. So, seemingly, that leaves us with the *associations* as far as organisational forms are concerned. However, sticking to associations as a basis for classification does not depict what actually happens in way of social activity and forms of organisation in the social economy in Denmark, as a considerable part of these activities appear to adapt the legal form of foundation or similar types of non-for-profit institutions ('almennyttige selvejende institutioner'<sup>1</sup>)

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<sup>1</sup>Literally speaking it means "self-owned-institutions for common benefit". It is a type of self contained not-for-profit foundation/organisation. They are value-based organisations, lead by a board, which is appointed according to criteria set down in the bylaws, but at a difference to e.g. cooperatives they are not per se democratically structured membership organisations.

**Table 1 Salaried employment in the SOCIAL ECONOMY, i.e in THIRD SYSTEM<sup>2</sup> organisations and enterprises in Denmark 1997.**

Types of third system ORGANISATIONS	Number of organisations and firms*)	Employment		Relative employment by segment	
		Number	Percentage	Commercial market	Social service segment
Co-operatives	3,142	77,883	3	99 %	1 %
Associations	10,640	79,806	3	38 %	62 %
Foundations, 'self-owned institutions'	4,702	128,250	4	9 %	91 %
<i>TOTAL 3rd SYSTEM *)</i>	<i>18,484</i>	<i>285,939</i>	<i>11</i>	<i>42 %</i>	<i>58 %</i>
<i>Total firms in DK with employees</i>	<i>129,477</i>	<i>2,699,300</i>	<i>100</i>	<i>65 %</i>	<i>36 %</i>

**Source:** reproduced from CIRIEC, 2001:55. The table is based on data provided by Danmarks Statistik. \*) These numbers indicate organisations and enterprises which have salaried employees. It does not include all those organisations of the third system entirely relying on voluntary work, or where the owners are the sole working. \*\*) If you include all firms, the number of VAT registered units is 421,408. **Note 1:** 'Commercial market' consists of organisations and enterprises within the following economic sectors: agriculture; industry; constructions; cars; trade; banking; business service; sanitation; hotels; transport; IT; Energy, water; housing; remaining categories. 'Social service segment' is composed of the following sectors: public administration; research; education; social welfare; health; leisure time associations; media; arts. **Note 2:** Of the total number of firms in Denmark, 129,577 firms have employees, of which the 18484 'third system organisations' make up 14%.

<sup>2</sup> 'Third system' is the term used in the CIRIEC study to encompass third sector organisations and enterprises both operating on the commercial market and in the social service sector broadly speaking. Third sector activities normally include activities operating in a not-for-profit perspective, and have an ambiguous approach to co-operative type organisations as a good part of the established co-operative enterprises today operate exclusively on the commercial market and in highly competitive markets. The "John Hopkins comparative nonprofit sector project" thus

## **Organisations and employment of the Social Economy**

The term *social economy* has not yet gained much recognition neither officially nor among people. The term *third sector*, on the other hand, has lately gained acceptance. It is used to denominate the various non-profit and voluntary private organisations that are, broadly speaking, engaged within *the social service segment*. It refers in particular to activities within the health and social sector (i.e. for people in need for various reasons). This sector is also one of the public sectors in Denmark where a lot of “third sector popular activity” has taken place in later years showing both creativity, and substantial social energy in many layers of the population. I am especially having in mind the many varied schemes of support, which have been developed and offered by organisations of the third sector, and which are directed to the integration and insertion on the labour market of the various socially and economically marginalised population groups. Such social activities are not unique for Denmark, at all. However - as revealed in the recent CIRIEC study<sup>3</sup> - the third sector seems to develop a somewhat different organisational pattern compared to other countries in Europe, including the Scandinavian countries; the main differences being that cooperative-type organisations are almost totally absent when it comes to new organising, e.g. in the field of labour insertion activities in Denmark, and that foundations or similar non-for profit-type organisations are rather common. Table 1 and 2 give a statistical evidence of this situation for the organisations and enterprises within the social economy which employ salaried personnel.

Table 1 presents an overview of the type and number of third sector organisations which have salaried employment. It is important to keep in mind, that besides the organisations and enterprises included in this statistics, there is a large unknown number of organisations in the third sector that entirely relying on voluntary work and which therefore is not included in this table. Also it should be noted that eventual cooperative enterprises which do not employ people will not be registered in this statistics - as would be the case with certain worker-owned cooperatives.

It appears that 11% of all employment in Denmark occurs within third system organisations and enterprises. Considering that more than 2/3<sup>4</sup> of the companies are one person firms, and 1/3 or 129.600 organisations and firms have employees, the ‘third sector organisations’ make up 14% of these companies and organisations. The table also shows that about 40 % of the employment in third system organisations and enterprises operate mainly on the commercial market and almost 60% function in the social service sector. The table gives a very clear picture of the employment in cooperatives by showing that only 1% is situated

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<sup>3</sup> The author formed part of the research team, having developed the Danish part of this research project, see CIRIEC 2001 a and b.

within the social service segment, 99% is on the commercial side. This is opposed to the position of foundations and self-owned institutions which have 91% of their salaried employment operating in the social service sectors.

**Table 2 The absolute and relative distribution of employment in third system organisations on types of organisations and enterprises in Denmark 1997**

Economic segments	Co-ops	Associations	Foundations	Total
Commercial market	77.104/65%	30.326/25%	11.543/10%	118.973/100%
Social service segment	779/-	49.480/30%	116.707/70%	166.966/100%
Total Third System	77.883/27%	79.806/28%	128.250/45%	285.939/100%

*Source:* CIRIEC 2001. *Note:* 'Commercial market' consists of organisations and enterprises within the following economic sectors: agriculture; industry; constructions; cars; trade; banking; business service; sanitation; hotels; transport; IT; Energy, water; housing; remaining categories. 'Social service segment' is composed of the following sectors: public administration; research; education; social welfare; health; leisure time associations; media; arts.

If we look at how third sector employment is distributed between the three types of organisations then we find in table 2 that 45% of the employment takes place in foundations and the rest is evenly distributed between co-operatives and association, 27% and 28% respectively. But if the sector is split according to economic sectors, a quite different picture appears. Within the economic activities mainly operating on the commercial market 2/3 of third system employment occurs in co-operatives, 1/4 associations and 10% foundations, whereas in the social service segment we find that 70% of the employment is within foundations 30% in associations and less than 1 % in co-operatives.

The thesis defended in this paper argues that this development is partially due to the particular dynamic between the public sector in Denmark and the associations. On the one hand there is a public social sector in a welfare state which provides many of the services to the citizens which in other types of societies will be provided via third sector organisations, on the other hand there is a flourishing third sector to a large extent financed by funds from the same public social sector. The public sector comprises the municipal, county and, as mentioned already, the state level. Cooperative co-financing or membership fees have little importance as schemes of financing..

So, the first questions to be asked are, how to understand the relationship between the public sector in Denmark and the associations? and how to characterise this



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claims that we have a situation of the public sector 'utilising' the voluntary sector for its own purpose and controlling what goes on in this sector, while the other claims that there exists a situation of complementarity and cooperation, where the public sector understands that certain services and problems are better dealt with by grass root organisations or other local entities? (Bengtsson in Borzaga & Santuari, 1998:182).

In the following section of this paper, I shall present a few historical data which will rather substantiate the second hypothesis, although it does not exclude the presence of the first hypothesis. In the last section, I shall illustrate how this particular social dynamics between the public sector and third sector organisations favours or conditions the adaptation of certain types of organisational solutions in the third sector which eventually on their side influence the social culture and dynamics in these sectors.

#### **Public support for third sector activities in social services (broadly speaking)**

At a general level the interaction between the public sector and these sector organisations has historically been rather one of cooperation<sup>5</sup>. The civil right of free association of citizens was written into the first democratic constitution back in 1849<sup>6</sup>.

In support of the second hypotheses, i.e. that this substantial economic support to activities of the third sector can be interpreted as part of a policy of complementarity rather than as part of a public control over the civil organisations, it shall be remembered that there is a tradition in Denmark of the public sector giving economic support to civil organisations which goes well back in history. By way of example, this has been the case for adult education since the 1890'ies, and similarly for sports and various leisure time activities. In general, this has been money granted to secure the normal running of activities of the associations, not to fund exceptional activities.

Another feature of this relationship in support of this hypothesis is that economic support has been rather free of ideological control on the part of the public sector.

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<sup>5</sup> Using the term 'relation of cooperation' does not imply that there has not been divergences of opinion and defence of interests. It refers to the way of solving such divergences and conflicts of interest.

<sup>6</sup> Denmark does not have a legislation similar to the French 1901 Law of Associations. An association has legal validity, when it fulfils the usual requirements of having a set of bylaws and a general assembly of members. In general terms one distinguishes between associations with a business purpose and those with a charity not-for-profit purpose. They are subjected to different tax regulations. In both cases they are run according to the general regulations for not-for-profit and for-profit organisations and

Even though important parts of the budget of many voluntary associations have come from public funds, traditionally the political climate has not favoured ideological control with regard to third sector organisations. The control has basically concentrated on the use of the budget.

A third element of the traditional relationship between the public social sector and the organisations, which also supports the hypothesis of complementarity, has been for public authorities to invite representatives of relevant third sector organisations to participate in commission work as consultants at legislative level.

Since 1988 the Ministry of Social Affairs has allocated substantial sums to social projects. In 1988-1991 the Ministry dedicated 350 million Danish Crowns (44 mill. ECU) to Social Development Means<sup>7</sup>. Since then, other support programmes have been set up, and by 1997 it covered a sum of 250 million ECU (2 billion DKR). These funds are explicitly aimed at the organisations of the third sector in order to strengthen local initiatives in the social area in favour of vulnerable social groups, and especially to projects which innovate the social service work, i.e. by starting new initiatives and new types of projects locally. So they are considerable public funds which have been and are channelled to the third sector organisations within the social service sector. But at a difference to some of the more traditional public support policy to the various voluntary associations and organisations<sup>8</sup>, as presented above, there is no requirement that the receiving organisation be a membership organisation governed by democratic principles.

The support programme of the Ministry of Social Affairs from 1988 and onwards is actually considered unusual internationally, including Scandinavia, because of its quite free criteria and vague principles with regard to content (Bengtsson in Borzaga & Santuari 1998:). The important criteria were that the project ideas be innovative and helpful to the targeted group (young, elderly, sick, disabled, immigrants).

Arguments in favour of the first hypothesis are presented by the critiques of the present support policy of the Ministry of Social Affairs. They express their worry that the voluntary organisations are on their way of losing their independence and movement character in order to become an extension at the service of the prevailing social policy. Compared to the traditional forms of economic support to third sector organisations, at present, a far larger part is given to projects which constitute unusual, innovative initiatives, and not, as has been the traditional form,

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<sup>7</sup> In Danish: "SUM-midler"; as a reference of comparison this amount corresponds in numbers to the total EU-program 'poverty 3' for that same period (Bengtsson in Borzaga & Santuari, 1998:182).

<sup>8</sup> For example, the Ministry of Education, various sports and leisure

support for the running of current activities of the association. This is seen as a procedure which opens up to a tighter ideological control on the part of the public authorities.

### **Discussing how public support structure may influence organisational patterns and praxis in the Third sector**

Now 12 years after the first programme of support to social projects and labour market projects was launched, it seems clear that this policy (which continues) has had consequences for the organisational pattern in the voluntary sector. A new type of organisation has emerged on which there is not yet a consensus on the used terminology. By some it is called project maker organisations, and by others network project organisations. In order to explain what this is, I shall briefly give an example.

*Case - an example of the mix between public and social economy in an autonomous non-for-profit-network-project organisation*

“Kulturkælderen<sup>9</sup>” started in 1988 in a rundown neighbourhood in Randers with a project that offered help and activities for immigrant women and refugees - as a means of integration into life and work in DK. Today, there is a range of activities of artistic and practical type which have developed and been kept going through fund raising for projects: puppet theatre, picture weaving, silk printing, computer design, tailoring, textile design, shops, language teaching, etc. The latest projects deal with urban renewal, entrepreneurship training and mentor support for the clients who wants to get self-employed (Jakobsen, 2001:10). Legally, this variety of projects is kept together by a ‘self-owned institution’. This institution is lead by a board and a daily manager. The board is appointed by the Municipality of Randers and counts members representing both public, private, and third sector, according to the principles set down by its bylaws. The daily manager is the originator and prime motor of the whole project. Depending on the preferred terminology, she is what we would call the “fire soul” or “social entrepreneur” of this institution.

There are 9 project leaders. In all 40 people are on the payroll today. Half are employed full time by the institution, and half are in social employments through different types of job activation schemes: ‘Job training’ and ‘pool jobs’ for unemployed, or ‘flex jobs’ meant for handicapped, disabled and other socially weak people. The economy of the organisation is entirely based on projects, which

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<sup>9</sup> “Kulturkælderen” means ‘Culture cellar’. The organisation started literally in the basement of an apartment building in a former run-down immigrant neighbourhood in

are financed half by EC-funds, and half by national co-financing by the municipalities, counties, or the state. After 12 years' existence and growth, employment in the organisation is still paid through project funding. It is a remarkable endurance and continuity in view of the precarious employment situation.

This case is one example. There are quite a number of organisations of this type in Denmark today, both in urban and rural areas. Names like 'The Side Street'; 'The Ecological Initiators', 'The Front Runners', are other examples<sup>10</sup>. They vary with regard to what is the central issue - urban ecology, young misfits, third age, training for project managing, community development, etc. A common feature is that they have been started by one or more "project makers" - i.e. people who combined social engagement with 'know how' to make project formulations. These are people who often -not exclusively- have a social pedagogical background, and they may have had a past as militants or active in youth movements and democratic movements of the 1970ies, so their social values often represent values like participation, democracy, personal growth and social solidarity. These organisations often have a rather strong, charismatic leadership. Voluntary work is an important ingredient in the activities of the organisation, also for the salaried personnel.

***A new organisational form or a new pattern? - network-project organisation or social entrepreneurial milieu***

What is the proper terminology to be applied to this social phenomenon of course depends on which aspects are emphasised. I have tried to show how the organisational complexity emerges over time as the different activities engaged in through the various projects take shape, gain some continuity and become a 'permanent' area of social action. More than a new form of organisation I understand it as a *social entrepreneurial milieu* or a *centre organised around a specific social issue, consisting of various types of organisational forms*. Like in the case described - 'The Culture Basement' - the central organisation that administrates the economics of the projects may be a *foundation - or self-owned institution*. There may also be a *membership association* - that groups the users and friends interested in the theme of the milieu, say 'urban ecology' or 'local community development', and social projects in this area. There may also be a *Day High School* organised as its own institution - offering different educational programmes for the targeted group. Frequently, there is a *board of support* with representatives of people selected from diverse external sympathetic and relevant

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<sup>10</sup>A comprehensive empirical study giving reliable data as to the extent and number of this type of organisations has yet to be made. This account is based on case studies, evaluation reports and information from practitioners and researchers in the milieu.

public and private organisations. Often there is also *some non-profit business activity - like a shop* the commercialises the products created in the various artisan or artistic workshops. This organisational complexity or 'milieu' thus appears as an autonomous entity, but it has an institutionalised interface or contact with the public sector. Among researchers in this field this complex type of organisations is also identified as "*project maker organisations*" (Bengtsson 1998:163) or "*network-project organisations*" because of the many units and the often, rather complex organisational set-up (Beck-Jørgensen and Hegland 1999).

***User influence, user orientation and employee-democratic forms of leadership, are they alternatives to this trend or is there a both-and?***

Returning to the issue of the organisational impact of the public support policy, one may ask what is the future of such organisations as fora of third sector development and alternative organisation?

Project money are by definition devoted to innovative projects which have a high degree of uncertainty beyond the period of financing, and the funding concerns a specific project. This situation naturally fosters a management style which must be pushed by the requirements of the funding projects in question, thus prioritising voluntarism and the strong, exceptional human efforts, leaving less space and resources for organisational development. At the same time many of these project-network organisations have developed an experienced and highly qualified personnel over the years. They, on their side, require participation and more formal structures of decision than the informal voluntary organisation model or the self-owned institution or foundation model might provide, and with the years they require a more predictable employment situation.

These conditions are pushing these organisation towards economic autonomy from public funding in order to become economically more self-sustained. At the same time the question of democratic management - and how the formal structures of the organisations interplay with the values of their practitioners in the organisations become more and more pertinent. In a certain sense, economically, it needs to develop an more autonomous and thus more businesslike approach to its activity. But will it mean going into private business with a corresponding management culture? Or will they be able to develop a new form of democratic economic organisation and style of leadership which is in accordance with the social values? I shall let these questions flow....

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## NEW LEGISLATION ON AGRICULTURAL CO-OPERATIVES IN HUNGARY

Szabo Gabor and Kiss Alexandra

### Introduction

One can find in the literature a number of important contributions regarding the connections between the State and (agricultural) co-operatives (Fregidou-Malama, 2001a, b; Ihrig, 1937; Spear, 1999; Szabó, 1995; Szabó et al., 2000 etc.), including the topic of legislation matters (Fregidou-Malama, 2001a, b; Gjems-Onstad, 2000; Ottolenghi, 2000 etc.). There are some more papers dealing with the managerial view (managerial behaviour) of the necessary changes in the co-operative strategies and/or structure when facing to the challenges coming from the changes and impacts of the (new) legislations (laws) on co-operatives and/or the changing market environment (Adrian and Green, 2001; Borgen, 1999; Fehér, 1995; Ihrig, 1929; Kalmár, 1996; Kiss, 2000; Módos, 1993; Russo, 2000; Szabó et al., 2000; Szabó, 2002; USDA, 1997 etc.).

The *main goal of the paper* is to show the recent Hungarian co-operative laws and to analyse the transformation process of the Hungarian agricultural co-operatives into joint stock companies or PLCs speeding up in the last two years. The study consists from three main parts. *First*, the main problems in the Hungarian agriculture regarding co-operatives will be discussed, *than* the very recent new laws on agricultural co-operatives will serve as theoretical basis. *In the third part* of the study the changes of Hungarian agricultural co-operatives in the last two years will be discussed, featuring case study including a co-operative which has been itself into a joint stock company (IOF).

*Main methods used* to carry out present research were: *literature review*, collecting *secondary (statistical) data* and *case study analyses*.

### Significant general and operational problems in Hungarian agriculture

*Fundamental problems* in Hungary concerning the emerging new agricultural co-operative system are the following:

- the lack of economic, political and moral (corresponding to social values) security and sound concepts;
- economic uncertainty given arising from the so-termed Compensation Law and procedure and continuing with the different 'co-operatives laws'



- low profitability in agricultural production;
- *collapses* in the domestic and *Eastern European markets*;
- *the inheritance* of the existing agricultural and *co-operative system*;
- *very low level of producers' ownership in the privatisation process, etc.*

It is difficult to establish a system which is distinctly different, due to insufficient incentives and the lack of security outlined above. There are of course *further problems (with respect to operation)*:

- firstly, the lack of capital and a convenient credit system for agricultural producers;
- for potential farmers it is unusual to run their own farm at their own risk;
- most people are not qualified to be real farmers; having until now been specialised in only one or two tasks which they performed on the former co-operative farms;
- there remain unclarified questions concerning land use and the land market;
- the 'always' changing Hungarian legislation concerning co-operatives is not practical and is very hard to interpret for the layman;
- finally, the institutional and infrastructural framework does not exist or is insufficient to stimulate and assist people to become farmers.

Due to the *privatisation process* the agricultural producers' share varies from branch to branch, but generally speaking it is a very minor one in the case of agribusiness. Due to the special tenders and procedures involved in the course of privatisation, producers hold only a limited part of the processing companies and almost nothing in the case of retail and wholesale chains. Since, in the course of the *privatisation process*, cash payment and the additional capital supplied were priorities, it was no advantage to the farmers that in the case of two similar applications the one submitted by producers would have been successful.

At the end of the *privatisation process* the multinationals and/or IOF firms now have a sound dominant market position, as well as property rights in agribusiness, while co-operative shares account for a very low proportion.

The so-termed *compensation procedures* had more ethical and political justification than the ones with rational economic consideration. However, in theory these would provide a good opportunity for farmers to obtain a share in processing companies. The lack of capital and information have led to agricultural producers not being able to use this possibility and having to remain at the production level. However, some smaller processing co-operatives run by the members have been emerging for a few years. These are active in pig meat and

dairy production. New co-operatives are now being established in the vegetable and fruit sectors. They are also some co-operatives in the branches of wine and frozen vegetables (Szabó, 1999, 2002). Another point of importance is that in most cases the transformed multi-purpose co-operatives (formerly engaged in agricultural production) have low capacity for the production of raw materials.

The greatest effects acting on the co-operatives are of course derived from the Transition and Unified Co-operative Laws (1992), as well as from the new laws on co-operatives come into force in 2001. The co-operative laws as general rules, supplemented by the statutes (by-laws), regulate co-operatives in Hungary.

### **Appearance of different interest groups in the transformation process of the Hungarian agricultural co-operatives due to legislation on co-operatives come into force in 1992<sup>1</sup>**

Besides the basic problems cited above, the so-termed Transition Law (Law II/1992: MK<sup>2</sup>, 1992b) also created many major problems for Hungarian agricultural co-operatives. This Law contained the transition rules for co-operatives for the purpose of changing their structure into that of genuine 'new type' co-operatives (guided by the so called Unified Co-operative Law, Law I/1992: MK, 1992a), companies or private family ventures. Due to the changes commanded by the above regulation there existed four different types of stakeholders in Hungarian agricultural co-operatives in 1993 (Varga, 1993):

- a) *active members* (a share of the co-operative property of about 40%),
- b) *retired members* (39%),
- c) *employees* (1%),
- d) *outsiders* (20%), who are also concerned with the co-operative through the business shares (certificates) which they obtained in exchange for their compensation vouchers.

The different interests, mentioned above, are still exist in the Hungarian co-operatives nowadays, like was the case in the transformed and converted co-op analysed in this paper (Section 5).

These opposite internal interests can basically be divided into *long term-short term and personal contribution-capital divisions*. In addition to these two basic groups there are three main types of totally different interests (Kalmár 1996, Módos

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<sup>1</sup> This section is based on Szabó et al. (2000), presented at the occasion of the ICA European and International Co-operatives Research Conference, 11-14<sup>th</sup> August 2000 in Oslo, Norway

<sup>2</sup> MK=Magyar Közlöny, which is the official gazette of the Hungarian Republic.

1993). The first is between the *active members and the so-termed retired members*. The latter term is a very interesting one which does not exist in agricultural co-operative practice in the Netherlands, Denmark or most of western Europe.

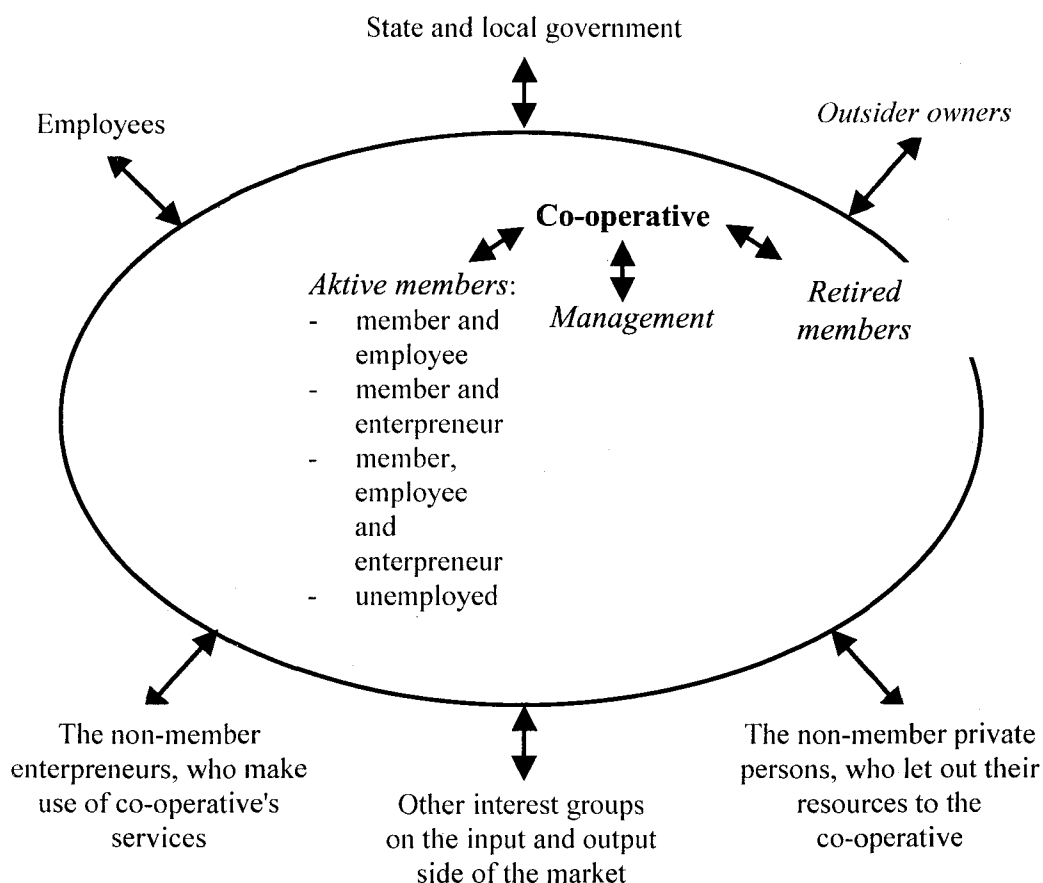
Secondly, there are different interests between the *(active) members and the outsider owners (as investors)*. The retired members and outsider owners are interested mainly in the short-term advantages of 'their' co-operatives, and because they have special shares in the co-operative they would like to obtain dividends on these shares as quickly as possible. They are not concerned with the long-term advantages of the active members. Finally, there exist some other misunderstandings between the *members/employees group and the 'new owners'*.

It is a unique situation in the history of co-operation that *outsiders hold a considerable proportion of the co-operative business shares, and retired members also control a large share of the co-operative property*. These *two groups are not interested in the basic activity of the co-operative (product/service line)*, but they would like to obtain the highest possible dividend on their 'investments' (business shares) as quickly as possible. Furthermore, their *interest is definitely short-term, in contrast with the interest of the active members (involving continuity of the activity of the co-operative)*.

There are *more different stakeholders* in an average co-operative in Hungary as can be seen in Figure 1. However, it is necessary to underline the *role of the management governing the co-operative*. The leaders of the co-op have got the *ability to control the main transformation process*, due to their *key position in the business and governance matters* of the co-operative. They have got plenty pieces of *information and very important connections* to members and to organisations and authorities, which are playing outstanding role in the life of the co-op. *Active members can be divided into more groups* on the basis whether they are working/earning additional income in elsewhere than in the co-operative. There are *some members who have got just special entrepreneurial business connections* to the co-operative, they are not working in the co-op. And there are *some who are employee of the co-operative and entrepreneur* at the same time.

**Figure 1**

**Different stakeholders in Hungarian agricultural co-operatives after 1992**



**Changes in the life of agriculture co-operatives in 2000-2001 and the Law CXLI on the agricultural co-operative business shares (2000)**

There were *significant changes in the Hungarian agricultural co-operative life* at the end of Year 2000, because of the *plan of a law on the settlement (arrangement) of the so-termed 'business co-operative shares'*. The government had planned to oblige the agricultural co-operatives to buy the business co-operative shares from outsider owners at their nominal (face) value. That was a real fear for the co-operative, since they had not got enough property to fulfil their obligation. It was clear for most co-operatives that the government prefers the western-type ("complementary") co-operation to the existing agricultural production type co-ops. Connected to the previous opinion, some of the co-operative leaders have

thought that the government would like to strengthen the family farm model, rather than to support the collective type production of the agricultural co-operatives.

There were hard disputes between the government and the representatives on behalf of the agricultural producers and co-operatives, and some of the co-operatives had decided to transform themselves partially or fully into (limited liability or joint-stock) company. There were remaining 952 agricultural co-operatives on 1<sup>st</sup> of January 2001 from the 1049 had been existed a year earlier. From the 97 co-operatives which were to be ceased, 45 were transformed itself into IOF company, in the last two months of year 2000. According to some opinion the latter cases were mainly due to the political atmosphere.

The Law on co-operative business shares (CXLIV/2000: MK,2000a) come into force from 1<sup>st</sup> of January 2001. The law obliged the agricultural co-operatives to buy the business co-operative shares from outsider owners with “subjective right”, at their nominal value. According to the legislation, if the co-ops had not got enough property to pay off the full price, the state would provide interest-free loan to cover the margin. According to the law mentioned above, the deadline to apply for the pay-off was 15 April 2001, however The Constitutional Court (hereafter CC) exterminated the above mentioned law (MK, 2001d). The main reasons were the following ones:

- The law violated the title to property with the obligation to pay-off the nominal (face) value of the co-operative business shares, because it deprived co-operatives of their property by means of executive power.
- The law violated the autonomy of the co-operatives with the compulsory pay-off and obligatory use of the state loan upon necessity (if the co-operative would not had got enough property).
- The unilateral arrangement of the rights and duties connected to the co-operative business shares was unconstitutional, because it had harmed one party’s private property.
- The laws provided unacceptable advantages for some objects of law.

Despite the decision of the CC, the procedure of collecting requests for the pay-off had been continued and 363 thousands applications had arrived until 15 April 2001. In May 2001 the government made it clear that they will *continue to arrange of the co-operative business shares and extend towards to the retired members*, which process has been started in 2002. In order to be able to carry out the above mentioned activity, the government entrusted the *Hungarian Development Bank Ltd.* (“Magyar Fejlesztési Bank”) with the foundation of an Ltd. for the *utilisation of the co-operative business shares*. The pay off has been carried out by that Ltd. in 100% from the governments’ budget. Recently, the process of collecting applications is being carried out in the regional offices of the Hungarian Ministry

for Agriculture and Rural Development. In the 5/2002 (MK, 2002b) decree the Government made it clear, that it is not an obstacle for the pay-off if in a co-operative there is a winding-up or liquidation process, or even when the co-op is close to go to the bankruptcy. The state *guaranteed the loans* connected to the pay-off procedures up to 2 billion HUF in a Government's decree (1025/2002: MK, 2002a).

Due to the above mentioned procedures the state has been getting property rights in the agricultural co-operatives in proportion of the co-operative business shares. There were and still are a number of questions regarding the state ownership in the agricultural co-operatives due to the above mentioned legislative procedures, like: what about the possible voting right(s) of the state or the rent has to be paid after the property (assets) has been used by the co-operative etc. However, it is clear that a long period will come in the arrangement process until the situation will solid and stable.

**Case study on the “doubly” transformed Kapostáj Agricultural Co-operative<sup>3</sup>**  
*Transformation of the former agricultural production co-operative according to the Laws come into force in 1992*

*The former Kapostáj Agricultural Co-operative* was a ‘traditional’ production co-operative located in Kaposvár-Toponár in the south-western part of Hungary. The *main aim of the co-operative was being above all to give the so-termed active members the opportunity to work and therefore to earn a living from agricultural production.*

After 1992, there was no longer any obligation for members to work in or for the co-operative, but on the other hand the co-operative (as any other co-operative) bearded no duty to offer work to its members. *Permanent employment* was the most important incentive for the members to stay in the co-operative. The number of active members was declining continuously in the last ten years due to the rationalisation taking place in the co-operative. This trend showed that a kind of hidden unemployment had been existed in the co-operative in the former decades, due to the regulation which had declared the right to work for the members of agricultural co-operatives.

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<sup>3</sup> Earlier, but a more extended version of the case study was presented at the occasion of the ICA European and International Co-operatives Research Conference, 11-14<sup>th</sup> August 2000 in Oslo, Norway (Szabo et al., 2000). See more details on the co-operative in Szabó et al. (2000).

Worthy of note is that, unlike members of other co-operatives during their transition after 1992, those of the Kapostáj Co-operative stayed together: none decided to leave the co-operative and/or withdraw assets or property, despite this was being easily possible due the legislation. There was no option to change into company form at that time, although in the that time this would have been easier to operate.

Liquidity and continuous cash revenues were also very important with respect to the viability and efficiency of the co-operative. In order to fulfil these basic aims the co-operative was engaged in the following main activities: *animal husbandry, including dairy (cattle), pig breeding and horse breeding, and cultivation of plants*. Animal husbandry in particular, incorporating dairy farming, was very important from the aspects referred to above.

According to the so-termed Transition (II/1992) and Unified Co-operative Laws (I/1992) co-operatives had to adapt their structure to conform to the new regulation on co-operatives. Changes in the economic and social system and the general problems outlined above, set a very difficult task for the newly elected Board of Directors (formed in October 1992) and the active (working) members. Rationalisation was the term used in establishing the new structure of the co-operative, including a plan to enable the common co-operative aims to be supported with the necessary basics of incentives for the various stakeholders (members and employees) of the different branches of the co-operative.

The *Board of Directors* consisted of 7 internal members and the *Board of Control* was composed of internal 5 members, both selected by the General Assembly and appointed for 5 years. The main authority was the *General Assembly*, which made decisions related to major events, such as acceptance of a by-law, winding up of the co-operative, mergers, separation, the appointment of a managing director, etc. There was no differentiation between the leadership of the co-operative as a society and that of the co-operative as a business enterprise. The *president of the Board of Directors was the managing director*, who was responsible for the General Assembly. *Voting rights* of members were based on the principle of one member, one vote; however, only the active and the retired members had the right to vote. They were therefore in a position to influence the long-term strategies and short-term activities of the co-operative.

### ***Financing and capital questions in the co-operative in 1999***

As can be seen in Table 1, the ownership structure was very complex in 1999, and had been become a great source of problems in the past years.

**Table 1 Share of the total co-operative property in 1999**

	Number	Co-operative shares in HUF	Business shares in HUF	Property in total in HUF	Division in %
<b>Members</b>	96	960,000	70,321,104	71,281,104	34
<b>Retired members</b>	219	2,415,000	83,304,811	85,719,811	40
<b>Inheritance matters</b>	25	25,000	3,937,374	3,962,374	2
<b>Members in total</b>	340	3,400,000	157,563,289	160,963,289	76
<b>Employees</b>	3	-	1,711,022	1,711,022	1
<b>Outsiders</b>	430	-	48,679,907	48,679,907	23
<b>Total</b>	773	3,400,000	207,954,218	211,354,218	100

Distribution of the co-operative property according to Law II/1992 (MK, 1992b) had been completed after an assessment of the property. This was rather a strange situation, since a co-operative is naturally a community of property, and due to the above legislation, there was no longer any *unallocated capital (i.e., reserves)*. So-called *co-operative business shares* were counted and established for each named member in 1992. There were, of course, *co-operative shares* as the financial symbol for membership of the co-operative. The value of each share was 10,000 HUF.

The following capital sources existed for the former Kapostáj Agricultural Co-operative:

- *balance sheet* (reserves from the net income made by the co-operative annually)
- *members loans* (short- and long-term)
- *credit* (short- and medium-term credits from a commercial bank)

The co-operative had to rent from the members, and pay rental costs for, the land used for grain production, which consequently decreased the efficiency of its activity. In some cases the co-operative financed the production costs incurred in the farming activity of members if there was a special 'contract production' arrangement.

The surplus made by the activity of the co-operative was distributed according to the personal contributions of the various members. Wages (mainly for manual work) represented a kind of cost to the co-operative. However, because it was very *important for members to be paid relatively high salaries, the management usually arranged for members to be paid during the year for their contribution, to the extent of it was still being possible for the co-operative property to remain workable.*



*Division of the surplus* made by the activity of the co-operative annually went to an unallocated reserve fund. In general the co-operative endeavoured to pay its employees relatively high wages, and therefore there was no real discussion about the volume of dividend paid back. Of course, money also had to be paid back to creditors.

*Payment in kind* to members (i.e., non-financial rewards) was very rare. Certain social activities did exist in theory, but in fact there was no money for such purposes.

On exit, members could claim back the value of their co-operative share (10,000 HUF), but could not take any asset away from the co-operative. *They could sell their business shares to the co-operative or to any of its members.* After leaving the co-operative, ex-members had not any liability, *since, as property might not be taken from the co-operative, the property of the co-operative was sufficient security against its debts.*

#### ***Different members – different internal interests***

Firstly, it is of significance that from 1992 till 1999 only new 5-7 members had been accepted. In accordance with the decision of the General Assembly, the Board of Directors was empowered to make decisions on the acceptance of applications for membership. Any individual wishing to become a member had to hold land property and/or some other assets and had to be willing to lease it/them to the co-operative. This was very important, since the basis of the co-operative activity is the land under cultivation. There was a natural geographical area from which members have so far originated. However, there was *no obstacle, regarding age, nationality, gender or size of transaction with the co-operative etc.*, to any individual becoming a member.

In the case of the co-operative examined general problems (listed in section 2 and 3) occurred from day to day; however, the situation had become harder, since *the number of the outsiders was increasing year by year.* They did not have control or decision rights, so they could not influence the business of the co-operative. As was stated earlier, no dividend had been paid on the co-operative business shares since 1992.

The main incentive for *active members* to stay in the co-operative was the *wage* they can earn for their work. They were also interested *in the growth of the value of their business shares.* The *income derived from the individual 6,000 square metres* was also part of the motivation package. For the *retired members* of the co-operative, ties were *more emotional* than rational, as they had worked in and for the co-operative for decades. Retired members also had 6,000 square metres on

which they could produce their own produce, or for which they might choose from the same possibilities given above. It often occurs that they could secure the best quality land for their own purposes. Active and retired members both had voting rights to influence the development of the co-operative. As in the case of 'outsiders', there was no dividend on co-operative business shares, even for members.

***The transformation the co-op into a joint stock company in December 2000<sup>4</sup>***

The General Assembly of the 'Kaposztáj' Co-operative decided to transform partially the co-operative into a joint stock company in December 2000. The main reasons to do the conversation so were the following ones:

- They would like to operate their properties in a *solid (stabile) legal form*.
- It would be possible to *dissolve the tensions* emerging due to the different entitlement (residual claims) of the owners.
- In the *new organisational form* a new organisational, governance and incentive structure will be established which will let a *more efficient operation to run*.
- The joint stock company as a *company (IOF) structure* will *make easier to absorb additional risk-bearing capital and loans*.
- The joint stock company such as, has got a *better image towards to the business partners* compared to the co-operative form.

However, it was a strong desire on behalf of the co-op to preserve or even to increase members' allowances in the new legal form as well. It is the cause why members had thought the transformation is not against their interests. The additional risk-bearing capital will make possible for the company to access to new markets, to obtain modern equipment park and therefore to enlarge their scope of services, all in all: to farm more efficiently.

**Table 2 Share of the total co-operative property in September 2000**

	Headcount	Co-operative shares in HUF	Business shares in HUF	Property in total in HUF	Division in %
<b>Co-operative members</b>	295	2,950,000	153,180,812	156,130,812	74
<b>Outsider owners of the co-operative business shares</b>	365	-	54,773,406	54,773,406	26
<b>Total</b>	660	2,950,000	207,954,218	210,904,218	100

Source: Györke, 2001

<sup>4</sup> This section is based on Györke (2001).

It is clear from the numbers of Table 2 that more than half of the owners of the co-operative were outsiders and they held the 26% of the total property. One can imagine that the compulsory buying up (pay-off) of the co-operative business shares would lead to a bankruptcy of the co-operative.

As we have referred earlier, there were different interests even between the different types of members, not just among the members and outsider owners, therefore it was hard to adjust the different interests (see Figure 1). The form of a joint stock company made available for every stakeholder to exercise an influence on the operation of the company. That was a successful project regarding to solve the interest tension among the different types of stakeholders. Recently, it is the interest of every owner to run the company efficiently and to get the results of their investments. However, the biggest disadvantage for them is the fact that everybody is just a business partner for the company, therefore the rent for their land is lower and the prices of the services offered by the company are higher.

#### **The Law CXLI/2000 on the new co-operatives**

The *definition* of the co-operative, incorporated into the new co-operative law (Law CXLI/2000: 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*.

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 12,000 EURO in 2002) as property of co-operatives shares*. In the case of *secondary co-operatives the minimum amount is 10 million HUF (proximately 40,000 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* is appearing 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 (Kiss and Szabó, 2001) 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.

### **Conclusions: future ideas and vision for the Hungarian co-operatives**

There is no precedent for a transformation from a centrally planned economy to a market economy. The co-operatives have to change their organisational form and activities without long-term strategies in agricultural policy, day by day reacting to the changes currently taking place in the Hungarian economy. In accordance with the economic and social circumstances prevailing in Hungary most co-operatives tend to have more than one function, including a greater or lesser degree of production of agricultural raw materials. Generally speaking, to remain in the co-operative seems to have been the decision of most members and to remain co-operative is still the choice of the most co-ops. The government has *supported family farms and the reorganisation of the agricultural production according to Western-European model* (Government's decree 326/2001: MK, 2001c). The farmer owning a family farm and meet some requirements, is eligible to apply for support to buy modern machinery or land, to invest into (re)constructing his

(premises) buildings etc. The government *also support the so-termed integrators* to give chances for family farmers against the big market actors.

However, the general and operational problems outlined earlier in this paper are still valid and signify a *very uncertain future for farmers and potential co-operative members*. Due to oligopolistic and monopolistic power in several industries, there are now only a few sectors and branches in which co-operatives are able to achieve success. In the case of the ‘doubly’ transformed Kapostáj Agricultural Co-operative it can be stated that the former co-operative, with its leaders, is a strong economic centre in the micro-region and has the capacity to adapt to different conditions and the changing economic and social environment with a *high degree of flexibility*. And that is the cause why the Kapostáj co-op transformed into an IOF form. However, one has to take in mind, that *only the careful examination the threefold (product, capital, control) connection between the members and the co-operative will show whether an organisation is still a co-operative or ‘just’ a(n) IOF firm, not the external-legal form* (Ihrig, 1929).

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## **GEMEINSCHAFT, GESELLSCHAFT AND THE THIRD SECTOR – ABOUT MYTHS, RHETORIC AND REALITY**

**Lars-Erik Wolvén and Bengt Flach**

### **General aim of the paper**

The aim of this paper is to analyse the third sector and its' near-related activities out of Ferdinand Tönnies classical concepts of "Gemeinschaft" and "Gesellschaft" (Tönnies 1867 and 1963). The hope is that this approach might facilitate the understanding of the controversies about the third sector.

### **Background**

One of the most controversial and debated questions over the past years has been how to best characterise the third sector. With a sweeping generalisation one could claim that left wing sympathisers tend to be sceptical to the growth of this sector, while right wing supporters have been more enthusiastic to the possibilities. Sceptics have spelled out that the third sector has been used to legalise cuts in the public sector, that inequality increases within this unregulated sphere, and as a consequence, the weaker groups in society are sometimes rather badly damaged. (See Antman 1993, Arvidsson m fl 1994, Busch och Zetterberg 1996, Trägårdh 1995, Sociologisk forskning/Sociological Research nr 4 1993 temanummer om Civilt samhälle, rätt och kärlek/Civic Society, Rights and Love och Sociologisk Forskning/Sociological Research nr 2 1994 temanummer om Staten, marknaden och det civila samhället/State, Market and Civic Society).

Supporters of the third sector have, on the other hand, claimed that the third sector first of all is characterised by friendship, solidarity and equal relations. In its turn this could constitute a good fundament for solving important societal problems such as child- and elderly care, small-scale handicraft businesses, provision shops in sparsely populated areas and so on. In sparsely populated areas in Sweden especially, these problems seldom have been handled satisfactorily by the State and/or the market.

### **What are Gemeinschaft and Gesellschaft?**

Expressed in another way one could describe – based upon the classical concepts Gemeinschaft and Gesellschaft by Tönnies – the attitude of the sceptics as being partly Gesellschaft-based and of supporters as being Gemeinschaft-orientated. The main differences between Gemeinschaft and Gesellschaft could be expressed as "value" differences in the following dimensions:

### *Language:*

In Gemeinschaft the language is spontaneous and emotional, in Gesellschaft instrumental and calculating. The differences could be illustrated by how friends care about each other in Gemeinschaft compared to the instrumental and goal-oriented behaviour between sellers and buyers on the market. Here the language is a mean to find products and services to maximise one's own utility.

### *Motives*

In Gemeinschaft the motives often are of a strong altruistic character, e.g. one acts in the spirit of the public good, whereas in Gesellschaft the motives are mainly egoistically founded. Using the Weberian terminology, Gemeinschaft is based upon value rationality, e.g. general values that might be of a religious or a philosophical character, whereas goal-rationality dominates in Gesellschaft, e.g. one chooses certain means to achieve certain goals.

### *Relations*

In Gemeinschaft the relations are close and intimate, in Gesellschaft on the other hand, they are peripheral and distant. In the former, love and hate are crucial feelings, while in the latter cooler feelings like satisfaction and discontent are frequent.

### *The bases of actions*

Gemeinschaft is ruled by the natural will (Tönnies: *Kurwille*), and Gesellschaft by the rational will.

### *Variation*

Stability, security and predictability prevail in Gemeinschaft and the world is easy to survey, whereas in Gesellschaft it is predominated by variation, insecurity and unpredictability.

Polemically expressed, the critics of the third sector look upon it as a bad variation of market relations, where everybody is competing against each other in an instrumental and egoistic struggle without the support of the State and the law to back up the weaker groups. In fact, many left wing supporters tend to regard the State as the best, or sometimes the only, support for the underprivileged groups in society.

The right wing supporters see the third sector quite on the contrary as an informal one, impressed by intimate relations, warmth, solidarity and justice, where man's language is of an expressive, not formal, character.

### **What do the third sector, civic society and social economy mean?**

One of the main problems in discussing the third sector is that what it stands for by no means is crystal-clear. Attempts to define it, as well as near-related concepts as civic society, social economy and even informal economy, usually results in special essays on solely that subject.

I avoid this problem by claiming that this article does not demand precise definitions. The reason is that I am interested in identifying Gemeinschaft-orientated activities no matter where they take place. And one of my points is that they are also performed within the State and on the market, even if they probably are more common between these sectors. For my modest purpose it is therefore enough to roughly treat this remaining "space" as the third sector.

However, something more can be added, out of Lidskog's (1995) interesting analyses of civic society. Lidskog claims, not surprisingly, that much of the controversies regarding civic society depend on the fact that different researchers tend to give the concept quite different meanings. In what Lidskog labels the neo-liberal ideas, the civic society is seen as an unobtrusive sphere disconnected from society. Here the civic society is a natural, harmonic place, with a structure that has emerged from spontaneous, irregular social processes. It is furthermore depolitized, not populated with political citizens, but with individuals with naturally given liberty and social rights. Thereby it can be looked upon as a private and unpolitical sector. Voluntarism and personal loyalties are thus regarded as the main characteristics of the civic sector. The consequences are that the State is looked upon as an invader of the civic sphere, disturbing and destroying spontaneously created orders.

According to Lidskog, this is partly a new and rather recent way of defining civic society. In the classical liberal perspective (See Locke 1691, 1984) the civic society was rather looked upon as something encompassing the whole society. From this point of view the State and the civic society could be in conflict with each other, since the State might violate the individual's natural rights and thereby also his harmonious freedom and self-regulation. Thus the State was only legitimate as long as it had active support from its citizens.

In the classical Marxist analyses, as well as in the neo-Marxist ideas, the concept of civic society is entirely different. Marx himself defined the civic society as all relations outside the State consisting of work exchange, reproduction, being an arena for selfish competition, capitalist exploitation and class inequality (See Peerz-Diaz 1978). At the same time Marx meant that the economy was the dynamic part of the society, influencing both the State and the civic society. The economic structure is in fact the fundament of all aspects of social order, including law and the State itself. Marx thereby demolished the idea of the civic society as some kind of idyll.

Neo-Marxists have developed the classical Marxist ideas, and the civic society is now seen as a sphere between the State and the market. It is also the setting where social reproduction and social struggle takes place. In Urry's version (Urry 1981) for example, the civic society is "a set of social practices outside the State and outside the relations and forces of social reproduction consisting of the overlapping spheres' circulation, reproduction and struggle". It is not only the class struggle that is of interest here but also interest groups and other forms of social movements. Today several sociologists have tried to develop a social theory that could better cope with the civic society and the importance of social movements in the capitalistic society.

### *Conclusions*

Based mainly on Lidskog's analyses of the civic society, I have tried to illustrate how hard the concept of civic society is to catch, depending partly on which ideological traditions the concepts are based upon. The difficulties will of course get worse when we also add concepts like "the third sector", "social economy", "informal economy" and other similar concepts. It is therefore not very surprising that one sometimes tries to go about the problem by defining these kind of concepts not analytically, but empirically in terms of family, neighbourhood, voluntary- and social movements. As already has been stated, I prefer to use the analytical concepts of *Gemeinschaft* and *Gesellschaft* as fundamentals for the forthcoming discussions.

(A similar association has been made by Forsell 1993)

### **Specific aim of this paper**

The idea of reshaping a kind of *Gemeinschaft* with economical interest is far from new. In fact the thought is already mentioned by Tönnies himself in a supplement to his classical text, in which his hope is assigned to the consumer- and productive cooperative movements. It seems that it is these thoughts or visions that are still very vivid for the supporters of the third sector and/or civic society. To which extent the visions really have been fulfilled is way out of hand for this paper. However, I will try to identify and analyse some business activities that – at least partly - might be of a genuine *Gemeinschaft*-character.

The aims could therefore be spelled as:

trying to identify and analyse business activities

- a. that still are of a traditional *Gemeinschaft*-type
- b. that used to be of *Gemeinschaft*-type but where *Gesellschaft* has intervened
- c. that seem to be *Gesellschaft*-orientated, but in fact have preserved most of its *Gemeinschaft*-character

- d. that present themselves as a Gesellschaft but are in fact more of a Gemeinschaft
- e. that present themselves as a Gemeninschaft but are in fact more of a Gesellschaft.

My point here is that the picture first given is sometimes deceptive, and that it could be of use to look somewhat closer at some business activities. Certain ordinary business activities might then turn out to be of a different and more genuine Gemeinschaft-character than seemed obvious at the first glance, but for others these results might be quite the opposite. I hope this paper in some modest way can contribute to interpret business activities in a little bit different way than is common. The ambition is also to give some clues to whether Gemeinschaft-oriented activities still can survive in a modern society, and that being the case, also where they can be found.

### **What are the main differences between State, Market and Gemeinschaft?**

One of the starting points for the forthcoming discussion is to try to differentiate Gemeinschaft from State and market. In the following table this is done by using the dimensions of goals, processes, resources and ideal types in the different spheres. (A similar idea for state, market and the third sector based upon values and mechanisms for control has been elaborated by Pestoff 1998)

	Goal	Dominating Processes	Strategical Resource	Ideal Type
Gemeinschaft	Solidarity/ Community	Cooperation	Network Ability	Altruism
Market	Profit	Competition	Winner Instinct	Egoist
State	Socialisation (of norms, values) Growth	Bureaucratisation	Administrative Talent	Instrumentalist

My description of the main characteristics of the three spheres is of course utterly simplified. Nevertheless, methodologically it bears a slight resemblance to the method used by Weber (Weber 1968) in order to identify his ideal types, e.g. trying to find what is in theory most typical for each phenomenon, and then still being aware of the fact that what in reality comes out seldom exists in this "pure" and oversimplified form.

Another objection towards the table might be that "market" and "the State" are more of empirical concepts compared to Gemeinschaft, that is highly theoretically constructed. Even if there is some truth in this allegation, I think that the main dif-

ferences depend on the fact that the concepts of "market" and "State," originally "pure" theoretical concepts, have been used so much over time, that they have been given clear, but not always well defined, empirical substance. This process has been strengthened by the fact that they also become part of the every day speech. The same conditions are of course not at all true for the concept of *Gemeinschaft*.

Some other comments must also be made. Whereas the assumed goals "profit" for the market and "solidarity/community" for *Gemeinschaft* might not be controversial, the goal of socialisation/growth of the State is not at all self evident. Many politicians especially, but also several citizens, might have preferred something like "securing the welfare of the citizens". However, in this matter I sympathise with the classical Marxist view regarding different sectors rather as rivals and in conflict, than as co-workers cooperating in a harmonious interplay.

Therefore, basically lies the conflict in either looking at the State as a rather idyllic implement working for the "best" of all citizens, or regarding it as an instrument for powerful groups to primarily benefit from their interests. If you believe that there are some sense in the latter statements, then you probably also are more willing to accept the idea that the State wants to grow "for its own sake" and that it wants to socialise its citizens into prevailing values.

Nowadays it is rather common in Sweden that even ordinary people, without ideological motives, criticize the public sector. Frequent themes are that the sector tend to suffocate the initiatives of the ordinary citizen, violates the integrity of the individual by intervening in the bringing up of children or limiting the choices of alternative primary schools, or not at all caring about the citizens' private lives by registering them in huge public computerised registers.

It is rather easy to associate that kind of public debate with the question of to what extent the State (= roughly *Gesellschaft*) should be allowed to intervene in family life (= roughly *Gemeinschaft*). It is worth noticing that even the political ambition in Sweden to privatise parts of the public sector is partly based on arguments of *Gemeinschaft*-character, e.g. hopes that in these new business activities, dimensions like closeness, intimacy, humanism and cooperation will be more salient.

One could of course also have different opinions on whether the most strategic resource within *Gemeinschaft* is "network ability" as well as if "winner instinct" and "administrative talent" really are the most important resources on the market and within the State sphere. My simple idea is that cooperation and community presupposes, or is even based upon functioning networks. The networks and the solidarity will also be destroyed if the actors are not mainly governed by altruistic motives.

The market can be looked upon as a total contrast to *Gemeinschaft*. That means that competition dominates the sphere where egoistic individuals can make profit easiest with winner instinct. In fact the atmosphere on the market is rather like the one prevailing on arenas for individual sports like athletics or swimming, where precisely winner instinct and egoism are the keys to success.

Finally when it comes to the State, which is a highly bureaucratic sector, administrative talents should be of utmost use. It also seems as if a cool rational actor calculating means and ends, e.g. an instrumentalist of the Weberian type, would be the most suitable one to solve problems within this sphere.

### *Conclusions*

Both the market and the State seem to suffer from increasing problems when it comes to matters of humanism, social relations, and solidarity. This is hardly a surprise since these two sectors never have had as a central goal to promote man's well-being. In fact neither "profit" nor "socialisation/growth" are very naturally related to some kind of life-quality. What might be surprising is the thought that activities within the State and on the market, directed towards others and partly conflicting goals, more or less automatically also would lead to better lives for most people (See also Wolvén 1990).

The last decades seem, quite on the contrary, to have shown that goal attainment within the State and on the market remarkably often takes place at the cost of men's well-being. As a consequence, ordinary citizens, as well as politicians and economical actors, are searching for solutions that are more in harmony with human nature and humanistic values. Expressed in another way, they are searching for a *Gemeinschaft* within, or in interplay, with the *Gesellschaft*.

In search of *Gemeinschaft* there are some traps. One is to falsely label economic activities as *Gemeinschaft*, when beneath the surface, we in fact deal with traditional *Gesellschaft*-activities. Another similar one is that we do not detect the *Gemeinschaft*-activist under the disguise of *Gesellschaft*. Furthermore, we do not "observe" or give traditional *Gemeinschaft*-activities the recognition they deserve. Finally we also have difficulties in analysing the conflicts when *Gesellschaft* intervenes in *Gemeinschaft*, or when *Gemeinschaft* tries to survive in *Gesellschaft*. The coming discussions have the ambition to shed some light on these different problems.

### **Traditional *Gemeinschaft*?**

One of the most typical example of traditional *Gemeinschaft* might be the natural economy in the agrarian community. This kind of exchange was primarily exerted between citizens in the local community, who both knew each other well and



trusted each other. A reasonable consequence is that they felt secure and safe when it came to the relations created by the exchange. It seems as if these kinds of relations are based on the fact that the citizens in many ways participated in each other's lives within the local community. Furthermore this kind of "informal economy" probably contributes to strengthen and develop the mutual relations in local communities.

Asplund (Asplund 1991) stresses in his book an interesting but controversial point. *Gemeinschaft* is the location for the productive work, whereas the activities in *Gesellschaft* do not produce any utilities at all. These activities ... "deal with supply and demand, deliveries and taking over, but on the whole leave the world unchanged and unimproved".

To find research in Sweden that thoroughly studies the self-production and the exchange in local communities, especially in sparsely populated areas, is not an easy task. My own research within that field in sparsely populated areas in the very north of Sweden (Wolvén 1984 and Wolvén 1990) however, indicates that this "informal economy" is of great importance. More than 90 % of the households in our study made some kind of production for their own household and more than half had a very high level of production comprising of baking, preserving, sewing and handicraft work. Comparisons with nearby towns showed that matching activities among "their" households were up to five times lower.

More specific, we also tried to investigate the amount of production for the own household and purchases outside the regular market of potatoes, different kind of berries, fish, meat and vegetables. In the order mentioned 75%, 51%, 36%, 23% and 10% were totally independent of the regular market, primarily because of their own production, but also adding transactions to the informal market.

In the same study we also investigated the informal production of services. As many as 75% could either repair their car themselves or with help of others. Corresponding figures for simpler repairs are 92%, paper-hanging and painting 87%, rebuilding 86%, repairs of domestic appliances 56%. It is also interesting that certain underprivileged groups seem to be compensated by the informal economy to a certain extent. That is especially true for those who have been out of work for a long time, as well as those who "only" work at home with their own household production. Households with small children and those who are out of the ordinary labour market are the ones most involved in producing and exchanging services. On the other hand, those who have retired from work participate only to a small extent in this kind of informal economy.

My idea of giving this kind of traditional informal economy special attention, is that it often seems to be forgotten at the cost of new and more spectacular forms. I do not judge it as fair, partly because we here find examples of that genuine

”Gemeinschaft” that other economic activities seem to aspire for, partly because I think that this kind of economic activities might still be of great importance in sparsely populated areas. That might be especially true if they have a long tradition of agriculture, hunting and fishing. One should also be aware of the fact that it might be complicated to search for these kinds of phenomena, since the participants in this kind of informal economy are not always that eager to reveal the (un-taxed) benefits they are getting out of it.

### **Gesellschaft in Gemeinschaft**

In the modern society the boundaries between Gemeinschaft and Gesellschaft have become more diffuse and open than in the old agrarian society. Since practically all small local societies today are strongly dependent upon the surrounding world in order to exchange products and services, it is logical to claim that Gesellschaft has intervened into most near, close, intimate and family-like relations. In addition to this type of conventional intervention, the rapid growth of an increasing amount of national and international media has brought about strong cultural consequences.

Nowadays rules and regulations practically always have a national or international character and these conforming tendencies take no consideration at all to special local conditions. In Sweden this can be illustrated by some well known examples: The idea that elderly drivers in sparsely populated areas could get a limited driver's license for driving to nearby stores, petrol stations and public service places was rejected, not without a bit of scornfulness. It has also been difficulties in constituting a reasonable tax relief for local sales of berries, which have been practised from time immemorial. The same goes for the exchange of the earlier mentioned services such as local help for repairs, painting and rebuilding as well as for private care of children. All these activities are taxable, although in practice, barely no one pays taxes for it. Still, representatives of the Gesellschaft are unwilling to change the tax regulations on these issues.

In Sweden we can also see clear signs that Gesellschaft is continually less willing to support local communities and sparsely populated areas. One very illuminating example is when Gesellschaft wants to close down maternity hospitals in the periphery for the benefit of bigger and more modern units situated in the centre of the cities. These decisions are of course based upon those instrumental and economical calculations that characterises Gesellschaft, totally disregarding the feelings of security, trust and intimacy between the staff at a local maternity hospital and its' patients. Besides, in the actual case even the rationality could be questioned, since time and distance – not the latest equipment – are the foremost important factors for mothers who have to be urgently delivered.

One of the few times however when *Gesellschaft* really has to pay attention to the values in *Gemeinschaft* is when activities shall be placed within the local community. The following is a description of a research project following the establishment and development of two provision stores in sparsely populated areas in the north of Sweden (Strandberg 1984, Wolvén 1996).

The story is that two villages in the interior parts of northern Sweden had been lacking provision stores during the entire 70s and the first years of the 80s. To buy their everyday commodities they had to travel to the nearest densely populated place situated about 10 English miles away. For a short while the households also had access to a special grocery bus delivering everyday commodities at least twice a week. For this reason two provision stores were established in the two local communities, initially also partly financed by the Swedish National Board for Consumer Policies. One of the stores was started by a person who had grown up in one of the above mentioned communities, while the other store was established by an "outsider".

The two shop managers developed totally different strategies in running the stores. Remarkably enough, the one who had grown up in one of the local communities began running the store on a strictly commercial (*Gesellschaft*-) basis, with a cautious slow build up of his assortment based upon actual demands. The other shop manager mainly deviated from commercial analyses and made the store into a social meeting-place, which soon made him socially, integrated in the community. After a while he became a handy man who ordered products and services way beyond the traditional assortment for provision stores.

The results became what could be expected. The latter shop manager who ran his store based upon "Gemeinschaft-values" succeeded rather well, while the other shop manager had to close down the store after two years because of financial reasons.

Taking the long view however the moral is a bit more complicated. The high ambitions to let the store remain a vivid social meeting-place in the local community, as well as the aspirations to continue being a well integrated handy man, led to a burn-out after some years. The shop manager is therefore forced to close his store and move back to *Gesellschaft* and take an ordinary job

### **Gemeinschaft in Gesellschaft**

Without being able to point to one tangible example <sup>1</sup> it still seems as if locally based tourism businesses more and more could illustrate this point of view. The

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<sup>1</sup> Stryjan's study of personal cooperative childcare might however be a good example (Stryjan 1995)

moving power in sparsely populated areas have often caused a commercialisation of the local activities such as hunting, fishing, local handicraft, sewing, baking, shooting of the rapids and the making of local food.

In a *Gesellschaft* with a constantly increasing tempo, concentration of population density, technocracy and anonymity, the interest in recreating in local communities is enhanced. At the same time there is a resistance and fear against exploitation. This scepticism is based upon worries that "strangers" might destroy the genuine local community, and will thereby contribute to shape a more artificial world out of what *Gesellschaft* is looking for in *Gemeinschaft* instead of being satisfied with the original conditions.

The relations seem to form a kind of paradox. The more genuine the local community is, the more attractive it seems to the surrounding world. On the other hand the more tourists, the greater the risks of shaping an artificial *Gemeinschaft* and, as a consequence, the less attractive it will become to outsiders. In fact, in the long run this intervention from *Gesellschaft* risks jeopardising the genuine values of *Gemeinschaft*.

#### **Gesellschaft-activities which are in fact more of a Gemeinschaft**

It is a bit difficult today to find organisations and companies that act on the international market, and still have managed to preserve (somewhat) of its original family-character. In fact, if you do not limit your search to legitimate activities "the Mafia" might constitute a good example. The fundamental basis here still seems to be close family- and friendship relations as well as traditions, although the activities are thoroughly commercialised and spread out all over the world. It is probably just because of this knit of relations, and by the hatred and love within these close ties, that the Mafia has been stable and solid and survived in a world that has become more and more global and turbulent.

Two Swedish examples might be Facit and IKEA. As for Facit it was put into liquidation partly because it hung on to traditional values in the local community, being sceptical towards new technology, development of new products and international networks (Facit's main products were office tools such as calculators and typewriters that were too slowly renewed). It seems as if *Gesellschaft* never really entered Facit.

IKEA, on the other hand, seems to have successfully transformed itself from *Gemeinschaft* to *Gesellschaft*. But it is really hard to know what is going on under the surface. Is IKEA in reality still of *Gemeinschaft*-character but wanting to present itself as a modern *Gesellschaft*? Or is it the other way around; the traditional *Gemeinschaft* does not at all exist in IKEA, but is just an illusion to profile IKEA on the international market?

### **Gemeinschaft-activities which are in fact more of a Gesellschaft**

Within the third sector, as has been said earlier, we find a big number of organisations of a very varying character. At least in Sweden, in parts of the political rhetoric, most of them are described as friendly, well-intentioned, non-idealistic aims – with altruistic members in a humanistic culture – performing activities where their motives to achieve high profits are subordinated other goals of a more social character.

In practice, however, some of these organisations are shaped out of pure necessity; The State might not have been able to take responsibility for the care of children and elderly in sparsely populated areas, or the unemployed see the third sector as their last desperate chance to get a job. In other cases sheer profit motives are camouflaged behind an image of idealism and humanism, just to facilitate marketing and the generation of profits. The latter has showed not to be unusual at all in Sweden when it comes to relief organisations. Although their official aims have been to help poor people, especially children, in less developed countries, in reality their greediness could be compared to varieties within huge international companies.

### **Conclusions**

My ambition has been to cast some light upon the myths and political rhetoric concerning the third sector. The ideological biases sometimes seem to have blocked a rational analyse of "what is really going on" here, at least in Sweden. My very simplified main point – if there is one – is that supporters of the third sector seem to have focussed on those parts that, in Tönnies world, are of a Gemeinschaft-character, thereby discovering activities that most of us sympathise with. The opponents, on the other hand, primarily seem to have concentrated themselves on the other parts, especially the ones that are of a strong Gesellschaft-character. The difficulties are worsened when activities that seem to be best associated with Gemeinschaft in fact turn out to be of Gesellschaft-character and vice versa. Besides, many activities are in transformation between the above mentioned dimensions.

The simple conclusion could therefore once again be expressed in a trivial and well-known sentence in science. Try to disguise the myths and the rhetoric, instead of being a part of them.

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***Part IV. Paths in local  
development***



## **STRUCTURAL CHANGE IN CO-OPERATIVES: RURAL ECONOMY TRANSFORMATION IN THE SOUTH OF SPAIN. A CASE STUDY**

**Mozas Moral Adoración, Bernal Jurado Enrique  
and Rodríguez Cohard Juan Carlos**

### **Introduction**

For twenty years now studies have been carried out on the processes of local development in rural areas in Spain (Vázquez Barquero, 1983; 1984a; 1984b and 1987; Bernabé et al, 1984; Granados et al, 1984; Costa Campi, 1988 and 1992; Vázquez and Sáez, 1995; Rodríguez Cohard, 2001) These have increased interest in analyzing the causes of the structural change which is taking place in rural environments: the creation of a more diversified business framework which is connected with national and international environments. Other reports recently published in Europe also focus on this problem (Rama and Calatrava, 2001; Melero and Calatrava, 2001; García Sanz, 2000; Gerbaux, 1997; Bateman and Ray, 1994).

Cooperativism as a form of association and participation has been shown to be appropriate for generating business structures in rural areas (Bel et al., 2000; Buendía, 2001 and García-Gutiérrez, 1999). In many cases social economy has played a role in the productive evolution in these areas. Thus, as we point out elsewhere (Mozas and Rodríguez, 2000), we consider that this type of company provides a reference point for real cooperation and interaction between rural environments and their communities, so that the processes of socio-economic transformation can be activated in the area. We also believe that the organizational characteristics of social economy companies, because of their capacity for the creation and development of social and economic networks in their own area and with other environments, make them one of the main potential engines for development in rural areas.

The objective of this article is to show how cooperativism has been the organizational formula that has played a crucial part in the structural change in the case under study. To carry out this study the qualitative method has been employed. The information has been gathered by detailed interviews with managers from the main co-operative societies in the area, as well as the local authorities concerned with the development and economy of the area. This fieldwork was backed up with a review of the bibliography on local development and cooperativism.

The organization of the article is as follows: First, we analyze the productive evolution of rural localities under the perspective of local development. Second,

we present social economy companies, especially co-operative societies, as entities that generate stable employment that is tied to the area; as organizations that increase social well-being and that contribute to the development of their locality and region. Third, we analyze the case of the socio-economic transformation of Bedmar – a rural locality in the south of Spain. Finally we provide some conclusions.

### **Structural change in rural environments**

The traditional conception of rural areas as areas specializing in agricultural products for the cities and guaranteeing environmental equilibrium has been changing for the past few decades. Not only because agriculture has experienced a profound evolution which has caused socio-economic change in rural areas, but above all because the conception of economic development has become more sensitive to the territorial perspective.

The generalized acceptance of rural pluri-activity and the promotion of it within the EU has made it possible to initiate areas of economic activity distinct from the agricultural, with the aim of facilitating structural change in the rural environment. The problems that these areas face have increasingly to do with production imbalances caused by the processes of global economic restructuring, and, as we shall see in this article, these areas have a role in the inter-territorial division of labour.

The consequences of change in the competitive process have led to production structures that are poorly adapted to global demand and with a poor capacity for increasing employment. Thus the rural localities still have low increases and even decreases in the population, and poor levels of training and professional qualification among their workers, which holds back attempts to improve their productivity.

In order to respond to this situation it seems to be useful to interpret the process in terms of local development theory: a process of growth and structural change produced as a result, first, of the transference of resources – manpower, capital, knowledge, etc – from traditional activities to modern ones; second, of the use of external economies; and third, of the introduction of technical and organizational innovations. All of this generates an increase in the well-being of the population (Vázquez Barquero, 1999).

In this process three elements stand out:

1. Economic: local business people use their capacity for organizing the productive factors – labour, capital, natural resources – with levels of efficiency sufficient to be competitive in the markets.
2. Socio-cultural: the local values and institutions form a basis for the process of development.

3. Political/administrative: territorial policies allow for the creation of a local economic environment that is favourable to, and promotes, structural change.

Two more elements can be added (Albuquerque, 1999):

1. Training of human resources: in which the educative and training entities, together with the local businesses, match the training on offer to the innovation requirements of the local productive entities, within a strategy that is responsive to the needs of the area.
2. Environmental: which includes attention to the specific characteristics of the local natural environment, in order to ensure that it remains in its current condition, or is even improved.

The importance of the concept of local development for analysing the problem of structural change in rural areas lies in the fact that it is a concept of action. The local communities have their own identities which push them to start initiatives for their own development – initiatives that combine the social and economic spheres (Vázquez Barquero, 1988).

The concept of local development has three objectives: to achieve and maintain efficient economic and business structures; to achieve social equity by measures preventing the process of economic efficiency from causing or increasing inequality; and to guarantee the lasting development of the locality, which implies not only pursuing strategies that do not harm the natural environment, but also putting into place mechanisms that preserve the potential for human development in the area, including a constant improvement in the level of training and education among the population.

The acceptance of this approach implies the acceptance that the territory is constantly in evolution (Rodríguez Cohard, 2001). Therefore structural change in the rural environment has not been definitively achieved. In fact, the adaptation of the rural economy to new forms of production and competition supposes a permanent dynamic process. That means that those areas which have undergone economic and even social restructuring cannot consider that they have overcome the present rural crisis – not in the framework of the current economic globalization.

Those territories that have achieved competitive advantage cannot consider it permanent because the very dynamic of change that reigns in the process of globalization (Garofoli, 1994) increases competition, reduces relative advantages and leads to an adjustment in local production systems. In the face of this, they have three options: an increase in the life cycle by differentiating and innovating; the disappearance of the activity; or to restructure by means of a new productive organization (Vázquez and Sáez, 1995).

The first option is related to changes in the demand and in the level of international competition which force the productive systems to adapt constantly, to change and

revitalize themselves within their own dynamic environment, leading to a constant recycling of productive, technological and human resources. The link between the productive medium and the urban environment on the one hand, and national and international markets on the other, allows for the introduction of new ideas which prevent the fall of products in the descent phase of the life cycle, increase the maturity stage, or start another expansion stage, thanks to the introduction of new commercializable goods in the final market.

The second possibility considers the disappearance of the activity. This analysis can be seen from two perspectives: the strategic, used by the territorial approach, and the determinist, put forward by theorists with functional approaches. In the first case the destructuring of the local productive system would be caused by its inability, fundamentally institutional, to adapt to new market conditions (Becattini and Rullani, 1996). In this sense, the imbalances to which the local environment is exposed are caused by a change in its normal functioning, which has broken the harmony between cooperation and competition – key factors in its previous success (Dei Ottati, 1996). In the second case, Krugman (1992), among others, ignoring the local strategic capacity in order to consider the environmental changes, and basing his analysis on a deterministic interpretation of Vernon's theory of the product cycle (1966), argues that standardization eliminates the advantages of the local productive systems, since the disappearance of the supply of specific territorial factors allows companies to look for localities where there is high demand so that transport costs can be reduced. Therefore the productions of the local productive systems would only exist in the first stages of the life cycle of a product which was developed thanks to chance, such as in the example of the manufacture of eiderdowns in Dalton in 1842 (Krugman, 1992, p. 42). However, the productions of the majority of the territorial environments, where there are small companies that have local origins, consist of what we could call standardized or mature products, in the terminology of the theory of the product life cycle.

In a more analytic and exhaustive study, Enright (1996) establishes five basic reasons for the disappearance of territorial productive systems: falls in demand, as a consequence of the obsolescence of the product; a new form in the organization of the local productive system, which we shall look at later, and which does not entail the loss of economic activity in the area; the system of local companies as an initial phase in the life cycle of the product, as Krugman believes; the loss of relations of cooperation and the interruption of information flows in the local context, following the line of Dei Ottati; and finally the specific difficulty of confronting change, caused in some cases by complacency with regards success, as Porter (1991) points out when he asserts that for a company to have permanent competitive advantages it requires a continuing process of improvement and creation of specific factors, which eliminates the dynamic mechanisms that lead to the adaptation of the local environment, as analysed by Grabher (1993) for the case

of the industrial complex of the Ruhr. All the reasons, except the third, of the destructuring of the territorial productive system are related to the strategic behaviours of local actors, especially the evolutionary characteristics of their institutions and their inclusion in innovative international networks, that allow them – or prevent them – from receiving the flows of adequate strategic information in order to confront changes in the global environment.

The third possibility, restructuring by means of a new productive organization, already put forward by Enright, introduces into the discourse the opportunity of reconciling different business strategies (or functional strategies, if you prefer) with the territorial dynamics of production. In this sense the local productive systems, comprising for the main part small firms, can evolve towards other development models, in which they share productive activity with large firms, as happened in the Swiss region of the Jura (Maillat, Nemeti and Pfister, 1995), so that they take advantage of the local productive and innovative dynamic, internalising the external economies derived from the area. This reorganization can lead to various forms of productive relations with other systems of manufacture in which the plants of industrial groups which have localized in the area participate (Maillat and Grosjean, 1999), changing the environment and confronting the territory with other processes of strategic change in function of the new character of its local and global relations.

### **The role of social economy in structural change in the rural environment**

For various decades now a profound process of transformation is occurring in the environment (whether it be economic, political, social, institutional, technological etc), which is affecting the world population. This is most obvious in the globalization of the economy, which is causing regional and national markets to lose importance to international markets; massive long-term unemployment; the deregulation of markets; and a crisis in the Welfare State. These have all made the problems of social marginalization more serious (Tomás and Monzón, 1998). In the face of this change, social economy companies have reacted with a parallel evolution covering shortages and/or deficiencies that the State has been unable to respond to.

At the present time not only the number of these organizations and the speed at which they are being founded surprises the observer, but also the areas of activity in which they have been able to function. Without doubt, one can affirm today that these entities function in all economic activities, carry out social work which the different public administrations would find hard to do, and they can be found in every village, town or city, since their location only depends on the choice of their founders (Mozas, 1999).

In addition to what we have discussed above, social economy has shown itself to be decisive in the generation of stable employment (García, 1997); in an increase in social well-being; and in local development. In fact the capacity for generating activity and employment of these organizations, even in times of crisis, is a proven fact (Tomás and Monzón, 1998). Thus, they create employment against the tide. But they also do so of course during stages of economic reactivation, so that their promotion and support by the various public administrations should be considered a priority (Mozas, 1999). Even the European Union recognizes them as entities that create more stable employment than firms of other legal statuses (García, 1997).

Additionally these entities are equally notable for their contribution to social integration, helping marginal groups, immigrants, the poor, the ill or disabled to improve their quality of life, get access to jobs, obtain minimum health care, and, in short, join the group of “first class citizens” (Mozas, 1999). Although we might consider the work carried out by social economy in employment and social well-being to be especially important, no less important is its role in promoting local development, which is understood to mean the process not only of growth but also of socio-economic transformation.

Undoubtedly these entities, with their various organizational formulas, are considered an adequate instrument for creating a business framework in “...depopulated rural areas where not only the possibility of many people to live in their birthplaces is endangered, but there is a threat of abandonment and degradation of areas and resources of great social and ecological value. The agricultural, craftwork and tourism co-operatives, the communal development of collective resources, the associations for the generation of development and the generation of an organized supply of rural tourism accommodation and services are important reference points for the functions that social economy is fulfilling in rural areas, where there is a wide panorama of possibilities for development” (Tomás and Monzón, 1998).

From the group of social economy entities people have designated, almost exclusively, co-operative societies as the most competent to direct the opportunities for development in rural areas. In this sense, Coque (1999) suggests that co-operative societies are undeniably linked to local development. Thus he asserts that they are companies originating in collectives of people and capital in each area, which links them to the local framework. As well as satisfying local needs, the companies promote the agents involved – their members – and can extend via networking from the local to the regional and international level.

In general, every social economy entity is characterized by its particular functioning, based on democratic participation in decision-making. This entails

members fixing and controlling the objectives based on their function as producers and/or consumers (García-Gutiérrez, 1995). In this way, as Buendía (1999) points out, the social economy entities form elements of social and economic democratization, which is one of the fundamental values of local development (Friedmann, 1992).

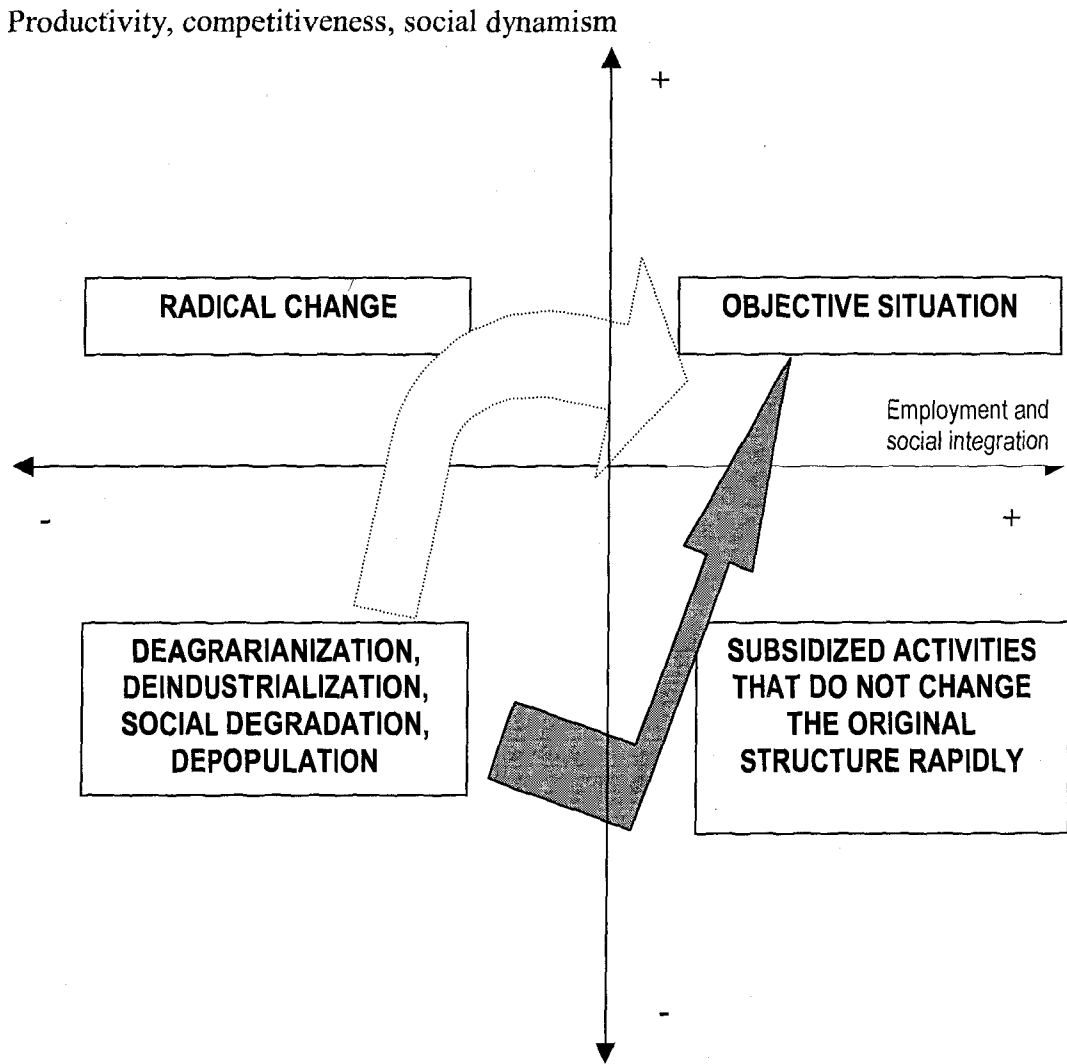
On the other hand the social economy entities, whether with or without profit motive in mind, are set up wherever there exists the initiative or conviction in people able to make their convictions a reality in the shape of these entities. Therefore these organizations are created by a group of entrepreneurs from a particular geographical location, with the aim of improving well-being, acting directly on the factors that may affect them, which leads to a strong inter-relation between development, quality of life and defence of territory (Mozas and Rodríguez, 2000).

#### **A case of economic transformation in the south of Spain: Bedmar**

Bedmar (population: 3,500) is a small rural town in the south of Spain. Until 1992 it specialized almost exclusively in the cultivation of olives and the manufacture of olive oil – activities which are largely seasonal. Its population has been in decline since the mid 1950's, due to emigration towards the big centres of urban industrial development, or for seasonal agricultural work, such as the grape or asparagus harvests. During the olive harvest – November to February – the locality receives manpower to work in the agricultural work. The rest of the year on the other hand a third of the population – 1,100 people – emigrate to other areas of Spain, especially the Basque Country, Navarre and the Rioja region, for the asparagus harvests, or to central European countries to work in other activities, above all building work. This emigration, which was initially temporary, became definitive in many cases, leading to depopulation, especially among the young.

The political authorities, worried about the situation, undertook a strategy of local development in three stages, to change the economic course of the area: social and educational services in the area; the provision of support services to emigrants both before and during their stay in their destination areas; and the preparation of new economic activities, based on the skills of the local workers, which would allow them to improve the difficult social situation that forced Bedmar's inhabitants to emigrate to other regions. Based on cooperativism, the development strategy avoided the possible approaches of exogenous industrialization which might have led to a radical change in the local productive structure. Instead they concentrated on building a development model of small steps forward with the support of the population, with the aim of supporting the adaptation of the society to the new competitive environment (figure 1).

**Figure 1**  
**The strategy of change of socio-economic structures**



**Source:** Adapted from Vázquez Barquero (1999).

First they acted to alleviate the effects of social and educational marginalization which the emigration caused in the displaced population: from 1956 to 1984 no children of seasonal workers achieved the level of basic education. Changes of schools, of teachers, of books, environment etc, three times a year to accompany parents in their emigration caused cases of social disintegration in the home town and lack of integration in the destination town. In order to correct this tendency the



Town Council promoted the creation of a co-operative society providing accommodation for the children of seasonal workers, from primary to secondary age levels. In a few years even access to university for the children of emigrants became a reality.

Second the strategy of development was extended further than the local environment: the priority was to improve the work conditions of the local population in their areas of emigration. With the help of the various public administrations, the emigrants left for their places of work with previously written-up contracts with agreed formal work commitments and with access to free legal advice in situations of difficulty. Additionally the transport of the emigrants was organized by the Town Council with the help of the various public administrations, and there were even travel grants given. At the same time the local administration checked on the conditions of the emigrants in their workplaces, where a network of relations with public organisms and companies was established, in order to improve conditions of housing, work and social integration.

The third step, which was seen as the culmination of the strategy, focuses on the aim of retaining the workers in the town. To do that they chose to initiate a programme introducing a new agricultural activity in the area, an activity related to the skills and know-how of the residents. The activity had to be compatible with the experience they had built up in their work in emigration, and had to complement the olive harvest and oil manufacture as one of the main local activities. The first experiment was the cultivation of asparagus. This was carried out with the total involvement of the Town Council, which in 1992 leased a hectare of land with agrarian public aid from the Rural Employment Plan, with the aim of planting asparagus and finding out if the product could adapt to the climate. The idea was becoming a reality: the results have been excellent.

In 1993 the Town Council leased another 41 hectares, prepared it for the cultivation of asparagus and ceded it to 38 families; it also introduced the cultivation of artichokes. In 1995 it promoted the creation of a co-operative society for fruit and vegetables with 55 members – the Mágina Hortofrutícola Sociedad Cooperativa Andaluza. The Town Council believed the management of the co-operative to be fundamental so it convinced a former resident of the town, the commercial manager of an asparagus company then living in northern Spain, to return to Bedmar to take over management of the factory. In the same year the first asparagus from Bedmar was canned: most of it was destined for export. As a result of the founding of the co-operative, and in order to take full advantage of its installations, peppers, leeks, beans, peaches etc began to be planted and commercialized.

The introduction of new products to cultivate in the area has led to the founding of two vegetable bottling and canning companies, apart from the co-operative, which have clearly led to productive diversification and to the consolidation of the process of local economic development. Additionally the factories have improved prospects for employment in Bedmar in addition to the purely agrarian: in management as well as in bottling/canning, which reinforces people's possibilities of staying in the town. This has led to other businesses being set up, and the commercial and productive adaptation of yet others, such as the co-operative which provided the accommodation service for children. This has undergone reorganization, taking over the role of kindergarten and day centre to aid working mothers.

### **Challenges and the adaptation of the local productive system to globalization**

In the 1990's the local productive system in Bedmar was transformed to a more diversified structure, starting from the traditional know-how of the local residents, and from the skills obtained in their work in seasonal emigration, and using cooperativism as the main agent in the process of development. All this is due to the initiative of and strategy carried out by the local authorities. However the new horticultural activity is facing change within the framework of the process of globalization.

Thus once they have imported the cultivation and canning/bottling models of agricultural products, the local companies have to adapt their productive and commercial organization in order to respond to the challenges brought about by the behaviour of their competitors, using the opportunities that the inter-territorial division of labour and activities brings.

The central axis of the new local productive system is the cultivation and packaging of horticultural products to sell them on the national market, acting as competition to the traditional leaders – the companies from Navarre. However the main entities of the sector are introducing new organizational approaches, which consist of the acquisition and management of the products in countries with very low harvesting costs, such as Peru and China. There the products are packed under the supervision of Spanish technicians, and then exported to European markets. Under these conditions the packaging market in Spain is under very great price pressure, which has begun to diminish the profitability of the local productive system.

In order to confront these threats the local companies are beginning a commercial change that requires organizational restructuring: orienting themselves towards the European market for fresh products, in order to avoid the strong competition of the packaged market. Thus the local production of fresh asparagus would be destined

for the German, French, Italian and Swiss markets, and for the national packaged market, products would be acquired from Peru and China, following the model adopted by other competitors. But the organizational challenges require of their workers new qualifications and international management skills which have not been evident so far in the local productive system. In any case the survival of the activity in the new international environment requires a new orientation from the local companies, which have been forced to become more flexible and quicker in their response to the market, and to adapt the qualifications of their workers and managers.

### **Conclusions**

The main effect of the structural change that the economy of Bedmar has experienced in the past two decades has been a brake on the emigration process, especially among the young, which had been depopulating the town since the 1950's. The mechanisms which have led to this new situation have basically been founded on two fundamental pillars: on the one hand the capacity of the local authorities to give an adequate and flexible response to the needs of the population with the resources that they had available, such as financing from the Rural Employment Plan to pay for the preparation of and work on the plots of land; and on the other, the choice of the co-operative as an organizational tool useful for managing the proposed process of productive change and economic diversification.

In fact agro-industrial cooperativism has been the main actor in the change that the local authorities stimulated, and it has decisively contributed to consolidating productive activity during the 1990's. However at present horticultural activity in Bedmar is facing new challenges thrown up by the process of economic globalization. Will the local co-operatives be adaptive enough to the international market of products and factors for them to be able to succeed in the future?

We cannot yet provide an answer to that question, which is fundamental to the functioning of the local economy, and also for the success of cooperativism as an adequate formula in international competition. Even so the capacity of adaptation which the local co-operatives have shown up till now provides certain grounds for optimism of success, if they can change sufficiently in the training and organizational spheres, something that the challenges of international commerce requires.

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**THE ROLE OF SOCIAL CAPITAL IN LOCAL DEVELOPMENT:  
A PROPOSAL FOR THE ESTABLISHMENT OF A VENTURE CAPITAL  
IN THE REGION OF WEST MACEDONIA, GREECE, FUNDED BY THE  
COOPERATIVE BANK, THE LOCAL AUTHORITIES AND LOCAL  
BODIES**

**Nikolas Sariannidis, Simeon Karafolas, and Ioannis Apostolidis**

**Introduction**

The Region of West Macedonia that consists of four departments: Grevena, Kozani, Kastoria and Florina represents a population of 2,8% of the total Greek population and produces the 2,7% of the GNP. Between the census in 1999 and the one in 2001, the population of the Region had a rise by 3,3%, significantly lower than the total rise in the country, which respectively was 6,7%. The Region mainly relies on electricity power production, agriculture, manufacture and services, representing the proportions of 19%, 5.4%, 1.1% and 2.2% respectively (Region of West Macedonia, 2002).

With regard to per capita income, in 2001, the Region of West Macedonia almost reached the Greek mean average (96%), while in comparison with the European Union it reached the percentage of 64%. However, the Region of West Macedonia has the highest unemployment rate in the country, 14,7% in 2001 while for the total population in Greece this rate is 11,1% (Table 1).

**Table 1 Unemployment in Greek Regions**

Unemployment	Total		Women		Age: Under 25	
	1999	2000	1999	2000	1999	2000
Greece	11,7	11,1	17,9	16,7	31,7	29,5
North Greece	12,4	11,0	19,8	17,5	32,3	28,8
East Macedonia & Thrace	12,8	8,6	19,2	11,7	31,5	19,5
Central Macedonia	11,7	10,7	18,8	17,0	30,2	29,1
West Macedonia	14,6	14,7	24,2	20,7	47,0	45,0
Thessaly	12,8	12,4	21,7	22,8	33,5	31,4
Central Greece	11,0	10,3	17,9	15,7	34,4	32,7
Epyrous	13,9	10,6	22,1	16,8	42,6	30,8
Ionian Islands	5,5	5,1	8,1	5,5	20,7	11,9
West Greece	11,8	10,2	18,6	15,0	36,9	34,0
Peloponnese	7,6	9,3	12,5	14,6	27,2	30,2
Attica	12,5	12,2	17,8	17,4	33,2	30,6
Aegean Islands	7,9	7,8	12,0	12,4	19,8	21,3

North Aegean	11,3	7,4	15,6	13,8	30,1	19,3
South Aegean	7,3	10,5	11,6	16,2	15,7	21,4
Crete	7,3	6,7	11,5	10,5	19,9	21,7
EU-15	9,3	8,4	10,9	9,9	17,9	16,1
Euro Zone-11	10,1	9,1	12,3	11,1	19,1	17,1

Source: Spinthiroudakis, M., *Vima Newspaper*, 20 July 2001

Enterprises in this region, mostly small enterprises, face important problems related to the financing system and management difficulties. The creation of a venture capital specialised on West Macedonia enterprises can provide appropriate solutions to their financing problems and support them at the managerial and organizational level.

The paper, after the introductory section, describes at section 2 the entrepreneurial status of the region; section 3 describes the main problem faces by SMEs and particularly them of West Macedonia; section 4 discusses the form of the venture Capital, its principal stockholders (local Cooperative bank and local authorities); section 5 presents the advantages of the venture capital of West Macedonia. In section 6 the main anticipated benefits and conclusions are provided.

### **Entrepreneurship in the region of west Macedonia**

The globalisation of the markets, in conjunction with the pressure of foreign business activities aiming at the 'conquest' of the markets, via super retail units, as well as the eventual merging wave, have led thousands of SM commercial and handicraft enterprises to a problematic situation. This situation is also aggravated due to the high cost of obtaining capitals, necessary for the modernisation and re-organisation needed to enhance their competitiveness. The negative result of this business environment is the fact that during the two-year period 2000-2002, 15.607 enterprises, mostly small-medium ones, was shut down. These enterprises represent the 6.8% of the active enterprises in 2001 (Table 2).



**Table 2 Active enterprises and failed enterprises, years 2000-2001(\*)**

Enterprises that stopped operations	
LEGAL FORM	
Incorporated Companies	1.390
Limited Liability Companies	1.465
General Partnerships	11.141
Special Partnerships	1.230
Individual Companies L 89/67	381
Total	15.607
<i>*Until November 2001</i>	
Active Enterprises	
LEGAL FORM	
Incorporated Companies	44.896
Limited Liability Companies	32.232
One individual Limited Liability Companies	4.344
Transportation Companies	448
General Partnerships	121.241
Special Partnerships	23.982
Shared Special Partnerships	18
Individual Companies L 89/67	227.584

Source: Ministry of Finance-General Secretariat of Data Processing

Considering the evolution and development of new enterprises in the Region of West Macedonia, the problem of entrepreneurship is obvious. The corresponding proportion of the new enterprises, was only 0,9% during the year 2000, which is the second smaller one among all Regions in the country, with the smallest one being the one of the Region of North Aegean (Table 3).

**Table 3 New established enterprises (Proportion of per Region), (%)**

Region	1996	1997	1998	1999	2000
East Macedonia & Thrace	3,6	2,9	3,4	2,3	2,1
Attica	56,3	58,4	58,4	58,9	61,4
North Aegean	0,8	0,5	1,2	0,9	0,7
West Greece	2,8	3,1	2,6	2,6	2,8
West Macedonia	1,2	1,1	1,1	1	0,9
Epirus	1,4	1,5	1	1	1,1
Thessaly	3,2	3,7	3,3	3,7	3,4
Ionian Islands	2,1	1,9	1,9	2,3	2
Central Macedonia	16,9	14,9	15,5	15,8	14,8
Crete	4,3	4,8	4,8	4,2	4,4
South Aegean	3	2,2	2,2	2,2	2,2
Peloponnese	2,1	1,9	2,4	2,8	1,9
Central Greece	2,4	3,1	2,1	2,2	2,3
Total	100	100	100	100	100

Source: ICAP, "New Enterprises 1996-2000" 1

The proportion of the total capital allocations for new enterprises in the Region of West Macedonia is the smallest one among all regions in the country, and only comes up to 0,2% (Table 4), reflecting a declining course since 1996, when its proportion was 1,2%. This means that the new established enterprises are mainly small-medium ones with relatively low investments.

**Table 4 Allocations for new enterprises (Proportion of capital per Region), (%)**

Region	1996	1997	1998	1999	2000
East Macedonia & Thrace	5	3,2	3,9	2,8	0,6
Attica	45,7	51,4	59,9	60,6	67,2
North Aegean	0,9	0,5	1,9	0,9	0,3
West Greece	2,2	3	2,3	2,1	0,9
West Macedonia	1,2	1,7	1,4	1	0,2
Epirus	1,4	1,8	1,3	1,3	0,4
Thessaly	3,2	5,7	3,5	3,2	4
Ionian Islands	5,4	2	2,5	1,8	1
Central Macedonia	12	14,8	12,5	14,4	21,6
Crete	5,9	6,5	4,6	4,3	1,4
South Aegean	9	3,9	2,8	3,4	1,1
Peloponnese	2,3	1,4	2,3	2,2	0,5
Central Greece	5,7	3,9	1,1	2	0,9
Total	100	100	100	100	100

Source: ICAP, "New Enterprises 1996-2000"

With the exception of the Public Power Corporation, the economy of The Region of West Macedonia, following the example of the total Greek economy, is based on small-medium enterprises. In Greece SMEs constitute the 93,7% of the total number of enterprises (OKE, 2001).

Individual enterprises constitute the basic core in the Region of West Macedonia. In a total number of 25290 enterprises registered in the four chambers of the Region, 22461 are individual ones, that is a percentage of 88,8% (Table 5).

**Table 5 Enterprises registered in the Chambers of West Macedonia**

Individuals	GP-SP	LTD	INC	CO-OP	TOTAL
22461	2240	153	377	59	25290

Source: Chambers of the Region of West Macedonia

### **3. Constraints affecting the development of SM enterprises**

In spite of their strategic role in the Greek Economy, SM enterprises face problems as (OKE, 2001):

- Low work productivity.
- Poor absorption of EU allocations.
- Difficulties in obtaining bank resources due to big actual securities and higher cost of capital in contrast to big enterprises.
- Inability of obtaining capitals from the stock market.
- Great dependence on fluctuations of the domestic market and technology.
- Low relation levels between science and production, as well as low levels of individual investments on research and development.
- Dependence, to a great extent, on usury. It has been estimated that usury, in Greece, reaches the amount of 177 million EURO each year. This illegal activity is the result of various factors (inadequacy of equities, reluctance on the part of banks for loan granting etc) and causes an overwhelming financial burden to SMEs.

Furthermore, it is worth mentioning the fact that each year, investment and business plans budgeting over 290 million EURO, regardless of their viability, are not enrolled in various programs and development schemes due to lack of state capital allocations.

The lending cost, the required guarantees and the limited long-term financing are problems that SMEs face in Greece and in other European countries as well.

More specifically, the constraints affecting financing by the Greek banks are due to factors such as (see Karafolas, 1999, on this point):

- Low economic standing of small-medium enterprises.
- Lack or inadequacy of actual securities.
- Inability, on the part of SMEs, of effective programming and appropriate submission of borrowing documentation.
- High cost on the part of the banks for investigating and evaluating the applying enterprises, in relation to low required loans. Commercial banks are for granting high loans to significant customers.
- In Greece, the cost of short-term lending remains the highest in Europe, as commercial banks have not adapted their services to the specific SMEs business activities, thus resulting to bureaucratic lending policies and lack of flexible products, a fact that eventually encumbers the average lending cost.

For the region of West Macedonia more specifically a sampling research among 40 enterprises, accomplished in order to define the way of operation and the needs of the regional enterprises, have shown (Apostolidis et al., 2001):

- Relatively small size family enterprises, with the owner being in charge of every aspect of the business.
- Machinery of rather new technology.
- Vestigial organisation in both horizontal and vertical levels.
- Enterprises with local or regional orientation with lack of programming and target.
- Lack of specialised personnel. (University Degrees, Postgraduate Degrees)
- Inadequate updating and training on current industrial evolutions that occur at a National and International competitive economic setting.
- Necessity of high-qualified scientists with knowledge of modern techniques and management tools for successful decision making and business strategy.
- Interest, on the part of almost all enterprises, in securing financial support by a local Venture Capital.

### **The establishment and financing of a Venture Capital in West Macedonia**

Based on the problems that arise in small-medium enterprises and particularly in the Region of West Macedonia, the development of a tool, which will respond effectively to the problem of funding, seems to be absolutely necessary. In this framework, the establishment and operation of the Venture Capital of West Macedonia could constitute a reliable alternative solution not only to the enterprises' funding problem but to the general development of the local economy as well.

With the term Venture Capital we refer to long-term capitals invested in enterprises, either by special financing institutions or by individuals, and which involve the element of risk. More specifically, the participating financing company takes a risk by participating in the capital stock of the enterprise. In addition, Venture Capital Company undertakes the responsibility of consulting the enterprise on technical, organisational, commercial and financial matters. Venture Capital differs from lending financing, as the investor participates in the risk, the same way the entrepreneur does, and besides there are usually no guarantees.

Venture Capital Company aims at making profits either by means of dividends or most commonly by means of capital gains due to advance of shares. Venture Capital may be used by enterprises from their initial establishment stage as Seed Capital until their complete development – Growth Stage. Operating enterprises wishing to proceed to expansion or modernisation at a posterior stage may also apply for venture capital called Development Capital, (see on Venture Capital in Greece, Arthapanou, 2000, Barlas, 2001, Daskalou, 1999, Giannopoulos 1995).

According to the Law 2367/1995, for the establishment of a venture capital company, the amount of 2,941 million EURO is required. Venture Capital of West Macedonia will be established in the form of a Joint Stock Company with a share-

capital synthesis and will be based in Kozani. Local social bodies and authorities, particularly, the Region of West Macedonia, the Prefecture, the Co-operative Bank of Kozani, and the Municipalities are proposed to be the establishing partners. In fact their participation will lead the way for a new direction of capital resources.

Under the measure 4.2 of the Regional Operational Program (R.O.P.), state allocations of 10,271.000 EURO, designated for financial support of SMEs, are directed to the Region of West Macedonia (Region of West Macedonia, 2002). Venture Capital is proposed to act as an intermediary body, undertaking the management of 1.5 to 3 million EURO of this amount.

Prefectorial Self-Governments of Kozani and Florina may also direct part of their own resources, obtained from the Special Industrial Development Tax, imposed to the Lignite Power Production Stations, to Venture Capital of West Macedonia. This particular tax represents a proportion of 0.4% of the Public Power Corporation annual turnover and is allocated to the counties of Arkadia, Kozani and Florina in proportion to the respective produced power. It is hence utilised under the S.D.P. (Special Development Program) on a five-year programming. The total budget for 2002-2006 is 49,890.000 EURO. Measure 2.1 provides 9,685.000 EURO for production environment development and measure 2.2 provides 7,337.000 EURO for private investments support. Venture Capital can again act as an intermediary body, undertaking the management of a part of 3,5-4 million EURO of these resources. The Co-operative Bank of Kozani, with almost 4,400.000 EURO equities, comprises a social capital able to support the establishment of Venture Capital of West Macedonia (Apostolidis et al. 2001).

## **5. Advantages of the Venture Capital**

In comparison to other development policies, the venture capital of West Macedonia (V.C.W.M.) can provide numerous advantages:

- Guarantee of a continuous funding flow:
- Funding obtained by each enterprise is repaid at a profit to V.C.W.M.. Hence it is directed to other enterprises. In this way, funding for continuous future support is secured.
- Continuous control and transfer of information and know-how to enterprises by the Venture Capital executives:
- These will be authorised economists and technologists who will contribute to its better organisation and performance, by participating in the Board of the financed enterprise. It has been estimated that this pattern of management will improve the performance of the involved staff and besides will contribute to the rapid development of the region through its own potency.
- On line network among enterprises for the promotion of products and exploitation of resources:

Financed enterprises will be connected with the V.C.W.M. which will play a vital role in the promotion and establishment of co-operations and joint ventures.

- Financing mainly depends on viability and performance and not on the legal form of the applying company (commercial, manufacturing, handicraft, services etc.).

In comparison to their venture capital in Greece, V.C.W.M. presents advantages for the SMEs of the region.

The two main principles of Venture Capital of West Macedonia, that is first that it will only deal with enterprises located in West Macedonia, unlike all other venture capital companies mainly oriented to the industrial zones of Thessaloniki and Athens and second that the executives of V.C.W.M. will come from the Region of West Macedonia secure:

- The best possible understanding of the local market and the local enterprises.
- The best possible and successful analysis and control of the local enterprises.
- The continuous and effective co-operation between enterprises and the local authorities and development bodies.
- Successful decision making on financing, as these will be taken by the Board of the V.C.W.M. consisted of members of the local population who live and work in the area and therefore have clear awareness of the problems and particularities of the Region.
- Co-operation links with Research Centres and Technological Institutes of West Macedonia, a fact that will upgrade their role and besides will lead enterprises to adopting new techniques and applications.

The under establishment venture capital company will function on the basis of free enterprise criteria (effectiveness, competitiveness, potency). Its management structure will be extremely flexible, and its executives high qualified, experienced and competent of meeting the needs of local enterprises. It is therefore estimated that it will soon become a leader in its field and will pay high profits to its shareholders.

### **Anticipated Benefits and Conclusions**

Venture Capital of West Macedonia is anticipated to:

1. Enhance the financing system of West Macedonia.
2. Support the development of SMEs at managerial and organisational level. The active participation of Venture Capital in the procedures of decision making as well as its advisory role, will help enterprises in overcoming occurring organisational problems that affect their effective operation and development and in choosing the right strategies and development plans.
3. Support SMEs financially.

By directing capitals towards developing enterprises, Venture Capital will assist in improving their economic indexes and will enable them to accomplish their expanding business activities at a lower cost. As a consequence, favourable conditions for high-qualified personnel posts will emerge, resulting to the improvement of the enterprises' development ratios.

4. Contribute to the decrease of unemployment.  
Rise in sales and the consequent job vacancies in SMEs will be the best response to downturn and to the constantly rising unemployment rates in Greece.
5. Encourage and promote the expansion of local enterprises abroad by strengthening competitiveness, productivity, organisation and business dexterity.

The Venture Capital of West Macedonia, backed by the local authorities and bodies, will establish a leading position in its field, in a very short time period, and will become an exemplar of development policy among all Regions in the European Union.

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*Part V. Agricultural  
co-operatives  
in transforming societies*



## **AGRICULTURAL CO-OPERATIVES AND SUSTAINABLE FARMING SYSTEM DEVELOPMENT IN BULGARIA**

**Aleksi Aleksiev**

### **Introduction**

During the last decade the organizational structure of agriculture in Bulgaria based on large-scale agro-industrial complexes has transformed into one based on privately operated co-operatives and private individual farms. The average size of individual private farms is small and their land is fragmented. This situation in agriculture makes more difficult a shift from subsistence farming toward more commercial production. The lack of willingness and skills for co-operating of the part of the new farmers impedes the common actions connected with resources use and sustainable development of farming systems.

Twelve years have passed since starting the reform in Bulgarian agriculture but crisis in the sector is still underway. The low efficiency of production, worsened quality of natural resources and continuously growing social problems in rural regions are main characteristics of this crisis. All that is what impedes the farming systems' sustainable development. High variation in production and market conditions does not allow a long-term planning of the family farms' activity.

The used restitution model of re-establishment of private land ownership led to a high level of land fragmentation. This hampers the cultivation of land and also leads to rising the production cost and lowering the land productivity. Cultivating of small plots involves a due change in the applied farming practices, which very often results in deterioration of soil. The worsened soil quality finds expression in different forms of soil degradation, i.e.: erosion, salt accumulation, acidification, compactness and contamination. However, it is beyond the powers of the small and medium sized farms to control the degradation of soil. Small parcels and partially degraded lands are often being abandoned due to a lack of resources and production experience. There has been a trend of increasing the total size of abandoned lands during the last years. These are usually high-productive lands located in regions with developed intensive agriculture.

The process of transformation of national economy to a market connected with a variation in agricultural policy and all macro economic parameters have a negative effect on using the water resources in agriculture. The large-scale irrigation systems intended to provide water to the enormous collective farms, failed in adapting to the new conditions. The lack of correspondence between the existing system of canals and land fragmentation led to considerable decrease in irrigated

areas. The delayed process of reinstating the owners in their lands and also the lack of resources for construction and maintenance of internal canal system prevented many farms from irrigating their lands. Some farmers accepted this situation and they only changed the structure of crops grown on their farms. However, substituting of intensive crops, such as fruit, vegetables and rice for extensive ones - wheat, sunflower and barley has led to considerable decline in the farm income. Other farmers who are running comparatively small parcels of land tried to find some alternative water sources. They started digging wells and using ground water for irrigation, which led to rising their irrigation cost in a short-term and deterioration of soil in a long-term period. In most cases of local water sources, water used for irrigation contains considerable quantities of salts and minerals, which may cause a secondary salt accumulation in the soils. The higher level of salt concentration leads to lowering the land productivity and efficiency of other assets in agriculture, and respectively to reducing the value and price of land.

Capital providing of the small and medium sized farms, is not adequate. It is determined by two main factors. First one results from the impossibility of providing sources of investment capital. Production and income are insufficient to save some considerable funds for increasing of assets. Also, the low value of assets and low income in small and middle size farms limits the possibilities of using bank credits. All this closes the ring of the poverty in rural regions. The second factor depends on how capital is being used and what is its rate of return. Many small and medium sized farms use the non-agricultural income of their families' members as source of capital. For example, they buy many of their assets (tractor, machines, cows, etc.) using funds received out of the farm. However, most of these assets can not be used effectively in the small farms, which hampers the return on invested funds and gradually leads to decreasing of the capital of the farm. The farms' possibilities to use the new assets in a more effective way are often being restricted by absence of co-operation skills.

The size and structure of farms production impede the effective use of the farm's available labour resources. Increasing the share of grains in the small and medium sized farms at the expense of fruit and vegetables share, leads to limiting the farm's income. Unemployment grows up in rural regions and they gradually become depopulated. Restricting of unemployment and rising of farm income necessitate switching to intensive and high-income crops, such as: tobacco, vegetables, vineyards and fruit. This involves development of integrated institutions in these regions. On one hand, these institutions should ensure the conservation and more effective use of resources in agriculture. On the other hand, they must contribute to enlarging the market of farm products and provide better conditions of the rural communities' development.

The main goal of the paper is to analyze the possibility of common actions in sustainable resources use in agriculture and modeling of alternative farming systems and co-operatives for supporting of farming system development. To reach the goal three stages are taken. The first stage is to examine the natural, economic and political determinants of the farming systems. In the second stage a system of indicators to capture the environmental, economic and social effects on agriculture is developed. In the third stage a model of alternative farming systems and co-operatives for sustainable resource use are offered.

The paper is a combination of results from both, the investigations held in the framework of the SFS project financed by Agricultural University of Plovdiv and the reports in the CEESA project financed by EU Commission DG research. The CEESA project is under 5<sup>th</sup> framework program and is coordinated by Humboldt University of Berlin, Germany.

The investigations in this report are carried out in the Plovdiv region in Bulgaria. The Plovdiv region is located in the western part of the Thracian lowland along Maritza River. Plovdiv region has about 480 thousand inhabitants. About 130 thousand of them live in rural areas and more than 69 thousand are engaged in agriculture. The total area of the region is about 170 thousand ha, of which about 150 thousand ha is agricultural land. The mean annual temperature is 11-13 °C and the temperature sum for the vegetation period 4000-4600 °C. The annual precipitation is 520-570 mm and atmospheric humidity deficiency is 520 to 320 mm, thus creating a need for irrigation. There are irrigation systems for more than 80% of the land, but approximately 10 percent of this area is actually irrigated. The Plovdiv agricultural region is characterized by more than ten different types of soil. The main soil types covering 90% of agricultural land are alluvial-meadow soils, chernozem-smolnitza and cinnamon-meadow soils.

Current conditions and the changes during the last years have led to an increase of the share of the medium-sized family farms. They manage integrated farming systems as a combination of plant growing and stock-breeding. A typical middle-sized family farm in the Plovdiv region consists of about 2-10 ha of agricultural land and 5-10 cows. The farms employ on average 2 persons per farm. The production of these farms is very versatile ranging from grains and fodder to vegetables and fruits. Lately there has been an increasing need for specialization. Large farms are specialized in grain production and small ones in more intensive production like fruits and vegetables. Significant changes have taken place in the region concerning the traditional four-field and eight-field crops-rotation. The farm co-operations and the family farms turn back again to the two-field crops-rotation. This change in the crop rotation with reduced and one-sided fertilizers use intensifies the process of destruction of soil structure and leads to lower soil fertility.

## **Methodology**

### **Definition of indicators to be used**

The concept of sustainability includes economic, environmental and social dimensions. The sustainability has been threatened also in transition economies when old institutions fall apart and the new ones are still weak. Unstable circumstances like unclear property rights and short term needs and necessities have often prevented actors from taking into account long term effects of their actions. However, the effects of transition are diverse. For example the falling intensity of production during the transition may be beneficial from the environmental point of view.

The complexity of sustainability as well as the complexity and diversity of farming suggests use of indicators as measures of environmental impact. The use of such indicators reveals the direction of development and may also provide a base for identifying the causes of unsustainable development. Soil parameters, which are a central element of agriculture, change rather slowly and their relation to management is only seen in the long term. The period of transition examined has only been about 10 years, and thus the overall effect of changes in management is hardly yet observable in soils. Use of pressure indicators allows us to make assumptions not only on the situation (the state) as it is today but also on the long-term effects of a particular technology.

The measurement of sustainability is rather myopic due to transition and uncertainty. The intersection of economic and environmental elements of sustainability gives anthropomorphic elements to ecology. Some of the social elements are included in the economic and ecological sets over time. For example, increasing employment opportunities are reflected as higher costs in agricultural production. Constraints are either set by the ecology or the economy, and these are also at least partly interrelated with time. The economic realities like budget constraints are decisive both at macro and micro levels. External constraints and opportunities connect the farming systems to agricultural policy.

Dynamic elements are simplified by using sets of indicators that reveal both state and pressure conditions. The indicators collected are problem-specific, reflecting economic viability and ecological sensitivity and resilience for water and soils. The soil is a complex and dynamic ecosystem. Problems related to soil are, erosion, salt accumulation, acidification, organic matter decomposition, nutrient depletion, contamination, loss of biodiversity in soil and soil compactness. State indicators of soil aim at measuring different aspects of the soil at a given point in time.

Cultivation practices, application of nutrients and pesticides and also water management are driving forces in the changes of agro-ecological systems. Environmental effects build up over time as a consequence of agricultural activities. Nutrient surplus or deficit is measured as a farm gate nutrient balance. The pressure on soil degradation is evaluated by a system of indicators connected to the intensity of land use and farm management practices. The choice of an operational set of indicators for evaluation of environmental impact of farming systems is made according OECD concepts (Wascher, 2000).

The economic indicators show the results of economic activities in the farms. They are closely linked with indicators on farm resources and management. The indicators of economic performance are productivity, profitability, diversity, stability, flexibility and time dispersion. Productivity of farms is measured by average yield per land or animal unit and by productivity of the resources. The main economic results from the agricultural production in the family farms are assessed by the indicators: gross margin (GM), disposable income (DI), net profit (NP) and the rate of return on variable costs (R%). Diversity is evaluated by index of diversity. Stability of agricultural production is assessed by the coefficient of variation (in percent) (CV). Flexibility of farm production is measured by the rate of flexibility (RF). This is the sum of multiplication of share of products and number of possibilities for their use. Time dispersion is evaluated by relative time-dispersion index (RTD) in man-hours.

The sustainable development of farming systems includes not only the economic and the environmental dimension but also the social dimension. Factors like farmers' age, education, land ownership and fragmentation of land indicate partly the social dimension.

### **Data collection**

The data from the case study area of Plovdiv region was collected using two independent techniques. First, centralized data sources from the Department of Agricultural Economics and Department of Ecology at Agricultural University of Plovdiv were utilized to get information of soil tests and analyses carried out in the region. Second, data were collected by a survey. The survey was conducted on middle-sized family farms in the spring 2001. Of the 76 villages in the region, 10 villages were chosen in the study taking into account their position to markets, using of the resources and the level of degradation of soil. The total number of medium-sized family farms in all these ten villages amounts to 2080, of which the sample covers 42 farms. Thus, the sample includes two percent of medium-sized family farms. The sample farms can be classified by specialisation to arable, vegetable and mixed farms (Table 1).

**Table 1 Middle-sized family farms classified by specialization.**

Measure	arable farms	vegetable farms	mixed farms
Numbers of Farms	12	11	19
Agricultural land totally ha	145	58	143
-of which irrigated land	65	48	93
Average indicators for farm			
-Agricultural land (ha)	12.1	5.3	7.5
-Respective animals	2.4	2.2	8.1
-Farm workers	1.3	2.4	2.1
-Invested capital (th. BLV)	22.0	17.8	27.3
Total number of animals	29	24	154
-of which cows,	7	5	94
-sheep	82	65	269
-pigs	35	19	57
-poultry	210	170	402
-horses	3	4	12

Source: Calculated from the survey collected information

A questionnaire was developed to specify connections and causalities between resource use and farming practices on the small and middle-sized farms in Plovdiv agricultural region. Farmers' responses were used to evaluate and compare different production technologies and their influence on sustainable resource use and vitality of the small and medium size farms.

## **Results**

### **State of the farming systems**

The agricultural region of Plovdiv is characterized by more of ten different types of soil. The level of fertility ratio in the region is 76 points which qualifies the group as possessing "good to very good lands" and the assessment rating for individual crops is 84 points for wheat, 78 for apples, 75 for vegetables, 67 for maize, 66 for vines, and 63 for alfalfa.

The agricultural land in Plovdiv agricultural region in the beginning of the period of transition suffers from some type of soil degradation, including erosion, acidification, salinization and water-logging. Soil parameters, which are a central element of agriculture, change rather slowly and their relation to management is only seen in the long term. The period of transition examined has only been about 10 years, and thus the overall effect of changes in management is hardly yet observable in soils. Use of pressure indicators allows us to make assumptions not only on the situation (the state) as it is today but also on the long-term effects of a particular technology.



The degradation of land in Plovdiv region has been caused by misuse of irrigation, fertilization, and cultivation practices (table 2). Each of them has a certain effect on the land use in the region and necessitates changes in the farming systems.

**Table 2 Degradation of land in Plovdiv agricultural region**

Types land degradation	Main reason	Area (in ha)	Percentage of cultivated land
Total soil erosion	Agriculture induced	800	0.5
Acidification	Natural and human-induced	46 125	32.2
Salt-affected	Irrigation and fertilization	7 500	5.2
Humus degradation	Agriculture induced	30 000	20.1
Total pollution	human and industry-induced	5400	3.8
Compacted	Agriculture induced	1800	1.3

Source: Ministry of Agriculture

This negative effect has a long-term character and considerable investments are necessary for it to be overcome. This is a problem of social importance during the period of transition and the restoration of the land ownership. It arose of the worsened soil parameters in some villages of the Plovdiv region.

The Plovdiv agricultural region is rich of water resources. Maritza river and its tributaries (Striama, Vacha, Chaia, Topolnitza and Parvenetzka river) supply a large quality of water for the agriculture in the region. There is an irrigation systems in the region for more that 85% of the land, but it is not well functioning during the last years.

Plovdiv region can be defined as agricultural ecological area (AGEC) with homogeneous biological production possibilities. The agriculture in the region is capital and labour intensive. Plovdiv region is specialized in vegetable production and fruit production.

Plovdiv region has about 480 thousand inhabitants. About 130 thousand of them live in rural areas and more than 69 thousand are engaged in agriculture.

During the process of the agrarian sector transformation, four main types of farm systems have been developed in the region (table 3). They are a result of the established organization forms and the objects they pursue. The development of each farm system is influenced by the environment and also by the due organization form opportunities of drawing additional resources.

**Table 3 The share of the farming systems in Plovdiv agricultural region (in %)**

LAND USERS	1990	1995	2000
State farms	12,3	6,7	5,2
Co-operatives	82,9	49,1	23,7
Private farms	0	28,6	44,3
Household plots	4,8	6,4	8,7
Abandoned d land	1,3	9,2	18,1

Source: Regional Agricultural Office

The first type farm system was developed in the farm production co-operations. It mainly includes specialized plant-growing production. About 80 per cent of the co-operations in the region are specialized in grain-production. This specialization is conditioned by the cooperators' needs of grain for the animals in their family farms and also by the mechanization available. The two-field crop-rotation wheat-maize is mostly applied in these co-operations. When autumn is rainy this crop-rotation switches to a one-crop growing of wheat and maize. This crop-rotation distortion and also the one-sided nitrogen fertilizing leads to the soil degradation and to decreasing its fertility. The technologies used are considerably deformed.

The second type farm system is developed in the large family associations and rent farms. Usually, several kinds of production are being developed in these farms in order the resources to be used more effectively. Modern technologies and balanced fertilizing are applied in the plant-growing and stock-breeding sectors. The land is intensively used. The big part of the cultivated land are irrigated. The managers of these farms are usually university educated and well experienced. However, not applying the organic fertilizing (manure, green fertilizing, use of post-harvest waste, etc.) and also pursuit of higher profit sometimes may lead to the secondary salt accumulation in the soils and humus degradation.

The third type farm system is developed by the medium-sized family farms. Most of the family members work in the farm, providing the main part of the family income. The medium-size family farm is usually integrating both the agricultural sectors - plant-growing and stock-breeding. That allows the family resources (labour, land, capital) to be rationally used. During the transformation period, the household farmers' attitude towards the soil degradation and the land use has undergone considerable changes. In the first years of the reform under the conditions of uncertainty and temporary use of the land, the issue of the farming system effects was not of primary significance for the farmers. During the last years however, the farmers show a marked concern about improving the land quality and restricting the soil degradation. The lack of knowledges and experience in some of new farmers is a main problem concerning the sustainable use of their land. Sometimes this causes unfavourable effect on the soil (acidification and

secondary salt affection). The market development of these farms will lead to removing the above mentioned weak points through use of the extension services.

The fourth type farm system is developed by the small family farms and household plots. The main object of their existence is self-sufficiency. They manage small areas and apply labour intensive technologies. Because of the great diversity of the products they produce, they develop a sustainable crop-rotation with applying organic fertilizing. Many families have also side earnings, which allows them to take the due to measures for restricting the soil degradation. These possibilities need the extension servicing support.

The examined four systems of farming will continue to develop during the next years. The trends of this development will be conditioned by the main parameters of the macro economic situation in the country and also by the development of negotiations for joining to EC.

The current condition and the changes during the last years lead to an increase of the share of the medium-sized family farms. They mainly develop integrated farming systems as a combination of plant-growing and stock-breeding. The goal of this kind of family farms is the effective using of available resources. In the future some farms will reduce diversity of the production and will become more specialized. The medium-sized family farm development will need involving of ecological friendly practices.

### **Principal farming system**

The middle-size family farm for the Plovdiv agricultural region is considered a farm sized 2-10 ha and where about 5-10 cows are being bred. The share of the middle-size farms in the ownership of resources and the size of production can not be easily specified, due to the prompt structural changes in the region agricultural sector. According to data of the Regional Agricultural Office, about 18500 family farms can be related to this type farming at the beginning of 2000. They manage about 65 per cent of the region arable land and also breed about 75 per cent of the animals. The average size of the middle size farm is about 5.1 ha. The middle-size farms provide a full-time employment of about 32000 persons, which represents 45 per cent of the region agricultural sector total employment. The share of the farms in the total size of the agricultural production of the region is gradually increasing. The process of specialization leads to increasing the share of the production for the market. By expert assessment, the share of the middle-size farms on the market of agricultural products amounts to about 70 per cent. This assessment was confirmed by the studies carried out in the local wholesale markets in Parvenetz, Rakovski and Joakim Gruevo villages.

The middle-size farms and also the other family farms have no a legal statute. According to the Bulgarian legislation their court registration is not required. The model of organization, production specialization and market position of these farms is determined by their size and mode of living. Usually they practice a group management (with expressed leadership of a member of the family). The management of this farm is highly depending on the family members' qualification and skills. The main object of the middle-size farm management is providing of higher gross margin for the family. This could be achieved through an effective use of the available resources. The first stage of the resources management concerns the appropriate allocation of the resources used in the farm and those being realized out of the farm on the basis of the opportunity costs with no any other factors influencing the decision. By reason of that, the younger members are still looking for a well paid job out of the farm. In many cases one or more members of the family may work out of the farm, while hired labour is being used there.

The second stage of the resources management is connected with their allocation within the farm between the different productions. The market orientation of production increases in this process. A process is starting of specialization of production. Diversification and insuring against the market risk is replaced by an obvious pursuit of a higher size of the production to be realized and also higher market receipts. This results in changing the used technologies and applied farming practices. The importance of the more effective factors is already considered and assessed and they are gradually being more used. During the last two years higher quantities of chemicals and fertilizers have been used in the middle-size farms. The investments for restructuring of the existing and building of new irrigation systems also increase. Because of the low rate of cooperating in irrigation, it is necessary to find out some individual solutions of the problem.

The development of the production specialization in the middle-size farms in the Plovdiv region is determined by the following three main factors:

- the structure of the available resources in the farm;
- the size of the opportunity costs for the resources;
- the position according to the local markets of agricultural products.

Combination of these factors contributes to establishment of three groups of farms, depending on the direction of specialization (table 4). The differences between them will become more and more significant with the development of the market economy in the country.

**Table 4 Land use and economic and environmental indicators.**

Average indicators for farms	Arable	Vegetable	Mixed
Agricultural land (ha)	12.05	5.32	7.53
Livestock units	2.4	2.2	8.1
Farm workers	1.3	2.4	2.1
Land use (%)			
-grains	77	50	64
-industrial crops	13	9	7
-fodder	4	7	20
-vegetable	4	19	5
-permanent grassland	2	15	4
Farm gate nutrients balance (kg/ha)			
-Nitrogen	- 42	- 25	- 34
-Phosphorus	- 49	- 41	- 43
-Potassium	- 95	- 92	- 93
Pesticides			
-Share of treated area in ( % )	32.4	67.3	42.8
-Active ingredients ( kg/ha )	0.86	2.05	1.14
-Pesticide acute risk index	0.10	0.29	0.18
Irrigation			
-Irrigated land %	45	81	65
-Share of ground water ( % )	19	28	24
Economic indicators			
-Land productivity (BLV/ha)	1724	3272	1885
-Off-farm return on input	1.56	1.82	2.14
-Farm gross margins (BLV)	4 748	6 948	5 182
-Invested capital (th. BLV)	22.0	17.8	27.3
-Net farm Income Ratio ( % )	29.8	18.6	23.4
-Rate of revenue diversity	0.48	0.55	0.59
-Revenue variation (%)	27.6	21.8	18.2
-Rate of flexibility	0.37	0.44	0.56
-Rate of time dispersion	36.5	28.9	21.3
-Self-sufficiency (%)	11.2	10.8	12.6

Source: Calculated from the survey collected information

The first kind specialization is being formed in the comparatively larger farms (7-10 ha), which are located more than 20 km from the main local markets. These farms are gradually specializing in grain and forage production and also in production of animal products. The opportunity costs of the resources used for production are comparatively low and the possibilities of their realization out of the farm are too limited. The gross margin per ha varies from 400 to 800 BGL (EUR = 1,95583 BGL) yearly. Some of the farms try to increase their incomes by growing industrial crops (sunflower, peanuts, sesame, etc.). The farms, which have

funds for buying the necessary machinery, can rent a land. In this group of farms, some conventional farming practices and also less production practices are usually being used.

The second type specialization of production is developing in farms sized 4-8 ha, located about 10-20 km from the main local markets. In these farms two types of production could be distinguished - intensive production and extensive one. Intensive technologies are being used in the vegetable-, fruit- and vine-growing. The production is intended for realization on the local markets or for processing by the due processing enterprises in the region. These productions provide most of the farm income. Some extensive productions, such as grain and forage production and animal husbandry can also be developed in the farm. The family usually consumes a part of the production. The realized average income per ha in this type specialization varies from 800 to 1600 BGL (per year). The opportunity costs of the resources are higher and a part of them are used out of the farm.

The third kind specialization is peculiar to the comparatively smaller farms (2-6 ha), which are located up to 15 km from the local markets of agricultural products. The farms are specializing in intensive production of fruits, grapes and vegetables. Other productions are developed only for self-sufficiency. The production in these farms has a marked seasonal nature. The land is used very intensively. The lack of experience and also some shortcomings in the existing technologies may result in degradation of soil. The opportunity costs of the resources are high and the share of the land unused is low. The gross margins per ha varies about from 2000 to 6000 BGL. Usually the total land under crops is irrigated. It could be observed insufficiency of organic matter in the soil in this type farms, which determines the application of manure for improving the soil structure.

### **The main determinants in the transformation of the farming systems**

The existing farming systems have been formed in the conditions of economic transition. Their main characteristics are a result of the common operation of the transition main elements: liberalization of prices and markets, privatization of ownership and restructuring of economy, including of agriculture.

The price liberalization and Government withdrawal from regulating of market relations, provoked the sharp worsening of trade conditions between agriculture and industry. The market of agricultural commodities is restricted by the decline in the country's agricultural export and the increased level of self-sufficiency. The slowly development of domestic market is additionally restricted by the low incomes and high level of unemployment. Notwithstanding the certain macro economic stabilization achieved during the last years, conditions of trade between agriculture and industry go on worsening.

Privatization of land and assets in agriculture has been accomplished in the form of restoration of owners in their property rights at the beginning of 1946. However, this historic leap in property rights did not give an account of changes that have occurred during the last fifty years. Results are worrying. The land is highly fragmented out between many owners, which is an obstacle to its effective use and also to functioning of the land market. The problems referring to allocation of land between all the rightful inheritors impede receiving of legal documents of ownership. Thus, the farming systems' formation, enlargement and sustainable development are getting complicated. The considered by the society (discussed in the society) possibility of land consolidation is difficult and costly act that requires the agreement of all farmers in a setting (village) for common action.

Restructuring of agriculture is a continuous process that aims at increasing of economic, ecological and social effectiveness of the sector. The delayed rates of farming systems development are determined by the very high number of participants and absence of well-defined and well-grounded agrarian policy. This led to emerging of great variety of farming systems, which do not correspond with the natural, economic and social environment.

Under the influence of the above mentioned factors, the following important changes occurred in the technologies and the systems of farming:

In the plant-growing sector, the process of transformation, which has started with the prices and markets' liberalization led to some changes in the structure of the production resources. The use of the more expensive resources is being restricted. The phosphates and the plant-protection chemicals are being less used, because of the considerable rise in their prices. The attempt they to be replaced by the farm own resources or by other not too expensive ones is unsuccessful. The quantity of nutritious substances in the soil is highly decreased.

The rise in the machines and fuels prices leads to decreasing the number of the soil cultivation, which could not be replaced by the higher number of the handwork practices. The rejection of the deep tillage has exercised a very negative effect on the compactness of some types of soils, such as the chernozem-smolnitza and the cinnamon-meadow soils. The relative high price of irrigation water and also the destroyed canal system have considerably influenced the plant-growing technologies and the overall development of the farming systems. The quantity of the irrigation water coming from centralized water sources sharply decreased. That resulted in an almost double decrease of the main crops yields and also in declining the farm incomes. Some attempts at using local sources of underground water for irrigation led to a secondary salt accumulation of the soils.

During the period of transition some important changes also occurred in the market of agricultural products. The export quantities of fresh and processed produce sharply declined, particularly of fruits and vegetables, which mostly are grown in the Plovdiv region. That necessitated some changes in the structure of the grown crops. The areas under vegetables and forage crops (alfalfa, peas, tare, etc.) highly reduced. Significant changes have come in the traditional for the region four-field and eight-field crop-rotations. The farm co-operations and the family farms turn back again to the two-field crop-rotation with alternating earthed-up crops and merged crops. This change in the succession of crops with a highly reduced and one-sided fertilizing intensifies the process of destroying the soil structure and leads to lowering its fertility. In a few family farms only, where more animals are being bred and the manure is rationally used, it could be observed a certain restriction of the soil degradation

The changes in the stock-breeding technologies during the period of transition are also considerable and they resulted mainly from the process of privatization in the agrarian sector. The comparatively low and controlled prices of the milk, meat and eggs during the initial years of the transition (1990-1994) contributed to the sector unprofitableness. Because of that reason the farm co-operations under reorganization hurried up to get rid of the animals available and to give up them to the owners of land. That usually occurred during the autumn or winter. The new farmers had no the necessary forage and utility buildings available, because of which most animals, even the high productive ones were liquidated. The changing economic conditions and also the claims of restitution caused the step-by-step disintegration of the large state farms. During that period the animals' total number decreased at an average of about 60 per cent.

The stock-breeding structure in the Plovdiv region has changed. Up to the beginning of the transition period, more than 70 per cent of the animals were being bred in large and modern farms; during 1999 only 8 per cent of them are in those farms. The main share of the animals are being bred in the new family farms (table 5). This fragmentation of the stock-breeding led to a change in the applied technologies. The modern industrial technologies with a high level of labour mechanization were replaced by the traditional technologies from the 60's.

Considerable changes could be observed in the process of the animals feeding. The daily rations of the animals bred in the small family farms do not meet their needs. This is due to the objects the farmers set themselves. First, that is supplying the family with animal products. Second, it is the best use of the plant-growing production; third, the use of the labour and assets available in the farm and at last - development of a high-profitable production for the market. The selection of the objects is confirmed by the farmers' reaction to the 50 per cent reduction of the cow's milk during the period 1998-2000. Against to expectations, the number of the animals did not sharply decrease.



**Table 5 Livestock number in Plovdiv agricultural region (2000)**

Farms	Cattle	Pigs	Sheep	Poultry	Horses
Co-operatives	1 916	134	1 282	98 000	24
Private	20 883	29 586	76 633	371 144	456
TOTAL	22 799	29 720	77 915	469 144	480
% variation	- 65.3	- 64.7	- 52.4	- 42.1	+ 5.2

Source: Regional Agriculture Office

The change in the structure of the animals daily rations switched to decreasing or fully excluding the high-protein components and compounded fodder, which were replaced by ground grain. That caused increasing the overall costs per unit of production in the pig-breeding and poultry-raising. The worsened structure of the daily ration led to lowering the animals' productivity.

There are three main factors, which determine the changes in the existing technologies. The first factor is the change in the structure of agriculture in the region. The large number of dairies and other small farms do not allow applying the modern technologies. The second factor is the lack of funds for providing mineral fertilizers, pest control chemicals, machines, irrigation water, etc. The undeveloped system of crediting the agriculture and also the absence of institutions for more effective use of the production factors impede the technologies advance. The third important factor of the change in the technologies is the human capital. During the last ten years, many people who have no the due knowledge and experience have entered the sector by economic reasons. Applying the modern technologies was found to be impossible for them, An extreme necessity arose of establishment of extension services for rendering to these farms the needed technological assistance. The above mentioned factors considered in terms of the changes in the technologies are closely connected with the processes of the soil degradation and the land use in the Plovdiv region.

### **Discussion**

Sustainable development of the small and medium sized family farms in the region calls for their organized interaction. The common actions of these farms must follow three main trends:

- coordination of the efforts in providing of production resources;
- collaboration with the purpose of more effective use of the available resources;
- co-operation in joint processing and marketing of produce;

The higher economic viability of the medium sized family farms depends on their enlargement. It is connected with providing of additional farmland - either bought or rented. In the conditions of high fragmentation of land and partial absence of notarial deeds, this involves considerable transaction costs. The disintegrating production co-operations in some villages, play the role of mediator in renting of

farm land. Risks that attend their existence are being transferred into the renting provisions. This prevents working out plans in a long-term and investing in improvement of land quality. The possibilities of using the national land market by the middle-bracket farmers are being restricted by the parcels' small size and also by the absence of local market structures. All this determines the necessity of the medium sized farms to co-operate in studying the land market, and also in buying or renting of farmland. This form of collaboration may be used in undertaking joint actions intended for improving the soil qualities in the regions with degraded soils (erosive, salt-affected, acidified, etc.).

The share of irrigated areas in the medium sized farms of the Plovdiv region, is going down. This is due to the following main factors: irrigation system, which is not fit for service of small water users; partially destroyed network of canals; uncertainty in water supply and finally, the comparatively high price of irrigation water. The forced withdrawal from irrigation results in lowering the efficiency of resources and farm income.

Most of the medium sized farms specialized in vegetable-growing have built their own water sources (wells) and they use ground water for irrigation. However, this contributes to increasing their production costs and also promotes the secondary salt accumulation of soil. It is especially risky to use ground water for irrigation in regions with salt-affected soils. Many farmers in the region is being realized by necessity of joint actions in supplying of irrigation water but restrictions provided in the Law of Water Associations impede development of co-operating in irrigation. Other important reasons for this are the land fragmentation, lack of long-term crediting and low level of return on investments in agriculture. The development of water co-operatives needs some changes in legislation and the investment support of Government. This would also contribute to restricting the state monopoly in the irrigation water supply and reducing the risk of secondary salt accumulation in the soil.

The medium sized family farms' development in the region is connected with switching to sustainable intensive technologies and farming practices. This will lead to increasing the share of production factors, which are not available in the farm and may be bought on the market. Transaction costs will increase and their effect on the farm's economic results will be considerable. This calls for joining the efforts in supplying of fuels, fertilizers, forage, pesticides, etc. with the purpose of reducing the transaction cost. The attempts to use the existing universal co-operations for that purpose have failed in some villages, because of these co-operations' limited financial resources. During the last several years, it was initiated establishment of informal associations of the middle-bracket farmers for providing mainly of fertilizers, forage and fuels. Because of their limited nature these associations do not aim at any legal form of existing. In the process of

enlarging the medium sized farms it is very likely they to develop into supply farm co-operations.

The access to short-term and long-term credits is of great importance for the medium sized farms' enlargement and modernization. During the process of its transformation, the country's bank system endured several crises that affected the size of the credit resource and the ways it is being used. The difficulties of crediting in agriculture have led to launching of a range of credit co-operations. Their activity on raising of deposits and re-investment is restricted by the Law of Banks. The possibilities of development of these co-operations are connected with establishment and court registration of agricultural credit bank, which to run the activity on raising of deposits under the provisions (terms) of law.

The medium sized farms' sustainable development implies the best use of all production factors. The relatively small size of these farms in the region on one hand, and highly diversified production on the other hand, do not justify providing the farm with all necessary machines and related equipment. That is why, the farms face the necessity of co-operating in using of tractors, harvesters and specialized machines. In this connection, some informal partnerships have been created in many villages, and it may say, that they operate successfully. There are mainly two kinds of partnerships. In the first case, the middle-bracket farmers own the machines, which they have bought during the liquidation of collective farms or disintegration of production co-operatives. These farmers prepare the schedule of using the due machine. The fixed costs are allocated according to the amount of completed work, and the variable costs are being paid by the farmer who are used the machine. The second kind partnership is based on an agreement of common providing with machines and equipment. Some of the middle-bracket farmers, who are relative in the main, buy the whole set of machines necessary for their production. Each farmer is an owner and he actually purchases only different machines and instruments. The set of machines is being used jointly and each farmer is responsible for the technical maintenance of the machine he owns. The members of both kinds of partnership may also do services to other farmers against payment. In the process of enlargement of the medium sized farms and their further participation on the market, partnerships in using of machinery will continue to develop.

There is also a relatively new form of collaboration between the medium sized farms in the region. They try jointly to provide the necessary information about technical achievements in agriculture, and ask the professional consultations of specialists from universities and research institutes. They also work out common projects relevant to applying for financing from the state fund "Agriculture" under the SAPARD program. With the increasing Government support to agriculture and enlarging of pre-accession funds, co-operation in this field will keep developing.

The medium sized family farms' market orientation is dominant in their development. The share of production realized on the local and central markets increases at the expense of restricted consumption within the farm. The process of specialization in these farms increasingly develops. Efficiency of resources and technological level of production are increasing. More and more middle-bracket farmers realize the necessity of co-operating in marketing of production. There are established informal associations of middle-bracket producers of fruit, vegetables and mushrooms in some villages from the Plovdiv region. In this way, the market power of farmers is growing up. They more successfully contract the terms of supply and prices with processors and also reduce their transaction cost. The associations created on relative or neighbourhood base are still predominating. Often, they are a logic continuation of the associations for common use of machinery and labour.

Establishing and effective operating of the farm co-operations in support of the sustainable development of medium sized family farms in the Plovdiv region, is attended by a number of difficulties. The restrictions are related with the applied model of agrarian reform in the country and with the socials' skills for co-operation in the conditions of transition also are determinative.

Transformation of agricultural sector in the country is running in the conditions of acute (deep) economic crisis. The used restitution model for establishment of property rights has led to a high fragmentation of land and emerging of a great number of small farms. The size and marketing capacity of the middle size farms prevent them from taking up good market positions and also impede their sustainable development. For to provide their viability, it is necessary to carry out consolidation of farmland and also to increase their average size. Only sustainable farm structures may successfully co-operate in order to improve their market positions and production potential.

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# ORGANISATIONAL RESTRUCTURING AND PERFORMANCE OF AGRICULTURAL PRODUCER'S CO-OPERATIVES IN BULGARIA

Krassimira Kaneva

## Introduction

Transformation of the former co-operatives into new ones was not an agricultural policy goal in Bulgaria. Quite the opposite, new producer's co-operatives were established despite the policy oriented exclusively to both family and big tenant farms. Ten years after the reform start, new producer's co-operatives exist and perform and nobody can say that they are temporary organisational forms. Unfortunately, they bear some disadvantages of the former labour co-operatives, such as over-employment, decapitalisation, availability of sunk costs, etc., which lead to inefficient performance. Co-operatives, like all agricultural producers in Bulgaria, perform under the totally free market. The State does not support them so many co-operatives are threaten with bankruptcy. Then a question arises how new producer's co-operatives can exist in the future and which is the way to overcome difficulties and improve their performance?

*This study attempts to reveal the process of restructuring of the former labour co-operatives during the transition period and the efficiency of performance of new production units.*

The paper is organised as follows: first the theoretical approach used for the investigation of production factors reallocation is discussed. Next section describes new agricultural units and the role of new producer's co-operatives in Bulgarian agriculture. After that, empirical results based on DEA Analysis are presented and finally, the main implications are summarised.

## Organisational Restructuring of Agriculture

Agricultural restructuring as part of the entire process of restructuring in transition countries has two dimensions: *reallocation* of production factors and *reorganisation* of the former organisational forms. Blanchard (1997)<sup>1</sup> has applied a two-sectoral model in order to explain the reallocation of employment between the state and the private sector during the transition and to show the sequences for the reorganisation of the former state firms in post-socialist countries. We have

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<sup>1</sup> Blanchard regards the two dimensions of the transition process as reallocation and restructuring, while we assume that reallocation and reorganisation are two dimensions of the agricultural restructuring process.

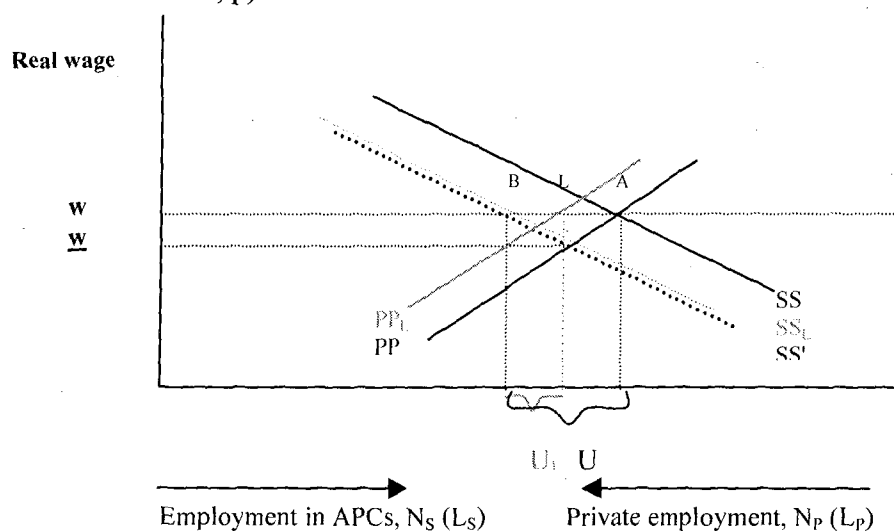
adjusted Blanchard's model in order to explain the reallocation of land and employment in the agricultural sector at the beginning of the reform. Producers' co-operatives are considered to belong to the former state sector, while the private sector consists of family and large-scale private farms. Further, we trace the process of reorganisation of former labour co-operatives and establishment of new agrarian units.

## Reallocation of production factors

### *A model for reallocation of production factors*

The main assumptions of Blanchard's (1997, pp.26-28) basic model are:

1. The production of goods is expressed by the function  $Y = F(N_i, K_i)$ , where  $Y_i$ ,  $N_i$ ,  $K_i$  denote output, employment and capital in sector  $i = s, p$  (the state and the private).
2. The wage rate is measured on the vertical axis (Fig.1). The nominal wage rate is denoted as  $w$ , while the real wage rate is  $\underline{w} = W/P_i$  ( $P_i$  denotes the price of goods in sector  $i = s, p$ ).



**Figure 1 Reallocation of production factors in the state and private sector**

Source: Based on Blanchard, 1997

3. During socialism, due to subsidisation of the state sector, the latter produced goods less valuable than those produced in the private sector. If one state good is worth 1, then one private good is worth  $(1+\theta)$  state goods,  $\theta > 1$ . The price difference of two goods reflects the quality differential. So, if the prices of state and private goods are denoted as  $P_s$  and  $P_p$ , then  $P_p = (1+\theta) P_s$ .

4. The two goods are substitutes up to the quality differential that implies a simple relation between the subsidies ( $\sigma$ ), tax rate ( $\tau$ ), affecting private sector and the quality differential ( $\theta$ ). In the short run the capital ( $K_i$ ) is fixed. Then,

$$\frac{1 + \sigma}{1 + \tau} = (1 + \theta) \quad (1)$$

The demand of labour in the state and private sector pre-transition is:

$$N_S = K_S f\left(\frac{W}{P_S(1 + \sigma)}\right) = K_S f\left(\frac{W(1 - \theta)}{(1 + \sigma)}\right) \quad (2)$$

$$N_P = K_P f\left(\frac{W}{P_P(1 - \tau)}\right) = K_P f\left(\frac{w}{(1 - \tau)}\right) \quad (3)$$

5. The equilibrium in the pre-transition period is at point A, where there is no unemployment. The demand for labour by state firms, SS, is going left to right on the horizontal axis. The demand for labour in private firms, PP, is measured going right to left.
6. During the transition period, due to the removal of subsidies while tax rates for the private sector are unchanged, the demand for labour in the state sector decreases and shifts from SS to SS'. It follows from the equation (1.3) that the demand for labour by private firms is unaffected, as they have not had subsidies, and PP does not shift.
7. At a given real wage  $w$ , the result is a decrease in the state employment and no change in private sector employment. Thus there is an unemployment increase from 0 to U. As long as the real wage does not decline to  $\underline{w}$ , transition leads to this initial increase in unemployment. The new equilibrium is reached when the real wage rates decrease to  $\underline{w}$  which is at the intersection SS' and PP.

Hypothesis: The structural development of Bulgarian agriculture during the transition period is specific. In contrast to the basic model, employment reached its equilibrium almost immediately after the reallocation started. One of the reasons might be that the real wage has dropped and thus unemployment has been avoided. The other reason can be seen in a decrease of working hours that also led to the preservation of employees. The third reason is, in contrast to the basic model, that the private sector has absorbed the employees dismissed from the state labour co-operatives. In our opinion all three factors affected the labour reallocation process. Regarding the use of land, the production function will be  $Y = F(L_i, N_i)$ , where  $L_i$  and  $N_i$  denote land and employment in sector  $i = s, p$ . In the short run employment is fixed. The model can help us explain why a large part of the land now is idle. The assumption is that during the transition the use of land in labour co-operatives decreases from SS to SS<sub>L</sub> and the private sector absorbs part of the free land to PP<sub>L</sub>. As the pace of decrease in the state sector is higher than that of absorption into the private sector, the idle land is equal to U<sub>L</sub> (the red one). If the private sector did not take over any land, then the idle land would be equal to U.



### *The Empirical Analysis of Labour and Land Reallocation*

Although many employees left former co-operatives right after the reform started, the employment rate in Bulgarian agriculture, in contrast to other post-socialist countries, increased in comparison with the pre-reform level (Table 2). New producer's co-operatives have about 100,000 employees (Working Units)<sup>2</sup>, or 7,5 times fewer than in 1988, while the private sector has accepted many of employees dismissed from co-operatives and industrial enterprises.

**Table 2. Agricultural Employment Structure over 1988 - 2000**

Year	Total Number, Working units	Public Sector, Working units	Private Sector, Working units	Share of public sector (%)	Share of Private Sector (%)
1	2	3	4	5	6
1988	753.8	753.8	x	100.0	x
1990	735.2	574.9	160.3	78.2	21.8
1992	676.7	359.5	317.2	53.1	46.9
1993	698.2	233.5	464.7	33.4	66.6
1994	738.2	159.0	579.2	21.5	78.5
1998	795.8	15.2*	780.6	1.9	98.1
2000	771.0	8.2	762.8	1.1	98.9

\* Data on Producer's co-operatives in 1998 have been reported in private sector data.

Source: Annual Report, MAF, 2001

The lower level of the employees during 1992-1993 can be partly explained with the dismissal of the former workers in the labour co-operatives but it can be mainly explained with the decrease in working days while the majority of workers were kept. This suggestion is based on the data about the natural number of households /employees/, as follow:

**Table 2 Family Farms and Natural Workers over 1985 – 2000**

Year	M	Number
1985	Households*	1,60 million
1993	Family farms*	1,90 million
1995	Family farms*	1,78 million
2000	Family farms (workers)	0,76 million (1,36 million)

\* National Statistical Institute provided data only about the number of farms in 1985-1995

<sup>2</sup> It is calculated as the difference between employees in the public sector in 1996 and 1998, when co-operatives were reported in private sector: (118,3 - 17,0 = 101,3 thous.)

Data show that during the first years of the reform, the number of households increase significantly, which means that many people /former industrial or agrarian workers/, who restituted their land started private, full or part-time farming. This is consistent with hypothesis, stating that the employment in Bulgarian agriculture, in contrast to the basic Blanchard's model, reached its equilibrium almost immediately after the reallocation of labour started, and that there is even over-employment.

The situation is different as regards **reallocation of the land**. It started just after the Land Ownership Act was past by the Parliament in 1992. By the end of 2000, the land property rights had been recognised on 5.95 million hectares. Nearly 25 % of the recognised ownership rights have been restituted in the real old boundaries, 70% by land division plans and for the remainder 5 % paper bonds were issued.

The total managed land is 5.38 million hectares, of which 4.88 million hectares are arable land. In 2000 the used land is 3.60 million hectares, or 74% of arable land. The rest 26% was idle land, overwhelming majority of which is at the disposal of the private sector. This confirms our assumption, based on Blanchard's model, that the private sector could not absorb the total land area given up by the co-operatives, which causes incomplete use of farmland.

### **Reorganisation of the Former Labour Co-operatives**

Reorganisation of the former labour co-operatives resulted in two main organisational forms- producer's co-operatives and private farms, which embody self-subsistence holdings, family farms and tenant farms. Later in the paper we use family farms for all types of private farms.

The establishment of producer's co-operatives followed political events in Bulgaria and depended on attitudes of the ruling parties towards co-operatives. The vast registration of producer's co-operatives during 1993-1997 was significantly supported by the Bulgarian Socialist Party (BSP), being in power at this time. After 1997 the Union of Democratic Forces (UDF) made efforts to set a legal framework for relationship between co-operative managers and members. According to the last amendment of the Co-operative Act (1999), co-operatives can only rent land. They are obliged to negotiate lease contracts with landowners but have not rights to buy land as juridical persons. This is a measure against co-operatives not paying rents but also against inefficiently use of land. However, there is evidence that the amendment is not applied everywhere and many co-operatives continue to perform in the known way.

The place of producer's co-operatives in Bulgarian agriculture can be seen in Table 2. They take only 0,45 of the total farm number but cultivate nearly 62% of the used land. Co-operatives contribute to over 70% of the production of cereals

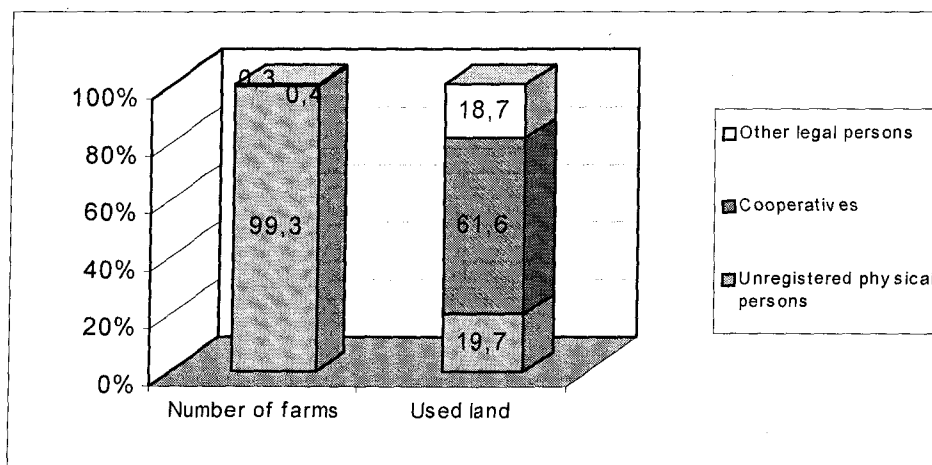
and sunflower. They nearly do not cultivate fodder and diminish significantly the size of orchards and vegetables. There are only few co-operatives, which breed any animals. More than 80% of animal products, vegetables and fruits are produces in private sector.

**Table 3 Number and Size of Agricultural Farms in Bulgaria 1999-2000**

	Number farms	Share in the group, %	Used land 000' hectares	Share of the used land, %	Average size hectares	Working Units*, 000'
1	2	3	4	5	6	7
Unregistered physical persons	755 300	99.3 %	708.0	19.7 %	0.9	693.7
Legal persons and self-employed merchants	5400	0.7 %	2 893.4	80.3 %	535.8	77.1
- incl. cooperatives	3125	0.4 %	2 218.5	61.6 %	709.9	n.a
- other legal persons and merchants	2275	0.3 %	674.9	18.7 %	296.7	n.a
Total:	760 700	100.0 %	3 601.4	100.0 %	4.7	770.8

\* 1 Working Unit = 1856 working hours or 232 working days per year

Source: Ministry of Agriculture and Forestry, Department "Agrostatistics"



**Figure 2: The share of co-operatives in Farm Number and Used Land**

Source: MAF, "Agrostatistics", 2001

## **Efficiency Measurement**

In order to measure the efficiency of the land and labour use, a Data Envelopment Analysis (DEA) is applied (Coelli, 1996, Anderson 1996, Mathijs et al, 1999)<sup>3</sup>. It is based on regional survey conducted in three regions in Bulgaria. The efficiency of producer's co-operatives is analysed in comparison with the efficiency of family farms.

### ***Survey sample***

The survey sample embodies 84 settlements with more than 150 inhabitants from the three regions - Varna (30), Montana (24) and Plovdiv (30). These regions differ widely in their natural resources, production specialisation and economic conditions. They consist of flat, semi-mountainous and mountainous areas. The Varna region has predominantly flat relief with cereal orientation but vineyards and orchards are cultivated on the hill areas. In the Montana region mostly cereals and sunflower are also produced but in the pre-reform period about one third of the cultivated land was under fodder crops. The diversity of agricultural production is the highest in the Plovdiv region but natural conditions are most favourable for vegetables and fruits. With the start of the reform, however, the share of cereals and oil production significantly increased at the expense of recultivation of fodder crops and perennials.

The choice of settlements was stratified randomly. First, we randomly chose settlements from all municipalities in the regions. As the majority of the sample was from the semi-mountainous and mountainous areas, we replaced a part of the settlements, taking others from flat areas. The distance from the municipal centre was also taken into account.

In each settlement one co-operative and three family farms were observed. A criterion was set: one self-subsistence holding, one middle sized family farm and one big tenant farm were to be interviewed. If there were no tenant farms, two middle-sized farms would be interviewed. In co-operatives the president or other manager of the staff was interviewed but in the family farms the farmer or his spouse was interviewed. The entities in each settlement were random chosen but they are not representative for their groups, due to their small number.

In the Varna region data are available for 32 co-operatives and 88 family farms, in the Montana region for 22 co-operatives and 74 family farms and in the Plovdiv region for 22 co-operatives and 98 family farms. The total number of the co-operatives in the sample is 76 co-operatives and 260 family farms.

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<sup>3</sup> The software and recommendations for DEA analysis, developed by Tim Coelli, are gratefully acknowledged.

Questionnaires were divided into 13 groups of questions concerning foundation and internal organisation, utilisation of main production factors (land, labour and capital), inputs, investments, marketing, services and social questions. In the next section we test our model for the efficiency of production factor adjustment at the regional level.

### **Description of the DEA Model**

DEA uses linear programming methods to construct a production frontier. It measures the efficiency of farm performance relative to this frontier, which is the best performance, in contrast to a typical statistical approach that evaluates producers relative to an average performance. The core of the DEA is in finding the best virtual farm for each real farm. If the original farm produces less output with the same inputs or produces the same output with less inputs than the virtual farm then the original farm is *inefficient*. A farm shows total technical efficiency if it produces on the frontier of the production. Then the efficiency is equal to 1, while for other less efficient farms the coefficient ranges from 0 to 1. The frontier production function is defined assuming constant returns to scale (CRS).

The best virtual producer for the target farm consists of the weights of the most efficiently performing other farms from the point of view of the target farm. These best performing farms are peer farms to the real producer. Finding the best virtual producer for  $n$  original producers is a set of  $n$  linear programming procedures.

In this paper an input oriented model is applied which seeks to identify technical inefficiency as a proportional reduction in the use of inputs. If a given farm uses inputs per unit of output, defined by the point P, the technical inefficiency of that farm could be presented by the distance PPc, which is the amount by which all inputs could be reduced without a reduction in output (Figure 3).

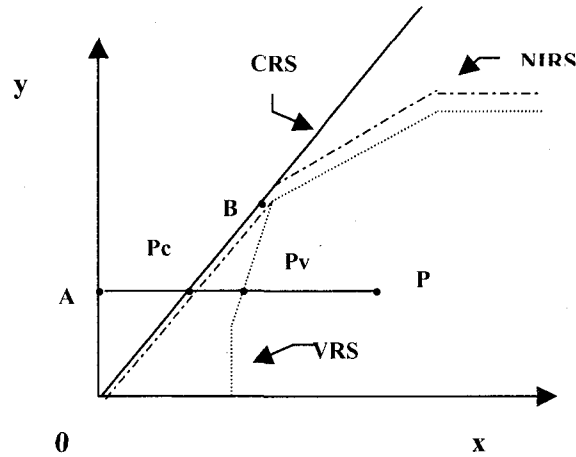
This is expressed in percentage terms by the ratio PPc/AP. The total technical efficiency (TE) of the farm under CRS is measured by the ratio:

$$TE_{crs} = APc/AP$$

The CRS assumption is only appropriate when all units are operating at optimal scale, The DEA approach allows total technical efficiency to be decomposed into pure and scale efficiency when variable returns to scale (VRS) are assumed. They are expressed by the ratios:

$$TE_{vrs} = AP_v/AP \text{ and}$$

$$SE = AP_c/AP_v.$$



**Figure 3: Efficiency Measurement**

Source: Based on Coelli, 1996:4,19

The DEA model can be briefly presented as follows: *lambda* ( $\lambda$ ) is a vector describing the relative weights of the efficient producers, used to construct the virtual producer and  $X$  and  $Y$ ,  $\lambda X$  and  $\lambda Y$  are the input and output vectors for the real producer.  $X$  and  $Y$  denotes the virtual inputs and outputs but the value of theta ( $\theta$ ) is the producer's efficiency (Anderson, 1996).

$$\begin{aligned} \min \theta, \\ \text{st. } Y\lambda \geq Y_o, \\ \theta X_o - X\lambda \geq 0, \\ \theta \text{ free}, \lambda \geq 0 \end{aligned} \quad (4)$$

The first constraint requires the virtual farm to produce at least much returns as the studied real farm. The second constraint finds out how much less inputs the virtual farm would need. This linear programming model must be solved for each farm, i.e, for  $n$  producers.

The CRS model can be modified to account for VRS by adding the constraint for non-increasing returns of scale where  $NI' \lambda$  is a vector of constants (Coelli, 1996):

$$\begin{aligned}
 & \min \theta, \\
 & \text{st.} \quad Y\lambda \geq Y_o, \\
 & \quad \quad \theta X_o - X\lambda \geq 0, \\
 & \quad \quad NI' \lambda = 1, \\
 & \quad \quad \theta \text{ free, } \lambda \geq 0,
 \end{aligned} \tag{5}$$

The DEA model accounting for scale efficiency is determined as  $NI' \lambda = 1$  is substituted with  $NI' \lambda \leq 1$ . If the non-increasing returns of scale (NIRS) score is unequal to the VRS score, a farm operating under increasing returns of scale and when NIRS and VRS are equal, the farm captures decreasing returns of scale.

### Data

Data is derived from the described survey of Bulgaria's newly established agricultural units. The data sets are for one year and contain information on production, land and labour. Farms for which information is missing and some extreme cases were eliminated. In total, data for 71 co-operatives and 258 family farms were proceeded.

In order to establish homogeneity, family farms and co-operatives were divided by the production specialisation in crop, crop-mixed, crop-animal mixed, animal and animal-mixed farms. More than two-third of output value in crop farms derives from crops, in crop-mixed farms comes from vegetables and fruits, in animal farms from ruminants, in animal-mixed farms from pigs and poultry and in mixed crop-animal farms no single branch contributes to more than two-third of output value. Producer's co-operatives were distributed in three groups- crop, crop mixed and crop-animal mixed.

### Variables

The dependant variable is gross output and independent variables are inputs of land (ha) and labour (WU) (Table 1). The gross output is calculated, as crop and animal products are multiplied by the same prices, as average weighted farmgate prices for family farms and co-operatives. Only cultivated land is included, which accounts for 90% of the total managed land. Labour is expressed in full-time WU, as part-time, seasonal and hired workers were equalised to full-time. Also, the

length of working hours during the summer and other seasons was taken into consideration.

**Table 4: Variables of the DEA model**

Variables	Unit	Definition
Y <sub>1</sub> - total production	000' Leva	Gross output from crops and animal products
X <sub>1</sub> - Land	ha	Used land
X <sub>2</sub> - Labour	WU	Working units per co-operative

**Table 5: Number of farms by the groups of production specialisation**

	Variant I		
	Total	Family Farms	Co-operatives
Total Farms	329	258	71
Crop Farms	117	58	59
Crop-Mixed Farms	44	33	11
Crop-Animal Mixed Farms	104	103	1
Animal Farms	17	17	
Animal-Mixed Farms	47	47	

Source: KATO Survey

### Results of the DEA

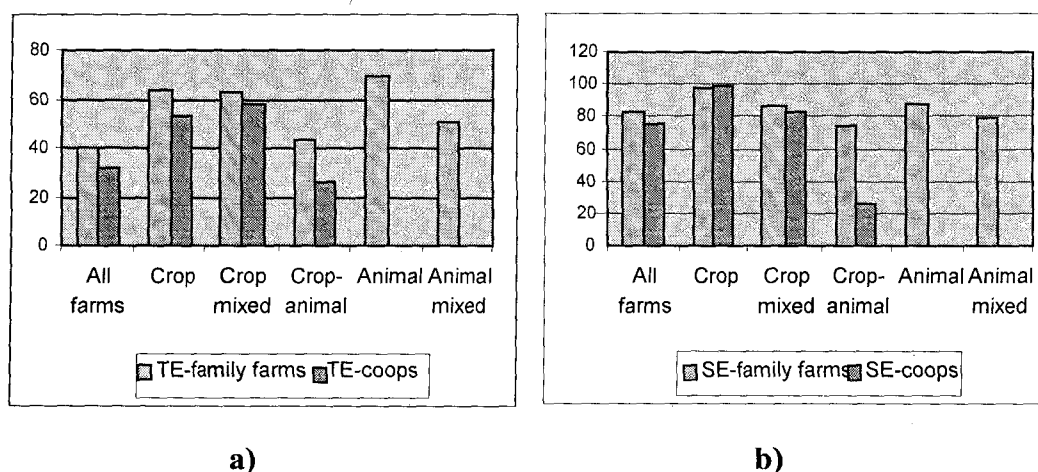
**Technical efficiency:** The average technical efficiency is nearly 40% for family farms and 32 % for co-operatives (Figure 4, a). This means that family farms should produce the output with 60% less inputs, co-operatives with 68%. All family farm groups have higher efficiency than the corresponding groups of co-operatives. Crop family farms reached 64% total efficiency, which exceeded the efficiency of crop co-operatives by 10%. Crop-mixed family farms have nearly the same efficiency as crop farms (63%), while crop-mixed co-operatives have 5 points more than the efficiency of crop co-operatives. Obviously, co-operatives that kept their fruit and vegetable production perform more efficiently than crop co-operatives.

Crop-animal mixed farms have the lowest efficiency – about 43% for crop-animal family farms and 27 % for the single crop-animal co-operative. Animal family farms are the most efficient group with 69% efficiency but animal-mixed family farms have 50%. This can be explained with the more intensive use of land in these small farms ( most of them have 1-2 cows).

Input slacks in the model show how much the available quantity of inputs exceeds the quantity that is necessary for receiving the same output or how much the



output must be raised for an efficient use of inputs. Both, family and co-operative crop farms have output and labour input slacks, which means that these farms have to raise the output but also to reduce the labour inputs in order to optimise their performance. On the average, crop family farms have 0,08 WU excess labour and crop co-operatives 0, 18 WU. Crop-mixed family farms have 97 thousand leva output slacks and negligible 0,4 ha land access, while crop-mixed co-operatives show average 1,2 ha. Crop-animal family farms have the highest output slacks of 285 thousand leva and show slightly land and labour access. These farms need to raise significantly their output value. Animal family farms have to raise output and reduce labour by 0,2 WU, while animal-mixed farms have a bit to reduce both, land and labour inputs.



**Figure 4: a) Technical Efficiency (TE), b) Scale Efficiency (SE)**  
Source: KATO Survey

These results give evidence that the production orientation has a significant role for farm efficiency. The higher specialisation of crop and animal farms predetermined their higher efficiency, compared to crop-mixed and animal-mixed farms. The lack of specialisation of crop-animal farms and co-operatives causes their lowest efficiency.

**Scale efficiency:** Scale efficiency of crop co-operatives (99%) is slightly higher than the efficiency of crop family farms but in all other groups family farms have higher scale efficiency than co-operatives (Figure 4, b). Most crop family farms (95%) operate under increasing returns to scale (IRS), i.e, they have not reached the optimum scale (size) and there is room to increase. In contrast, 34% of crop co-operatives reached frontier production function (operate at optimum scale), which means that crop co-operatives are closer to optimum scale than crop family farms.

Between 40% and 48% of crop-mixed and crop-animal family farms operate under increasing returns to scale (IRS), and almost the same part are working under decreasing returns to scale (DRS). They have reached higher than optimum scale and capture diseconomies of scale. In order to reach the optimum, they have to decrease in size. All co-operatives in this two groups operate under decreasing returns to scale, which speaks that co-operatives with fruit, vegetable and animal production extensively use land and labour.

### Productivity measure

MALMQUIST-DEA is applied to measure productivity. As survey provides data only for one year, in order to calculate Malmquist index panel data for co-operatives and family farms at the national level are used.

### *MALMQUIST-DEA Model*

The Malmquist index measures the Total Factor Productivity (TFP) change between two data points, by calculating the ratio of the distances of each data point relative to a common technology. The Malmquist output-oriented index, expressing TFP change between period  $s$  (basic) and period  $t$  (current) is given by the ratio (Coeli et al., 1998):

$$m_o(y_s, x_s, y_t, x_t) = \frac{d_o^t(y_t, x_t)}{d_o^s(y_s, x_s)} \left[ \frac{d_o^s(y_t, x_t)}{d_o^t(y_t, x_t)} \times \frac{d_o^s(y_s, x_s)}{d_o^t(y_s, x_s)} \right]^{1/2} \quad (6)$$

Malmquist index may be decomposed in two components, one part due to technical efficiency change i.e. shifts in the distance to the frontier, measured with the ratio outside the square brackets. The other part measures technical change (shifts in the frontier itself). It is the geometric mean of the change in technology between the two periods, evaluated at  $x_t$  and  $x_s$ .

Using DEA-like linear programme requires the solving of four linear programming problems. Four distances are calculated, relative to:  $d_o^t$  the previous period's CRS DEA frontier;  $d_o^s$  the current period's CRS frontier;  $d_o^t$  the next period's CRS DEA frontier;  $d_o^s$  the current period's VRS frontier. It is assumed a constant return to scale technology.

### *Data*

Data sets are for seven years (1993 –1997, 2000 and 2001) and contain information on net output value and material costs, depreciation, labour and service costs. The net output value and costs are the sum from crops, animals and

agricultural services, i.e. only main agricultural activities are taken into account. The time series are adjusted by GDP deflator, obtained from the National Statistical Yearbooks, as follow:

1993	1994	1995	1996	1997	2000	2001
63,9	121,9	32,9	410,8	578,6	7,0	7,4

### Variables

The dependant variable is the net output production and independent variables are four inputs - materials, depreciation, labour and service costs (Leva).

### *Results of the MALMQUIST-DEA*

The results show that the average factor productivity for co-operatives and family farms declined at 5% during 1993-2001 period, due to the decline in technical change, while technical efficiency remained constant. This reflects the lower factor productivity of co-operatives, due to decrease in technical change index. In contrast, family farms reached growth at 9% due to technical change, which suggest that TRP arose from the innovation in technology but not from improvement in technical efficiency.

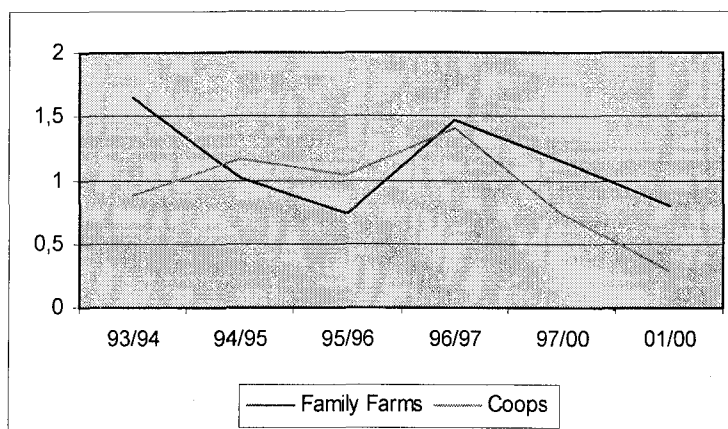
**Table 6. Malmquist Indexes**

	EFFCH	TECHCH	TFPCH
Co-operatives	1,000	0,826	0,826
Family Farms	1,000	1,093	1,093
Mean	1,000	0,950	0,950

*EFFCH* – Efficiency change index; *TECHCH* – Technical change index

*TFPCH* – Total factor productivity change index.

Cumulated TFPCH Index (fig. 5) depicts that the situation changed for the worse, particularly for co-operatives, during the last two years. This can be explained with the stagnation on cereal market and unprecedented drought in 2001. Someone has to have in mind, however, that 1997 was the year of hyperinflation in Bulgaria and although the time series data were adjusted applying the GDP deflator, the hyperinflation might be influenced the results. Moreover, there is a gap in series data and the last two years were compared with 1997.



**Figure 5. Cumulated TFPCH Index**

### Conclusions

From the theoretical approach and the analysis the following implications can be made:

- Reallocation of production factors in agriculture shows that the private sector has absorbed the labour force dismissed from the former co-operatives, so significant unemployment is not observed, but it could not absorb all the farm land, one fourth of which is idle,
- Due to reorganisation of the former labour co-operatives in Bulgaria, a dualistic agricultural structure was established. On the one hand, there are small and middle-sized family farms, on the other hand are big tenant farms and producer co-operatives.
- The DEA analysis proved that both family farms and co-operatives perform inefficiently, They overused more than 60% of land and labour inputs, which leads to a 40% technical efficiency of family farms and 32 % of co-operatives. All crop family farms (crop, crop-mixed and crop-animal) are more efficient than corresponding co-operatives by 6% - 16%. Animal family farms are the most efficient group (69%), which can be explained with the more intensive use of land in these small farms.
- Co-operatives perform poorly. Their total factor productivity (TFP) declined, due to aggravation in technology, while technical efficiency remained constant. Family farms reached growth at 9%, due to improvement of technology but technical efficiency is also constant.

The conclusion is that in the middle run the existence of many producer's co-operatives is questionable. The restriction in labour input and increase in efficiency is urgent. They have to make innovation in technology in order to

improve their total factor productivity. Most family farms have to optimise their size in order to increase efficiency.

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## Annex

**Table : Technical Efficiency of Family Farms and Co-operatives**

Groups of farms	<i>in %</i>							
	CRS			SE			IRS/ DRS/FR	
	Total	Family Farms	Co-operatives	Total	Family Farms	Co-operatives	Family Farms	Co-operatives
1	2	3	5	6	7	8	9	10
Total Farms	38,1	39,8	32,1	81,1	82,6	75,9	21/76/3	1/99/0
Crop Farms	58,4	63,6	53,2	98,5	98,0	99,0	95/0/5	63/3/34
Crop-Mixed Farms	61,6	62,8	58,1	85,9	86,9	82,7	39/42/18	0/100/0
Crop-Animal Mixed Farms	42,7	42,9	26,6	73,3	73,7	26,6	48/47/5	0/100/0
Animal Farms	69,0	69,0	-	88,1	88,1	-	6/76/18	-
Animal-Mixed Farms	50,5	50,5	-	79,2	79,2	-	38/51/11	-

*CRS- Constant Returns to Scale (total efficiency); SE – Scale Efficiency; IRS – Increasing Returns to Scale; DRS – Decreasing Returns to Scale; FR – Frontier Production Function*

## **NEW INSTITUTIONAL ECONOMICS AND AGRICULTURAL CO-OPERATIVES: A HUNGARIAN CASE STUDY**

**Szabo Gabor**

### **Introduction**

The main objective of the paper is to show the possibilities for agricultural (marketing) co-operatives, with a view to their economic substance in New Institutional Economic theory in the Hungarian practice. The study consists of two main parts. First the theoretical basis for co-operation, mainly from a new institutional (featuring transaction cost) economics approach, will be analysed, then a Hungarian case study on a successful marketing co-operative, active in the fruit and vegetables sector, will be presented.

In the first part of the paper, the theoretical basics will be discussed. The new institutional or so called organisational economics has got four fields which are relevant to co-operative literature: property rights, transaction costs, agency and incomplete contract theories. These approaches are interrelated and there are some areas where one can find intersections of the different theories mentioned above. However, due to the limited space, we are going to focus mainly on the transaction cost economics (hereafter TCE) theory explanations underlining advantages and limitations of carrying out (vertical) integration (hereafter VI) by agricultural marketing co-operatives. In the second half of the paper we are going to analyse a case study on the Hungarian Mórakert Purchasing and Service Co-operative, Mórahalom, which is active in the fruit and vegetables sector.

Main methods used to carry out present research were: literature review, collecting secondary (statistical) data and case study analyses.

### **New Institutional Economics and Agricultural Co-operatives**

The new institutional has four fields which are relevant to co-operative literature: property rights, transaction costs, agency and incomplete contract theories. However, we focus mainly on the transaction cost theory (TCE) explanations underlining advantages of carrying out vertical integration (VI) by agricultural marketing co-operatives (MC), since according to Ollila and Nilsson (1995) and Williamson (1985) "transaction cost is the main factor responsible for decisions to integrate." (Ollila - Nilsson 1995: p.4).

The earlier theory of TCE was built mainly on the works of Coase (1937) and Williamson (1985) and was expanded by some other contributors, like Klein-Crawford-Alchian (1978). Transaction costs (TCs) are to be considered as the “price of pricing mechanism”, e.g. connected to any other movement or action aimed to carry out transactions (selling, buying, hiring anything) on the market. Briefly we can divide TCs into three categories: *information*, *contracting* and *monitoring-enforcement* costs. One can categorise TCs into ex ante (before contracting) and ex post (after contracting) costs as well.

According to Williamson (1985) the main premises (assumptions) of the TCE are the *bounded rationality* and *opportunistic decision behaviour* in contractual relations. TCE focuses mainly on the *different forms of asset specificity*, like site specificity, physical asset specificity, dedicated assets, and human asset specificity. In addition of the above mentioned asset specificity, there are three more factors (attributes) that one has to take into account as the key determinants of any of the organisational forms: *uncertainty*, *frequency of transactions* and *externalities* (Williamson, 1985). Generally speaking, in the agriculture the uncertainty (sometime converted into risk) regarding the production and marketing activities is high. In most sectors the frequency of transactions is also very high and there are some externalities, which are also can influence the level of transaction costs (Ollila 1994; Ollila - Nilsson 1995)

In addition, thinking about vertical integration, there are exist some other factors in agriculture e.g. *perishable products (physical assets)*, *specificity of production and characteristics of the place of production*, which can influence actors to integrate vertically. The numbers of buyers and suppliers are also very important since it can influence the market power and position of every potential contractor (Kyriakopoulos 2000). All of the above mentioned characteristics of agricultural transactions underlie the necessity of a closer vertical co-ordination (e.g. vertical integration), for example through different types of contracts. In some countries and sectors this process used to be taken by agricultural (marketing) co-operatives.

*Assymmetric information* and *hidden information* (Royer 1999) are both the reasons of the fact that, generally speaking, that the contracts are not complete and many areas of post-contractual opportunistic behaviour and moral hazard can occur in any contractual relationship. These areas are more related to agency and incomplete theories, however the above problems and the related ex post (monitoring, enforcement etc.) costs can influence the level of TCs. Probably the most known example for ex post problem/cost, which is also relevant in agriculture, is the *hold-up problem* “that arises when one party in contractual relationship seeks to exploit the other party’s vulnerability due to relationship-specific assets” (Royer 1999, p. 49). Because of the above mentioned attributes (like asset specificity, uncertainty etc.) The hold-up problem is really significant in



the dairy and fruit-vegetable sectors, therefore it is not wonder that shares of co-operative are high in that industries (Staatz 1984, van Bekkum-van Dijk 1997; Kyriakopoulos 2000).

In Williamson's theory the *governance structure will be chosen according to minimise the production and transaction cost*. However, he supposed that the production cost is not changing during the time and process, while the ideal organisational structure will be established. One of the main advantage and possibly reason of the popularity of the TCE, is the fact that TCE discovers that *there are exist some other factors–insitutions which can influence the market mechanism above the outstanding role of the price*. VI through co-operative or other producers' organisation can be ones of the institutions mentioned above. Since there is no complete ownership integration (merger) among the members and the cooperative, the co-operative form of VI is just a *partial one*: "A cooperative is a way of combining both integration and independence" (Ollila 1994, p.89).

### **The place of the agriculture co-operative in the vertical coordination continuum**

A growing number of authors (Cook 1995, Harte 1997, Hendrikse – Veerman 2001b; Ollila 1989, 1994, Ollila-Nilson 1995, 1997; Royer 1999, Røkholt 1999, Staatz 1984, 1989, Sykuta – Cook 2001; van Bekkum 2001 etc.) analyse the (agricultural) co-operative phenomena, using partly or featuring TCE approach, however most of the studies are only theoretical, sometimes heuristic analysis of the pros and cons of co-operatives. *There is not exist, however a consistent transaction cost theory of agricultural co-operatives* like of the neoclassical approach summarised by LeVay (1983) and Staatz (1989). It is more a rule of thumb that writers are giving some general TCE background and a list of advantages or disadvantages of co-operatives or they analysing a specific issue regarding transactions, governance and financial structure of the co-operative.

Before embarking on detailed analysis of the co-operative-TCE field we consider the fact that *three main relation* (links) exist between the member and the marketing co-operative:

- 1) the product,
- 2) the capital and
- 3) the democratic managing-control line.

The so-termed 'economic' *co-operative principles* are based on the three main connections (lines), as they *were formulated in coherence with the elements of the co-operative's business activity* with the members. In accordance with the above relations, in our study we use the *basic American co-operative concept* which

reflects three basic criteria: "A cooperative is a user-owned and user-controlled business that distributes benefits on the basis of use" (Barton, 1989, p.1).

*Vertical co-ordination* can be defined as "the alignment of direction and control across segments of production/marketing system" (King 1992 cited by Peterson - Wysocki 1997, p:2) According to Sporleder (cited by Peterson - Wysocki) there are different factors that can be controlled through vertical co-ordination : e.g. price, quantity, quality and terms of exchange. The scale of vertical co-ordination is continuously running from the spot (open) markets to complete vertical integration (Peterson - Wysocki 1997: pp. 2-4) Vertical integration (VI) is one end of the continuum.

*Vertical integration* is defined by den Ouden et al. (in accordance with some other authors) as "the combination of two or more stages of a production-marketing chain under single ownership" (den Ouden et al.1996: p.2).

We can distinguish upward and downward integration from the aspect of marketing channel. Furthermore, in the literature and in practical economic life functional and organisational integration can be observed. However, the two main forms of VI are

- \* integration by contracts and
- \* integration by ownership.

With respect to this research the latter is more important, since the co-operatives used to be considered as the classical form of co-ordination of different and independent farmers in order to *protect themselves against the large commercial and/or industrial companies* which are often in a monopolistic or oligopolistic position. They use long, medium and short term contracts to secure the raw material for themselves and to be able to govern the whole marketing chain (*integration by contracts*). The co-operative, *in the modern sense, is a hybrid formula*, because above the common property (*integration by ownership*) the members sign a special "multilateral contract": the statute or bylaw, which are the formal legal guarantees that the co-operative will never act against the members, and on the other hand that members will enjoy their advantages and fulfil their duties. The bylaws also defend third parties against the co-operative, making it possible to sign contracts and obtain loans and credits in the name of the co-operative. "The cooperative has, in a way, both markets and hierarchies within the same organisation" (Ollila 1994, p.88).

In the new co-op models there are additional contracts between members and the co-operative, forcing the members to compete inside the co-op. In fact some of the new co-operative models are acting as market institutions (Cook 1995; van Dijk 1997; van Bekkum-van Dijk 1997; Nilsson 1997, 1998b).

Why are the co-operatives appropriate institutions for establishing VI? The following section will summarise briefly the most important reasons, featuring TC related incentives-considerations.

### **Advantages of co-operatives in vertical integration**

According to the co-operative literature reviewed the main incentives for the establishment of co-operatives as a form of vertical integration are the following.

First, co-operatives traditionally can provide access and secure markets for the long term, therefore give protection for independent farmers against the large commercial and/or industrial companies. They can also carry out services otherwise not or available at very high costs.

Second, co-operatives build up countervailing power and above a certain economics of scale they act as competitive yardstick for non-co-operative, conventional firms (CF) and the whole sector with a better influence on the market and prices.

Third, co-operatives in some cases can increase technological and market efficiency and carry out activities with a higher added value.

Fourth, co-operatives can decrease and internalise transaction (information) costs, with a better flow of information on consumer demand - closer proximity of consumer to farmer and with a unified decision role between two or more levels of the marketing channel. The co-operative can also lowering both economic and technological uncertainties, therefore decrease TCs. To avoid (ex post) hold-up problems in the case of perishable products and different types of asset specificity is also a main reason to use a co-operative as a governance structure.

Finally, co-operatives can increase the income of the members above by lowering transaction and production cost, by reimbursement of the surplus for the members made at another level of the marketing channel.

All in all, we conclude that co-operatives can reduce TCs in a several ways. However, the cooperative is a partial vertical integration, which means that farmers can save a relatively high degree of independence of economic action: "Thus, it is possible to reduce transaction costs and uncertainty through the cooperative and maintain the entrepreneurial incentives through the market at the same time." (Ollila 1994, p.88)

In addition there are several non-economic reasons, which can also be a matter of importance and can be crucial factors in the success of vertical integration by co-operatives (Hakelius 1996). First, co-operatives used to be considered as organised trusts. At least in smaller communities (e.g. villages) a highly important issue is

which persons are to be responsible (manage) for the organisation of the co-operative.

Second, the social and informal network of the members or potential members is also relevant as a determinant factor in decreasing (external and internal) transaction costs and in the process of the establishment and the running of the activity of a co-operative. Better knowledge and confidence (Røkholt 1999) among the members is the secret of how co-operatives can be highly efficient from the aspect of human resources, despite the lack the necessary capital to invest. Human asset specificity may become more and more important in the process and success of flow of information.

*An other advantage of the co-operatives are based on the more closely and informal connection among the members and between members and co-operative. The organisational form and decision-making (control) mechanism of the co-operative and the so-called co-operative principles (ICA, 1995; Hakelius, 1996; Røkholt, 1999) can be taken into consideration as formal-legal securities (guarantees) of trust between the member and co-operative. Hence the hold-up problem usually not as significant like in any other contractual relation between a farmer and Investment Oriented Firms (IOF).*

#### **Limitations of traditional marketing co-operatives and solving the TCE-Agency problems by alternative (producer) governance structures**

Is there any limitation for co-operatives using the above listed advantages in the light of the *fundamental changes in the economic and market environment concerning agribusiness nowadays?* We have to stress that in very differentiated product markets co-operatives need additional risk-bearing capital to be able to compete, which is hard to provide due to their financial structure. One can put a question like, under what circumstances is better to choose an other co-ordination-organisational form, despite the fact that co-ops can decrease for example TCs 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, p. 49). Because of the above mentioned attributes (like asset specificity, uncertainty etc.) The hold-up problem is really significant in the dairy and fruit-vegetable sectors, therefore it is the cause that shares of co-operatives are high in that industries (Staatz 1984, van Bekkum-van Dijk 1997; Kyriakopoulos 2000). The members of a MC are not likely to fear that after they have bought/built 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, when searching for the 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 problem can be solved in the market of homogeneous products 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 develop brand names (Hendrikse – Veerman 2001b). The democratic decision making will become more problematic (Hendrikse – Veerman 2001b), especially when the membership has a great value of heterogeneity, hence increasing internal organisation costs (Harte 1997). It is also true that 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 VI is challenged by the opportunity to invest into the farms' assets. It is hard to collect financial funds provided by outsiders for the co-operative as well, because of 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 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) transaction costs are not really high compared to the internal organisation costs, then a VI (and the co-operative organisational form) is not as desired governance structure and/or marketing strategy, than in the previous case (Harte 1997). Hendrikse – Veerman (2001a) also state that in differentiated product markets where a high level of asset specificity is required, marketing co-operatives are probably not the best solution as governance structure. They predict governance structures in which members (farmers) have less decision power (Hendrikse – Veerman, 2001a). However, empirical evidences still have to be presented since there just but a few studies on the field, and some of them reported controversial experiments on the viability of the co-operatives in modern agriculture.

As a very closely related issue to TCE and the (democratic) decision-making process, there are a number of potential problems of the traditional (countervailing power) co-operative model (van Bekkum-van Dijk 1997, Nilsson 1998b) according to the agency theory (Nilsson 1998a, Cook 1995, Vitaliano 1983). Based

on the incomplete contract assumption, the agency theory concentrates on incentive and measurement problems featuring the individual and not focuses on the transaction which is the basic unit in TCE (Royer 1999, Mahoney, 1992). The basic source of the agency-type problems of complex organisations is the separation of ownership and control. In the case of co-ops, the separation of the management (agent) and the owner-members (principals) can arise different incentives, therefore managers sometimes carry out business according to their objectives at the expense of the owners (Royer 1999).

The most *important agency problems can be divided into two main groups* (van Bekkum, 2001): *investment related and decision-making process agency problems*. In the first group one can find the *common property problems* including external and internal free rider problems, *horizon and portfolio* problems, which are connected to the member interest to invest into the co-operative. The *decision-making process agency costs are relating to monitoring and follow up the management activities*, as well to the *influence cost* acquiring if there are different groups with different interests in the co-op, and finally linked to *decision problem of the management* caused by large and heterogeneous membership with different priorities and opinion.

Cook (1995) employs a co-operative life-cycle model consisting from five stages, whereas on stage three he definite 5 problems. *The five inherent organisational problems of co-operatives* are the following according to Cook (1995) also cited by Cook-Iliopoulos (1998), Royer (1999) van Bekkum (2001): *free-rider, horizon problem, portfolio, control and influence cost* problems.

There are some possibilities for co-operatives to cope with the above listed organisational weaknesses. The co-operative can solve some of the above problems (Cook-Iliopoulos 1998), *like control and influence cost problems*, however the changes in the European agriculture and the possible and competitive answers given to them tend to influence the spread of *new co-operative models with alternative financing methods and new organisational structures/strategies* (van Bekkum - van Dijk 1997; van Dijk 1997; Nilsson 1997, 1998b). Even *some other forms of alternative producer governance structures* with appreciable and transferable equity shares (Sykuta-Cook, 2001) are likely to emerge, as well *grower associations and participation companies* (Hendrikse – Veerman 2001a). It is necessary to state, however, that there is exist a so-termed *conversation process*, e.g. co-operatives transform themselves into CF (IOF) structure, like in Ireland (Harte 1997, Hendrikse – Veerman 2001a,b; Zwanenberg, 1992). In the latter cases well defined property rights (Cook-Iliopoulos, 1998) and the transferability of the residual claims (co-operatives shares) on the secondary market can solve almost all of the above mentioned agency and property rights

problems. Harte (1997) finds the above mentioned conversation process as a sure and “normal” stage of his co-operative life-cycle model.

In the second half of the paper we are going to analyse a case study on the Hungarian *Mórákert Purchasing and Service Co-operative, Mórahalom*, which is active in the fruit and vegetables sector.

### **A Hungarian Case Study: The Mórákert Purchasing and Service Co-operative, Mórahalom**

Mórahalom is a small town in the south-eastern part of Hungary. This is a typical agricultural area, which means that more or less the only way for its inhabitants to earn their living is by agricultural production. In this section we examine a successful so-termed “new type co-operative”, the *Mórákert Purchasing and Service Co-operative, Mórahalom*, which is active in the fruit and vegetable sector.

The quality of the soil is very poor due to the extreme climatic conditions. In some parts of the arable lands small-holders produce crops (maize, wheat, etc.), which serve mainly as animal feeds for their own livestock. However, the most important products are vegetables: potato, tomato, green pepper, delicate and hot paprika and various types of cabbage. These constitute the basis of commodity production, as the greater portion of production is usually sold on different markets. Plastic tunnels and greenhouses now cover a significant proportion of the cultivated land.

Before 1990 there was a traditional production type co-operative which in the 1960s changed its form into that of a so-called specialized agricultural co-operative, bearing more of the characteristics of the western-type promotional co-operative. This type was more suitable for individual farming, particularly in labor-intensive branches of agriculture such as vegetables and fruit. This specialized co-operative ceased its activity in accordance with the obligations incorporated into *Laws I and II on Co-operatives* (Transition and Unified Co-operative Laws) which came into force in 1992; the co-operative became defunct without a legal successor.

There was a situation in which about 1500 private (small-holder) economic units attempted to do business at their own risk. The average area cultivated by the small-holders was very small, even compared to the EU average: only 3-5 hectares. However, the machinery facilities were sufficient to ensure good quality and profitable production. The problem was connected with their market relations: they were too small to purchase their inputs and to sell their produce. They faced oligopolistic and monopolistic players on the market. In 1993 the Department of Agriculture was established in order to help small-holders submit forms for various applications. The main incentive for establishing a co-operative was very

similar to the Danish tradition: economic necessity, arising from the economic and market situation at the beginning of the 1990s. In addition the biased economic structure of the geographic area and the very low profitability of agricultural production led to a situation in which the local authority had to make a choice: to establish an organization to promote farming among the inhabitants or to give them social assistance.

The *Common Agricultural and Entrepreneurial Society, Mórahalom* was established in January 1994 with the aim of organizing small-holders within a loose network. It is a non-profit organization. Noteworthy is that, due to the existence of the former co-operatives in Mórahalom, 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 number of founding members was 35, but by October 1999 membership had increased to 1996. The main activity, in addition to organizing joint projects, was the *organizing 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 fertilizer 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, Mórahalom in April 1995*.

It is important to note that the society was and is still in existence, in parallel with the newly established co-operative. These two organizations were and are still working together, sharing activities and roles in order to achieve the main objective of assisting in and promoting farming among the members. Membership of the co-operative requires at least one year's prior membership of the society and contribution to the activity of the co-operative. Potential members have to apply for membership status, on which the Board of Directors or the General Assembly takes the decision.

The *Mórákert Purchasing and Service Co-operative, Mórahalom*, 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 organized 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 64, and in the Year 2000 the co-op had got more than 200 members. All members have their own land property and assets for farming.

The co-operative employs a staff of 23 throughout the year, which is of great significance, since its work is otherwise rather sparse and co-operative employees enjoy relatively high salaries in comparison with the local average. Total area of co-operative cultivated by members is 614 hectares, of this, 225 hectares are devoted to vegetables and fruit.

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 endeavoring to establish secure markets for the long term. It offers *services* and organizes the buying of input materials and the functioning of selling outlets in a more coordinated 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-op carries out *services for the members*, like providing consultation (advice) within various fields, such as plant cultivation, the filling in of application forms for subsidies, storage etc.

Transportation from and to the main sites of the co-operative is usually achieved through the services of transportation firms. The co-operative has no transport vehicles, and members have to transport their own produce and/or input materials from and to the sites of the co-operative. However, this is cheaper and easier than to transport produce to the wholesale market.

The co-operative has a site equipped with a full infrastructure. For the purpose of achieving easy market access the co-operative endeavors to store some products at a cold storage depot. This depot covers an area of 186.36 m<sup>2</sup>, and the vegetable storage unit 188.42 m<sup>2</sup>. The cold store has a capacity equivalent to approximately 40 wagons.

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 recognize 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.

The results of the purchasing and selling activity of the co-operative can be seen in Table 1. 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.

**Table 1 Purchasing and selling activities of Mórakert Purchasing and Service Co-operative, Mórahalom in 1,000 HUF**

	1997	1998	1999	2000
Purchasing from members	103,987	212,390	233,629	380,937
Joint selling	115,620	256,479	282,127	474,447
Surplus to cover cost	11,633	44,089	48,498	93,510

About 90 % of the products distributed on domestic markets by the co-operative are sold to retail chains (Tesco, Metro, Spar, Julius Meinl, 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.

A question of importance was that the co-operative should be able to influence the farmers' way of thinking in order to avoid by-passing. It was an indispensable requirement that members should decide to sell their produce through the co-operative, even if it were possible to sell it at higher wholesale market prices. The small-holders soon realized that they could save transportation costs and time by selling in bulk quantities at the co-operative site. More balanced prices for their

produce also gave an incentive for the small-holders to sell to the co-operative. A very important step was that members accepted what kinds of vegetables and fruit it would be better to produce to find a relatively secure market, to attain higher prices and to ensure better conditions for sale.

*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.

The co-operative is more or less satisfied with the contracts and connections already established, but it should be noted that it is extremely difficult to fulfill the exacting requirements with respect to quality, quantity and range and the other terms of trade and payment stipulated by the retail chains. However, these do provide a secure market and a degree of stability for the farming activity of the members.

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 extend to purchasing on behalf of non-members.

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.

All in all, the co-operative is endeavoring to achieve competitiveness on highly changeable markets. The significance of wholesale markets is now declining. The co-operative is willing, in the interest of its members, to display and market their produce.

According to Table 2 and 3, one can compare the development of the turnover of main types of vegetables between 1997 and 2000 in Hungary and in the case of Mórakert Co-operative. It is necessary to underline however, that the rising numbers of the turnover (e.g. potato) in the case of the co-op are partly due to the increasing portion of the non-member trade. In the year 2000 Mórakert Co-operative has increased its turnover in the case of the main products distributed through the co-op, while the production of the same products in Hungary has

declined. The main reason is above the successful marketing work, that their membership is increased, as well the number of the non-member suppliers did.

**Table 2 Total production of various vegetables and potato in Hungary 1997-2000 (ton)**

Type	1997	1998	1999	2000
Green peppers	100 048	109 686	132 001	97 570
Tomato	219 706	329 665	301 492	203 448
Cabbage	171 317	178 390	173 616	119652
Carrot	116 924	118 379	117 246	89348
Melon	5 762	7 155	7 706	5948
Cucumber	119 053	125 583	125 791	102651
Potato	1 139 547	1 147 818	1 198 681	863 511

Source: CSO, 1998, 1999, 2000, 2001

**Table 3 Main products distributed and marketed by Mórakert Purchasing and Service Co-operative, Mórahalom 1997-2000 (ton)**

Type	1997	1998	1999	2000
Green peppers	675	1 001	1 000	1 590
Tomato	102	211	200	732
Cabbage	141	526	660	1157
Carrot	20	8	10	385
Melon	2	8	8	139
Cucumber	14	8	10	17
Potato	158	1 354	1 800	6025

Source: Hódi (2001)

They reinvest the surplus made in the co-operative annually. In year 2001 the co-operative's plan is to increase the capacity of their cold-storage depot and operation plant significantly. However the biggest 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 fact the co-operative can solve some of the horizon problems, as we argued in a previous subsection, if the co-operative is going to grow, the common property and horizon problems are also possible to face with. 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.

The co-operative endeavours to integrate, not only horizontally but also vertically, the members' farming activities, and also to develop activities with higher added value. In the Year 2002 a so-termed "agri-logistics centrum" was set up by the co-operative, which covers 2,958m<sup>2</sup> including a cold storage depot which is 1/3 of the total area. A handling, sorting and packaging line for vegetables and fruit was put into operation in September 1999 in an other place in Mórahalom, however these kinds of activities will be carry out on the same new site in the future. Therefore everything will be handled in one place, such as purchasing, handling, sorting and packaging of products coming from members and other suppliers, as well as the storage and transportation activities. There will a computer supported information system in the new headquarter.

All in all, as the case of a newly established Mórakert co-operative shows, such co-operatives an other can be a solution for farmers to cope with their problems arising from incomplete pricing mechanisms and to reduce transaction costs, at least at regional level. It must be emphasised that problems of farmers cannot be solved simply by government support, however it seems to be vital in the case of emerging producers' organisations, like co-operatives, to be able to set up.

### Summary

Analysing the TCE theory explanations, which approach underlines advantages and limitations of carrying out (vertical) integration, *one can find a number of TCE related reasons, why the agricultural marketing co-operatives are appropriate institutions for establishing VI*. In addition there are *several non-economic reasons*, which can also be a matter of importance and can be crucial factors in the success of vertical integration by co-operatives. However, in the light of the *fundamental changes in the economic and market environment concerning agribusiness nowadays*, there are some limitations of the traditional type agricultural co-operatives according to the agency and property rights theories, as very closely related approaches to TCE. Well defined property rights (Cook-Iliopoulus, 1998) and the transferability of the residual claims (co-operatives shares) on the secondary market can solve almost all of the agency and property rights problems, mentioned in the first part of the paper.

Although the so-termed conversation process analysed in the first part of the paper (and mainly caused by political and state support uncertainties in the Hungarian case) is taking place in Hungary as well, the Mórakert co-op still preserve its legal status and organisational structure. There are a number of reasons, why members have still loyalty to their co-op. The organised trust connected to relational connections in the co-op are crucial factors to solve the above mentioned first hold-up problem, *e.g. prevent post harvest hold-ups* (Hendrikse – Veerman 2001b), at least at the relatively low level of product differentiation. The co-

operative is very good example, how an agricultural co-operative can achieve some of the potential (above listed) advantages, solving many “traditional” TCE and agency problems and serving its members with a continuing growth.

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***Part VI. Solidarity and quality:  
Wine and olive-oil co-operatives***

# **THE WINE COOPERATIVES FACE THE DEMAND FOR QUALITY: CALL FOR A RENEWED SOLIDARITY IN LANGUEDOC (FRANCE) AND IN THE WESTERN CAPE (SOUTH AFRICA)**

**Chiffolleau Yuna, Dreyfus Fabrice, Ewert Joachim, Touzard Jean Marc**

## **Introduction**

Vineyards of Languedoc in France and of Western Cape in South Africa are both characterised by the importance of cooperative firms, implemented in the first middle of the 20<sup>th</sup> Century to produce table or distilling wines. Faced with the big decrease in the demand for these wines, these vineyards and their cooperatives are jointly involved in re-conversion towards quality wines production. However, both regions face profound and complex changes in matters of consumer requirements regarding wine production : in addition to taste, brand or geographic origin, current dominant features, “traceability”, food safety, environment-friendly practices or labour conditions of workers are emerging in the definition of “quality”. Such an evolution implies a considerable programme of diverse innovations, which have to be developed and coordinated in local grape and wine producing systems. This paper, issued from a collaborative programme between French, South African and British researchers, looks at the ways in which wine cooperative firms adapt to and manage these changes. It focuses on how the “solidarity” which grounds these kinds of organisations (Desroches, 1976) is both questioned and renewed in the development of a “quality revolution” which has to combine more and more diverse innovations. After a compared presentation of the historical trajectories of wine cooperatives in Languedoc and in the Western Cape (1), we present the forms taken by the core technical and organisational innovations (2) and the new domains of change (3). Then we show that these innovative processes may rely on a specific “solidarity” including new kinds of actors and favouring resources exchanges within the cooperative (4), that leads to a new step of action-research relative to skills and labour force management.

## **From mass production under national protection, to quality wines for international market**

### ***Western Cape : heritage of distilling wine production under Apartheid regime***

The first wine cooperative firms were established in the Western Cape (main wine production area in South Africa) at the beginning of the 20<sup>th</sup> Century (1905). The founder white farmers were seeking to benefit from scale economies and to

stabilise the quality of standard and distilling wines (Williams, 1999). However, to face the effects of chronic overproduction, the first five wine cooperatives, in association to the major part of the vine-growers of the region, found in 1918 a cooperative of national dimension, the KWV<sup>1</sup>, who in 1924 get the monopoly on distilling wine market. In 1940, KWV's responsibilities were extended to the fixation of a minimal price for "basic wine" and "quality wine" (i.e. "saleable" wine) and to the definition of production quotas. KWV's protective framework, fiscal advantages and development of spirits market thus favoured the creation of new wine cooperatives : they expanded in number from 6 to 59 between 1940 and 1965. These cooperatives brought together white farmers who were producing grape on big polyculture farms, employing many black and coloured workers. The mainly supplied wine to the two dominant manufacturing-wholesaler firms, Stellebosch farmers Winery (SFW) and Distillers, who sold wines, spirits and imported whiskies to the domestic market under well-known trade marks. The KWV disposed of the unsaleable "surplus" for distilling into brandy and other spirits.

Under the KWV regulation regime and in the Apartheid context, Western Cape cooperatives locked themselves in a work intensive mass production logic (high yields, sale in bulk, employment of much labour force...). They strengthened their specialisation on low quality and distilling wine production, destined to the wine domestic market and especially to black labour social classes. In 1978, SFW and Distillers amalgamated into Kaapwyn, who controlled over 80% of the market in wines. In the 1980s, estate producers and few cooperative members began to expand plantings of premium aromatic cultivars and cooperatives increased their direct sales to retailers and the public, reducing Kaapwyn's market share substantially. In the early 1990s, estate producers and cooperatives challenged production quotas and the minimum price established by the KWV, considered as constraints to the development of new kinds of wines. They were suspended respectively in 1992 and 1993.

Since 1992, tremendous changes in the wine sector and in the national context induced strong pressures on cooperatives :

- the ANC (N.Mendela's party) came into power in 1995. The end of the Apartheid put wine sector work organisation into question, as well as a part of its institutions (the KWV for instance) which were linked with this system and were securing means to the white minority ;
- the KWV has been converted in 1997 from a cooperative to a company, its statutory power for surplus disposal has been abolished, in line with the state's liberal thrust ;

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<sup>1</sup> KWV is the acronym for "Köoperatiewe Wynbouers Vereniging van Suid-Afrika" (Cooperative Winegrowers Association of South Africa).

- cooperatives can no longer secure “cheap” loans subsidised by the state ;
- the Government has developed an “empowerment policy” towards the “previously disadvantaged communities”, that aims to “create the conditions in order these populations are able to better manage their destiny” ;
- a structural funds (SAWIT) is established from KWV’s assets, to finance empowerment of farm and cellar workers (about 55 000 permanent people, black or coloured), through skills development and land attribution (Ewert, Hamman, 1999) ;
- since the end of the boycott, the international market has been opened to South African wine exports, which increased fivefold between 1993 and 1999 (SAWIS, 2000).

Faced with these drastic economical and political changes, Western Cape cooperatives have to overcome many difficulties : conversion of members’ vineyards, mainly composed by white multi-purpose varieties whereas demand tends to red and aromatic cultivars (Montaigne, Martin, 2001) ; necessity to invest in new vinification technologies without state aid ; difficult position in front of few wholesalers ; weak skills in matters of management and commercialisation ; reorganisation of wage work and necessity to build a new collective identity according to the new state political orientations... On the other hand, along with deregulation, cooperatives are now free to engage in new marketing ways : bottled wine, direct sales, exports, marketing networks and supermarkets (Ewert, Visser, 1999). The dismantling of the previous system and its means are thus “negotiated” in exchange to guaranties on property rights and on economic expansion perspectives in a liberal frame. Cooperatives products and strategies are diversifying quickly, but heritage of the mass production model remains very present : 40% of the total production is still dedicated to distilling wine and 80% are sold to wholesalers (Martin, 2001).

***Languedoc-Roussillon : the negotiated re-conversion of the vineyard by communal table wine cooperatives***

In Languedoc, the first wine cooperative firms were also established at the beginning of the 20<sup>th</sup> Century (1901). But unlike South Africa, they proceeded from voluntary associations of small vine growers or workers who were seeking to get free from big owners and wholesalers (Temple, Touzard, Jarrige, 1997). The expansion of these cooperatives has been particularly strong between 1930 and 1960, leading to their creation in almost every grape producing village (550 in 1970). This success may be explained by several factors : progressive revelation of economic gains in the first cooperatives (due to technological and commercial scale economies), imitative mechanisms between little and big producers and between neighbouring villages, implementation of incitement political measures



(financial support). This expansion is also due to the role played by a new network of wine production leaders, relying on socialist and mutualist references. Cooperatives controlled progressively more than 70% of the production and constituted the base of a regional lobby able to negotiate a favourable policy for table wine national market stabilisation (Laporte, Touzard, 1998). Protected by this political system and by a still high level of national consumption, cooperatives tended to lock themselves in table wine production routines and in an increasing tasks separation, between grape production (members), vinification (salaried workers) and commercialisation (regional wholesalers).

In the 70s, changes in lifestyle (safe driving habits, health concerns) and in class structure (fewer manual workers), on top of regular increases in per capita income, resulted in a table wine consumption crisis in France. At the same time, France's integration into the European community enlarged the space of economic competition and overall sectoral negotiations, reducing the capacity of Languedoc wine organisations to maintain a protectionist table wine policy. After violent demonstrations in 1976, a new political arrangement ratified the necessity of cutting table wine supply and of re-directing table wine production towards "quality wines". A set of measures guided the transition : subsidies for vine uprooting, compulsory distillation for high grape yields, subsidies for aromatic vine cultivars replanting and for technological investments, implemented within the juridical frame of "producers' groups". Generally speaking, the wine cooperative sector has responded favourably to this regulatory package by significantly reducing table wine production (40% decrease between 1986 and 1996) and by developing two types of quality wines: appellation or "terroir" wines (AOC) and variety wines (mostly sold as "Pays d'Oc" wines).

In this transition, Languedoc wine cooperatives have split into divergent trajectories (Laporte, Touzard, 1998) : i) some of them have maintained a dominant production of table wine according to the inherited organisational model, ii) others have taken the "exit choice", by merging with neighbouring cooperatives, iii) most of the cooperatives have followed innovation trajectories, by developing a wider range of wines ("vins de pays", organic wines...), but also by modifying the organisation inside the firm (new remuneration rules) or outside (subsidiaries, alliances), by initiating new services towards their members (e.g. agricultural extension) or by getting involved in local development initiatives (e.g. tourism, culture, land management).

***Common evolutions and strategies beyond different regional and national contexts***

Comparison between Languedoc and Western Cape cooperative sectors highlights obvious structural differences. If in 2000, cooperatives vinify in both regions almost  $\frac{3}{4}$  of the production, they are 360 in Languedoc for 220 000 hectares of vineyard and only 50 in the Western Cape (60 if we add the 10 “companies” as private organisations recently issued from cooperatives) for 90 000 hectares. In terms of members and workers, situations are also very different : Languedoc numbers about 50 000 cooperative members (mostly retired or part-time farmers), 5 000 on-farm workers (permanent and part-time) and 2 000 cellar workers. The Western Cape on the other hand, numbers 4 000 cooperative members, 3000 cellar workers, 55 000 regular farm workers and around 55 000 seasonal workers (almost exclusively coloured and African). In background to similar statutory and technological orientations, one thus may be likely to distinguish communal “popular cooperatives” of small producers in Languedoc, from “club cooperatives” of big paternalist owners in the Western Cape (Ewert, 2000).

However, in Languedoc as well as in the Western Cape case, histories of wine cooperative firms show important similarities : i) emergence at the beginning of the 20<sup>th</sup> century to face markets fluctuations and wholesalers pressure, ii) expansion of these organisations through distilling or table wine, relying on the experience of the first implemented cooperatives but also on an important domestic market and above all, on a national political device built by the cooperatives’ leaders themselves ; iii) cooperatives lock up in mass production logics inducing a high division of tasks ; iv) transition to quality wines production around a wide diversity of strategies that disrupts cooperatives and sector organisation.

Moreover, precedence of “quality revolution” in Languedoc may not be so determinant. Re-conversion started in the 70s, around a little number of actors, in few communes and mainly in AOC area. The maintenance of a supportive device towards table wine, in parallel to incentives for quality, spared a brutal transition but kept favourable conditions for mass production in plain areas until Dublin European agreements in 1985. The difference between the two regions thus refers more to transition rhythm and conditions. In Languedoc, it has been implemented progressively, along the joint evolution of markets and political compromises. In South Africa, transition to quality has been much more brutal since the country exited from its economical isolation, and the process has not been supported by the State, who currently pressures the white wine farms owners to improve the labour conditions of the workers issued from the “disadvantaged communities”.

Nevertheless, in Languedoc as well as in the Western Cape, cooperatives are implementing similar strategies which combine the quality model of the Ancient world (quality linked with geographic origin, according to the AOC model) and the New World's one (quality associated to aromatic varieties and promoted through brands).

To account for the wine cooperatives innovative trajectories in these two regions, we use an interdisciplinary framework we built from structural interactionism, the concepts and methods of which have been particularly developed by H.C.White. Cooperative firm is construed as an "identity" (White, 1992), that means a set of interactions and of common values around specific objects of action (i.e. grape and wine, in the wine cooperative case). This identity, only temporarily stabilised, aims at the control and the coordination of its internal and external environment, in order to anticipate and to manage ongoing innovation processes in various domains of action (Chiffolleau, Dreyfus, Touzard, 1999).

### **Technological and organisational innovations in the heart of a radical change in cooperatives**

#### ***Coordination of technological innovations to modify wine materiality***

To produce more aromatic wines, without major default and eventually specific to the cooperative, that supposes great modifications in technical operations. These changes are implemented through the development of new technological chains, which rely on radically different principles compared to those underlying mass production : separation within grapes and wines, increasing control of the product at every step (temperature mastering...), lengthening of operations (wines ageing, bottling...). Their management is more complex and mobilises more information and new skills, in order to face a stronger uncertainty in matters of technology and economy.

Moreover, technological innovations are implemented in interaction with technical changes in members' farms : planting of new aromatic cultivars, new vine-growing practices. They are also linked with the actions developed by downstream enterprises (wholesalers incentives), cooperative's or members' suppliers and technical extension services. Beyond the vinification management, the challenge then consists in guarantying long-term coordination between all these actors, thus shaping a relevant "innovation network" around the cooperative (Chiffolleau, 2001).

However, two significant differences have to be pointed out between Languedoc and Western Cape cooperatives : i) innovation possibilities are more extended in South Africa, in matters of agronomy (variety, irrigation...) or oenology (blends,

shavings use...). This technological freedom is nevertheless limited for high quality wine producers, who follow the European references and try to distinguish their wine from an industrial product ; ii) access to labour force is much cheaper in South Africa (basic salary fivefold lower) that induces a less strong pressure on productivity gains quest by mechanisation and automatisisation. However, new regulations of labour make constraints and labour force cost increase, and the differences are less important for high-skilled tasks.

### ***New internal rules to sustain technological innovations***

In both regions, these technological innovations are associated with changes in cooperative internal rules. The system of grape classification and payment is a significant illustration of this kind of change (Touzard, Gaullier, 2001). Increasingly cooperatives are shifting from a the grading of grape deliveries according to variety, sugar ratio and sanitary state, towards the grading of blocks (planted with aromatic varieties) before the harvests. It is implemented along criteria which appear to be very similar in both Languedoc and the Western Cape, even if they are less formalised in the latter case, Western Cape wine-makers first referring to the “story” of the plot and to berries taste. Anyway, these rules appear in both cases as necessary to sort out the raw material, to remunerate the efforts implemented by members, and above all to incite them to pursue the re-conversion. In both regions, these new rules are discussed, criticised, revised. They consist in organisational innovations that put “equality principles” to test and substitute to them “equity principles”, which take into account member’s involvement in the quality revolution. Conflicts are frequent about classification criteria or evaluation procedures (Chiffolleau, 2001). Moreover, price accorded to the best class is not always sufficient to balance the required yield decrease (Biarnès, Touzard, 2001). In South Africa as well as in Languedoc, these changes in internal rules present similarities because they are linked with the same kinds of technological innovations and coordination problems (opportunism, collective discipline... ; Olson, 1965). Differences may be explained according to the social relationships that are locally in use (“club” decision between few white owners vs. general meetings gathering many “small producers”) and to enterprises strategies (terroir wines vs. variety wines).

### ***Changes in cooperative boundaries***

These changes in technology and rules are interacting with modifications of the cooperative boundaries : merging between cooperatives, integration in bigger producers’ groups, development of subsidiaries along different statuses, contractualisation with wholesalers... The search for new scale or variety

economies, aiming at complementarity between new investments or better control on all the supply chain, justifies these different forms of integration. In such a context, the cooperative status is sometimes challenged and some organisations even see it as a constraint to deal with the quality transition : in the Western Cape, ten firms have converted into companies, while in Languedoc, an increasing number of cooperatives opt (for the moment) for subsidiary or groups development to get new markets or to finance new activities (17% of the cooperatives in 2001 ; Touzard, 2001). Most of the Western Cape firms have nevertheless reacted to deregulation by keeping their founder status but try to become partially independent from the wholesalers by developing ways of self-marketing for quality wines (Martin, 2001)

Even if the “quality revolution” started somewhat earlier in Languedoc than in the Western Cape, the diversification of marketing strategies is not really implemented, except with regard to exports, something which was developed in tandem with variety wine production. Nevertheless, only 14% of the volume is sold in bottles or small bulk quantities (Touzard, 2001). Most of the cooperatives are not very pro-active in matters of sales, often waiting for the demand to come from wholesalers. Inspired by the Australian model and “pushed” by the brutality of the transition, South African cooperatives appear to be more offensive with regard to potential buyers.

### **New domains of innovation in the cooperatives**

#### ***The building of a new relation to environment***

The necessity to adapt the new cultivars to soil and climate conditions on the one hand, the search for products differentiation on the other, lead cooperatives' actors to develop new relations with their environment. The development of environment-friendly production, for instance, accounts for this logic : compulsory for all South African producers, that is implemented through many voluntary initiatives in Languedoc, taking varied forms. More largely, the building of the wines image and their promotion suppose to take into account new factors, specific to the local environment : landscapes, ecosystems, history traces, cultural tradition... More and more cooperatives are taking part in the valorisation of these resources by associating with off agriculture actors (local authorities, tourism agents...). In Languedoc, these dynamics take part in the new frame of “territorial activity contracts” (45% of the cooperatives are involved in such devices in 2001). Such contracts secure subsidies for farmers insofar as these tend to link quality production to environmental practices and/or job creation. Wine routes, associating producers and tourism agents, are another illustration of these innovation processes linked to environment and territory (Vandecandelaere, Touzard, 2001).

### **Skills improvement and diversification of human resources**

Human resources constitute another domain of innovation in the two wine settings, possibly linked with the development of territorial assets. The quality revolution requires indeed new skills, as recognised for instance by the South African wine industry's strategic study group 'Vision 2020'. Regarding skills, the study group's documents state that "*a substantial, if not radical, improvement in the stock of human resources is urgently required*". Severe shortages are said to exist in management and cellar teams, but also at the farms level, where workers need higher skills (Leibholdt, 2001). Along with Vision 2020 group's advice and in the SAWIT frame, a new institution, the Vineyard Academy, has been developed in order to organise and to certify new individual training programmes. As yet, Western cape cooperatives and their members are hardly involved in such programmes. Where training does occur, this is mostly done by private cellars, particularly those involved in the Ethical Trading Initiative, developed by British supermarkets and stipulating the respect of a "base code" in matters of labour conditions for farm workers.

In Languedoc, human resources renewal is carried out by the leadership of the cooperative sector itself and is implemented through measures for training as well as for establishment of new kinds of farmers. Indeed, focused on the planting of new varieties and the development of new vine-growing techniques at first, grape producers have been progressively required to manage an increasingly complex activity system on larger farms. This requires not only more technical knowledge, but also more investment and labour, demanding the management of a more complex organisation, manpower and finances. Faced with new needs and new problems (e.g. water management, due to vineyard consolidation), producers are forced to look for help and to reactivate exchanges with other members of the cooperative. Indeed, the diversity of social trajectories amongst members actively promotes complementary exchanges, for instance swapping technical against financial advice, or exchanging labour (e.g. the cleaning of ditches) between established producers and new part-time farmers (Chiffolleau, 1999). In the context of an ageing membership without children to take the farm over, such new exchanges, developed by necessity between people who thus recognised their complementarity, encouraged some leaders of cooperatives, but also of social economy associations, to claim for and to develop a supportive programme for establishment of new kinds of farmers. These ones, eventually ancient or current part-timers, coming from cities, are endowed of skills and networks that are potentially complementary to those of the current cooperative members. Programmes for progressive, late or part-time establishment, consist above all in support for land acquisition, main limiting factor relative to establishment (Nougarèdes, 1999).

Establishment emerges also as a domain of action in the South African wine sector. As a result of state pressure, the South African wine industry has started to embrace the idea of land reform, i.e. the settlement of new farmers, mostly from the ranks of existing farm workers. Contributors to the Vision 2020 project have proposed that 30 000-50 000 ha of land should be made accessible to 15 000 new wine farmers over the next 20 years, with a sub-target of at least 15 000 ha to 5 000 farmers in the next five years. So far, only a few land reform projects have been launched in the Cape wine industry, all of them initiated by private wine estate owners (i.e. non-co-operative vine-growers). Nevertheless, these first experiences show promising results relative to professional commitment of the farm workers who thus became owners of a vineyard plot.

### **Solidarity and transition to quality**

In Languedoc as well as in the Western Cape, innovation trajectories followed by previously mass wine producers are characterised by an increasing degree of complexity. They have to adapt to technical evolutions as well as to markets dynamics, like in other industrial sectors. But the deal is also to learn a new relation with the environment and to include in enterprise strategies activities that previously didn't exist, as wines promotion or services for tourists. The challenge thus consists in developing or maintaining a suited form of "social capital" (Lin, 1999), that means relevant interactions which enable them to carry through such a project, that proceeds from a new form of "solidarity".

According to their resources, their technical and social practices and their "equivalence position" (Chiffolleau, 2001) towards the cooperative project, actors within the organisation are able to propose diverse contributions which may be combined in a collective learning process. Interactions between the managing team and actors evolving in different positions thus allow the development of a form of social capital, all the more efficient than the heterogeneity within involved actors is sufficient to cover and to catch all the elements of cooperative both internal and external environments. Nevertheless, this social capital may favour cooperative adaptation and efficiency if, and only if, actors adopt solidary behaviours and are ready to exchange their understanding of the diverse signals of the environment. To guarantee this collective learning process, the cooperative then has to develop a suited "style" (White, 1992). The style is implemented through the internal and external organisational patterns, which combine institutional rules (linked notably with the status) with specific choices in matter of "discipline". According to White's definition, a "discipline" refers to an ideal-type conception of collective action development.

Cooperatives are very specific kinds of firms, in which every shareholder is theoretically equal, regardless of his/her share. However, equality does not imply solidarity, and whereas the phenomenon was less pronounced during the mass production period, more than one cooperative firm is now threatened by opportunism, free-riding or even exit. This may result in even weaker efficiency (Olson, 1965). Indeed, equality may be an element that congeals the group in a given form and slows down the cooperative ability to acknowledge the contribution of new actors. As Boudon argues, if equality leads to relativism and routine, equity is more likely to induce involvement and innovation (Boudon, 1996). Some firms' way of promoting "equity", as a recognition and valorisation of diverse contributions from heterogeneous actors, may be more suited to the development of a "micro-solidarity" within the membership, as i) a form of real "loyalty" (Hirschman, 1970) towards the collective project on the one hand, and ii) exchanges of different resources between members on the other.

Some firms have already discarded their former cooperative status, in an attempt to improve their adaptability to the new context. In the case of Western Cape "paper companies", it has not yet resulted in a change of external and internal organisational patterns (Martin, 2001). In this case, a radical change of status does not provide any new answer to those in search of building an organisational learning process more in tune with the complexity of the current situation. Nevertheless, conversion into a company may provide a bigger manoeuvre margin for the implementation of "equity" and the promotion of "organic solidarity" (Durkheim, 1893). Companies are thus free of egalitarian principles and "mechanical solidarity", that while efficient in a mass production context, can not answer to the quality revolution challenges.

Although cooperatives may still possess many aspects that favour solidarity, the egalitarian founding principle may need to be revised. Right now, innovation in matters of membership status should seek to facilitate the development and the maintenance of extended social capital, through the exercise of a new kind of solidarity, reasoned by and for a quality production objective. The challenge may consist in developing solidarity at the local level, thus strengthening a territory embedded in a local development process, beyond the projects of single firms (Chiffolleau, 1999). It may also entail the building of new forms of social capital within the cooperative sector, at the international level, in order to promote specific products originating from "social economy" firms, thus renewing the solidarity conception and practice.



## **Conclusion**

The Western Cape and Languedoc wine producing regions appear as enlightening cases (Mitchell, 1983) to assess the dynamics involved in a drastic transition towards quality production, the latter implying a large-scale programme of various types of innovations. Moreover, as wine regions dominated by cooperative firms, they put in question the conditions and modalities of collective action around complex projects. They illustrate why and how “solidarity” arises as a real need in the “quality revolution” context. As the objects of action, as well as the actions themselves are changing, it implies a collective learning process around a two-fold cognitive project (Favereau, 1994) facing both the external and the internal environment of the firm, and involving the building of new relevant forms of social capital for new types of positive outcomes. That implies also new or renewed kinds of coordination structures for the firms, in order to recognise and to valorise “equity”, thereby promoting and/or strengthening solidary behaviours amongst the membership.

Two interdependent strategic issues may be pointed out to strengthen and to valorise the “quality revolution”. First, promotion of quality wines is more and more linked with the valorisation of territorial assets, that challenges the building of new relations between farmers, non-farmers and local authorities, as well as the formalisation of new types of territorial coordination structures. Second, in relation with the first issue, labour force and skill management appears as a key factor in the building of quality, from the vineyards to the market, through cellars. Caught between new state regulations and market incentives, it tackles quantitative as well as qualitative issues, such as working conditions, labour force and skills management and it claims for collective answers whereas actors stand alone in front of these question, especially at farm level. A new step of action-research in the two countries is thus launched to match this objective (Chiffolleau, Dreyfus, 2002).

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## **TOO MUCH COMFORT, TOO LITTLE INNOVATION: SOUTH AFRICAN WINE COOPERATIVES BEFORE DEREGULATION**

**Ewert Joachim**

### **Introduction**

The last ten years have seen dramatic changes in the economic and political environment of South African co-operative wine cellars (Ewert, 2000). Almost overnight they came face to face with a process of brutal deregulation, access to international markets and democratization of the labour regime – profound changes that represent opportunities, but especially risks.

*Until 1997, the marketing of wine, like most sectors of agriculture in South Africa, was extensively regulated by statute. However, whereas most of the marketing schemes introduced from 1930s onwards brought markets under state Control Boards, wine, like sugar was regulated by the industry's own institutions. In response to periodic surpluses, farmers took steps to address the problem, creating institutions, and specifically the KWV (in 1918), to manage the problem, but they never succeeded in solving it. This led to ever more sophisticated attempts to manipulate the market. Industry insiders persisted with arrangements such as guaranteed markets and fixed prices in periods of shortage and surplus as if farmers would voluntarily forego increased production in the boom years and not continue to expect assured markets and guaranteed prices when supply rose again ahead of demand.*

Although the state provided few direct subsidies, the industry did benefit from state price support and import protection, which enabled it to pass costs on to consumers, and from favourable excise taxes, which favoured the distilling of grapes into spirits at the expense of sugar producers.

Nevertheless, the wine industry faced the same pressures for deregulation as the rest of the agricultural sector of South Africa, which has been extensively deregulated over the past 20 years. The government of national unity, elected in 1994, ushered in policies across the entire range of government activities. In agriculture, some tended to follow the direction of changes already under way. New policy initiatives included the land reform programme; laws protecting agricultural workers and labour tenants against eviction and extending their rights; liberalization of international trade and agricultural marketing; a new rural development policy; and institutional restructuring in the public sector. The

purpose of the reforms was to correct the injustices of past policy, principally through land reform, to direct agriculture towards a less capital-intensive growth path, and to enhance its international competitiveness. The wine industry did not escape these changes (Vink et al., 2002:1).

Suddenly finding themselves in a market-driven environment devoid of any regulation, growers and wine cooperatives were faced with a steep learning curve and a number of strategic choices. The signals coming from the market, especially overseas ones, suggested that a shift towards 'brands' in the medium and premium price categories

(especially red varieties) was the obvious thing to do. They fetch the highest prices, especially if paid in foreign currency. However, in their attempt to adapt to a more differentiated international market, South African wine cooperatives are constrained by the legacy of mass production of large quantities of cheap wine for the domestic market. Research shows that so far only a minority of South African co-operative cellars have succeeded in competing in the 'quality' market. The output of the majority of cooperative cellars remains standard price wine produced in bulk for the wholesale sector (Martin, 2001).

The paper tries to explain why this is the case, exploring economic, political and cultural factors. It shows how the legacy of the erstwhile regulatory regime, financial constraints, a non-strategic management style and the political culture of the co-operative farming community combine to make the transformation from mass to quality production a difficult process – a process that a substantial number of cooperatives are unlikely to survive.

### **Creating a comfort zone: the regulation regime in the South African wine industry<sup>1</sup>**

#### ***Early history: booms and busts***

The South African wine industry was established in the 17th century and reached maturity in the first half of the 19th Century. The number of vines planted, for example, increased from 15 million in 1808-1810 to 32 million in 1823-25. Wine production increased by 83% over the same period. Between 1810 and the 1820s wine was the most important export commodity from the Cape, being responsible for some 90% of total exports from the colony. Under imperial preference, the

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<sup>1</sup> This historical section draws heavily on two sources: firstly, Nick Vink's chapter 1 in Ewert et al (1998); and secondly, Gavin Williams' section in Vink et al (2002). Nick Vink and Gavin Williams are part of a research team that, together with French colleagues from INRA, Montpellier, compare the transformation of the wine industries in respectively South Africa and Languedoc-Rossillon, France. The French colleagues are Yuna Chiffolleau, Fabrice Dreyfus and Jean Marc Touzard.

duties payable on Cape wines were a third of those levied on Iberian wines, their main competitor. As a result, Britain became the largest market for the South African wine industry.

Throughout this period, the success of the industry was heavily reliant on state actions. For example, when the imperial preference was abolished in 1825, exports to Britain fell by 75% and plunged the industry into depression. Despite continued complaints about the quality of the wine, the industry revived sufficiently to export wine to the value of more than £120 000 to Britain annually in the late 1850s. However, intervention again changed the market calculus, this time with the adoption of free trade between Britain and France in 1860. By 1861 wine exports to Britain had dropped to £8000. In the absence of alternative markets, the industry once again faced disaster.

To make matters worse, market access for South African producers was constrained by the nature of the product: heavy, fortified wines against the lighter ones produced by their competitors from Europe.

The 19<sup>th</sup> century saw the first attempts by farmers to regulate the industry. However, born in times of adverse conditions and near disaster, most of these attempts, such as the establishment of De Zuid-Afrikaansche Wijnbouwersvereniging in Paarl in 1877 and the Paarlberg Wyn- en Brandewynmaatskappy Bpk. in 1885, failed to last more than a few years.

### **Bringing the surplus under control: the establishment of the KWV**

The latter part of the 19<sup>th</sup> and the early part of the 20<sup>th</sup> century was characterised by alternating periods of booms and busts - overproduction and low prices, followed by periods of lower production and higher prices.

During the latter part of the 19<sup>th</sup> century, adverse developments included the 1860 French- British trade agreement, oidium, phylloxera and other diseases. Recovery from the ravages of phylloxera was slow, but local consumption did not rise to meet expanded supply. Farmers made several attempts to co-operate in the face of disaster. However, most of the organizations established for this purpose, failed to survive more than a few years. In this period wine (and wheat) farmers organised politically against excise taxes to defend their economic interests, secure a political voice and advance their aspirations. In 1905, a Committee of Inquiry reported that producers and merchants were holding large stocks that were practically un-saleable, or saleable only in small quantities at un-remunerative prices. In the same year the government provided loans to finance the creation, under the Companies Act, of nine co-operative cellars to improve the quality of wines.

In the meantime the expansion of vineyards proceeded apace facilitated by the expansion of irrigation – only to be followed by a slump in demand and the overproduction of mostly poor quality wine. To make matters worse, in 1916 the South African government announced plans to increase excise duties at a time when farm gate prices had slumped.

When the customary representations to the government again fell on deaf ears, plans for a congress of wine farmers gained momentum. At this time Charles W H Kohler, a leading figure in the industry, started agitating seriously in favour of the establishment of a country-wide co-operative whose membership would consist of wine and brandy farmers only. The co-operative would regulate the prices at which vine products were sold to the 'trade' (i.e. merchants and manufacturers) by controlling the supply of grapes and wine.

The KWV was initiated as a co-operative in 1916 and registered as a company in 1918. Members would have to sell through the co-operative and contribute a levy of 10 per cent on their sales. KWV would declare an annual 'surplus', which it would remove from the market. The surplus would be delivered to the KWV free of charge and turned into spirits, the latter being disposed of at the discretion of the organisation. However, disposal would be restricted in the sense that no produce was to be sold on the domestic market below a set minimum price. The income thus generated would be used to finance the purchase of distilleries, vats and buildings. Any profits from the administrative fee raised or from the disposal of the surplus would be distributed to members on a pro rata basis. In addition, KWV was also granted the sole rights to market and sell South African wines overseas.

It was estimated that 90% of the wine farmers in the Cape had signed the constitution of KWV by the end of 1917. Notable exceptions were a few Stellenbosch farmers and most of the Constantia farmers. They argued that they had no need of such an institution, as they were producing a superior quality wine.

Distillers and merchants were opposed to the idea from the outset. However, faced with the threat of KWV entering the trade in its own right, they decided to go along. In 1918, the two parties reached a 'gentlemen's agreement' whereby the trade agreed to distil and store the surplus on behalf of KWV. This was in exchange for an undertaking from KWV not to compete in the same product market and not to deal directly with the merchant's clients.

***With a little help from the state: the elaboration of the regulation regime***

However, the establishment of the KWV hadn't solved the problems for good. On the contrary, it had the ironic effect of creating yet another surplus, for the regulation of which the KWV had been established in the first place. Already in 1918, a member of KWV warned, that he was '...afraid things are going too well. There will be a surplus for sure, because farmers are simply planting according to the [ guaranteed minimum] price' (Vink et al., 2002:2).

True enough, in the early twenties some 25% of the total production had to be destroyed. By 1923, the surplus had grown to 50% of production and the KWV had all but lost the ability to stop its members from selling to the trade at lower than the minimum price. By the end of that year, KWV could no longer sustain its control of the market. Merchants could buy wine directly from farmers below the minimum price but well above what farmers would receive through KWV. As a result, the merchants withdrew from the agreement. KWV had no way out other than to resort to a scheme for compulsory co-operation.

A bill put before parliament conferred a monopoly that enabled KWV to charge an artificially high price '... for wines to enable them to pay their members for the portion of the crop which is not required, and which will then become their property at no cost to themselves' (Vink et al., 2002:4).

The Wine and Spirits Control Act of 1924 provided that the KWV would fix a minimum price for the sale of any wine for distilling, and that sales could only be made 'through or with the consent of' KWV'. KWV was required to supply wine only in wholesale quantities and at a uniform price to 'any bona fide distiller, wholesale trader or co-operative society' for sale anywhere in southern Africa. The 1924 Act laid the foundation on which the institutional structure and patterns of production of the industry were built for the following 73 years.

From 1929, the directors of KWV warned their members that continuation of surplus production would lead to a fall in producer prices. In 1931, they set up the first of a series of committees, and supported a bill in parliament, which sought to produce a scheme for discouraging surplus production. They all ran up against conflicts of interest between the established districts of Paarl and Stellenbosch and the expanding and irrigated districts of Worcester, Robertson and Montagu.

During the 1930s, continued surpluses resulted in the appointment of a Commission of Inquiry into the industry (the so-called the Wine Commission of 1935). Released in 1937, the commission's report recommended that KWV be given further controls over the level of production. It decided that the only solution to the failure of partial control was to apply a comprehensive system of



necessary cellar and distilling capacity. The Commission argued for minimum prices for 'good wine' and 'quality' wine, opposed production quotas and suggested the creation of an advisory board. This was done in opposition to the Commission of Inquire into Co-operation and Agricultural Credit, who had criticised KWV in its 1934 Report, arguing that it was inappropriate for a co-operative to exercise statutory controls.

The Wine and Spirits Control Act of 1940, introduced over the trade's objections, empowered KWV to set an annual minimum price for 'good wine', and for 'quality' wine of which wholesalers had to buy a minimum percentage. It made provision for production limits but did not introduce an advisory board or require KWV to discount sales of spirits for export. Thus, KWV had maintained and extended its control of the industry, acquired the powers to set prices for distilling good and quality wine, protected its effective monopoly of the export market and secured, in principle, powers to limit production.

Demand for brandy during the war solved the immediate problem of surplus disposal. Prices of good wine increased relative to distilling wine and KWV withdrew from buying grapes for export production so that farmers needed access to cellars to produce 'good wine' (most of which was not very good at all). Farmers delivered grapes to their co-operatives who took delivery and paid farmers from a pool in accordance with tonnage, sugar content, and sometimes cultivar.

The incentives to produce standard, high-yielding grape varieties on irrigated land continued. The number of co-operative cellars increased from 6 to 19 between 1939 and 1944, to 30 by 1950 and 46 by 1955. This initially suited the merchants to whom the co-operatives now supplied wine rather than grapes. The costs of new technologies, notably cold fermentation which was first introduced to South Africa in 1959, encouraged more farmers to join and form co-operatives, whose number rose to 69 by the end of the 1975.

From 1954 to 1963, increased production led to rising surpluses. After numerous attempts to control production by limiting the output of each farmer, KWV agitated for an amended quota system based on the production of each farm. As a result, a new quota system was adopted in March 1957 and introduced in 1960. They were set above current output and expanded ahead of supply and thus encouraged people to increase production to justify their quotas. Responding to rising demand, quotas were again increased in 1964.

Despite sanctions being launched against South African wines, demand kept on rising during most of the 1960s and '70s, increasingly putting pressure on the quota system. Production quotas allowed rather than restricted an expansion of

output far ahead of consumption, particularly in the irrigated Olifants and Orange River areas, where new distilleries were opened in 1977 and 1978. Although quotas were amended a number of times between the mid-1980s and the early 1990s, there was a growing consensus that the changes were falling short of making the system sufficiently flexible to react to market signals.

The system by which KWV unilaterally set uniform prices for distilling, good and even quality wines protected farmers' incomes, but discouraged competition among buyers; wholesalers' ties to retail outlets discouraged competition among sellers. Regulation of the industry facilitated monopolistic arrangements but throughout this period, it also resulted in continuous political contests for control of marketing arrangements between KWV and the trade.

### **The system unravels: from regulation to markets**

However, critical changes began to take place in the 1980s. State regulation and commercial monopoly slowly began to be undermined. These changes in turn created conditions that made possible the response of the industry to the opening of export markets in the 1990s and the collapse of the system of regulation.

From 1980, producers progressively began to shift production away from high yielding to higher value cultivars. In the early 1990s, a number of events overtook the industry in rapid succession. These included the political changes that were set in motion in 1990; the development of the grape juice concentrate market and of diversified products such as flavoured wine and alcoholic fruit beverages; increasing exports and increased domestic consumption of good wine. Taken together, these developments made the further maintenance of the quota system, as well as the surplus removal scheme, redundant. By 1996 virtually all the KWV's powers of intervention existed on the statute books only.

In 1992, KWV agreed to suspend quotas. The task of regulating production was now transferred to the co-operatives. They were encouraged to define, limit and even charge for their members' rights to crush grapes. The co-operatives now needed to discriminate more carefully in the prices paid to their members for different cultivars and for grapes, or even vineyards, or different qualities. These changes exposed conflicts of interests among co-operative members and brought into question the established arrangements for paying members for their produce.

Rather than consolidating their domination of the wine and spirits market, the manufacturing-wholesalers saw their share of the market fall significantly from their initial 85 per cent to 65 per cent in 1991 and 49 per cent in 1996. Increasingly cooperatives were sidestepping the wholesalers and selling directly to the market (Ewert et al., 1998: 21).

The final episode in this regulatory saga commenced in December 1996, when KWV applied to the courts to change its status from a co-operative to a company. After an investigation by a commission of inquiry and an out-of-court settlement between KWV and the Minister of Agriculture, this was granted. At the beginning of December 1998, KWV formally changed its status from a co-operative to a company, with its farmer members becoming its major shareholders.

### **Farming in the comfort zone: regulation, growers and the co-operative system**

From a development of the sector reached its zenith in the mid-1970s when the official wine industry statistics recorded 69 cooperatives. This remained the case until the late 1990s.

When it was still intact, the system of regulation decisively shaped the features of the South African wine industry for the greater part of the 20<sup>th</sup> century:

Firstly, it encouraged the mass production of cheap (white) wine mainly for the domestic market. Even today, only some 15% of total production is being exported, although this is on the increase.

Secondly, farmers and their co-operatives sold their most of their grapes/wine in bulk to KWV and a handful of big wholesalers. Although producers were guaranteed a minimum price, it was modest beginning of nine cooperative wineries established in 1905, the a buyers' market until the early 1990s. Even in the year 2000, more than 75% of total cooperative production was still being sold to the wholesale trade.

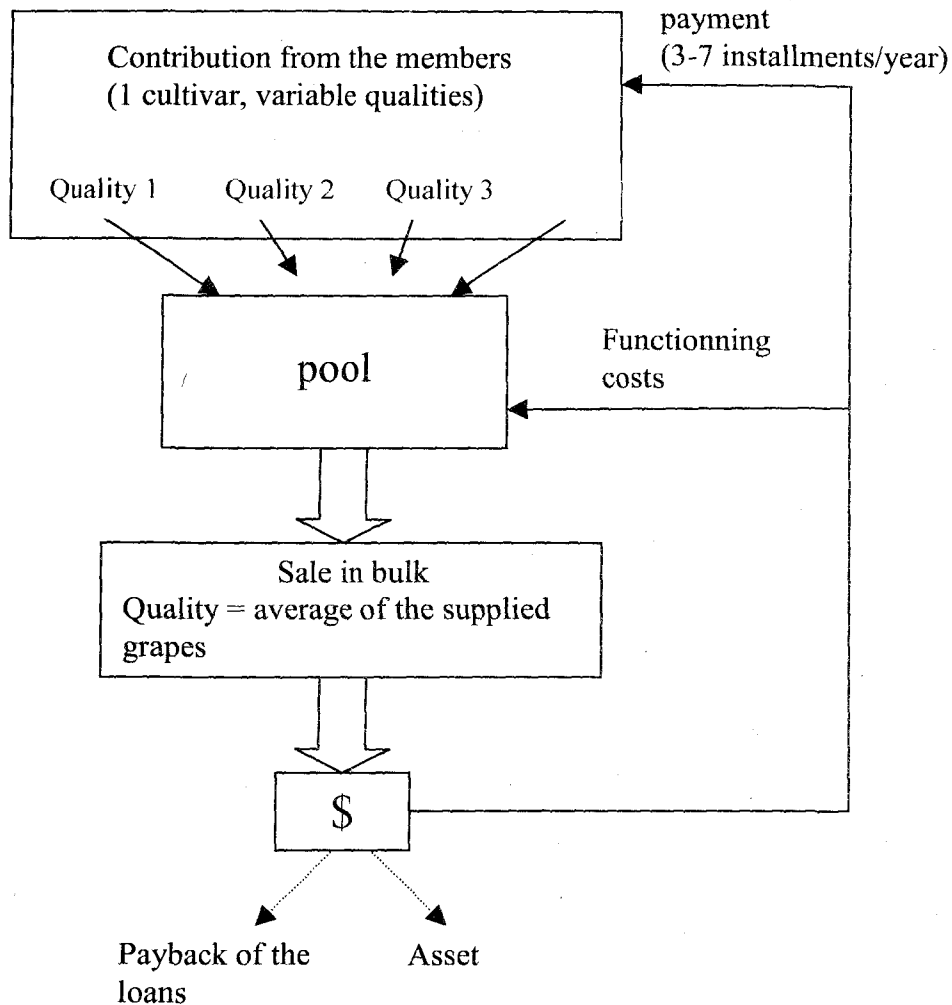
Because the emphasis was on mass production of cheap bulk wine, it did not force co-op staff and management to develop special skills in relation to winemaking, marketing or distribution. Until recently, for example, most co-ops combined the jobs of wine making and manager into one person. Lacking a business orientation, the notion of a 'brand' hardly featured in the mindset of the coop management.

The emphasis was on lateral expansion. Concepts like 'terroir', 'superblocks', 'harvest control' and 'canopy control' were not part of the vocabulary of the majority of South African wine farmers. The current emphasis on 'terroir' in the discourse of the South African wine industry is a very recent development.

Predictably, little innovation took place at the farm and co-op level for the greater part of this century. Whatever innovations were made in viticulture and oenology, these were mostly the result of research done at R & D institutes (e.g. Nietvoorbij), either linked to the wholesalers or the universities. Also, these innovations were not easily transferred to the farm level. For most co-op members, wine farming became a matter of predictable routine.

The heart of the co-op regime was the 'pool system'. The quantity of grapes supplied by the members corresponded to their share of the asset (constituting supplying quotas) that they had invested in the co-operative. The classification of the grapes was done at delivery on the basis of chemical analyses (sugar content and acidity) and the grapes' state of health (visual inspection). Normally there were between 3 and 6 classes depending on the co-operative, corresponding to different uses of the grape: transformation into drinking wine, distilling wine or fruit juice. The payment differences (by ton) between the classes varied between co-operatives: it could be as much as double the amount between the top and the lowest class. The number of classes by cultivar varied according to their utility: they were more classes for the multi-purpose varieties compared to the ones specifically destined for drinking wine. Within the "drinking wine" class, the payment gaps between the cultivars varied from cellar to cellar (Martin, 2001).

All the grapes from the same cultivar were put into the same tank (i.e. 'pooled'). The payment system was simple: members would be paid (proportionally to the supplied volume) according to the price realised for the pool after deduction of overhead costs. Payment was mostly done in several installments spread over a year (see diagram below).



Source: Martin (2001: 10)

As shareholders, farmers were represented by fellow farmers on the co-op board of management. Given the system, farmers had a vested interest in realising the highest possible payouts. This was perfectly rational, but had the consequence that technological innovation and retooling was sorely neglected. Replacing crushers, presses and filters and adding more tanks for the sake of quality differentiation required capital. As the legal form of the co-op did not allow the procurement of capital on the open market, capital investment meant lower payouts. Barred from overseas markets and shielded from international competition, most cooperative farmers saw little reason for long term investment

or breaking new ground. Technically and commercially, very little innovation took place in the cooperative sector before the mid-1990s.

### **After deregulation: what future for the cooperatives?**

The years 1995-96 were a watershed in the South African wine industry. After the lifting of sanctions in 1993, cooperative farmers and cellars largely adopted a wait-and-see attitude in the light of the upcoming democratic election in 1994. However, after their minds were put to rest by the conciliatory attitude of President Nelson Mandela, cellars and farmers started to expand, innovate and invest in earnest. Old vineyards were uprooted, new ones established and additional labour hired. Old 'staple' varieties were progressively replaced by 'noble' ones – especially reds. Those cellars who could afford it, installed new processing equipment.

However, for some cooperatives these technical changes did not go far enough. Of the 69 cooperatives that still existed officially in the late 1990s, almost twenty changed their status to that of a company by the year 2000 (Martin, 2001). Although the motive behind this transformation was not purely commercial in all cases, the main consideration was to put the firm onto a business footing and to replace the cooperative orientation with a business culture.

Characteristic of these new companies is also that they have embarked on the road to self-marketing. They have cut their ties with the wholesalers, bottle their wine and try to establish brands in both the domestic and the international market.

However, even after almost ten years of deregulation and the opening of international markets, most of the remaining cooperatives (including some of the 'paper companies') continue to sell more than 70% of their wine in bulk to contracted business partners, mostly wholesalers (Martin, 2001).

This represents a problem, especially in the context of a relatively stagnant domestic market and the surplus (of white wine) experienced by the industry over the last three years. It is generally accepted in the South African wine industry today, that survival requires a shift from mass to quality production. This, in turn, demands that cellars develop and establish brands in overseas markets. In order to make this transition successfully, a cellar does not only need sizable sums of capital, but above all a new mindset.

Some observers tend to think that this is too much of a challenge for many South African wine cooperatives. Estimates are that as many as 40% of the remaining cellars will no longer exist in a few years' time.

The precarious state of the cooperatives was the reason behind the commissioning of a strategic study of the industry in 1999 (called 'Vision2020'). The study came

up with a report and a strategic agenda two years later (Spies, 2001a,b). Although the recommendations may be sound, there is nobody to take the agenda forward or to put it into action. After deregulation, the South African wine industry happens to find itself in an institutional vacuum.

Into this vacuum has stepped the government. Although it subscribes to neo-liberal economics and is not receptive to a return to regulation, the ANC government is nevertheless concerned about the future of the industry and the thousands of livelihoods involved<sup>2</sup>. Responding to Vision2020, it has instructed the industry to establish an 'industry structure'<sup>3</sup> in order to translate the strategic study's recommendations into practise. Headed by the MD of South Africa's biggest wine firm<sup>4</sup>, the industry forum is expected to bring about cooperation between primary producers (i.e. growers), cellars, labour and the 'trade'. However, traditionally at loggerheads (i.e. coops and the trade) or marginalized and actively fought (i.e. labour by farmers), it remains to be seen whether the main stakeholders can forge a synergy and create a more competitive industry all along the value chain.

## Conclusion

Although neo-liberal policies have increasingly come under fire elsewhere, deregulation may actually be the best possible 'medicine' for the South African wine industry. Protected for decades from market competition, aided by repressive state labour policies (Ewert, 1996) and granted statutory powers nothing short of monopoly, the sector by and large never developed beyond an industry geared towards the mass production of cheap wine. In this self-perpetuating system, no force strong enough ever challenged the established routine of cooperative farmers and cellars. Nor did the system have the capacity to renew itself from the 'inside' as it were. Too many 'stakeholders' had a vested interest in its maintenance. The upshot was little or no innovation, whether in the vineyard, with regard to the labour regime or in the cellar.

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<sup>2</sup> It is estimated that between 200 000 and 250 000 employees and their dependents make a living from the wine industry.

<sup>3</sup> The industry structure will consist of four 'chambers' representing the different 'stakeholders: 1) primary producers; 2) Cellars; 3) Labour and 4) the Trade. For the moment the 'structure' has a chairman and an executive committee who are charged with getting the institution off the ground. Constituencies linked to the official stakeholder categories have been invited to make submissions to the executive.

<sup>4</sup> The person in question is Jan Scannel of Distell, a recently established company after the merger of two of the biggest wholesalers, Stellenbosch Farmers' Winery and Distillers Corporation.

Pressure for change did not come from within, but from the outside. In the 1980s increasing pressure from the estate and private cellar sector eventually resulted in the abolition of the production quota system. In the 1990s market forces overtook the cooperative sector and made the statutory minimum price practically redundant. All of this occurred in the exciting political climate of the transition to democracy. Tired of an bankrupt authoritarian state and an overbearing KWV, there was no stopping the industry forces in favour of deregulation. Business and market oriented from the start, the private and estate cellars had little sympathy for an ailing cooperative sector, now brutally exposed. Nor could white growers, cultivated for decades by a white government, expect much help from a newly elected black government focused on the alleviation of mass poverty.

Now, a decade after the onset of deregulation, almost half the cooperative sector is in danger of going under. With state financial help or a return to regulation a zero option, it is up to the 'industry' to save whatever is left of the cooperative sector - without compromising the imperative of greater international competitiveness. It will be an interesting balancing act to watch.

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## PERFORMANCE AND MANAGERIAL STRATEGIES OF THE PORTUGUESE WINE CO-OPERATIVES

João Rebelo, Manuel Teixeira and José Caldas

### Introduction

In recent decades rapid change in the agricultural sector and improvements in technology have changed the farming systems and are created new opportunities and challenges for agricultural co-operatives. The development of consumer markets requires a new approach to meet demand. At the same time, agricultural co-operatives must satisfy their members who joined primarily for economic reasons (Cobia, 1987).

Co-operatives play an important role in the European Union (EU) food system. In 1995, there were almost 32,000 agricultural co-operatives in the EU member-states, representing over 12 million farmers, engaging “in a range of value activities including farming, food processing, farm services and farm input production whose value amounted to ECU 187.5 billion” (Kyriakopoulos, 2000: 15).

The occurrence of technological and structural changes in the agro-food chain raises a fundamental question: how can the co-operative organisational form, where the primary users of the service are also the main owners, survive and grow in a world in which emphasis is increasingly placed on market conditions? This question focuses directly on the economic role of agricultural co-operatives.

Two different theoretical currents of literature have dealt with cooperatives in terms of their conceptualisation and performance (Kyriakopoulos, 2000). The first stream rests on the adaptation of the neo-classical theory of the firm to co-operatives and attempts to derive price-output equilibrium. The second takes advantage of recent theoretical advances related to transaction costs, agency/property rights theory and game theory. Whilst neo-classical theory deals with market failure in terms of production efficiency, transaction cost economics<sup>1</sup> explains the formation of co-operatives from the point of view of transaction efficiency. Agency theory views co-operatives as having, essentially, control and ownership functions, noting that these organisations face a set of problems that influence resource allocations and investment policies. Game theory, building on a

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<sup>1</sup> I.e. the costs of gathering and processing the information needed to carry out a transaction, reaching decisions within the organisation, negotiating contracts with other parties, and policing and enforcing those contracts.

divergence of interests amongst stakeholders (i.e. members, directors and managers), considers co-operatives to be coalitions that determine stable equilibrium in terms of allocation of costs and benefits between members, financing options and membership policy.

Using a neo-classical model, the first objective of this paper is to present a function that characterises theoretically the economic role of agricultural co-operatives and describes their main managerial strategies. Additionally, using a multinomial logit model, we analyse the impact of these strategies on the economic performance of Portuguese wine co-operatives (PWCs).

The paper is organised as follows: section 2 gives a structural overview of the Portuguese wine sector; section 3 discusses how to measure the economic performance of agricultural marketing co-operatives and characterises, theoretically, the managerial strategies that co-operatives are able to apply; section 4 analyses data and the results relating to the performance of the PWCs following different managerial strategies using discrete choice modelling. Finally, some broad conclusions are drawn.

### **The Portuguese wine sector: a structural overview**

Portugal is a country with a marked aptitude for vine-growing, which activity has been well documented over time. Vine growing and wine making in Portugal goes back to the 7th century B.C. and increased during the Roman occupation of the Iberian Peninsula. Later on Portuguese history illustrates numerous references to the production of wine, dating back to the beginnings of the 13<sup>th</sup> century with early documents showing evidence of production in the current demarcated region of the "light wines". Today, vineyards are spread throughout Portugal.

Despite the specificities of PWCs, their activities are linked to the movement of the wine chain. Therefore it is important to characterise, briefly, the present structure of the Portuguese wine *filière*.

In 1997, the world area under vines constituted almost 7.1 million hectares of which 45% was in the EU and 3.3% was in Portugal (Pomarici, 1999; Aguiar, 1999). In the EU, on average, during the period 1993-97, Spain presented the highest vineyard area (34%), followed by France (26.6%), Italy (25.3%) and Portugal (7.5%). Moreover, Portugal ranked 2<sup>nd</sup> in the number of farms, 5<sup>th</sup> in wine production and 7<sup>th</sup> in both productivity and area per farm (Table 1).

**Table 1. Indicators on the wine sector in different EU countries (average: 1993-97)**

	Germany	Greece	Spain	France	Italy	Luxemb.	Austria	Portugal	EU 15
Area (1000 ha)	104	74	1 167	912	868	1	49	258	3 433
(% Eur 15)	3	2.2	34	26.6	25.3		1.4	7.5	100
Production (1000 hl)	8 872	3 744	25 755	53 802	56 250	150	1 999	6 784	157 356
(% Eur 15)	5.6	2.4	16.4	34.2	35.8	0.1	1.3	4.2	100
Productivity (hl/ha)	85	51	22	59	65	118	41	27	46
Farms (N°)	41 140	149 740	191 250	181 020	850 280	590	30 350	367 007	1 811 377
(% Eur 15)	2.3	8.3	10.6	10	46.9		1.7	20.2	100
Area/Farms. (ha)	2.5	0.5	6.1	5.0	1.0	1.7	1.6	0.7	1.9

Source: Commission Européene (1998)

In Portugal vineyards play an important role in the national agricultural sector, representing 11.7% of the total number of farms, 5% of agriculturally usable land and 8.8% of the volume of labour (MADRP, 1999). The Portuguese vine is mainly concentrated in small farms (Teixeira, 2001). From the 367,007 farms with vineyards, about half (50,9%) had less than 2 hectares and only 30.4% had more than 5 hectares.

The 116 PWCs provide almost 50% of the total Portuguese wine production (Teixeira, 2001); the majority have their origins in the 1950s and 1960s and were created in a top-down process with substantial technical and financial support from the government. At the time, the support given to the creation of these organisations was justified in terms of the need to reduce wine production costs, maintain the quality of production, solve problems of stocking, and obtain by-products, so that the income of wine co-operative members could increase. That is, given their prevailing economic environment, public entities considered PWCs as the most appropriate form of commercial organisation able to reduce market failures.

Generally speaking, PWCs are micro-firms, employing on average 18 persons (Rebello et al., 2000), with an average of 620 members<sup>2</sup>, each of these with an average vineyard area of 1.6 ha. They are geographically dispersed throughout Portugal, even though a larger number of them are concentrated in areas in which

<sup>2</sup> Of co-operative members, 5% have higher education, 13% secondary education; 70% primary education and 12% are illiterate. Moreover, 46% of these are more than 60 years old, and 12% are less than 40 years old (source: Survey to PWCs).

vineyards historically have played an important economic role, essentially in the oldest Demarcated Wine Regions.

In the long run, PWCs can only survive if they are able to offer additional net benefits, compared to other alternative forms of marketing of grape production (co-ordination with no contract; contract farming or quasi integration; ownership integration; and farm co-operatives, as suggested by Rehber (1998)), namely either the sale of grapes to private sector wine-manufacturing firms, with or without formal contracts, or ownership integration.

Presently, PWCs are competing with the investor owned firms (IOFs). If PWCs are not profitable, i.e., if they are unable to generate, either directly or indirectly, net benefits differentials, relative to those of their competitors, in the long run, they will not survive. In this context, the existence and competitiveness of the PWCs and, consequently, the impact of their performance in the returns of a large number of growers will require, necessarily, an adaptation to the market environment, using efficient strategies. Therefore, in the next section, we will discuss which strategies, from a theoretical point of view, are able to support the existence, in a more and more competitive market, of the agricultural marketing co-operatives as a differentiated type of firm.

### **Economic role and strategies of agricultural co-operatives**

An agricultural co-operative is an organisation usually owned and controlled by agricultural producers, horizontally co-ordinated (constituting a sort of “club”) in order to achieve vertical integration. According to Sexton (1986) because a co-operative projects its members either forward (marketing co-op) or backward (purchasing co-op) in the marketing chain, it accomplishes many of the same purposes as does vertical integration (VI). From the members’ perspective, to explain the co-operatives’ role in a market oriented economy is simultaneously to answer the following questions: (a) Why do farmers want to vertically integrate? (b) Why do farmers want/need to integrate jointly rather than individually?

Assuming that: profit is denoted as  $\pi_i$  for producer  $i$ ; producers are non risk lovers who individually seek to maximise expected utility,  $E[U(\pi_i)]$ , where  $U' > 0$  and  $U'' \leq 0$ ;  $U^*(\{i\})$  and  $U^*(\{j\})$  denote the maximum expected utility for the producers  $i$  and  $j$  under non-integrated state;  $U^0(\{i\})$  and  $U^0(\{j\})$  denote the maximum utility under an individually vertically state. Assuming that utility is continuously transferable between agents, then  $U^0(\{i\} \cup \{j\})$  is the maximum utility attainable by  $i$  and  $j$  through VI.

- If  $U^0(\{i\} \cup \{j\}) > U^0(\{i\}) + U^0(\{j\})$  the benefits to VI are super-additive (super-additivity property), i.e., there are benefits to conducting VI jointly.
- If  $U^0(\{i\} \cup \{j\}) > U^*(\{i\}) + U^*(\{j\})$ , i and j have an incentive to integrate jointly.

The causes of super-additivity (Sexton, 1995) in a marketing co-operative can be formalised and set together, as explained below, in strategies related with returns, security and/or a combination of both (mixed strategies).

Assuming rationality, from a pure microeconomic perspective, a farmer will only join a co-operative if he is offered more economic advantages than those offered by one of the other forms of vertical co-ordination available to the potential member. Becoming a co-operative member involves a decision to both invest in the co-operative's assets and to patronise the co-operative. In contrast, the decision to patronise a non-co-operative firm does not require an investment in its assets. More precisely, it should maximise the present value of its asset-ownership cash flow and the total differential patronage cash flows. For  $m$  identical members (Peterson, 1991) this objective can be expressed as follows<sup>3</sup>:

$$(1) \quad \underset{A, Fc}{\text{Max}} \quad \frac{E[A + m * (Fc - Fn)]}{r}$$

where:  $E(.)$  = the expected value operator;  $A$  = periodic ownership cash flow generated by a co-operative's assets, if these were operated as efficiently as in the non-co-operative firm case;  $Fc$  = periodic ownership cash flow generated by a potential farmer-member asset, if a co-operative is patronised;  $Fn$  = periodic ownership cash flow generated by a potential member's farm asset, if a non-co-operative firm is patronised;  $r$  = the appropriate discount rate.

The objective of maximising the owner's wealth through the maximisation of its present value is similar to that of private firms, except that the sources of cash flows are different. The latter type of firm seeks only to maximise asset ownership cash flows for investors, while co-operatives seek to maximise both asset ownership and differential patronage cash flows.

The main condition for constituting a co-operative is an imperfect or inefficient market. If the market is competitive, information is available and known by all, entry and exit are free and transaction costs are insignificant, and therefore the factors (agricultural products) are remunerated according to their marginal

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<sup>3</sup> To simplify the notation a perpetual cash-flow is assumed.

productivity. In such a market, there would be no source of differential patronage cash flows, i.e.,  $F_c$  is equal to  $F_n$ .

In summary, the starting point for any assessment of the long term economic role of agricultural co-operatives, should be whether or not co-operatives produce a set of net benefits for farmer members at least equal to those produced by other forms of vertical-co-ordination that can also address market failures. As in the case IOFs, the achievement of the mission of the agricultural co-operatives is related to the set of strategies adopted by them.

Depending on whether the objective of these strategies (Peterson, 1991) is enhancing returns, providing security or a combination of both, they can be divided into three groups, as shown in Figure 1. The return enhancing strategies try to change the level of desirable cash-flows in one or more states of nature, while security providing strategies attempt to modify, in a favourable manner, the probability distribution of the states of nature. Both types of strategies can thus improve differential cash-flows ( $F_c - F_n$ ) and all of the strategies arise from attacking inefficiency and market failures.

<b>I. Enhancing Returns</b> Competitive yardstick Improving transaction and agency costs efficiency Serving missing or incomplete markets	<b>II. Providing Security</b> Savings bank Pooling Maintaining the market Conservative investment Diversification Stable end market
<b>III. Mixed Strategies</b> Improved information flow Mixing the cooperative business form with the non-cooperative	

**Figure 1. Potential marketing co-operative strategies**

One of the main reasons to form a marketing co-operative is to remove the external barriers to competition, enhancing the countervailing power of producers relative to input providers and marketing/distribution agents. At the input level, the strategies intend to exercise the competitive yardstick<sup>4</sup>, capturing both the

<sup>4</sup> One of the roles that co-operatives play suggested by Nourse (1922) is that of the competitive yardstick. Staatz (1987: 97) notes that "farmers, faced with unsatisfactory performance by invested-owned firms (IOFs), may form a co-operative firm whose purpose is to force the IOFs, through competition, to improve their services to farmers. In successfully enforcing competition, the co-operative generates benefits that it does

producer and the consumer surpluses, that correspond to the inefficiency costs of a monopsony market, and distributing them among its members, thereby, improving their returns.

The marketing co-operative can also enhance its returns by improving transaction costs efficiency and/or serving missing or incomplete markets. The vertical integration in the form of a co-operative, harmonizing the conflicts between the co-operative firm and its members, may lead to improved information channels, causing a reduction in the transaction costs and therefore increasing production efficiency (Sexton and Iskow, 1993; Staatz, 1984, Staatz, 1987). Otherwise, the fact that in a co-operative the members are, simultaneously, investors and users, facilitates their permanent contact with the management policy, which may result in relatively lower additional costs of the management control, that is, a reduction in the agency costs referred to by Jensen and Meckling (1976).

Sexton and Iskow (1988) suggest that, among other functions, co-operatives also serve markets whose demand is unfulfilled by other firms. In this context, another set of strategies generating additional returns can be identified: that of supplying the goods required by this type of final market and consumer. Shaffer (1987) argues that, compared with what happens in a competitive market, this set of strategies favours co-operatives because it makes communication easier, i.e., required quality criteria are transmitted to farmers in a more accurate and timely manner.

The objective of the strategies of providing security is to alter the probability distribution of future cash-flows. Contrary to enhancing returns strategies, referred above, security providing strategies are linked to specific risk preferences.

To become a member of a co-operative is one of the several alternative investment opportunities available to potential members, with higher returns and lower risk being the main attractions. Due to the specificity of agricultural assets, the model traditionally used to explain the strategy connected with risk is the "Mayers model (1972)", which is an extension of the traditional CAPM (*Capital Asset Pricing Model*). In marketing co-operatives, security may be subdivided thus:

- The co-operative as a saving bank (Sexton and Iskow, 1988), not in the sense that it literally becomes a banker, withholding payments in one period to be returned in another, but in the classic form of this strategy, with the cooperative maintaining buffer stocks for storable commodities and/or balancing plants for perishable goods. For instance, in the latter case, the purpose of this plant is to take off excess supply in "bad" times (high supply

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not capture, but which accrue to the farmers-stockholders, as well to other farmers in the area".



and low prices), keeping prices and farm returns from falling as low as they would otherwise do.

- Pooling arrangements (Cobia, 1987, Sexton, 1995) across several commodities, which allows some risk reduction through commodity diversification in addition to market timing considerations (exclusion of daily price fluctuations). Since daily fluctuation is not an issue with members under pooling arrangements, the co-operative may be able to plan capacity utilization, which may produce economies in processing thus improving total returns to members without penalizing individual members for their harvest timing.
- Maintaining the market is the strategic mirror image of serving missing or incomplete market. The second is an offensive (enhancing return) strategy designed to create new markets, while the first is a defensive (security) strategy to avoid the potential losses of market decline.
- Conservative investment (Cobia, 1987), i.e. to take on only the most certain of assets investments is a pure security strategy.
- Diversification. A co-operative can reduce risk by diversifying its assets with investments or activities outside those normally undertaken simply to serve the patronage of members.
- Stable end market is a strategy of developing a market niche with high and less fluctuating prices. This strategy can in essence be pursued at the same time as a strategy to serve a missing or incomplete market.

The mixed strategies are those that can affect both returns and security. If the co-operative could follow simultaneously both strategies, it would be in the best possible strategic position. It would potentially attract both risk-neutral and risk-averse farmer members and thus have a greater chance for long-term viability. The first mixed strategy arises from a consideration of information. An effort to develop and exploit all possible information could potentially have positive effects both on risk and return. Improved information can feed product innovation efforts, help in monitoring co-operative management, increase cost efficiency and validate members expectations of mutual objectives, reducing and sharing risk.

The second mixed strategy is to combine the co-operative business form with the non-co-operative. For instance, the co-operative procures the raw farm input (securing member markets) and processes the output, while the other part of the business markets the finished product, bearing effectively the risk of searching out new markets and product innovations and increasing returns over the long term.

Having presented the different economic roles of marketing co-operatives and the strategies that are able to contribute to a positive differential net benefit (economic performance) to them, in the next section we will investigate which of these strategies are used by the PWCs and what is their impact on the PWCs economic performance.

## Performance and strategies of the PWCs

### Data

The data collection used in this research took place in 1999, using direct face to face interview techniques, using a previously elaborated and tested questionnaire put to, in general, the chairman of the board of directors<sup>5</sup>. The response rate was 90.5%, corresponding to 105 of the 116 PWCs.

In general, the PWCs did not provide any other relevant services to their members, beyond the transformation of their wine-grape production, and we concluded that, in strictly economic terms, their set of total differential net benefits<sup>6</sup> derives almost entirely from the prices they pay for the grapes ( $Y_i$ )<sup>7</sup>. This raises a fundamental qualitative question, namely “*are the prices paid to the members for the grapes they sell to the co-operative lower, equal or higher than those paid by other firms?*”. The survey shows that 12 (11.4%), 48 (45.7%) and 45 PWCs (42.9%), paid prices that, respectively, were lower<sup>8</sup>, equal to and higher than those

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<sup>5</sup> The information provided by the chairman of the board of directors was informally checked and completed by talking to the PWCs economist and production expert. In general their views corroborated those of the chairman.

<sup>6</sup> For such a study it would be important to obtain quantitative information on both PWCs and private firms; however this is not an easy task, due to the confidentiality of most of the data required. As a result, in our work it was necessary to use proxies, even accepting that this approach has some limitations. We are aware that, from the members' perspective, this approach is a very restricted indicator of the performance of the PWCs, because it is only related with past events, and to some extent, does not take into account the specific positioning of each co-operative in the market and its individual capacity to generate cash-flows. In the case of the private firm admitted to the stock options market the influence of the above mentioned variables is captured by the value of their shares.

<sup>7</sup> In Portugal, as in other European countries, the application of the cooperative laws implies that the benefits of the PWCs are derived from or influenced by decisions related to their net income allocation, equity redemption and the pricing policy of raw material handled. In PWCs the net income is mainly returned as a price adjustment (and partly to unallocated reserves), which was confirmed by the answers to our survey, since 88% of the PWCs interviewed considered the differential price as the most important factor in being/remaining a member.

<sup>8</sup> In the long run, this unfavourable situation can only persist if there were no alternative buyers of vine growers. This statement is reinforced by the results of a simple logit model that shows a positive and statistical significant relation between the probability of the PWCs paying higher prices and the market shares of their private competitors.

paid by competitive firms. That is, PWCs have so far maintained membership levels and, in the long run, will continue so to do, if they can provide a positive differential (i.e. better) cash flow to members.

To test whether PWCs applied the strategies referred to in 3. (above), a set of questions was put to the co-operatives to which they answered yes or no. These questions are summarised in the second column of Table 2.

**Table 2 – Strategies pursued by PWCs**

Specific Strategy	Question of the survey	N° of yes
Competitive yardstick (X <sub>1</sub> )	Transforms the total amount of the grapes produced by the members, so that, individually, they will feel better in the co-operative than outside.	105
Improving transaction costs (X <sub>2</sub> )	Deals with the collection and management of information related with all the activities of the co-operative in order to reduce transaction costs.	17
Serving missing or incomplete markets (X <sub>3</sub> )	Transmits an image of specific quality for the wines produced by the co-operative, so that consumers are able to distinguish between co-operative wines and IOFs wines.	76
Saving banks (X <sub>4</sub> )	Make security stocks so that the annual returns to the members do not change significantly.	43
Pooling (X <sub>5</sub> )	Produces different goods in order to stabilise the returns and prices per harvest.	6
Maintain the market (X <sub>6</sub> )	Invests in declining markets, even the IOFs competitors are pulling out of these markets	0
Conservative investment (X <sub>7</sub> )	Invests only in markets and activities that have perfect knowledge.	0
Diversification (X <sub>8</sub> )	Searches for alternative sources of returns, that is, beyond those strictly related with the activities of the members.	0
Stable end market (X <sub>9</sub> )	Strongly invests in image/brand, selling in markets where demand and prices are stable, that is, in market niches.	18
Consideration of information (X <sub>10</sub> )	Strongly invests in the diffusion of the available information to the co-operative stakeholders, with the objective of improving both the product(s) and the production processes.	9
Mixing the co-operative business with non-co-operative form (X <sub>11</sub> )	Searches for partnerships with IOFs in the transformation and marketing of the products.	10

From the analysis of the answers to these questions we can easily conclude that, from a restricted point of view, PWCs assign more importance to the strategies denominated as enhancing returns, assuming all of them to have a competitive yardstick role, followed by the concern of serving missing or incomplete markets (72% of the PWCs).

In the providing security strategies the emphasis must be placed on “saving banks” (41% of the PWCs) and “stable end markets” (17% of the PWCs) strategies. Those that are related with “maintain the market”, “conservative investment” and “diversification” are not adopted by any co-operative.

As to the mixed strategies designated “consideration of information” and “mixed business”, they are adopted only by 9 and 10 PWCs, respectively.

In summary, despite the difference in the number of answers we can infer that the PWCs adopt a “mix” of returns and security strategies, which is according to the dual nature of their objectives: enhancing returns and providing security to the members. To try to understand the impact of these strategies on the performance of PWCs we used a multinomial logit model, whose results are discussed in the next section.

### **Results**

Due to the nature of the data obtained, in order to analyse the effects of managerial strategies adopted on the economic role of the PWC, a multinomial logit (MNL) was estimated. With regard to the exogenous variables, as a consequence of the number of yes responses, with a concomitant perfect multicollinearity, we decided to exclude the variables  $X_1$ ,  $X_6$ ,  $X_7$  and  $X_8$

The multinomial logit (MNL)<sup>9</sup> is used when the dependent variable takes on more than two discrete outcomes. In this case,  $Y$  assumes values of 0, 1 or 2, if the co-operative pays a lower, equal to or higher amount relative to that paid by non-co-operative firms for the grapes purchased. Multiple equations are estimated jointly in order to make an efficient use of the information available, and the coefficients for each possible outcome are interpreted with respect to a reference group, in this case the co-operatives that paid a lower price for grapes.

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<sup>9</sup> From the very beginning of the interview phase, given the environment under observation, our intention was not to construct an ordered set of discrete outcomes related to the dependent variable, but to compare alternative outcomes, i.e. an unordered set of outcomes. Consequently the MNL was clearly the approach most appropriate to the data set in question. Had, in fact, the dependent variable been constructed on the basis of an ordered choice set, then the approach to be used would have been an ordered (probit or logit) model.

Initially, a regression model was estimated (model 1 in Table 3) including all the exogenous variables already mentioned above. By the analysis of the t-Student, we concluded that the slope parameters associated with the variables classified as the set of strategies designated as “providing security” are individually non-significant. The application of the generalised likelihood-ratio test led us to infer that globally they can be excluded from the regression model (globally, they are not statistically significant at 5%<sup>10</sup>), resulting in the model 2 presented in Table 3.

In both models, the value of the chi-squared (27.54 for model 1 and 20.57 for model 2) provides evidence (at 5% significance level) against the hypothesis that all slope parameters (14 and 8) are equal to zero. However, as the simultaneous exclusion of the variables  $X_4$ ,  $X_5$  and  $X_9$  is not statistically rejected<sup>11</sup> the economic interpretation of the results of model 2 is assumed and provided below.

**Table 3. Regression analysis of the impact of managerial strategies on the performance of PWCs (MNL coefficients)**

Variables	Model 1		Model 2	
	Y=1 (Same prices)	Y=2 (Higher prices)	Y=1 (Same prices)	Y=2 (Higher prices)
Constant	0.693 (1.354)	0.354 (0.587)	0.759 (1.585)	-0.112 (-0.199)
Improving transaction costs ( $X_2$ )	0.502 (0.370)	1.549 (1.168)	0.284 (0.224)	1.237 (1.004)
Serving missing or incomplete markets ( $X_3$ )	1.577* (1.967)	2.061* (2.451)	1.548* (2.133)	2.272* (2.972)
Saving banks ( $X_4$ )	0.318 (0.379)	0.933 (1.096)		
Pooling ( $X_5$ )	29.321 (0.000)	28.482 (0.000)		
Stable end market ( $X_9$ )	-1.061 (-0.808)	-0.016 (-0.013)		
Consideration of information ( $X_{10}$ )	27.951 (0.000)	27.631 (0.000)	27.662 (0.000)	27.762 (0.000)
Mixed co-operative business with non-co-operative form ( $X_{11}$ )	-2.502* (-2.187)	-1.625 (-1.584)	-2.179* (-2.090)	-1.171 (-1.257)
Chi-squared (d.f.)	27.54 (14)		20.57 (8)	
Significance level	0.016		0.008	
Log likelihood function	-87.96		-91.44	

<sup>10</sup> An opposite result was attained in the case of the variables related with the mixed strategy.

<sup>11</sup> The adoption of security strategies, that reduce risk, seems not to have any impact on the economic performance of the PWCs, since the relative probability of paying their grape prices equal to or higher than those offered by IOFs is not influenced by the variables that defined those strategies.

As usual, for each event, the MNL coefficients in Table 5 indicate the impact of each independent variable on the probability of each event with respect to the baseline case (i.e. the payment of a lower price), and are interpreted as the odds ratio  $\ln(P_{ij}/P_{i0}) = \beta'_j X_i$  (Greene, 1993).

The sign and significance of the parameters associated to the variables related with the use of the enhancing returns strategies indicates a positive impact on the performance of PWCs, with a special emphasis on the variable serving missing or incomplete market, since the coefficient of the variable improving transaction costs, although positive, is not statistically significant. These results show that the creation of an image of quality for the co-operative products is relevant for the relative probability of the PWCs to pay their members a price equal to or higher than that paid by competing non-co-operative firms. Thus, from an initial orientation of favouring the strategies of product maximisation and cost efficiency, PWCs are now paying special attention to demand, i.e., to market conditions, producing goods able to satisfy consumer demand.

The parameter associated with “mixing the co-operative business with non-co-operative form” shows clearly that the relative probability of the PWCs paying prices that are equal to (coefficient negative and significant) or higher than (coefficient negative but not significant) than those paid by the competing private firm is negatively related to the adoption of this strategy. These results confirm what we detected during the inquiry phase, i.e., the PWCs that applied this strategy were the ones facing additional difficulties in marketing their wines consequently they set lower prices, with the inherent reduction in the returns to their members.

### **Final remarks**

Agricultural marketing co-operatives develop their activity in environments that are becoming more and more competitive, where their survival and economic competitiveness depends, ultimately, on the adoption of management strategies able to generate economic benefits that will convince members to stay in the co-operative.

Economically, if farmers have different alternatives to market their agricultural products, they will only patronise a co-operative organisation if it is able to provide a differential net benefit at least similar to that of non-co-operative forms. Theoretically, to achieve this goal, the management of agricultural co-operatives has a myriad strategies that can be grouped in enhancing returns, providing security and/or a mixing of both.

Based on the information collected from an elaborated questionnaire, questioning in general the chairman of the boards of directors of 105 PWCs, the objectives of this paper were: first, do PWCs see themselves producing a set of benefits for producer-members which is different from those offered by non-co-operatives, and

what are the sources; second, are PWCs predominately oriented toward producing returns, providing security or a mix of both; third, what is the influence of these managerial strategies on the performance of PWCs?

In general, the PWCs did not provide other relevant services to their members, beyond the transformation of their wine-grape production: their set of differential benefits derives almost entirely from the prices paid for the grapes. Among the different available strategies, PWCs prefer the enhancing returns strategies, assuming that all of them have a competitive yardstick role, followed by a concern to serve missing or incomplete markets. From the set of strategies of providing security the primary importance goes to that of the saving bank, based on the constitution of buffer stocks, in order to stabilise the annual returns of the wine-growers.

For the observed technology (products and productive processes), the results of the MNL show that PWCs can increase the probability of improving their relative performance, in terms of net benefits provided to their members, through the increasing service to missing or incomplete markets and by reducing the mixed business with non-co-operative forms.

Co-operatives are complex units, as far as decision-making processes and control are concerned, where members play a crucial role. In fact, Fulton (1995) and Cook (1995) claim that the increasing heterogeneity and individualism among farmers represents perhaps the greatest threat to future co-operative growth. In this context, a better perception of such a complex problem clearly requires additional research in areas such as: (1) the definition and testing of indicators other than that of differential cash-flows adopted in this paper, as proxies for performance in the evaluation of different co-operative managerial strategies, with research relying much more on scaled, rather than on categorical, responses; (2) a complementary examination of the factors that contribute to co-operative membership and patronage, linking this question to problems associated with the structure, conduct and performance of co-operative business, i.e., opportunities (e.g. easy vertical coordination), external (market self correction) and internal (e.g., difficulty in defining benefits, variety of risk preferences, adverse selection, moral hazard, free-riders) limits and special tactics in order to reach a specific strategy ; and (3) the need for a coherent and rigorous specification and measurement of the value of the externalities generated by PWCs.

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## STRATEGIC ALTERNATIVES IN THE PROFESSIONALIZATION IN THE OLIVE-OIL COOPERATIVE

**Elia García Martí, Manuel Aranda Ogayar**

### **Introduction**

The olive-oil cooperative is a type of cooperative society which transforms the product of its partners (olives) into olive-oil, and sells this oil in the market. Like other cooperative society, the partners fix the objectives and delegate in the board (a group of partner elected in the general assembly) the capacity to manage the olive-oil cooperative to fulfil the partners objectives.

In the cooperative society, the partners are those who establish the objectives, who start the productive process, who agglutinate factors, etc. (García-Gutiérrez, 1992), and it is the management of the organization the one that guides the company, coordinates the different individuals or groups and makes decisions for the securing of its objectives (Cuervo,1993).

At the moment, there are several circumstances that condition the situation in which we find the management of any organization. One of them is the growth, because the number of decisions, the activity to develop and the coordination necessity and control are hugely multiplied. Such a complexity demands to manage the company keeping in mind these circumstances.

The board don't have any time and don't have a group of knowledge which are necessarily to manage the olive-oil cooperative in the market. Besides, this board don't receive any remuneration to do this function so they don't effort to learn to make it better. For this reason, this type of enterprise needs a professional manager to survive in the market.

So, it is necessary to rely on professionals for the positions of responsibility. This way, the need for professionalization appears in the olive-oil cooperative. So, the changes of the competitive environment, the complexity of the commercial systems, the decrease of the different mechanisms of incentives, the lack of specific knowledge of the members of the board reinforce the need for relying on management professionals to manage and negotiate these changes.

Under these circumstances, the company should fill the key positions with professionals that assume the responsibility in the management of the company towards the objectives established by the partners, as the ability to make decisions within the different managerial flows. This way, the separation takes place among partner's function that established the objectives of the company in the general

assemblies and in the board and the management-administration function, developed as any other job position, by people qualified to work in it. This situation will give place to the appearance of problems in the organization as a consequence of the separation of the property and the management in the company.

In this situation, we imply that professionalization may become one of the factors that contributes to meet the necessity of the olive-oil cooperative to maintain and to improve its competitive position in the market, because it allows an appropriate organizational renovation of its people, an adaptation of its culture and systems to the requirements of the environment and the introduction of people with specific qualities for the management of the organisation. The professionalization can contribute this way to reach this important purpose of the company because the maintenance of the competitive position of the company in the market is one of the main objectives of the olive-oil cooperative.

This reality means that the transition towards a professional administration can be studied from an agency perspective, due to the existent similarity among the problems derived of the separation between property and control that have been studied in depth in the agency theory, although, undoubtedly, differential aspects exist in the olive-oil cooperative and they necessarily have an effect on providing the situation with specific features.

The problems which the agency perspective is applied to are, evidently, much older than itself. The agency theory tries to offer an explanatory framework of the organizational behaviour, when understanding these as the common link of a group of contractual relationships which are established among different agents with different individual interests that often enter in conflict with those of the organization, becoming this a stimulus so that they may behave in a not very appropriate way with the form and content of the relationship, main objective of the contract. This way, we identify in the cooperative societies multiple agency relationships in which the figures of the principal and the agent are assumed indistinctly by the partners that integrate them (García, 2002). Therefore, each one of these members will assume the role of principal and/or agent in the relationships, base of the behaviour of the organizations, as far as they act as partners, as members of the board or as a manager.

The agency theory has shown a special interest for the relationship that appears among the owners of the company and the managers that run it. The first articles about agency studied this question. This way, Jensen and Meckling (1976) analyse the structure of property of the big corporations and conclude that the surrender of actions to the managers makes equal the interests of both collectives, diminishing this way the agency problem. On the other hand, Fama and Jensen (1983) try to

describe the role that the board plays as an information mechanism that is used by the shareholders to try to limit the opportunist behaviour of the high executives.

Certainly, literature is scarce devoted to analyse the professionalization in the olive-oil cooperative society (Hansmann, 1996; García, 2002), although it is more extensive the one that highlights the necessity of it (Juliá, 1993; Barea & Monzón, 1996; Olea, 1996; Bel, 1997; Fuentes, 1999), trying to justify the necessity of the professionalization of the management as a means of maintenance of the competitive position of the organization. In this sense, we consider necessary to have a bearing on the professionals of these companies and establish a suitable profile of people that can occupy the directive positions in the olive-oil cooperative.

As a consequence, this work tries to show the different ways that olive-oil cooperatives have for being professionalization, the reasons that take them to prefer one or another, like the professionalization of the partners, as well as the repercussions that this decision means for the maintenance of the competitiveness of the olive-oil cooperative.

### **The professionalization in the olive-oil cooperative**

It must be described what is understood as professionalization in the olive-oil cooperative, delimiting its concept and defining the professional role in this type of organization. Starting from the establishment of these conceptual premises we will advance asking ourselves about the alternatives that the cooperative society has to integrate professionals in the company management.

In a general consideration, we understand professionalization of the company as the disposition of managers and competent managers, well-organized and an effective management system (García-Gutiérrez, 1993). Following Schein (1968), we will highlight different criteria that define the management professionals, and they are: a) their actions are guided by principles and general and independent propositions; b) they are expert in the field of the management and know the customer necessities, and their behaviour must be rational and objective towards them; c) they reach their position depending on their abilities in the company; d) they belong to professionals' voluntary associations. This way, we won't consider professional's managers those who only have knowledge in finance, production, accountancy, organization, human resources... and don't fulfill the suitable features established previously.

This way, it can be understood the role of the management professionals as the individuals who, gathering the requirements stated by Schein, guide and order the behaviour of the company, subordinating those performances to the structure of power, which in the case of the olive-oil cooperative is in the partners.

So, professional management is introduced in the olive-oil cooperative to improve the organization effectiveness. When applying the knowledge of the Administration Science, olive-oil cooperatives are helped in order to obtain competitive advantages. So we tend to base the taking of decisions on the logical and rational analysis rather than on the intuition, as it happens in non-professionalized companies or in their first stages.

But professionalization may mean problems for the cooperative society, problems derived from the differences among the cultural values and the objectives pursued by the partners and the professional managers. A question is in relation with the professional managers had improved or have put obstacles in the effectiveness of the organizations (Arrivas & López, 1989). This way, we show several problems. Problems to understand the human behaviour, problems derived from the vision that professionals of the management have in the olive-oil cooperative in a shorter term. Besides, there are problems between partners and professional managers when they analyse the situations, as well as in their relationship.

These problems in the professionalization in the olive-oil cooperative have different intensity degree, depending on the chosen alternative to integrate professionals in the management. This is due to the possibility that these professionals possess a personality and some abilities more or less adapted to the features of the olive-oil cooperative, and it will mean a different alignment with their objectives. So, there will be professional managers more motivated to lead to the company, to the mission and the objectives of the organisation and they can achieve a more appropriate balance between the internal characteristics of the company and the necessity of the organizational change. This is a very important consideration, because the problem of the professionalization will delimit if the olive-oil cooperative will continue maintaining and improving its competitive position in the market.

In this sense, we can establish some basic alternatives to the olive-oil cooperative to introduce professional managers in the organization. We follow the proposal that Dyer (1989) offers to the professionalization of the family company that could also be applied to the olive-oil cooperative. This way, professionalization can be carried out in three different ways: a) to choose professionals managers in the external labour market; b) to professionalize the employees of the company who occupy non-directive positions and; c) to professionalize the members of the olive-oil cooperative, that is any partner.

The first alternative is a permanent possibility for all the companies, and in the olive-oil cooperative it can be one of the options that mean more tension within the organization, when introducing new values and behaviours that can be far from its peculiar organizational culture. As a consequence of it, when carrying out the

separation between the property and the management of the company, informative asymmetries and interests' conflict base of the agency problem could appear.

The second alternative consists in offering non partners employees an appropriate training and some abilities, which they can develop when the company needs them in management positions. This option would moderate somehow the agency problem that may appear in the organization, because these individuals have been working in the company for a long time. They know and have assumed the cooperative values and culture, which is the base of the behaviour of this type of companies, restricting the appearance of informative asymmetries and conflicts of interests among the members of the organization.

The third, the professionalization of any partner, is a specific alternative of the cooperative society that can allow the continuity of the cooperative values and its strategic focus. Also, it is the one that means smaller resistance among the rest of the partners, due to the identity of objectives pursued by both parts. This alternative will be studied next in more detail.

Starting from these considerations we can conclude with the following statement:

Statement 1: The olive-oil cooperative has an additional alternative to establish its professionalization process, the professionalization of its partners.

### **Keys for the professionalization decision**

It would be interesting to know which of the three possible proceedings to professionalize the olive-oil cooperative is the most appropriate. There are different reasons to think that the olive-oil cooperatives would opt for the second or third alternatives, particularly for this last one, that is, for the incorporation of qualified partners to occupy directive positions in the company, before allowing the entrance in the organization of external people to it that don't share the same cooperative spirit, base of the cooperative culture. The election of this alternative would be based on the cultural likeness and in the objectives pursued by the partners.

From the exterior of the cooperative societies, it generally has the idea that the best way of introducing more professional rules in the administration is the incorporation of managers with the appropriate abilities who don't work for the company before, who change the way of administering the company and, solving, this way, its loss of competitive position and improving its expectations of future benefits.

However, the vision of the problem that the partners have is completely different. For them, merely economic reasons, as maintaining a level of wealth or guaranteeing the economic stability of the partners, are almost as important as

those related to the possibility of offering the members of the organization the chance of control their own life with a high grade of autonomy, favouring the perpetuity of cooperative values and culture. The incorporation of managers who don't work for the company can be helpful to reach the objectives of economic nature, but it doesn't necessarily have to do with the continuity in the cooperative culture.

Nevertheless, this is not the only reason that justifies such a rejection. Frequently, the olive-oil cooperatives face the material impossibility of hiring management professionals, because in the olive-oil cooperative, the scale of their work restricts the performance that can be obtained from them. This means that the managers' possibilities are very limited; they quickly reach high hierarchical positions and not have therefore, future promotion possibilities that mean a motivational element in the manager's behaviour. So, other types of solutions are tried to look for.

The management of the olive-oil cooperative is aware of the fact that, in some cases, the competitive advantage of the company is dependent on the features of the cooperative culture, in which the individual is put before the capital, granting each partner a vote when making decisions, independently on the capital that he is contributed to the organization or which is the volume of his activity in the olive-oil cooperative. As far as an abrupt change in the administration can mean putting the capital before the individual, the characteristics of the cooperative culture may become threatened and, therefore, its continuity in time. Consequently, unless the situation of the company is really serious and urgent performances are needed, other professionalization proceedings will be preferred instead of the incorporation of management professionals who don't work before for the organization.

The incorporation to the management positions of non-partners employees that have developed their work in inferior positions of the organizational hierarchy during a period of time, we think this is a better option than the previous one. In fact, the characteristics of the problems derived from the costs of vigilance of this option seem smaller than in the case of the incorporation of an individual who doesn't work before for the organization, due to the knowledge that one has previously of the individual. Experienced professionals in the company have the advantage of knowing it, as well as they have a stronger grade of adhesion to the managerial project. It is normal that in the olive-oil cooperatives, the social character of the organization means the assimilation of a series of values that determine its behaviour. This reality, together with the deep knowledge of the non-partners employees of the olive-oil cooperative on the part of the partners, could end up transforming employees into appropriate candidates for more responsibility positions.

Following García (2002), the experience gathered through the analysis of different cases of olive-oil cooperatives shows us that this alternative is successful, although

there are some exceptions. The reasons of these exceptions that could explain this situation refer, from the point of view of the partners, to the lack of the workers' preparation to occupy management positions and the partners don't want to lose the power in the organization, so they try to place the partner as head of it, instead of a worker of the olive-oil cooperative. Other valid arguments that mean an exception to this possibility of professionalization in the olive-oil cooperative are the persistence of the agency problem in the organization, although this one could be mitigated by the assimilation of cooperative culture by the workers. Also, we have been able to check that, in many cases, the reason that justifies the promotion of non-partners employees, to the highest positions in the hierarchy, is to avoid the power vacuum that would take place in these positions during the transition stage from a partner to the following one.

Due to all of it, the incorporation of partners can be an appropriate way to professionalize the olive-oil cooperatives. On the other hand, when deepening in the process of the partners' professionalization, we usually find elements like the following ones: implication and participation in the company since young, academic formation and professional experience in other companies.

Generally, the participation in the company since young and the grade of the partners' implication is not the only element considered in the remaining professionalization options, that means a way of differentiation of the two previous options. With this behaviour, the pursued purpose is usually to wake some interest up and the partners' descendants' affection for the olive-oil cooperative that means securing the continuity of it following its culture. In this sense, García (2002), points out that in order to increase the efficiency in case of professionalization of the company through their partners, the children should be implied and participate in the olive-oil cooperative since young.

It is also necessary to keep in mind the desirable academic formation for the partners. Only those partners who had any university degree, together with specific knowledge on the sector, could carry out the management of the olive-oil cooperative, if we consider the requirements established by Schein (1968) that were kept in mind at the beginning of this work. However, another option that could be contemplated would be the partners' incorporation to management positions, so that they may learn as they work as managers of the organization. This way of carrying out the professionalization in the olive-oil cooperative could be valid, although it is not contemplated in the requirements established previously by Schein, like base of the characteristics of a manager.

Lastly, the partners' labour experience in other companies has as its main objective that future management carries out practice in business management in other type of companies, sharing the excellences and the problems of other managerial cultures and facilitating the acquisition of a bigger awareness of reality



in unknown activity sectors. One of the reasons that can be added as a base that justifies the benefits of the possible future manager partners' labour experience is the widening of the managerial vision these people could enjoy, beyond the ability to work and the group of knowledge accumulated in the olive-oil cooperative.

From what was said in the last paragraphs, we can conclude that in the professionalization of the partners there is a union of elements which are difficult to find in any other of the two other options outlined previously. Also, the reason of its election can be in the added value that this option contributes to the olive-oil cooperative. It all allows us to think about a second statement.

Statement 2: The olive-oil cooperatives prefer to tend to professionalize the partners to cover their management positions.

### **The professionalization of the partners and the continuity of the olive-oil cooperative**

The option of this professionalization alternative is not casual, but it reflects the priorities of the partners when presenting the professionalization process. As it has already been pointed out, the selection of this alternative strongly mitigates the intensity of the agency conflict, when eliminating the problem derived of the separation between property and control, which join together in the partner's figure. If the partners have the abilities and knowledge to carry out their work efficiently and they have followed a socialization process in the organization, developing an attachment feeling to the olive-oil cooperative, their election to occupy the management can be the most appropriate.

Nevertheless, it is possible to think that the wish of the partners to maintain the spirit and the cooperative culture is one of the basic reasons for their election to professionalize the olive-oil cooperative. This way contributed to strengthen the bonds among the partners, and they see that one of them, who are the head of the organization, is defending their interests and rights. This way, the necessity arises of planning in a detailed way the process of change in the management, because the maintenance of the spirit and culture of the company will depend on the success or failure in that change of the management. So, we have been able to observe that the olive-oil cooperatives don't try to contract external people, while the selection tests between the partners and partners' children offer positive results.

Therefore, in the professionalization in the management in the olive-oil cooperative the partners will use any strategy, to guarantee the maintenance of the cultural characteristics of the company. This way, the professionalization of the partners seems, to a certain extent, an appropriate measure to reach this objective. That's why many of the partners show the importance of their own professionalization to maintain intact the cooperative culture. This position allows us to enunciate the third statement.

Statement 3: The professionalization of the partners contributes firmly to maintenance the cooperative culture in time.

Up to now, we have showed the positive aspects of the partners' professionalization for the continuity of the cooperative culture within the olive-oil cooperative. But we haven't to forget that this process can bear negative consequences. In the first place, when dealing with reduced olive-oil cooperatives, some partners with specific knowledge and professional experience in other companies, can hardly be satisfied their aspirations, in case they decided to incorporate to the management of the cooperative society, so they wouldn't possibly accept.

Also, if we decided that partners were incorporated to the management of the olive-oil cooperative, we would find some more problems in this process. For example, the president or some of the members of the board decided not to give the manager power to decide, because they are afraid of losing their own power. Some authors, as Hansmann (1996), show the difficulty that exists in many boards of directors that refuse to delegate that power to the new manager, blocking the possibly successful transition towards the professionalized management of the organization. This author points at the following reasons to avoid the change and the surrender of capacity of decision and power:

- The convenience of waiting for the incorporation of partners in the management, until the members of the board have done some performance that may solve the problems of the olive-oil cooperative.
- The members of the board of directors don't take into account the possible partners, which could carry out the management of the cooperative society, are prepared enough for it.
- The strong belief that they (the members of the board) are appropriately prepared to undertake actions that improve the competitive position of the company.

These situations are the ones that sometimes favour certain problems between the members of the board and the manager. So, in many cases these individuals left their position disappointed by the limited usefulness that they find in it, as well as for the loss of power they have suffered when having to delegate some functions on the manager. Also, they try to watch over closely to the new management to try to show to the rest of the social base, any of the problems that may arise with the manager's work. They try to demonstrate that the management carried out by this individual are not good and they should return to the old way of organizational management. As a consequence we enunciate the fourth statement.

Statement 4: The professionalization of the partners can become a negative element for the olive-oil cooperative, due to the longings of power of the board, or to the attitude of it.

## Conclusions

Once we have shown the necessity to professionalize the management of the olive-oil cooperative to facilitate its competitiveness, we have tried to show the different possibilities that this process could adopt in the olive-oil cooperative keeping in mind the specific characteristics of this type of companies, as well as the particularities of their members.

This way, the partners' professionalization means for the olive-oil cooperative an additional possibility to cover its management positions. This possibility is also used by this organization in a preferable way, due to the implications that the conjunction of elements that coincide in it for the maintenance of the cooperative culture has. Nevertheless, in some circumstances this type of profesionalization can clash with the longings of power and the attitude of the members of the board of directors, contrary to the loss of power that means to delegate in the manager the administration of the organization.

Likewise, as far as the nature of this work is concerned, we have proposed some indications related to the professionalization in the olive-oil cooperative that could serve as base for future investigations like complement to this work. Although we have started from the conceptual mark of the agency theory, because we think that it explains the problems that professionalization introduces in the olive-oil cooperatives appropriately, we should not forget other focuses that supplemented the agency vision, like Davis et. alt. (1997) with the "Stewardship Theory" tries to provide a complementary explanatory framework to the agency theory when incorporating a non economic treatment in its arguments. On the other hand, it would be appropriate to analyze these problems using other theories or focuses like the most recent advances in the field of management of knowledge.

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## COOPERATIVE CULTURE AND OLIVE OIL COOPERATIVES EFFICIENCY

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### **Introduction**

From the moment a group of people decides to set up a cooperative business, certain rules must be followed which will shape the way the new enterprise works as well as how the members will behave within the enterprise they jointly run.

If the behaviour of these members is not in line with the type of behaviour associated with the members of a cooperative, or the cooperative business is not run following the cooperative model, we can't say that cooperativism fails, but that, in practice, this company's or these peoples' performance do not correspond to cooperative values. These cooperatives could be considered cooperatives in theory but not in practice<sup>1</sup>.

These days, we can't consider striving for the democratic participation of members, their training or their information to be an error, even more so when other types of capitalist companies that search for "business excellence", try to provoke participation in decision making amongst their own workers, suppliers and customers, considering this to be a source of competitive advantage.

In a paper which analyzed the characteristics of the best managed companies in the United States Peters and Waterman (1989, p. 271) underlined the following: "people must be treated as adults, as members; with dignity; with respect. The members, and not investment or automation, must be treated as the main source of the increase in productivity. These are the main lessons learnt from our research on outstanding companies". From this statement we can appreciate the importance of people over capital, which is one of the key features which characterize cooperative companies.

Nowadays, we believe that the cooperative formulae is a valid path for any group of entrepreneurs to follow in setting up a business. We must take the cooperative business for what it is, a company, with a characteristic way of running (based on cooperative values and principles), which, if put into practice correctly, will allow

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<sup>1</sup> See García-Gutiérrez (1995, p 53-87).

it to achieve what other companies try to gain from participation, that is, “greater efficiency” (Mozas, 1999, p. 123).

In this paper we intend to empirically demonstrate the previous statement. More specifically, we set out to see if cooperative culture implies better business results. In order to do this the relationship between the level of fulfillment of cooperative values and the level of business efficiency reached is analyzed. The sequence followed in the development of the paper is as follows: firstly, we describe the theoretical framework of the previously mentioned phenomenon; secondly, the methodology used is described; in third place, we describe the results achieved for a sample of 75 cooperative olive oil mills in the province of Jaén (Spain), the greatest olive oil production area worldwide, and; finally, we present our conclusions.

### **Theoretical Background**

Culture is a set of values and expectations shared by the members of an organization. These values and beliefs produce rules of conduct (norms) which very much shape the behaviour of individuals and groups within the organization, and distinguish them from other structures. Culture characterizes the set of traditional ways and capacity to think, feel, decide and react when an organization is faced with threats and opportunities (Leal, 1986, p. 191-192). Likewise, Schein (1985, p. 23-24) defines culture as “a model of basic suppositions -invented, discovered or developed by a given group as it learns to face external adaptation and internal integration problems-, which have had sufficient influence to be considered valid and, consequently, be presented to the members as the correct way to perceive, think about and feel these problems”.

In short, business culture, understood as we have stated in the previous quotes, that is to say, as a set of shared values, as an organizational management philosophy, should have a considerable influence on business results. However, in the literature studied, we have not found sufficient empirical evidence that assures the existence of a clear relationship between culture and business yields, although we can see a certain positive correlation between both magnitudes (Kotter and Heskett, 1995).

Although the influence of culture on business results should appear in any type of organization, it would do so much more clearly in cooperatives given that they are institutions whose management, in theory, must comply with a series of values and common principles (cooperative culture). Something quite different is how cooperatives interpret those values and principles. Aranzadi (1989, p. 173) upholds that, when talking about principles and cooperative doctrine, cooperativism shouldn't be considered to be out of date but should be proud of the fact that it implies a philosophy which should necessarily be taken advantage of.

To sum up, the cooperative company is a business, in so far as it carries out economic activities and competes in a goods and services market, but it is different from other companies because it adopts cooperative principles imposed by the International Cooperative Alliance (Vara, 1985, p. 69). Like Briganti (1991, p. 178-179), we uphold that cooperative companies have their own particular ways of surviving and the use of these methods will result in greater efficiency.

The values that the ICA defines as the essence of cooperativism are self-help, self-responsibility, democracy, equality, equity and solidarity, and, what's more, it underlines the ethical obligation of the members to conserve the values set by the founders of this type of organization, making reference to openness, social responsibility and caring<sup>2</sup> (ICA, 1995).

Each value or set of values is revealed through cooperative principles. The principles currently in force<sup>3</sup> and their relationship with values appear in Table 1.

**TABLE 1**  
**CO-OPERATIVE PRINCIPLES AND VALUES**

Co-operative principles	Values
Principle of voluntary and open membership	Equality
Principle of democratic member control	Democracy, Equality
Principle of member economic participation	Equity
Principle of autonomy and independence	Self-help, Democracy
Principle of education, training and information	Self-responsibility, Honesty
Principle of co-operation among cooperatives	Self-help, Solidarity
Principle of concern for community	Solidarity

Source: Adaptation of Vargas (1995, p.181).

The fundamental value underlined in cooperative companies is democracy. Vargas (1995, p.180), on justifying this value, states that currently democracy is an irrefutable value that characterizes developed society and is found at many levels (political, educational, judicial, etc). Cooperatives “accompany history” (Aranzadi,

<sup>2</sup> With the modification of principles in the ICA Congress in Manchester together with the promulgation of the values they imply, many publications have been made. In this sense, see Paz, 1995; Martínez, 1995; Monzón, 1995; García-Gutiérrez, 1995; Lejarriaga, 1995; Bakaikoa, 1996; Juliá and Gallego, 2000.

<sup>3</sup> Apart from the seven principles which encompass cooperative values, there are another four called underlying principles. They have not been specified by the ICA, but they have accompanied the cooperative ideology from the beginning, and are perhaps the most shared and widely spread principles amongst its members. They are namely the mutualistic, non-profit making, homogeneity and subsidiarity principles (Carrasco, 1993, p. 34-37).

1989, p. 176) given that they imitate and copy the way in which decisions are made in the political world in which they move.

To be more precise, the incorporation of democratic member control principles and the economic participation of members in cooperatives, has lead them to be considered inefficient. However, there is a line of thinking to the contrary, which is based on the idiosyncrasy of the values with which cooperatives define themselves, that states that they can reach business excellence<sup>4</sup>, from the cooperative culture perspective or approach and based on the argument of its influence on company results.

In this sense, as Kilmann points out (1988, p. 8), “the success of an industry and business does not only depend on the capacity of an executive, or on the visible characteristics of an organization -strategy, structure and payment systems. The organization itself has an invisible quality- a certain style, character, way of doing things- that can be more powerful than the dictates of any one individual or formal system. In order to understand the soul of the organization, we must look deeper into the organisms, regulations, machinery and buildings until we reach the underground world of corporative culture”.

In this paper we intend to make progress in this line of research, assuming that the fulfillment of cooperative principles should suppose an improvement in business efficiency. In this way, we consider the possibility of filling a gap in the literature on olive oil production cooperativism given that the previously mentioned relationship has yet to be analyzed.

## **Method**

### ***Sample***

To carry out this study we have used information obtained from two data bases. The first was product of an empirical study on organizational aspects made amongst olive oil producing cooperatives in the province of Jaén in 1996. A hundred and sixty-two surveys were carried out using personal interviews with the President of the cooperative. After sifting through the surveys, 159 were found to be valid.

The second data base contains economic-financial information on 85 olive oil producing cooperative companies in the province of Jaén in 1995. This information was gathered through personal interviews with the Presidents of the cooperatives who agreed to collaborate by making available the annual accounts for the campaign 1994-1995.

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<sup>4</sup> See, in this sense, Vargas, Grávalos and Marín (1994, p.1053-1064), Vargas (1995, p.182-183) and Rodrigo (1995, p. 44-53).



Combining the information from both data bases, we went on to eliminate those olive oil mills that did not appear in both, leaving a total valid sample of 75 cooperatives<sup>5</sup>, which is 40.76% of the olive oil mill cooperatives existing in 1996 in the province of Jaén.

### ***Variables***

#### **Endogenous variable**

In economic literature there is a great disparity of criteria in reference to the measurement of business efficiency. The degree of efficiency is generally identified by the return on both equity and on investment (Calvo and González, 1999). Other authors assess efficiency on the basis of the productivity produced by asset management (Server and Melián, 1999).

Based on what we have previously mentioned, we have used the following efficiency indicators: return on investment (ROI)<sup>6</sup>, paid price to members, capital turnover (total sales/equity capital), total sales/personnel costs and average productivity as a gross added value/olive oil sales.

#### **Explanatory variables**

As we pointed out in the theoretical background, we are going to use the cooperative principles which characterize cooperative culture as determinants of business efficiency. We will now go on to explain with which variables we have calculated the degree of fulfillment of each of the principles analyzed:

- The principle of voluntary and open membership has been measured in terms of whether the cooperative allows the members to freely choose to become part of the cooperative or not.
- The principle of democratic member control has been measured through the percentage of members assisting and participating in the general meetings, as well as those members who ask for information about the cooperative or are interested in its management<sup>7</sup>.
- The principle of member economic participation is measured through the member's loyalty to the cooperative, using a dichotomic variable which shows

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<sup>5</sup> The maximum sampling error is 8.9% for  $p=q=0.05$  and a level of confidence of 95.5%.

<sup>6</sup> The normal practice within olive oil production cooperativism to pay the members according to the gross margin criterion (Domingo and Loma-Ossorio, 1991) means that the analysis of this return loses interest, since this criterion implies a non-existing surplus or takes into account the adjustment deviations in the paid price to members. For this reason we believe it is necessary to include the paid price to members as a measurement of efficiency.

<sup>7</sup> The original variables used to measure these two principles were not of a dichotomic nature, for which reason we had to convert them.

- if the olive oil mill is aware of the members who participate or not in the cooperative.
- The principle of education, training and information has been measured using a dichotomic variable that shows if training programmes have or not been carried out in the cooperative .
- The principle of cooperation among cooperatives has been measured using a dichotomic variable that shows if the cooperative in question is or is not integrated in another of a second or superior level.
- The principle of autonomy and independence and the principle of concern for community have not been analyzed, given that in accordance with the objectives set in this paper, both these principles are less related to business results. More specifically, the principle of autonomy and independence is fulfilled by all the olive oil mill cooperatives in the sample, as all the members are olive oil producers and amongst them there are not seen to be any collaborating members or associate (Mozas, 1999).

### ***Analysis***

With the aim of determining if there are any behaviour patterns which differ in the degree of fulfillment of the cooperative principles amongst olive oil mill cooperatives in the province of Jaén, and in order to identify their characteristics, the methodology chosen is based on the application of several analysis cluster algorithms<sup>8</sup>. We have considered the obtained groups to be consistent given that the same groups are formed when using different algorithms.

Table 2 shows the three groups obtained, ordered hierarchically in terms of the degree of fulfillment of each of the cooperative principles analyzed.

<b>COOPERATIVE PRINCIPLES</b>	<b>GROUP 1</b>	<b>GROUP 2</b>	<b>GROUP 3</b>
Principle of voluntary and open membership	1°	3°	2°
Principle of democratic member control	2°	1°	3°
Principle of member economic participation	No differences		
Principle of autonomy and independence	Not analyzed		
Principle of education, training and information	2°	3°	1°
Principle of co-operation among cooperatives	2°	3°	1°
Principle of concern for community	Not analyzed		

Source: drawn up by us.

<sup>8</sup> More specifically, we have used ascendant hierarchical methods, as well as the Ward algorithm recommended by Punj and Stewart (1983), both provided by the SPSS statistical package.

With reference to the principle of member economic participation, measured through the degree of members' loyalty/disloyalty, low levels of exclusivity have been discovered in the three groups. That is to say, all the cooperatives are aware of the fact that an important percentage of their members do not work exclusively with their cooperative. For that reason, this principle has been of little use to us in characterizing the differences existing between each of the groups.

Moving on to describe the basic characteristics of each group, we can see that group 1 is more directed towards the fulfillment of the principle of voluntary and open membership. This principle has been measured by taking into account if there is any restriction on the entry of new members or not. The results show that the greatest tendency towards the free entry of new members occurs in the cooperatives integrated in group 1.

The second group of cooperatives is more directed towards the fulfillment of the principle of democratic member control. This principle is the golden rule of cooperative ideology and is based on the fact that the decisions taken in the cooperative company are made with the participation of all the members in the departments established to that end (general meeting of members). In this group we have discovered the highest percentage of members that attend general meetings, that participate more actively by putting forward ideas and offering solutions, that ask for most information on the evolution of the cooperative and, lastly, that show most interest in its running.

The third group is directed towards the fulfillment of the principle of cooperation among cooperatives and the principle of education, training and information. Thus, regarding the first principle, this group presents the highest index of cooperatives that belong to an entity of second or superior level. With reference to the principle of education, training and information, this group also presents the highest percentage of cooperatives that programme training activities.

Having formed these groups, and in order to determine the influence exerted by cooperative principles on business efficiency, a variance analysis was carried out.

## **Results**

The following Tables show the correlations existing between the efficiency variables for each of the groups analyzed, although high correlations have not been found.

**TABLE 3  
CORRELATIONS OF EFFICIENCY MEASUREMENTS FOR GROUP 1**

Variables	ROI	Paid price to members	<u>Total Sales</u> Equity capital	<u>Total Sales</u> Personnel Costs
ROI				
Paid price to members	0.217			
<u>Total Sales</u> Equity capital	0.433 (*)	0.248		
<u>Total Sales</u> Personnel Costs	0.095	0.106	0.518 (**)	
<u>Gross Added Value</u> Olive Oil Sales	- 0.71	- 0.011	- 0.090	- 0.414 (*)

(\*\*) Correlation is significant at 0,01.  
(\*) Correlation is significant at 0,05.

**TABLE 4  
CORRELATIONS OF EFFICIENCY MEASUREMENTS FOR GROUP 2**

Variables	ROI	Paid price to members	<u>Total Sales</u> Equity capital	<u>Total Sales</u> Personnel Costs
ROI				
Paid price to members	0.085			
<u>Total Sales</u> Equity capital	0.748 (**)	0.207		
<u>Total Sales</u> Personnel Costs	0.070	0.108	0.539 (*)	
<u>Gross Added Value</u> Olive Oil Sales	- 0.228	- 0.297	- 0.297	- 0.471 (*)

(\*\*) Correlation is significant at 0,01.  
(\*) Correlation is significant at 0,05.

**TABLE 5  
CORRELATIONS OF EFFICIENCY MEASUREMENTS FOR GROUP 3**

Variables	ROI	Paid price to members	<u>Total Sales</u> Equity capital	<u>Total Sales</u> Personnel Costs
ROI				
Paid price to members	0.377 (*)			
<u>Total Sales</u> Equity capital	0.429 (*)	- 0.236		
<u>Total Sales</u> Personnel Costs	0.422 (*)	- 0.127	0.295	
<u>Gross Added Value</u> Olive Oil Sales	- 0.151	0.333	- 0.252	- 0.253

(\*\*) Correlation is significant at 0,01.  
(\*) Correlation is significant at 0,05.

Table 6 shows the results of the statistical tests made to determine the existence of significant differences in efficiency in terms of the group to which each cooperative belongs.

**TABLE 6**  
**STATISTICAL TESTS AND AVERAGES BY GROUP**

<b>EFFICIENCY MEASUREMENT</b>	<b>GROUP 1</b>	<b>GROUP 2</b>	<b>GROUP 3</b>	<b>Significant statistical differences</b>
ROI	1.18	1.68	1.20	No
Paid price to members	95.90	93.06	92.7	No
<u>Total Sales</u>	3.6	4.56	4.54	No
Equity capital				
<u>Total Sales</u>	43.27	56.61	39.29	No
Personnel Costs				
<u>Gross Added Value</u>	0.97	1.60	1.11	No
Olive Oil Sales				

The test made shows that there are no significant statistical differences in efficiency levels between the groups of olive oil mill cooperatives in terms of the degree of fulfillment of cooperative principles.

### **Conclusions**

In this paper we have been able to confirm the existence of three groups of cooperatives in terms of the cooperative principles that they consider most important for their internal management. The first group stands out for the greater implantation of the principle of voluntary and open membership; the second is more directed towards the principle of democratic member control; while the third group is directed towards the principles of cooperation and training, education and information.

With reference to the objective set in this paper, namely to determine if the cooperative culture generates better business results, from Table 6 we can deduce that there are no significant differences between the levels of efficiency of these groups.

However, it should be pointed out that no group totally fulfills the set of cooperative principles that should govern the way they are run. For that reason, we can't confirm that the cooperative culture, measured through the fulfillment of all the cooperative principles, has no influence on business efficiency. On the other hand, we have discovered different cultures in each group, due to the fulfillment of different principles in each one, and it has been proved that these differences do not lead to differences in efficiency.

In this sense, the total fulfillment of just one cooperative principle, or, two at very best, does not allow us to identify the culture of these organizations with cooperative culture. Therefore, in the case that cooperative culture should lead to better business results, it is clear that the groups identified are not taking full

advantage of it. In our opinion, the causes that provoke this situation could be determined by the unfulfillment of any of the cooperative principles or any group of them: lack of loyalty by the members, lack of interest in training, lack of commitment of the members in cooperative management, lack of commitment in intercooperation, etc.

In short, in this paper we take on the previously mentioned theory that efficiency goes hand in hand with the application of cooperative principles. In this sense, we recommend cooperativists to assume the running characteristics that consolidate them as cooperatives, that is to say, cooperative principles.

In the future, we intend to apply the DEA methodology (Data Envelopment Analysis) to estimate business efficiency and compare the results with those achieved in this paper. Likewise, we think it would be convenient to introduce the time-factor perspective to analyze the influence of the cooperative culture on efficiency, that is to say, see how efficiency measurements evolve through time in relation to the fulfillment of cooperative principles. In fact, the analysis of just one year could be marred if we are dealing with an atypical campaign. On the other hand, we should also take into account that many of the effects derived from the fulfillment of cooperative principles are obtained over a long period of time.

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***Part VII. Women and tourism  
co-operatives***

## **WOMEN'S CO-OPERATIVES IN GREECE. AN ON-GOING STORY OF BATTLES, SUCCESSES AND PROBLEMS**

**Olga Iakovidou, Stavriani Koutsou, Nicolas Gotsinas**

### **Introduction**

In the context of endogenous development, which begins in the social space in which it takes place and is based on local resources (Daoutopoulos, 1995), given that the main goal of the agricultural policy was to mobilize the local resources and population, farmwomen obtained an important role. Women were a significant labour force in reserve, and had skills in promoting and mobilizing the endogenous resources, supporting the initiatives aimed to preserve and promote the cultural heritage and traditional culture, and increasing heterogeneity in the rural areas (Gidarakou, 1999). New employment opportunities were created in various fields for rural women. Their main features were time flexibility, part-time work and flexibility (Schauer, 1993, Little and Austin, 1996, Bock, 1999). The fact that rural women undertook extra-agricultural activities was an emerging phenomenon in Europe (Ventura, 1994; Bock 1994; Gidarakou, 1999). The main fields of activity were a) agro-tourism b) the handicraft / home handicraft production and trade of cultural products and c) the production and trade of products of alternative forms of agriculture. A common characteristic of these activities was that they were all part of the housewife's duties and were, therefore, familiar to farmwomen (Garcia-Ramon et al., 1995, Iakovidou, 2002). At the same time, women participate in the manufacture of a diversified agro-tourist product, which could create sustainable forms of employment in the countryside, increase their income and have a multiplying impact on the mobilization of other sectors of the local economy and society.

Empirical research that was carried out in Greece (Iakovidou and Turner 1995, Iakovidou, 1997, Gidarakou, 1999, Gidarakou et al. 2000, Iakovidou, 2002) showed that the farmwomen who were involved in extra-agricultural activities preferred working in a team or a community because in this way they felt stronger. Most probably, this was due to their personal constraint and to the fact that they had to take on responsibilities. However, the main cause was the provisions of the rural policy about women's awareness on employment (Gidarakou, 1999). In Greece, for example, the agents involved in the promotion of rural tourism urged women, mostly through funding, to establish new co-operatives or participate in existing ones rather than to establish personal units (Iakovidou 1992, Tsartas & Thanopoulou, 1994, Gidarakou, 1999). Besides, farmwomen's presence and

participation in collective units and mainly to mixed co-operatives was relatively limited (Drossopoulou, 1989, Tsartas & Thanopoulou, 1994) mostly because of women's perception about the role of the two sexes (Tsartas & Thanopoulou, 1994).

### **Women's co-operatives in Greece**

The history of women's co-operatives in Greece dates back from the 50s and began with an initiative of the Ministry of Agriculture (the first women's co-operative was founded in 1957 in the region of Grevena). Women's co-operatives aimed at increasing their family income and upgrading their social status. Nevertheless, they did not succeed in making their presence felt because the priorities of the agricultural policy, at the time, were the increase of productivity and the modernization of the traditional agriculture. In the meantime, some co-operatives suspended business, new ones were set-up and, by the mid-80s, there were only about 10 left (Gidakou, 1999).

In the 80s, the raise of awareness of the European Union, on matters of equality between the two sexes in the rural space was achieved thanks to the efforts to raise awareness and mobilize women in the countryside through vocational training on the creation of small enterprises. The saturation of the existing tourist model, the increased raise of awareness of the population on environmental issues and the natural beauties of the country created very favourable prospects for extra-agricultural activities within the framework of the rural tourism. Within this framework, the first women's co-operatives of the country were established thanks to an initiative of the General Secretariat of Equality General Secretariat of Equality of the Ministry of the Interior, Public Administration and Decentralization.<sup>1</sup>

The first co-operative was set-up in 1983 and started operating some time later. In the following year (1984), no co-operative was established while, in 1985, there was an "outbreak", since six women's co-operatives were established by the Equality Council (predecessor of the General Secretariat of Equality) and the Ministry of Agriculture. Another two were established in 1986 and a third one in 1987. Then followed 3 years of inertia while, from 1991 onwards, new co-operatives were gradually established. In the two last years (2000, 2001), there has been an "outbreak" of new co-operatives, which amount to 28. These new co-operatives were established with the help of other bodies, such as PASEGES, the Prefectural and Local Self-Government and, Local Action Group which hoped that

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<sup>1</sup> This is the authority responsible for promoting and guaranteeing the legal and substantial equality of opportunities and the equal treatment of men and women in "all sectors of economic and social life".

women's co-operatives would give a solution to the pressing problem of female unemployment and would keep the young girls in the countryside. The total number of the co-operatives reached 99 in the end of 2001.

The ideology of the new co-operatives does not differ significantly from that of the old ones. It consists of the fact that these co-operatives are not considered as co-operative businesses in a country with a long tradition in mass, organized tourism but as tools for change of the farmwomen's status or as collective action centres for women (Tsartas and Thanopoulou, 1994).

Besides, their aim, as it was mentioned by Laiou-Antoniou (1985), was "to ensure the economic self-reliance of Greek farmwomen, as a first step towards their social liberalization". Emphasis was therefore laid on women's economic self-reliance rather than to the creation of a second source of income for rural families and the promotion of local characteristics, which are the main aims of agro-tourism.

The initiative of the GSE consisting of promoting women's co-operatives was based on the following conclusions (Iakovidou, 1992):

1. The participation rate of women from rural areas in social economy institutions (i.g. co-operatives, associations etc) was low,
2. It was easier for women to participate in women's co-operatives than in mixed ones,
3. In spite of their active participation in agricultural activities, women did not have a personal income,

Then, mainly in the early 90s, many agents (Ministry of Agriculture, PASEGES, Development Agencies) took advantage of the EU programs to raise awareness of the rural women and urge them to establish purely agro-tourist and agro-industrial co-operatives, specialized in the production of a wide range of traditional and cultural products. However, in most cases, the efforts of these agents were limited to organizing training seminars for women or providing assistance during the establishment of a co-operative and did not foresee further support and promotion. Besides, if we examine the evolution of women's agro-tourist and agro-industrial co-operatives, we see that these agents' attitude (such as GSE, Ministry of Agriculture, PASEGES, ATE) towards them was very often ambiguous and variable. More specifically, because of the policy priorities of these agents, the results of their interventions were not widely felt. And because of the change in its leadership, the GSE sometimes showed a great interest to women's co-operatives and sometimes it ignored them. The policy of the Ministry of Agriculture (which was expressed mainly through the Division of Agricultural Domestic Economy) also had to deal with the change of point of view (some times conscious) of its successive leaderships. The transformation of the Division of Agricultural Domestic Economy into a Department, which is underway, even symbolically, is indicative of this situation. Such elements can be found in other

agents' policies. A similar policy aiming at supporting women's co-operatives can also be implemented by the Regional, Prefectural and Local authorities even though in this case the local character, the "outcry" that may arise against their negative attitude, and the need for support that will guarantee their re-election (since very often women's co-operatives, even if they do not realize it, represent a significant electorate) do not let the authorities ignore them, let alone facing them in a negative way.

However, in any case (both in the case of the GSE during the 80s and the other agents later on), the choice of mobilizing women by means of co-operatives was successful, because, on an individual basis, a woman's participation in a co-operative implied lower part of responsibility, smaller investment and, thus, lower economic and personal risk than the establishment of a personal enterprise. Therefore, women's mobilization was easier.

Initially, women's co-operatives in our country were, both in theory and practice, modern and strong elements in the creation of new structures in the rural space. Then, the local development institutions went through a period of economic and social stagnation, which was mostly due to the lack of support from the competent agents and especially those launching the agro-tourist programs in our country. The State agents considered this type of co-operatives, within the framework of short-term programs, more as an opportunity to receive EU funds rather than an element of local development. In addition, while, initially, some of them fully supported the co-operatives, then they withdrew their support completely, unexpectedly and at an inopportune time while the structures required for ensuring the self-reliance had not yet been established. (Apostolopoulos and Giagou, 1998).

In other words, women's co-operatives were not considered within the framework of a strategy aimed to the development of agro-tourism in the country, that would imply firstly, planning the raise awareness and mobilization of the rural world, secondly, contributing to the establishment of co-operatives and thirdly, providing support and encouragement to co-operatives at least at the beginning of their operation.

The co-operatives that survived and were developed owed their success to one of more of the following factors:

- They had a nucleus of women, who were particularly active and had leading skills, (i.e. Ayios Germanos, Petra, Ayios Antonios, Poroia).
- There was a local agent that encouraged and supported their efforts actively, (i.e. Tyhero, N.Zihni).
- They used the bottom-up approach for their establishment.

Although most of the co-operatives were funded by national or EU programs, very few of them managed to overcome their problems and the state subsidy

“syndrome” and promote their activities dynamically, which would enable them to finance them. (Tsartas and Thanopoulou, 1994).

Today, there are 99 women’s co-operatives. Most of them were established as agricultural co-operatives with special end, according to the Law on Agricultural Co-operatives (L.1257/82 and especially L.1541/85), while others according to the legal regime governing the Urban Co-operatives (L.1667/86, as modified by Art. 27 of L.2166/93). In March 2000, the new Law on Co-operatives (L.2810/2000), which provides for the establishment and operation of the Agricultural Co-operatives, was laid down. It must be pointed out that the agricultural co-operative is the form of enterprise that was chosen by most women because of the tax incentives it offered and the support provided to the agricultural co-operatives by the Ministry of Agriculture, PASEGES and, recently, the Union of Agro-tourist, Handicraft and Home handicraft Co-operatives in Greece, founded in May 1999.

The form of the urban co-operative was chosen, either because of women’s lack of information or because the establishment process of an agricultural co-operative, as provided for by the previous Law on Co-operatives was longer (it required the consent of PASEGES and the Ministry of Agriculture). The counter-incentive for the small communities was the number of members required for the creation of a co-operative (20 members and exceptionally 15). The new Law on Agricultural Co-operatives put an end to these problems because the agro-tourist and agro-industrial co-operatives were classed as agricultural activities and the minimum number of members was set to 7.

Most of the co-operatives were founded during the 90s due to the EU and national programs that were implemented after the 90s (LEADER, NOW, National Organization of Employment etc.).

According to the data of the General Secretariat of Equality, Ministry of Agriculture and PASEGES, 28 out of the 71 co-operatives that reported their field of activity worked in the production of traditional foodstuffs (conserves, jams, frumenty, pasta etc.), 8 in the production of traditional foodstuffs as well as the manufacture of handicrafts, 11 provided accommodation services, 3 catering, 13 worked in the manufacture of traditional garments and carpet manufacturing and the rest, in other fields of activity (pottery, floriculture, restaurants etc.).

As far as their geographical distribution is concerned, 19 were situated in Macedonia, 16 in Thessaly, 15 on the Aegean islands, 12 in Crete, 11 in Thrace, 10 in Epirus, 10 in the rest Sterea and Euboea and 2 in the Peloponnese, Ionian islands and the Region of the capital. The Prefecture of Magnessia and Lesvos, had the highest concentration of women’s co-operatives (10 in each Prefecture) followed by the Prefecture of Evros (8), Heraklion (7), Euboea (6), Florina (5) and Chania (5). It is worth noting that in 16 Prefectures of the country there are not any women’s co-operatives.

### **The main results of the fieldwork**

The members of the 40 co-operatives, which participated in the research that was carried out in February 2000, amounted to 1184. Therefore, there was a small difference compared to the 1190 founding members. The average number of members per co-operative was 30, with a maximum number of 120 members and a minimum number of 15 members. Most of the co-operatives had 15-30 members, according to the Law that was in force at the time of their establishment and set the minimum number of members to 20 (and exceptionally 15). Only three of them exceeded by far the average number of members. Precisely, the co-operative of Tihero in Evros which had 120 members, the one of Kissamos in Chania, also with 120 members and the one of Zagora in Pelion with 90 members. Given that recently the number of the members of the co-operatives has decreased while the number of the co-operatives has increased, we presume that neither does this form of enterprises go through a crisis nor has it lost its prestige.

Some of the following data concerning the problems, expectations and relations of the co-operatives with the local society and agents help us examine this presumption.

Out of the 40 co-operatives that were questioned, the first one was set-up in 1983, followed by another six that were set-up by the end of the '80s. The remaining 38 were set-up in the '90s while the 22 of them in the 3 last years. Among the 40 co-operatives, 31 (69%) are agricultural and 14 (31%) are urban. 28 of them produce traditional food products (while at the same time 8 of them also produce handicraft products), 7 produce handicraft products and 5 are purely agro-tourist co-operatives and rent guest houses or rooms belonging to their members thus providing accommodation and breakfast to the visitors. If we add to this last category the 6 co-operatives that did not participate in the research but do provide accommodation to visitors, we draw the conclusion that the purely agro-tourist co-operatives have a total capacity of 300 rooms or 650 beds in total. It must be stressed that these co-operatives are scattered throughout the country, going from Nestorio, Agios Germanos, Psarades and Leptokaria in Macedonia, Ampelakia, Almyro, and the villages of Pelion in Thessaly to Perahora of Ithaca, Petra of Lesvos and Gavalohori in Crete.

The rather high cost of investment required for the agro-tourist accommodation, the high maintenance and operation costs and the policy of the competent bodies on the new licences apparently discourage co-operatives to work in this field. Therefore, most of women's co-operatives do what their members know better, that is production of food and/or handicraft products, which does not require big investments.

As for the agro-industrial co-operatives, we see that the production of handicraft or home handicraft products usually takes place in the houses of the members rather than in laboratories, which causes problems related to the quantity and quality of the products. Certainly, laboratories are not always necessary (ex. in the case of hand-woven products), but in the case of the co-operatives that produce food products, the lack of laboratories makes it impossible to ensure quality control, homogeneity of the products, stable quality, and thus the promotion of the products. Nevertheless, things have been changing recently since more and more co-operatives have been setting-up laboratories (ex. Co-operatives of Zagora, N. Zihni etc.)

Among the food products, the conserves and jams hold the first place and are followed by the aromatic plants and herbs and different kinds of pasta. Women were familiar with the production of such products and turned it into a bread-winning job. However, in their effort to satisfy the needs of the consumers for low-calorie products while preserving the traditional methods of production (preservatives free), women's co-operatives faced various problems related to the preservation, quality and promotion of their products.

With regard to the labour force of the co-operatives, the research revealed that most co-operatives covered their needs with their members. Only 7 of them employed permanent staff (usually a secretary) and 4 of them assigned their account books to accountants. None of them employed qualified employees that would be in charge of their organization, management and marketing even though they recognized the need for a better organization and a more effective promotion of their products. The main reason for the lack of qualified personnel was the limited financial resources of the co-operatives.

The problems facing the women are related to the production, organization and management of their co-operatives, promotion and advertising of their products and services and capital raising.

As far as the production problems are concerned, according to more than half of the co-operatives (21), these are due to the lack of laboratories, warehouses, mechanical equipment, knowledge in production matters, quality control and insurance, as well as to maintenance problems.

According to 22 co-operatives, the most serious organizational and management problems of the co-operatives are due to the misallocation of duties among the members and the lack of a secretary and a qualified accountant - tax consultant. It is a common belief that the allocation of duties among the members may lead to clashes and conflicts among them. Besides, many accountants - tax consultants who work for co-operatives are not familiar with the tax regime governing the agricultural co-operatives, which affects them reversely as they cannot take



advantage of it. A more detailed analysis of the answers indicated that all co-operatives face organizational problems regardless of their years of existence and that the agro-industrial co-operatives face more problems than the agro-tourist ones.

However, the problem facing 70% of the co-operatives is related to the marketing of products and services. The incapacity of the co-operatives to promote and advertise their products and services is a serious problem and may be due to the low capital and the lack of specialized knowledge required rather than to the fact that women downgrade this factor.

The fact that the market of the co-operatives is limited is indicative of this problem. Most often, the co-operatives sell their products within their facilities. In very few cases the shops of the area or the nearest urban centre agree to promote the products of the co-operatives or to sell them wholesale to merchants who standardize and distribute them. This is not only due to the inexistent, insufficient or ineffective promotion policy or the incapacity of the co-operatives to find new markets, but also to the low production rate. Yet 26 out of the 40 co-operatives that participated in the research answered that they can increase their production with their existing equipment and members provided that there is an increase of the demand. However, 55% of them stated that they are in no position to widen their market not only because they do not have the adequate personnel but also because they do not have the necessary experience in finding new markets.

Anyway, most of the co-operatives do make efforts to advertise their products that are usually sponsored by local agents.

30 out of 40 co-operatives stated that they advertise their products by means of brochures or through the local media, while 25 of them said that they participate in national or local exhibitions where they distribute their brochures. The lack of a high capital and a marketing plan makes it very difficult for them to launch a regular advertising campaign which would anyway require a higher capacity to increase the production in order to respond to a potential increase of the demand.

It must be stressed that women's co-operatives are also present on the Internet thanks to initiatives of public or private agents. They are also advertised on the pages of the ArIsti network, which was created within the framework of the EU initiative NOW and funded by the European Union, Ministry of Labour and Social Security and General Secretariat of Equality.

A serious problem for most co-operatives is the lack of capital for investments or for guaranteeing the floating capitals. Given the low co-operative parts and the small number of members, the total capital available can only cover few activities.

Even though many co-operatives have received financial aid from various local, national and EU agents, very few of them made good use of them.

According to the same research, 44% of the co-operatives took advantage of EU programs (Integrated Mediterranean Programs, Leader etc.) while 50% of them resorted to national ones (National Organization of Employment, EOMMEX, Ministry of Labour). In many cases, the available capital could not even cover the participation costs of such programs. On the other hand, the research showed that only 6% of the co-operatives resorted to loans from financial institutions. Women's negative attitude towards loans shows either that they lack business spirit or that they are uncertain about this business activity.

It is obvious that the low capital resources of most co-operatives and the cautious attitude of their members towards loans make it difficult for them to plan future activities and/or improve their operation.

Very often, the aforementioned problems cause clashes and conflicts among the members of the co-operatives, which, in turn, result in malfunctions. 17 co-operatives admitted having faced similar problems and believed that, in many cases, this is what led their members to indifference and inertia. It must be stressed, however, that many women-members are fully aware of these problems and try to find solutions. They believe that training can be of great help in solving these problems. More than half of them (56%) were trained in the last three years but, stated that, very often, their training programs (which were organized by public and, in most cases, private educational institutions) were too vague and fell short of their expectations and real needs. They also said that they would rather be trained in the other fields: 31 of them would like to be trained in organizational matters, 27 in management, 27 in marketing, 22 in production methods, 19 standardization and 14 in packaging methods. These answers express, to a great extent, their worry about the current organization and management of their co-operatives, and the fear when being in contact with the market. However, women believe that they need training even in production matters, which they know better than anyone else. More specifically, they believe that they need training in quality and maintenance matters. Furthermore, they do not feel ready enough to face the aforesaid problems, which, according to them, are the reason for the malfunction of their co-operatives.

In this context, the GSE suggested to create the "Connection Network", an assistance and support body, which will, *inter alia*, launch a common advertising campaign, create a distribution and sales system, provide consulting services, offer to women an on-going training on specific technical, organizational and management issues, promote and standardize "best practice models", establish exhibition centres in the large urban centres etc.

## **Conclusions**

More likely, women's co-operatives in Greece are a business model that inspires farmwomen, Prefectural and Local Self-government and other bodies involved in the development of the countryside. These bodies consider women's co-operatives as a tool for promoting local development and presenting to the female rural population new employment challenges that exist mainly in the agro-tourist sector.

The collective business initiatives undertaken by farmwomen and the evolution of women's co-operatives, in the last few years, are indicative of high dynamism. However, the problems that have arisen during the operation of these co-operatives lead to the conclusion that great efforts are necessary in order that women consider these co-operatives as businesses that can operate, survive and grow in a competitive environment. In an economic background with highly competitive conditions, the co-operatives must operate as businesses. This implies a business spirit, which, in practice, means search for new development potential (national or EU programs, favourable loan conditions etc). The lack of business spirit that characterizes the members of the co-operatives may be due to their lack of experience and knowledge or to the fact that, very often, co-operatives are their second occupation. Therefore, women do not spend enough time and "money" on them. Besides, the fact that many co-operatives were established thanks to the funds of national or EU programs shows that it is very difficult for them to overcome the state subsidy "syndrome" and undertake dynamically the promotion of their activities that would enable them to finance them.

Consequently, co-operatives must, on the one hand, offer products or services that meet the high standards set by the particularly demanding consumers and, on the other, promote these products or services to a highly competitive market. Still, most women are not ready for this. Most of the numerous training seminars that were held by public or private institutions took place before the establishment of the co-operatives and confined themselves to informing women, local societies and agents about agro-tourism and the co-operatives movement. As a result, they did not provide women the necessary knowledge on the management of the co-operatives and other technical issues related to the production and distribution of their products. Moreover, in very few cases, training programs for women were organized after the establishment of co-operatives. As a result, women now face serious problems and are in no position to satisfy the needs of the market.

Apart from the financial problems and lack of know-how, women's co-operatives face another problem related to the distribution of their products. That is why, women must focus on finding favourable measures that will facilitate the entrance of their co-operatives to the domestic and foreign market. Nevertheless, women alone cannot satisfy the requirements implying special knowledge as well as

planning and technical skills. On the other hand, co-operatives alone cannot hire qualified personnel in order to achieve their goals. Therefore, it is necessary to establish an institutional or an assistance service.

Of course, the fact that women work in the production of local products or in the hospitality field does not create new work positions. However, to run an agrotourist unit (whether it is a co-operative or not), apart from the knowledge of the production methods, women need other knowledge and skills in such fields as management, marketing etc. This combination of skills creates in the rural space a new profession which to date was totally unknown to women. Yet turning this occupation into a profession does not only require good knowledge of the production methods, good will and high-quality products but also a high capital and other skills that most women in the countryside do not have. That is where, most likely, lies their incapacity to overcome the problems they face already at the beginning of operation of their co-operatives.

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# **RURAL COOPERATIVES AND TOURISM: POTENTIALS AND LIMITATIONS**

**Yair Levi**

## **Introduction**

Rural tourism fulfils an important role in a policy that seeks employment beyond the traditional notion of 'work'. A distinction has to be made between mass tourism as part of a consumerist society, and tourism as a vehicle for the diffusion of cultural and environmental values in rural areas. Our session aims to stimulate discussion about recent trends in rural tourism cooperatives, mainly – though not exclusively – controlled by women. Based on a number of case studies, we aim to analyze the interplay of the cooperative component and a type of ecotourism or 'nature oriented' tourism that transcends the limits of conventional tourism centered on the mere supply of lodging, food, buying and entertainment services. Both cooperatives, in their not-for-profit orientation and ecotourism, in its quest for nonconsumptive resources and policies of decommodification that subordinate economic value and ends to social and cultural considerations, depend on qualitative criteria to assess their performance. How do they interact? What are the potentials and the limitations of such an interaction?

## **Cooperative tourism: setting the frame**

A value judgement with regard to tourism is current even before one enters the specific cooperative domain: we are used to distinguish between 'mass tourism' and 'ecotourism', the first referring to indiscriminate large numbers of visitors who may damage the ecological balance of local – mainly rural – areas, and the second aiming to counter, or mitigate, the effects that conventional or mass-based tourism may have on the environment.

Ecotourism has been defined as:

Purposeful travel to natural areas to understand the culture and natural history of the environment; taking care not to alter the integrity of the ecosystem; producing economic opportunities that make the conservation of natural resources beneficial to local people.

(Koch, 1994)

The notion of 'cooperative tourism' covers a wide range of activities spanning two quantitative vs qualitative poles: on the one hand - cooperatives as a means of pooling resources among suppliers of tourist services with a view to achieving

economies of scale and increased rentability.<sup>1</sup> On the other hand - cooperatives as a means to empower marginal areas, to enhance the image of the community in the eyes of both locals and visitors, to train and educate towards a new kind of 'environmental tourism' as a combination of new sources of revenue and the valorization of natural and cultural resources. Similar differing views can be embodied, on the one hand, by an externally induced business approach, and, on the other hand, an approach that sees tourism as a joint effort, by local and external protagonists, to adapt available natural, cultural and socio-economic endowments to new openings. In brief, since tourism is inseparable from nature, a difference between action *on* nature, as distinct from action *with* nature.

Cooperative tourism, by definition, implies the commitment to a specific value content, whose aim would be to justify a 'cooperative difference'. If we endorse the view that the special identity of cooperatives rests on such values as a not-for-profit orientation; the subordination of economic to social considerations in decision-making and in a possible distribution of surpluses to members and/or stakeholders; and extending the benefits of mutuality from the restricted realm of membership to broader community and social contexts, then we may appreciate how an ecotourism, or otherwise qualitative, approach to the issue of tourism, can match the particular character of cooperation as a blend of association and enterprise.

So, we may assume a kind of 'noblesse oblige' assumption (to mean that 'ranks bring responsibility') that puts on cooperatives a special commitment towards meta-economic goals in any discourse about tourism.

### **A review of case studies**

Distinguishing between mass and ecotourism would be beyond the scope of this article. So, we assume that the difference is sufficiently clear to limit our analysis to a distinction between eco and agri/agro tourism, on the one hand, and between the macro and the micro level where each case takes place, on the other. Although the notion of 'ecotourism' seems to resist that of 'mass tourism' we may safely assume that the notions of 'agro/agri tourism' do not necessarily coincide with that of 'mass tourism'. By agri/agro the distinction is made between services provided at the household and at the village-community level, respectively (Iakovidou, 2002).

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<sup>1</sup> In early 2001, a co-op of tourism entities in the Williamsburg, VA, area joined to introduce the Williamsburg Flex, a vacation package that allows the partners to pool their resources in a coordinated effort to increase revenue and market the Williamsburg area as a major vacation destination (...) with the introduction of the Flex, guests average lodging stay rose from 4.2 nights to 4.38 in 2001. (Copyright VNU e Media, Inc. Mar 25, 2002).

Our cases include three instances of ecotourism (Italy, Peru and Mexico) and two cases of agri/agro tourism (Greece and Israel).

	Ecotourism	Agri/agro tourism
<b>The macro level</b>	1. Italy	4. Greece
<b>The micro level</b>	2. Peru; 3. Mexico	5. Israel

### 1. Italy

Under the label 'Cooperation in Naturalistic Tourism' the Italians (Caldelli, 2001) provide a comprehensive portrayal of a movement that they identify with ecotourism, aimed at combining leisure time, environmental preservation and sustainable economic growth in rural and alpine areas, national parks and sea resorts. In 1999 there were in Italy 236 cooperatives operating in the domain of naturalistic tourism, of which 111 in the South, 75 in the North and 50 in the Centre. Their main areas of activities were:

- the management of sites of historic-cultural interest (mainly archeological) adjacent to urban areas;
- the management of hostels and refuges in naturalistic sites;
- the provision of services of guide and escort for excursion with a strong environmental component (trekking, canoe, mountain bike, rock climbing);
- the provision of services of environmental education, both indoor and outdoor, coupled with a stay in sites of particular interest for specific issues, like natural parks and reserves;
- the planning and offer of touristic packages such as 'green sojourns' and special bicycle and riding itineraries and tours to discover areas of particular ecological interest.

These cooperatives are small-sized (an average of 23 members) and with relatively medium turnovers (a yearly average of 500-600 million IT LIRE). The smallest ones offer services of accompaniment (48 in number) and are of recent establishment. On the whole, the establishment of these cooperatives was evenly spread along the past twenty years. All the cooperatives maintain close contacts with public bodies dealing with environmental issues, yet tend to develop their own clientele. They are particularly attentive to the need to build a distinct profile vis à vis a growing number of organization claiming for 'environmental correctness'. Areas of future integration include biological handicrafts and agriculture and the 'social economy', to prevent the 'ghettoization' of disadvantaged people like elders and disabled.



## 2. Peru

The island of Taquile on the lake Titicaca, Peru, underwent an exceptionally rapid change within a period of a few years. In 1976 it was still an unspoiled place, largely unknown to outsiders. The distance from the port of Puno to the island was too long to be afforded by the then available wooden sailboats. In 1978, newly established sailboat cooperatives dropped the travel time from Puno to Taquile from twelve to three-and-on-half hours. By 1982 the number of cooperative transport groups had raised to thirteen and the round-trip fare set by the authorities was \$ 4.00. In 1978 sixty-eight families were authorized by local authorities to take in overnight foreign guests. Between January and August 1982 5,300 tourists visited Taquila, most of the visitors staying for two or three days. By the end of the 1980s there were seven restaurants operating on the spot and two fishing cooperatives of twenty and fifty members. Community-run artisan stores and committees organize the production and sale of local crafts and locally woven textiles. The Taquilenos advertise their weavings by proudly wearing them and organized a museum to preserve and display their older textiles. While the women produce food and take care of the household, the men assiduously weave day and night.

On the whole, the isolation of Taquile and its 'unspoiled' authenticity have helped the islanders to develop their skills while preventing outside entrepreneurs from controlling the local economy. Revenues from the new touristic activities help Taquila to overcome the difficulties of periodic droughts that afflict the *altiplano*. The experience of Taquila has taught that tourism, even of a certain size, needs not necessarily to be controlled by outsiders and be culturally destructive and that, in this regard, cooperatives can be a vital success factor. This, however, does not remove the threat of commodification :

Tourists with clicking cameras congregate at all major rituals and religious festivals. Community life continues, seemingly stronger than ever – but at what point do the rituals and fiestas become simply spectacles for tourists? When does the community become merely a stage?

( Healy and Zorn, 1988)

## 3. Mexico

A combination of women based membership, ecotourism and ecological awareness typifies the initiative of more than 200 women from six different rural Mexican communities in the state of Puebla who, in 1987 founded a cooperative named "Indigenous women working together". In addition to the hotel, the cooperative manages a health food store, a greenhouse for medicinal plants, a traditional craft store and workshops for the production of recycled paper and biodegradable cleaning products. The ecological character of the project manifests

itself in the hotel's reforestation project, its sustainable agriculture programs and the way the cooperative can overcome times of crisis due to bad harvests or the collapse of coffee prices. The importance of women's self organization is sustained in a variety of workshops and training sessions by a movement called Comaletzin, operating in several villages (Freeman, 2002).

#### **4. Greece**

Rural women's cooperatives seem capable to act in response to economic and cultural challenges posed by tourism at a time of globalization. From a perspective of gender policy, they can provide alternatives to an economic model biased towards a men-urban-production paradigm. Rural women's cooperatives in Greece have developed along such activities as renting rooms to tourists and the production of home-industry and handicraft articles. From an inspection of three articles that appeared on the *Journal of Rural Cooperation* in the years 1996, 2000, and 2002, a number of limitations and potentials emerge. Prominent among the first are a top-down approach to cooperative formation, shortage of adequate educational and training facilities, problems of marketing of local produce and – of particular concern – the pessimism as regards the readiness of the new generation daughters to continue the role of their mothers. These limitations, though, seem to be balanced by such factors as the willingness of women to work in groups, their favorable approach towards fulfilling new specific roles in the family and the community, and their capability to combine participation in household and income generating activities, in turn combining entrepreneurial and cultural elements (Giagou and Apostopoulos, 1996; Gidarakou and Thephilidou, 2000; Iakovidou, 2002; see mainly the papers of this session).

An assessment of Greek women's rural cooperatives published in 1991 suggested that:

Women in rural areas of mass tourism need to be more aware of autonomous alternatives opened to them and, perhaps more importantly, women's peripherality needs to be taken more seriously. This would give women the opportunity of voicing their discontent concerning the social effect of tourism on them.

(Castelberg-Kouma, 1991)

As far as we can judge, the protagonists of the Greek rural cooperatives have shown to be able to rise to the challenge.

#### **5. Israel**

'The study examines tourism in Kibbutz Gvanim in the Galilee, where tourism is a major source of income. It investigates the relations between tourism and the community from the perspective of the community members, as well as the place

of tourism in the wide range of changes in the Kibbutz in the 1990s. The study is based on anthropological fieldwork carried out over a three-and-a-half year period (1996-2000). The findings show the kibbutz' increasing dependence on tourism as a source of livelihood and the centrality of tourism in the re-construction of the new kibbutz identity and communal organization. Analysis of the different meanings given by the kibbutz members to the involvement with tourism in different periods in the kibbutz history highlights the changes that occurred in the way in which kibbutz members define their community. Analysis of the discourse on introducing tourism into the kibbutz shows the efforts of the members who initiated this development in the early 1940s to reduce the conflict between service work and kibbutz values. The study describes their efforts to institute *kibbutz tourism* whose organization and style of hospitality would reflect the main values of kibbutz society. It also analyzes the strategies that the early tourist workers, kibbutz members - most of them women- used to enhance their prestige in face of the clear preference in the kibbutz for production work in general and agricultural work in particular. The findings show that the changes that occurred in the kibbutz members' perceptions of work made work in tourism attractive in comparison to work in other branches. The expansion of tourism in the 1990s blurred the boundary between tourism and the kibbutz. A salient manifestation of this process is the development of services for tourists in areas that had previously been meeting places solely for kibbutz members. This process led to the transformation of the entire kibbutz space into a tourist area. The study examines the process, focusing on the strategies that various kibbutz members adopted in the wake of these changes'.

(Grossman, 2002)

From the foregoing cases four main analytical dimensions emerge:

**Origin:** 1) top-down; 2) bottom-up; 3) mixed, referring to the source of initiative to create the cooperative, where by 'top-down' is meant the political establishment and related institutions (whether local or central); by 'bottom-up' is meant the initiative of grassroots and popular and ideological movements (whether at the local/regional/national level); and by 'mixed' is meant a combination of both sources.

**Gender:** 1) women; 2) men; 3) mixed.

**Field of activity:** 1) agri; 2) agro; 3) eco; where the first two refer mainly to the services of accommodation and the sale of local products at the household and the village community level, respectively; and the third refers to activities ranging beyond the former;

**Geographical scope:** 1) local; 2) regional; 3) national

## **Discussion**

The foregoing cases offer a glimpse of the potentials and limitations of cooperatives in a policy of tourism development. At first sight, the ratio of cooperatives to tourism, even in its more restricted meaning of ecotourism, is low. In the light of the vast scope of tourism in the world, possibly the largest industry of today, the impact of cooperatives appears to be negligible. This view, however, might change as soon as a qualitative interpretation of tourism is endorsed. Two issues are critical in this regard: 1) the dynamics tourist-people of destination; 2) the gender dynamics. The moment the emphasis on the relative powerlessness of the local people vis à vis the dominant tourist is replaced by an emphasis on collaborative relations between the two parties, we place ourselves on a new plane of reciprocity that rejects the alleged superiority of Western values over nature and the culture of destination as commodities to be controlled by tourists and tourism operators rather than by the local populations or jointly (Selwin, 1992). As to the gender issue, we have seen how the stereotypical superiority of men over women as regards power and ownership can be overturned in favor of women.

As popular and participatory organizations based in their communities of origin, cooperatives have much to contribute to such qualitative and de-commodification trends. The specific potential and role of cooperatives in this regard has been briefly examined and deserve more attention in our future research. The global spanning of the tourism industry provides for unlimited realms of development and expansion in the cooperative field. We have seen that the scope of involvement may range from active participation in the delivery of services to tourists (lodging and food, accompaniment, guide, training, etc.) to the sale (by individuals or groups) of local products; to fishing and farm activities, and to the organization of community supporting structures and networks. Ecotourism can encompass locally involved rural populations and/or urban - voluntary or paid - groups, as is the case in Italy. The cooperative approach allows for the integration of able and disabled populations, as shown by the 'social cooperatives' of Italy. Most importantly, being ideally based on grassroots origin and on a clear not-for-profit orientation, cooperatives enable local people to pool scarce resources and to build economic and social capital attuned to local needs and cultures. Under the growing threat of delocalization as part of economic globalization, the combination of ecotourism and strong cooperative movements can help the local community and tourists to join efforts towards its protection against such negative effects.

As to the limitations, there is a danger, for even the most self-determined and self-sustained communities, of an erosion of the original values, as part of a process of accommodation to a kind of tourism increasingly controlled by the dominant neo-liberal paradigm. Hence the importance of strong networks of cooperative and

related institutions and a strong ecological culture, to counter such prevailing trends.

Both ecotourism and cooperatives need security and peace to survive and persist. Of late, tourism is severely menaced by new trends of insecurity. There appears to be evidence of a link between the forces underlying the recent global upsurge of violence and the ever-growing economic gaps in the world. Any attempt to refer to these and related issues, though, is obviously beyond our limited scope.

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***Part VIII. Economic models  
on co-operatives***

## **COOPERATIVE GOVERNANCE, SOCIAL CAPITAL AND VALUE OF PRODUCTION IN AGRICULTURE: AN ANALYTICAL ESSAY**

**Sigismundo Bialoskorki Neto**

### **Social Capital**

According to Mankiw (1999), capital can be understood as a production factor that represents a certain stock in economy, such as structure and/or equipment, that is, a production factor. In an intangible form, we have investments on education and capacitation of the so-called human capital as an important development-promoting factor.

However, when we consider economy and the development process, we realize that the cultural and social level of a certain area plays an important role in the way that area is organized, what, in turn, influence development.

Bebbington (1999) considers some forms of capital in the development process of agriculture, such as financial capital, physical capital, natural capital, human capital and social capital. The latter is considered an important facilitator of the economic process of development.

The same author shows that factors as land, credit, and labor are important for a project aiming at success in agriculture, but factors such as the access to new markets and technology, the ways of achieving better terms of transaction, of changes in market structure are also determining and, moreover, he defines that the networks and social organization may account for the success in the development process.

According to the author's conception we can notice that the access to production factors may determine the possibility of development, that is, this capacity may be given proportionally to the intensity of the existence of a new social capital or, in other words, the social organization which allows this access to production means, markets and favorable terms of transaction.

Social capital can be measured as a collective efficiency, as a community sense, or yet, as the competence of the community. Thus, the characteristics of the community and its organization, such as economical efficiency and competence, when compared to individual levels can measure the dimension of social capital in a certain place.

Spagnolo (1999) quotes Putnam (1993) and argues that recent works in political sciences and economy attribute an institutional spreading of social capital –

organizational efficiency – or different development to growth and “*per capita*” income rates within the regions and concludes that social capital plays a role in the promotion of an additional power to communities presenting a wider network of horizontal social relations.

The author also defines social capital as the increase difference of power in social relations, which can also be interpreted as the ability of certain agent groups – community – when linked by horizontal social relations that determine individual behavior.

However, the agents present linearly separated functions which can be added in two different ways: by employing them in the same social network or, yet, by creating opportunities for workers to interact socially. Cooperation takes place if there are gains in productivity to support collectively strict situations of scarcity and/or limitations, or, yet, to promote individual gains to the agents. The degree of coalition the agents will form in order to have a cooperative production will depend on the facilities and incentives (Spagnolo, 1999).

Stryjan (1999) emphasizes that cooperative coalition differs from entrepreneurship in several aspects and adds that characteristics, such as collective operation, generation of collective benefits, of social and public benefits, of social and public externalities, and the fact that they establish themselves as social movements, make this kind of organization somewhat different from enterprises and, consequently, suited to contribute to the increase of social capital.

The author still affirms that the Swedish experience shows that public policies for the incentive of cooperative societies are cost-efficient in the creation of new jobs and that these societies produce economic effects of externality, being a sphere between the public sector and entrepreneurship, developing and enabling economic contributions for development, increasing the social web of communities and, consequently, expanding the levels of social capital.

We can verify that the human capital and the educational level are variables that are strictly connected to the concept of social capital, motivating participation and providing lower asymmetries of information in contractual transactions.

Helliwell and Putnam (1999) indicate that the educational level both absolutely and relatively, influence the social engagement and the intensity of participation. They still show that the educational level is positively correlated to the trust of a certain collective group.

Glaeser, Laibson and Sarcedote (2000) state that those who invest in education also invest in social capital even if repeated social interactions end up lessening free-rider problems as well as contractual opportunism, so that social structures can replace legal structures which are costlier to society, facilitating investments and financial transactions.



### **Governance and development in agriculture**

Lazzarini (2000) argues that the relations among agents cannot be analyzed apart from the context in which they occur. Thus, the performance of economic transactions depend on a network of relations – which can be understood as the intensity of relations in a network – social – and among economical agents.

These discussions of different points of view and analyses suggest that the development of economy depends on a particular institutional environment in which the efficiency of organizations and the structures of systems governance determine the success. At the same time, this efficiency can be attributed to the existence of a determined stock of social capital, or yet, of embeddedness in the relations among agents.

Given a determined state of technology and knowledge, the distribution of property rights determines the state of economic efficiency, according to Eggertsson (1990). The political structures, the present organizations and their efficacy can in turn condition the distribution of property rights and transactions costs.

North and Thomas (1973), quoted by Eggertsson (1990), show that economical growth happens if property rights provide conditions for society to begin and keep a high productive activity. The creation, establishment and stable maintenance of property rights have costs and, when the benefits are higher than the costs, the rights will be established and, economy can in turn present a crescent function. Therefore, both formal institutions, such as religious groups, and informal ones, such as the rules adopted by society, also characterize, according to north (1991), the institutional environment and, therefore, the development process of economy.

Glaeser, Laibson and Sarcedote (2000) admit that the structure of social capital has its logic and takes place as consequence of the individual decision of investment. Thus, the agent would accumulate capital when in the presence of higher private incentives.

Lazzarini (2000) evidences governance mechanisms, in a dynamic way, path dependence, under the perspective of the relationship of groups of individuals or organizations, networks, or simple agents and firms, and considers the importance of these mechanisms for the accretion of returns in a determined activity. Zylbersztajn (2000) explains that ethics in society and organizations is a parameter to be considered in the analysis of economical efficiency once it can lead to the reduction of asymmetries of information and, therefore, transaction costs.

In this sense, the kind of governance resulting from contractual relations of a cooperative organization can offer the necessary and individual incentives that would compensate participation costs reducing transaction costs and influencing the development process. Thus, we can affirm that development conditions are

determined both by the factors of production through the neoclassic point of view and by the institutional environment.

The object of this essay is to analyze the influence of human capital, social capital, governance structure, and technology in the development of agriculture. In particular, in the generation of production value both per production unit and in the intensity of generation, production value generated per ha.

### **Empirical analysis**

The empirical analysis was developed in two phases. In the first we analyze the correlation among certain variables by means of a multivariate factorial analysis, through the method of main components. For this analysis we selected variables from the Rural Development Office of the Agriculture and Food Distribution Department of the State of São Paulo, with basis on the Survey of Productive Units for the agricultural year of 1995/96, obtaining:

**Vlpr/upa** – production value per agricultural productive unit – (APU).

**Vlpr/ha** – production value per hectare.

**Coop** – proportion of producers who are members of agricultural cooperatives.

**Assoc** – proportion of producers who are members of associations.

**Sind.** – proportion of producers who are members of unions.

**Info** – proportion of agricultural productive units which make use of computers.

**Com** – proportion of agricultural productive units which make use of communication.

**Astecpar** – proportion of agricultural productive units which make use of private technical assistance.

**Astecgov** – proportion of agricultural productive units which make use of governmental technical assistance.

**Eduinc** – Proportion of owners per agricultural productive units with incomplete education.

**Edu2gr** – Proportion of owners per agricultural productive units with high school degree.

**Edusup** – Proportion of owners per agricultural productive units with a university degree.

**Cocustos** – Proportion of agricultural productive units which control costs through accounting.

**Resid** – Proportion of rural workers who reside on agricultural productive units.

The variables were chosen to reflect the production value, the social capital stock, the human capital level and the technological state of production. Thus, the production value per productive unit was selected to characterize the total amount of value per productive unit and the production value per hectare, which could reflect the intensity in the use of production factors per agricultural establishment.

The variables chosen to characterize the level of human capital were the proportion of farmers with incomplete education, with high school diploma and with a college degree. The variables chosen to characterize a determined level of social capital were the proportions of rural producers associated to producers associations and unions and, as a form of contractual architecture and governance, producers associated to cooperatives.

Finally, we attempted to analyze variables that could represent the technological level of the agricultural production unit. In this way, we have the proportion of agricultural production units that make use of computers, communication, private technical assistance, governmental technical assistance, and the ones that make use of methods for costs control.

The multivariate analysis, through the main components method, could explain 57.9% of the variation found, after the definition of two factors and a rotation through Varimax's method. Thus, we can observe the results by means of a matrix of factorial loads, table 1, as well as graphically, that is, by observing the variables according to the factorial loads of the extracted components, picture 1.

**Table 1 Factorial loads of the main components extracted from the multivariate analysis**

Variables/Components	Component 1	Component 2
Vlpr/upa	<b>0.764</b>	0.391
Vlpr/ha	0.157	<b>0.749</b>
Coop	<b>0.859</b>	-0.169
Assoc	<b>0.652</b>	-0.131
Sind	<b>0.579</b>	0.036
Eduinc	<b>-0.504</b>	<b>-0.540</b>
Edu2gr	0.039	<b>0.643</b>
Edusup	<b>0.573</b>	<b>0.556</b>
Astecpar	0.471	<b>0.622</b>
Astecgov	0.086	<b>-0.775</b>
Info	<b>0.649</b>	0.472
Com	-0.129	<b>0.738</b>
Cocustos	<b>0.656</b>	0.125
Resid	<b>-0.873</b>	-0.103

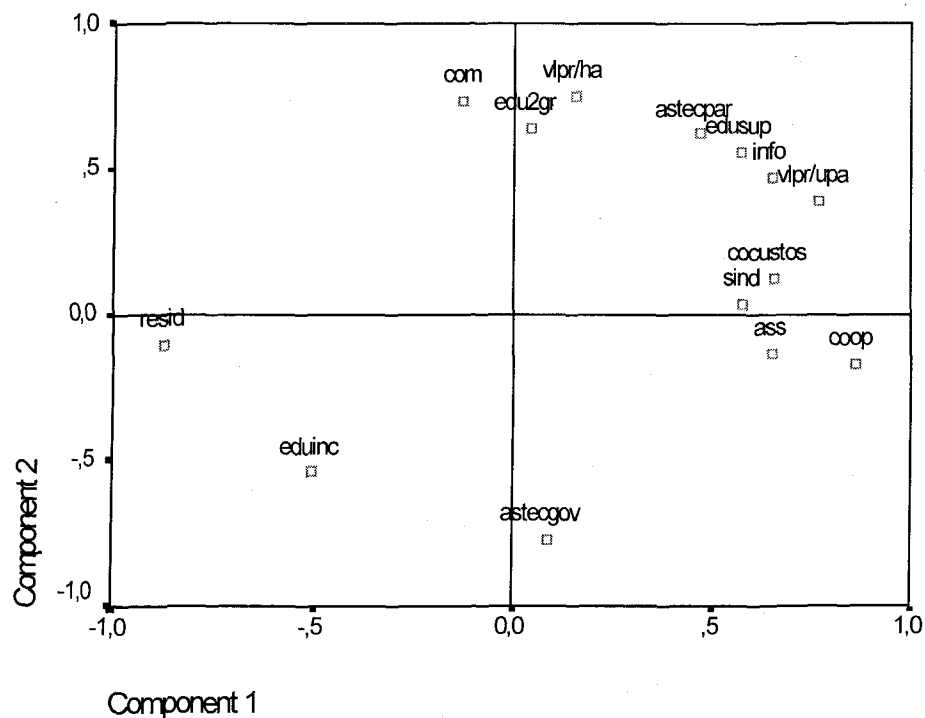
Source: research data

We can analyze that the first component presents a more intense correlation to the variables which represent the production value per APU, the degree of organization in cooperative, associations and union, higher educational level, applied technology, and costs control, being negatively correlated to the place of residence of the rural producer.

The second component is more intensely correlated to the production value per area unit, the private technical assistance variables, the existence of communication and the higher educational levels. It can apparently be characterized by a more modern group with more refined production techniques.

These components show that initially we can characterize a typification, that is, a group composed of establishments with higher value of the production and income correlated to higher levels of rural organization, social capital, with more attention to costs control and use of computers. Yet, another group is characterized: the one associated to a wider use of technology, use of technical assistance, higher production value per production area and higher educational level, but not intensely and positively correlated to the organizational level, that is, social capital.

**Picture 1 Graphic result of the multivariate analysis with the calculation of two main components, after the rotation through the Varimax's method**



In a second statistical analysis we attempted to characterize the proportion-of-cooperative-members variable as a form of governance in contractual relations in agriculture. Thus, a pondered logarithm regression was formulated in order to investigate the relations between the variable on the logarithm of the proportion of members of agricultural cooperatives – **Lcoop** and other variables.

Thus, we selected for the second analysis the variables turned into logarithms that reflect the relations of social capital, such as participation in associations and unions, educational level, production value per productive unit per ha., which have already been mentioned, according to the following model:

$$Lcoop = a + b1 Leduinc + b2 Ledu2gr + b3 Ledusup + b4 Lsind + b5 Lassoc + b6 Lvalor + b7 Lpdtv + error$$

The results presented in table 2 show that there is a relationship between the proportion of cooperative members and the educational level, which is significant and positive for complete university level, but negatively correlated for high school level. It also shows a positive but less significant relationship with other forms of organization such as associations and unions.

Finally, we can see the significant and positive relation with the production value per unit of agricultural production, as noticed before, but a negative relation with the coefficient of the variable that shows productivity in terms of production value per hectare.

The linear logarithm regression weighed by the number of production units present a coefficient of determination that explains the model reasonably and does not present problems of self-correlation to the variables.

**Table 2** Results of the linear regression analysis between the variable dependent on the logarithm of the proportion of cooperates per agricultural production unit and chosen variables, weighed by the amount of agricultural production units per Rural Development Office in the state of São Paulo.

Variable	Coefficient	Test – t	Significance
Leduinc	0.291	0.972	0.338
Ledu2gr	-0.869	-1.749	0.090
Ledusup	1.083	2.703	0.043
Lsind	0.414	1.414	0.167
Lassoc	0.530	2.528	0.170
Lvalor	0.738	3.538	0.001
Lpdtv	-0.465	-2.757	0.010
Constant	-0.984	-0.446	0.658

Determination coefficient  $R^2$  of 0.71

### Preliminary Analysis of the results

We can initially consider that the main components, calculated through a multivariate factorial analysis, show that there is the formation of two distinct groups of variables. The first is formed by a stronger correlation between the variables on production value per agricultural production unit associated to organization – social capital stock – and the variables representing the efforts in

production costs control and the use of computers. The latter, formed by variables with a more expressive correlation between production value per ha – what may show a higher effort on the intense use of production factors – associated to variables representing higher educational levels – human capital –, communication, and the use of technical assistance, what may represent a higher technological level.

Thus, we can consider that variables representing social capital and human capital are more strongly correlated to the production value per production unit and production value per area unit, respectively. So, we discuss that rural organizations, from the ones with economical purposes – cooperatives – to the ones with representation and political purposes – associations and unions, respectively –, are associated to a group of productive units which probably represent relatively larger areas as well.

This fact probably helps not only in the process of value generation, but also in the maintenance of this process. However, we must be aware that the second component shows a strong correlation between technology – technical assistance –, human capital – education –, and the production value per ha., but a very low correlation to the variables which characterize social capital.

On the other hand, we can notice the importance of an analysis of the influences of some variables in a determined relation of contractual governance, as cooperatives. This analysis shows that the level of education is significant and keeps a strong and positive relation in this complex organizational form, if the proportion of rural producers with a university degree is considered.

Helliwell and Putnam (1999) show the importance of the analysis of education both at a relative and absolute level, and in this model we can preliminarily verify a possible intense educational inequality, that is, the model showed that there is a positive relation to both the proportion of incomplete education and the higher education: two extremes that could show a possible inequality in educational levels correlated to the proportion of cooperative members, but, still, they show the negative relation to high school education and a possible particular relation to be detailed in further studies.

The result of this regression also shows that the organizational structure of cooperatives is positively related to the level of production value per productive unit and other forms of political representation, such as unions. Therefore, a positive correlation between economic purposes organization and political representation organizations is indicated.

On the other hand, a negative correlation to productivity was also showed. Thus, cooperatives are a form of architecture of important contracts for the value of production per unit, but not for intensity of the use of factors. This is an important

evidence to be studied, that is, a positive correlation between economic organization – cooperative – and production value per APU, and, negative, with the production value per hectare.

Glaese, Laibson and Sarcedote (2000) emphasize that the economic model for social capital formation shows that investments in social capital decrease when the time opportunity costs to economical agents increase. In this way, we can argue that the higher the production value per hectare, the higher the time opportunity cost, what brings the participation level and the importance of organizations down.

Although there are theoretical evidences of correlations between education, economic organization forms and governance as well as evidences of the importance of social capital stock for the reduction of information asymmetries, hold-up and contractual opportunism problems, the models used did not present enough explanation leading to the need of new investigations.

### **Final considerations**

Theoretically, social capital, its forms of stock, and the intensity of social relations are supposed to provide a higher development level. We also consider that the governance of contractual relations can be an explanatory variable to the generation of value provided that there is the establishment of formal and informal contract relations, of lower risks of asymmetry and hold up and, therefore, higher efficiency.

Thus, the so-called human capital – such as education – is relevant as a variable which determines a process due to its correlation to a higher intensity in the use of factors of production and technology, what results in a higher production value per ha. On the other hand, the capacity of organizing the productive process is a fundamental element, that is, the social capital determines a certain form of governance in the contract relations between economical agents, becoming an determining factor in the generation of higher production values per productive unit.

However, further analysis on the matter is necessary so that we can analyze the correlations between human capital, social capital and governance of contractual relations. Therefore, the continuation of this discussion is necessary in order to expand the model with some complementary variables that can measure other relevant states of governance.

We can observe that the form of governance should probably be considered separately from the concept of social capital, that is, there would be the necessary human capital, the necessary social capital, but the intrinsic economical efficiency would be hypothetically attributed not only to the set of production factors, but

also to a specific form of governance in contractual relations between economical agents.

Finally, we must consider the initial evidence of the separate consideration of human capital and social capital, the importance of the analysis of educational inequality as a relevant variable as well as the distribution structure of property rights on the land and the organizations as possible relevant information sources. Furquim and Bialoskorski Neto (1998) discuss the distribution of property rights in areas with problems of definition in the property of the land and conclude that this distribution is determining of types such as private investment levels and, therefore, of production value as well. On the other hand, we question what relations would they be and how intense. This way, the concept of governance is not only important to the analysis of the efficiency of organizations, but also as an important and complementary variable in economic analysis of social and human capital.

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## **EVALUATION AND RANKING OF THE FINANCIAL STATUS OF THE WESTERN MACEDONIAN REGION RURAL COOPERATIVES, BY A PROTOTYPE COMPUTER EXPERT SYSTEM THAT MAKES USE OF MULTICRITERIA ANALYSIS AND FUZZY LOGIC**

**Hliadis Lazaros, Michailidis Anastasios, Arabatzis Garyfallos**

### **Introduction**

The activities of the rural cooperatives are very important and they expand in many different fields. They supply rural accoutrements (fertilizers, pesticides, seeds, forages etc) and they produce and manufacture rural products (forest, agricultural, cattle, fishing). They make arrangements of the rural faith, by allowing various types of loans (cultivating) to the members. Finally they are activated the field of trade of rural products in Greece and abroad. (Kamenidis 2001).

The structure of rural cooperatives subtends the join of Physical Persons to primary cooperatives, and the join of the first-class, second-class and third-class cooperatives to the higher cooperative stage. The second-class cooperatives are known as Unions of Rural Cooperatives (U.R.C).

During the last years the associations in Greece affront many difficulties that threat the physiognomy and the identity of the cooperative movement. Those problems are related to the lack of good management, to the misty procedures and to the lack of a serious control mechanism.

The aim of this paper is to describe the development of an expert system that takes into account financial data that affect the function of six U.R.C from the region of Western Macedonia in order to evaluate and rank them. The expert system uses multicriteria analysis and fuzzy logic in order to carry out the evaluation and the ranking of the six U.R.C.

The project was designed to evaluate the U.R.C. for periods of three years, due to the fact that the differentiation of the financial statement of each U.R.C. is more obvious if it is examined in periods of three years. Though data from 1993 to 2000 are available for the six U.R.C. the net flow for each one of the U.R.C. was calculated only for the years 1994, 1997 and 2000. Then the Fuzzy Expected Inetrvals F.E.I. were produced for the year 2001. These are the intervals of values in which the net flows are expected to be for the year 2001. Due to the fact that the inventories of the U.R.C. of Western Macedonia have not been published yet, the validity of the calculated Expected Intervals will be tested in the near future.

**The multicriteria analysis methodology.**

The PROMETHEE II methods are part of the theory of relevance superiority. (Brans 1982). They use six types of general tests with the corresponding test's functions in order to determine the superiority between two alternative solutions. In this case the aim is the determination of the superiority of one U.R.C.  $X_i$  over a U.R.C.  $X_j$ . The type of general level test criterion was selected to be used in this project, with the corresponding criterion function, because it has an indifferent region, for the determination of the superiority. (Brans and Vincken 1985). This type of general criterion is the most appropriate to be used in this case, due to the fact that it does not apply a strict choice. Only pairs of U.R.C. are tested in the form  $(v_i, v_j)$   $i=1,2,\dots,8$ , in order to determine which one  $v_i$  or  $v_j$  has the superiority according to the financial indexes.

The function  $H(d)$  used to express the superiority is the following:

$$H(d) = \begin{cases} P(v_i, v_j), & \text{superiority of U.R.C } v_i, \text{ if } d \geq 0 \\ P(v_j, v_i), & \text{superiority of U.R.C } v_j, \text{ if } d < 0 \end{cases}$$

As  $P(v_i, v_j)$ ,  $P(v_j, v_i)$  are the functions of preference.

**Function 1: Level criterion function that uses preference functions. The value of variable  $d$  is the difference between the financial indexes of each pair of U.R.C.'s  $(v_i, v_j)$  for the criterion under evaluation.**

The function 1  $H(d)$  can take values according to the following formula:

$$H(d) = \begin{cases} 0 & \text{if } |d| \leq q \\ \frac{1}{2} & \text{if } q < |d| \leq p \\ 1 & \text{if } p < |d| \end{cases}$$

**Function 2: The level criterion function. It should be mentioned that  $p$  and  $q$  are parameters that usually have a fixed value.**

When it is examined which of two the U.R.C.  $(v_i, v_j)$  is the superior, the superiority function  $H(d)$  is applied according to the price of  $d$  (positive, or negative) for each criterion. The  $q$  and  $p$  parameters are partly estimated in this project and they do not have a fixed value.

The estimation of  $p$  and  $q$  is performed in the following way. First of all the annual performances of the six U.R.C. is calculated for each criterion. If there exists a U.R.C. with a very high value of performance that is clearly much higher than the

performance of the other five U.R.C. it is excluded for the criterion under testing. This is done in order to avoid problems that might be caused in the calculation of p and q. Afterwards, all of the differences d are calculated, for each pair of U.R.C. that is examined for each criterion. If the preference function takes into account |d| (the absolute value of d) only the positive values of d are considered.

Afterwards the range E between the maximum and the minimum values of d is calculated using formula 1.

$$E = d_{\max} - d_{\min}$$

**Formula 1. Calculation of the range**

Finally q, p are estimated using the following formulas 2 and 3.

$$q = d_{\min} + \lambda * E$$

**Formula 2. Calculation of p.**

$$p = d_{\min} + \mu * E$$

**Formula 3. Calculation of q.**

The coefficients  $\lambda$  and  $\mu$  are considered to be threshold values that will be used for the estimation of p and q respectively. The parameters  $\lambda$  and  $\mu$  can be assigned specific values, depending on the type of the problem and on the degree of sensitivity of the superiority control. In this case  $\lambda$  has been assigned the value of 0.2 and  $\mu$  the value of 0.4. In this way the q, p were calculated for each criterion and for each year (Koutroumanidis et.al 2001). The multicriteria indicator of preference  $\Pi(v_i, v_j)$  which is a weighted mean, of the preference functions  $P_t(v_i, v_j)$  with weights defined by the researcher, expresses the superiority of the U.R.C  $v_i$  against U.R.C.  $v_j$  after all the criteria are tested. The values of  $\Pi$  are calculated using the following formula4 (Brans et.al. 1986).

$$\Pi(v_i, v_j) = \frac{\sum_{t=1}^k w_t * P_t(v_i, v_j)}{\sum_{t=1}^k w_t}$$

**Formula 4. Calculation of the multicriteria indicator.**

It should be mentioned that k is defined to be the number of kriteria (k=8) and  $P_t(v_i, v_j)$  the preference functions for the k kriteria.

The multicriteria preference indicator  $\Pi(v_i, v_j)$  takes values between 0 and 1.

When two U.R.C.  $(v_i, v_j)$  are compared to each other each one is assigned two values of flows the outgoing flow and the incoming flow.

The outgoing flow is calculated that by the following formula 5 (Baourakis et al. 2001)

$$\varphi^+(v_i) = \sum_{v_j \in A} \Pi(v_i, v_j)$$

**Formula 5. Calculation of the outgoing flow.**

In both cases A is defined to be the number of the alternative solutions U.R.C.  $v_j$ . (Which in this case are five). The outgoing flow expresses the total superiority of the U.R.C.  $v_i$  against all the other U.R.C.  $v_j$  for all the criteria. The incoming flow is determined by the following formula 6 (Baourakis et al. 2001).

$$\varphi^-(v_i) = \sum_{v_j \in A} \Pi(v_i, v_j)$$

**Formula 6. Calculation of the incoming flow.**

The incoming flow expresses the total superiority of all the other U.R.C. against U.R.C.  $v_i$  for the criteria. The net flow for each U.R.C.  $v_i$  is estimated by the following formula:  $\varphi(v_i) = \varphi^+(v_i) - \varphi^-(v_i)$ .

The net flow is the number that is used for the comparison between the U.R.C. in order to obtain the final ranking. Each U.R.C. that has a higher net flow is considered to be superior in the final ranking.

The superiority of U.R.C.  $v_i$  over the U.R.C.  $v_j$  can be expressed using the following expression:

$V_j P v_j$  ( $v_i$  is superior to  $v_j$ ) or  $v_i \longrightarrow v_j$ , when  $\varphi(v_i) > \varphi(v_j)$

When  $\varphi(v_i) = \varphi(v_j)$  the superiority relation is written as follows:

$v_i I v_j$  (This means that the relation between  $v_i, v_j$  is neutral).

**Description of the inference engine**

The expert system was designed to be rule-based and it consists of facts, rules and object-frames. It was designed and constructed to have a main rule set and local rule sets within the object frames (Jackson 1992).

The most important part of an Expert System is the Inference Engine, which is the mechanism that leads to the goal. The Inference engine strategy that was applied was backward-chaining with opportunistic forward, which means that it was designed to be a goal driven expert system, to use Forward Chaining only for the phase of Data Gathering in order to make it faster. It starts from the goal and it evaluates only the necessary rules in order to reach the final conclusion (Leonardo User Guide 1992).

Knowledge about real world objects is stored in the object frames that contains various types of slots. Each slot describes the properties and the characteristics of the associated object (Jackson 1992).

### **Input Data**

The data that were used as input to the expert system come from balance sheets of the U.R.C. for the period 1993 -2000. According to these balance sheets, the financial indexes were calculated. **These indexes express the efficiency and the performance of the management of the U.R.C.** These indexes were used (in past research projects) for the evaluation of investments, using multicriteria analysis. (Evrard and Zisswiller 1982)

The weights of the financial indexes that were used in the analysis are the following:  $w_i = 0.125$  ( $i=1,2,\dots,8$ ) with  $\sum_{i=1}^7 w_i = 1$

**Table 1 Financial indexes used for the determination of the initial input data.**

D1	R * 360 / S	Reserves * 360 / Sales
D2	R * 360 / S	Receivable * 360 / Sales
D3	S / TA	Sales / Total Assets
D4	LC * 360 / C of S	Current Liabilities * 360 / Cost of sales
D5	L (L+EC)	Liabilities long – term / (Liabilities long – term + Equity Capital
D6	TC / TA	Total current / Total Assets
D7	CA / LA	Current Assets / Current Liabilities
D8	EBT/EC	Earnings before taxes / Equity Capital

### **Results of the analysis**

Initially the expert system performed the calculation of the net flows of the six U.R.C. that belong to the Western Macedonian region for periods of three years. The calculation of the net flows was performed according to the financing indexes that were mentioned in table 1 and for the period 1993 - 2000.

Afterwards, all of the U.R.C. have been ranked in proportion to their periodic net flows and for the entire period of 1993 -2000. These rankings can be seen clearly in the following tables 2 and 3.

**Table 2 Periodic ranking of the U.R.S. according to their net flows.**

1994		Annual net flow	1997	Annual net flow
Ranking	U.R.C.		U.R.C.	
1	Florinas	-0.125	Florinas	0.625
2	Kozanis	-0.125	Kozanis	-0.625
3	Kastorias	-0.125	Kastorias	-0.125
4	Grevenon	-0.125	Grevenon	-0.375
5	<b>Amyndaiou</b>	<b>0.625</b>	<b>Amyndaiou</b>	<b>1.625</b>
6	Voiou	-0.125	Voiou	-1.125
2000		Annual net flow		
Ranking	U.R.C.			
1	<b>Florinas</b>	<b>1</b>		
2	Kozanis	0.0625		
3	Kastorias	0		
4	Grevenon	-0.5625		
5	Amyndaiou	0.6875		
6	Voiou	-1.1875		

The net periodic flows of all the six U.R.C. that were used in the project, are selected and presented in table 3.

**Table 3 Selective presentation of the net flows for periods of three years of the six U.R.C.**

	U.R.C.	'94	'97	'00
$\Phi(F)$	<b>Florinas</b>	-0.125	0.625	<b>1</b>
$\Phi(Ko)$	Kozanis	-0.125	-0.625	0.0625
$\Phi(Ka)$	Kastorias	-0.125	-0.125	0
$\Phi(G)$	Grevenon	-0.125	-0.375	-0.5625
$\Phi(A)$	<b>Amyndaiou</b>	<b>0.625</b>	<b>1.625</b>	0.6875
$\Phi(V)$	Voiou	-0.125	-1.125	-1.1875

The periodic rankings of each U.R.C. and the average ranking for each one, for the total period 1993-2000 is shown in table 4.

**Table 4** Periodic position for each one of the U.R.C. in the rankings of the period 1993 – 2000 and the average position of each U.R.C. in the same rankings

U.R.C.	1994	1997	2000
Florinas	2	2	1
Kozanis	2	5	3
Kastorias	2	3	4
Grevenas	2	4	5
<b>Amyndaiou</b>	<b>1</b>	<b>1</b>	<b>2</b>
Voiou	2	6	6

#### **The concept and the use of fuzzy expected intervals**

One of the main features of the expert system is the calculation of the Fuzzy Expected Interval (F.E.I) for each one of the Union of Rural Cooperatives of Greece. This means that it can produce a narrow characteristic interval of values. The flow of the company is expected to fall into this interval for the following years.

For example the F.E.I. could be (1.200 , 1.480). This would mean that total flow for the company would fall between 1.200 and 1.480 in most of the cases. In this way the F.E.I can be used to forecast the future flow of each Union of Rural Cooperatives of Greece. Thus, a classification of all Union of Rural Cooperatives of the country, according to their expected flow, can be achieved. It is important that the system manages to produce an interval that is as narrow as possible.

The central idea is that statistically and practically there is no interest in forecasting the exact number of the future flow, but rather in finding the general tendency and its direction. The main point is to know if the flow will increase from 1.200 to 1.900, or if it will drop to 0.600 and not to estimate the precise number concerning the past flows of the U.R.C. (Zadeh, 1965)

This means that data can be grouped in an imprecise way (using various keywords) and thus Fuzzy Logic can be applied. (Patridge and Hussain, 1995)

For example if the past data of net flows are 0.980, 1.010, 1.090 and 9.99 for four years, they can be grouped in the following way:

*On four occasions the net flow was almost 1.000.*

In this way the data can be grouped imprecisely.



There are four types of sentences that can be used during classification of the data.

	keywords	Lower Bound	Upper Bound
1 <sup>st</sup> type	almost	x-20%	x-1
2 <sup>nd</sup> type	more or less	x-20%	x+20%
3 <sup>rd</sup> type	over	x+1	x+20%
4 <sup>th</sup> type	much more than	2x	$\infty$

In a hypothetical situation using this approach, the net flows can be classified imprecisely into groups in the following way.

5 times the flow was almost 0.600

8 times the flow was more or less 0.850

3 times the flow was over 1.100

2 times the flow was much more than 1.500

This is very flexible way of classifying existing data.

Fuzzy logic was introduced by Zadeh in 1965. All the theorems that are used in the following section were described by Kandel and Byatt (1978).

After the classification, there are four steps that should follow according to Kandel (1992) and they are as follows:

**A.** The first step is to input data from the imprecise classification, into the characteristic function  $C(X)$  and find all  $C$ 's. Kandel (1992).

**B.** The **characteristic function** is the following:

$$C(X) = \begin{cases} 0 & \text{IF } X \leq 0 \\ \frac{X}{100} & \text{IF } 0 < X \leq 100 \\ 1 & \text{otherwise} \end{cases}$$

Where the number 100 is used as the maximum number of flow that was ever calculated according to the data existing so far. (It is the most extreme case according to the designers' judgment). This function is used for the forecast of the total flow.

**B.** The second step, Kandel (1992) is to find all  $\mu$ 's, which are the candidate Fuzzy Expected Intervals. The  $\mu$ 's are intervals of the form [LB, UB] and they can be calculated from the following equations:

$$UB_j = \frac{\sum_{i=j}^n \text{MAX}(pi_1, pi_2)}{\sum_{i=j}^n \text{MAX}(pi_1, pi_2) + \sum_{i=1}^{j-1} \text{MIN}(pi_1, pi_2)}$$

**Equation 1** This equation is used to find the upper bound of every interval  $\mu_i$ .

Where  $pi_1$  is the lowest bound of group  $i$  and  $pi_2$  is the upper bound of group  $i$ .

$$LB_j = \frac{\sum_{i=j}^n \text{MIN}(pi_1, pi_2)}{\sum_{i=j}^n \text{MIN}(pi_1, pi_2) + \sum_{i=1}^{j-1} \text{MAX}(pi_1, pi_2)}$$

**Equation 2** This equation is used to find the lower bound of every interval  $\mu_i$ .

Where  $pi_1$  is the lowest bound of group  $i$  and  $pi_2$  is the upper bound of group  $i$ .

C. The third task is to find the minimum interval of each line using Theorems 1, 2 and 3 according to Kandel (1992). The theorems 1 to 6 are used to compare pairs of intervals of values and to determine which interval is larger and which is smaller.

**Theorem 1 is:**

$$\text{MAX}(S, R) = \begin{cases} R & \text{if } r_m > s_1 \\ S & \text{if } s_n > r_1 \end{cases}$$

Where  $S = \{S_1, \dots, S_n\}$   $R = \{r_1, \dots, r_m\}$  and  $R \cap S = \emptyset$

**Theorem 2:**

$$\text{MAX}(S, R) = \begin{cases} R & \text{if } r_m > s_n \\ S & \text{if } s_n > r_m \end{cases}$$

Where  $R = \{r_1, \dots, r_m\}$   $S = \{S_1, \dots, S_n\}$   $R \cap S \neq \emptyset$ ,  $S \notin R$   $R \notin S$

**Theorem 3:**

If  $R = \{r_1, \dots, r_m\}$   $S = \{S_1, \dots, S_n\}$  and  $R \subseteq S$  then  $\text{MIN}(S, R) = [S_1, \dots, r_m]$

D. The final task is to find the maximum interval over the minima using the Theorems 4, 5 and 6 according to Kandel (1992)

**Theorem 4:**

If  $R = \{r_1, \dots, r_m\}$   $S = \{S_1, \dots, S_n\}$  and  $R \cap S = \emptyset$ .

Then  $\text{MAX}(S, R) = R$  if  $r_1 > S_n$  and  $\text{MAX}(S, R) = S$  if  $S_1 > r_m$

**Theorem 5:**

If  $R = \{r_1 \dots r_m\}$   $S = \{S_1 \dots S_n\}$  and  $R \cap S \neq \emptyset$ ,  $S \notin R$   $R \notin S$ .

Then  $MAX(S,R) = R$  if  $r_m > S_n$  and  $MAX(S,R) = S$  if  $S_n > r_m$

**Theorem 6:**

If  $R = \{r_1 \dots r_m\}$   $S = \{S_1 \dots S_n\}$  and  $R \subseteq S$

Then  $MAX(S,R) = [r_1 \dots S_n]$

The maximum interval found is the Preliminary Fuzzy Expected Interval. The maximum number of flow (which in this case is 100) should be multiplied to the bounds of the Preliminary Fuzzy Expected in order to produce the real fuzzy expected interval. This interval could indicate the expected situation for the specific Union of Rural Cooperatives. It is obvious that the narrower this interval is, the more useful it is. To achieve a narrower interval, for example, [1.500-1.700] for the net flow of the following year, the classification of the groups of frequencies should be successful.

**Discussion of the U.R.C.'s expected intervals of values**

Actually the testing was done for six Unions of Rural Cooperatives of Western Macedonia. The initial knowledge base of the system, included financial data for the Unions of Rural Cooperatives from 1993 to 2000. Though the evaluation of the U.R.C. was performed only for three periods, the results have shown that the U.R.C. of Amyndaio and Florinas have been qualified as having the best financial management and status. Of course this was done based on the specific eight indexes that were used.

After the evaluation of the six U.R.C. the expert system was used to estimate the fuzzy expected interval of the net flow, for the U.R.C. of Amyndaio and Florina that have been shown as the most important ones. It is estimated that the values of the net flows of these two U.R.C. will fall inside these intervals for the following year 2001.

**Table 5. F.E.I. for the U.R.C. of Amyndaio and Florina for the year 2001**

U.R.C.	F.E.I. for year 2001
<b>Florina</b>	(0.9, 1)
<b>Amyndaio</b>	(1, 1.1)

The expert system will be used and tested again with future data. This means that the task of the evaluation of U.R.C will continue and the system's credibility will also be evaluated.

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