

## **Background paper on cooperatives**

### **Introduction – the significance of cooperatives to a world in crisis**

Cooperatives, as economic enterprises and as self-help organizations, play a meaningful role in uplifting the socio-economic conditions of their members and their local communities. Over the years, cooperative enterprises have successfully operated locally-owned people-centred businesses while also serving as catalysts for social organization and cohesion. With their concern for their members and communities, they represent a model of economic enterprise that places high regard for democratic and human values and respect for the environment. As the world today faces unstable financial systems, increased insecurity of food supply, growing inequality worldwide, rapid climate change and increased environmental degradation, it is increasingly compelling to consider the model of economic enterprise that cooperatives offer. The cooperative sector, especially in developing countries, also presents itself as an important element that can contribute to the realization of the Millennium Development Goals (MDGs) by 2015.

The current financial crisis characterised by the massive public bail-out of private, investor-owned banks worldwide has underlined the virtues of a customer-owned cooperative banking system. Cooperative banks in the form of credit unions, building societies and cooperative banks, by focusing primarily on the needs of their members, have displayed prudence and avoided the excessive risk-taking that plagued many large global financial institutions. As cooperative banks continue to operate and provide loans to their clients and enjoy the trust and confidence of their members and depositors, they play an even more critical role as consumers and businesses face a credit crunch. There are some 49,000 credit unions serving 177 million members in 96 countries, under the umbrella of the World Council of Credit Unions that continue to operate despite the current financial crisis. Even the larger cooperative banks, such as Rabobank which is the largest agricultural bank in the world<sup>1</sup>, continue to demonstrate the value of the cooperative banking model.

The cooperative enterprise is also relevant in addressing the problem of food insecurity. The World Bank estimates that food demand will double by 2030 as the world's population increases by another two billion people. There is an urgent need for developing countries to increase the output of food yet, as the World Bank's 2008 World Development Report on Agriculture for Development has shown, the rural economy has been badly neglected. One solution is to encourage farmers to mobilise collectively in agricultural and marketing cooperatives that engage in the production, processing and marketing of agricultural products and give them access to markets. Farmer cooperatives are growing in most developing countries. For example, India's 100,000 dairy cooperatives collect 16.5 million litres of milk from 12 million farmer members every day, making a significant contribution to India's food supply.<sup>2</sup> Nevertheless, farmer cooperatives have yet to reach their full potential as they address their requirements for financing and technical support.

Cooperatives can contribute to the achievement of the MDGs by 2015 because of their inherent characteristics. Because cooperatives are economic associations, they provide the opportunity for poor people to raise their incomes. Because they are democracies with

each member having one vote, they empower people to own their own solutions, and because they pool risks at the level of the enterprise and offer micro-insurance they increase security.<sup>3</sup> In addition, there is increasing evidence indicating that cooperatives also contribute directly and indirectly to meeting several of the other MDGs<sup>4</sup>, such as primary education for children, gender equality and reducing child mortality.

The cooperative enterprise also presents an important model as many of the world's poorest and disadvantaged face social exclusion, lack of access to opportunities and growing economic inequality. As the uneven effects of globalisation have led to a rise in the unregulated informal economy, workers in the informal sector have formed shared service cooperatives and associations to assist in their self-employment<sup>5</sup>. In rural areas, savings and credit cooperatives provide access to banking services which are lacking in many communities. Credit cooperatives also play an important role in the formation of small and micro businesses. They can effect the kind of financial 'deepening' that the World Bank envisages, as they consistently reach the poor in a sustainable way.<sup>6</sup>

### **What are cooperatives, and how big is the cooperative sector?**

Cooperatives are member-owned businesses. The simplest way to understand them is that they aggregate the market power of people who on their own could achieve little or nothing, and in so doing they provide ways out of poverty and powerlessness. The representative body for cooperatives, the International Cooperative Alliance (ICA), defines a cooperative as:

*An autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations, through a jointly owned and democratically controlled enterprise<sup>7</sup>*

This definition and the ICA set out seven cooperative principles: voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training and information; cooperation among cooperatives; and concern for community. The first four of these are core principles without which a cooperative would lose its identity; they guarantee the conditions under which members own, control and benefit from the business. The education principle is really a commitment to make membership effective and so is a precondition for democratic control, while cooperation among cooperatives is really a business strategy without which cooperatives remain economically vulnerable. The last principle, concern for community, is about corporate responsibility, and it leads into other concerns that the ICA is promoting such as prevention of poverty and protection of the environment.

The cooperative sector worldwide has about 800 million members in over 100 countries through the membership organizations of the ICA. Across different countries, the proportion of the cooperative membership to population varies, but can be as high as 1 in two people as in Finland and Singapore, one in three in Canada, New Zealand, Honduras, and Norway, one in four in the USA, Malaysia and Germany. Viewed in terms of households, cooperative membership represents as much as 1 in 2 households in Finland, and 1 in 3 in Japan. In terms of percentage of a country's GDP attributable to cooperatives, the proportion is highest in Kenya at 45 per cent, New Zealand with 22 per

cent. Cooperatives account for 80 to 99 per cent of milk production in Norway, New Zealand and USA. They account for 71 per cent of fishery production in Korea, 40 per cent of agriculture in Brazil; 25 per cent of savings in Bolivia; 24 per cent of the health sector in Colombia; 55 per cent of the retail market in Singapore, 36 per cent in Denmark and 14 per cent in Hungary. It is estimated that cooperatives account for more than 100 million jobs around the world<sup>8</sup>.

### **Cooperatives in developed countries**

In the now-developed countries, cooperatives have had the chance to develop in their own ways over the last two centuries, without much government interference. The first type to develop was a 'friendly' or mutual health society that insured people against sickness and provided basic health care. In countries with a mixed system of state and private funding, such as France, Germany or the Netherlands, becoming a member of one of the health mutuals is still the main way in which people gain access to health care. In the USA, some of the largest health providers are consumer cooperatives; in the Pacific Northwest one cooperative provides health care for 570,000 members; in the Mid-West another has as many as 630,000 members. In Japan, 120 consumer cooperatives provide health care for around three million members, who meet in small 'han' groups to discuss preventive health issues.

Consumer cooperatives, which emerged in Britain in the 1840s along the Rochdale system<sup>9</sup>, are today the market leaders in Italy, Switzerland, Singapore and Japan. They are also very active in the Scandinavian countries and Atlantic Canada. In the UK, which has seen the fiercest competition among consumer chains, consumer cooperatives are fifth in market share and are pre-eminent in the small supermarket sector. Consumer cooperatives have a strong record of creating decent work for their employees, engaging in fair trade with producer cooperatives in developing countries, setting industry standards for honest labeling, and promoting healthy diet.

Housing cooperatives have played an important role in developed economies. Much of the housing built in Norway and Sweden in the second half of the last century has been cooperative. Housing cooperatives in the USA have been popular among higher income dwellers and retired people. They have proved effective wherever private or public renting has failed; in New York 27,000 homes abandoned by private landlords have been taken over and renovated by housing cooperatives designed for low income people<sup>10</sup>. In Britain, management cooperatives have taken over unpopular 'council' estates, and tenant-owned cooperatives are challenging conventional social housing landlords to involve more tenants in the governance over social housing<sup>11</sup>.

Another important area of cooperative involvement is in utilities. In the USA, over 1000 electricity cooperatives supply power to around 12 per cent of households, mainly in rural areas. In Wales, the privatization of water to investor-owned businesses proved unpopular, and has now been bought back by a semi-cooperative which has stakeholder-members.

Some of the world's biggest insurers are cooperatives. The International Cooperative and Mutual Insurance Federation (ICMIF) has 184 insurance companies in membership from 70 countries, with seven percent of the world's premiums. Behind the success of these insurance companies is the underpinning principle of pooling risks among large numbers

of people without having to pay outside investors thereby providing insurance at cost. This is a particular business advantage in with-profits pensions<sup>12</sup>. However, recently there have been some serious governance failures in mutual insurers in the UK which had to demutualise because of poor decision-making by boards that had insulated themselves from member influence. As a result, the UK government advocated for a new code of conduct for life insurance mutuals.<sup>13</sup>

Other forms of cooperatives are also active in developed economies. Retailer cooperatives provide small storekeepers with grocery, hardware and pharmacy supplies and compete directly against the large multiple chains. Worker cooperatives, particularly in the Emilia-Romagna region of Italy and the Basque region of Spain provide shared services such as banking, technical education and product development to their members. There are also emerging cooperatives in personal services such as social care for older people and people with disabilities. Worker cooperatives have also proven successful in preserving jobs by taking over failed businesses; as happened in Western Europe in the 1970s and 1980s.

There are primary producer cooperatives, which supply inputs and do marketing and processing of products for farmers, fishermen and forestry workers. They include some of the world's biggest businesses, including conglomeration of farmers, ranchers and primary cooperatives whose success made to the Fortune 500 listing. Some are cooperatives of small farmers struggling to survive in a tough market where prices paid by supermarket chains are falling and farm subsidies are being cut. In the UK, there is a cooperative that operates 400 markets on behalf of 65 cooperative market societies, through which 12,000 producers can sell direct to consumers<sup>14</sup>.

A recent development is the new generation cooperative in the U.S. where members contribute capital in proportion to the amount of product they intend to supply to a processing coop. The resulting share confers a right to supply, and can be traded among farmers at market value. In return, they get a guarantee from the co-op to return all the value from processing back to the farmers, again in proportion to the amount they have supplied. This new form of co-op, of which there are around 200, is raising the incomes of farmers dramatically, and revitalising the local economies of North Dakota, Minnesota and neighbouring states<sup>15</sup>.

### **Threats and challenges faced by cooperatives in developed countries**

One of the biggest challenges to cooperatives is the lack of awareness of their business potential among governments and the general public. It also often leads to mischaracterization of their interests. In Europe, for example, the International Accounting Standards Board is seeking to have member's shares in cooperatives treated as liabilities rather than equity or capital. This means members will be considered creditors of the cooperative rather than equity owners. International cooperative organizations are opposing the proposed treatment as the proposal is contrary to the nature of cooperatives.

Another concern is the treatment of cooperatives with large market shares as a monopoly. For example, the Swiss Competition Commission is concerned about the large market

share of the two consumer cooperatives in Switzerland that have between them over 50 per cent of the market, despite the fact that the consumers actually own the cooperatives. These cooperatives are seeking a compromise on the monopoly law.

In addition, there have been de-mutualizations in insurance coops, engendered by minimal relationship between members and management and self-perpetuating attitude of board members who are insulated from criticisms. In the UK, the recent financial crisis has caused problems for demutualized building societies, while those that have remained as mutual building societies have largely avoided the problem.

### **Cooperatives in transitional and developing countries**

The growth of cooperatives in transitional and developing countries at first faced many challenges. In the transitional countries, cooperatives have been viewed as state enterprises; with the collapse of communism, these cooperatives collapsed as well. In the developing countries, cooperatives in the 1950s and 1960s operated under the sponsorship of nationalist governments. These governments saw cooperatives as instruments, taking them over and using them as parastatals within a controlled economy and as mass organisations through which the ruling party could reach the rural population. There were success stories in sugar and cotton cooperatives in India, dairy cooperatives in India and Bangladesh, coffee cooperatives in Tanzania and Kenya and in several countries a more independent credit sector. Nevertheless, with market liberalization in the 1990s and the withdrawal of government support, many state-sponsored cooperatives could not compete with the private sector and had to shutdown.

After these experiences, independent cooperatives have since formed. In the transition economies, new laws were passed and old cooperatives were returned to their members and new ones have formed. In Bosnia and in Serbia<sup>16</sup>, for example, agricultural and marketing coops were formed in response to the demand for produce by a growing supermarket sector<sup>17</sup>. While the whole cooperative movement in these transitional economies remains weak, they are expected to continue to grow in such areas as credit, agricultural supply and marketing, and even a renascent consumer cooperative sector. The USAID has been active in the Balkan region in promoting cooperative formation; governments in Eastern and Central Europe and the CIS countries can go a long way in promoting the formation of autonomous cooperatives.

In the developing countries, the international efforts by ICA, ILO and the UN, have been instrumental in the formation of new cooperatives that are independent of their governments. The ICA Identity Statement and cooperative principles, the United Nations Guidelines of 2001 and the ILO Recommendation No. 193 on the promotion of cooperatives have served to guide cooperative formation, as well as limit the role of governments to one of providing an enabling environment and level-playing field so cooperatives can operate on a sustainable basis alongside other types of business. These mechanisms recommend that there should be an 'early and complete disengagement of governments from the internal affairs of cooperatives'.<sup>18</sup> The ILO Recommendation No. 193 emphasises the need to promote the business potential of cooperatives so they can contribute to sustainable development and decent employment. It does not advocate the complete withdrawal of government but recommends an institutional framework in which

government registers cooperatives as simply and efficiently as possible, regulates them in the same way as other forms of enterprise, and provides a wide range of support such as human resource development, access to credit, and support services for marketing, all without infringing cooperative autonomy.

The cooperative sector is experiencing a renaissance despite many difficulties. A study of 11 countries in Africa estimates that around seven percent of Africans are co-op members and that even in countries where apex cooperatives have collapsed, such as Uganda and Rwanda, the numbers have continued to grow<sup>19</sup>; there were only 554 cooperatives registered in Uganda in 1995, but nearly 7500 now. Savings and credit cooperatives are growing, including non-traditional sectors such as housing, consumer, cottage industries and distilleries. They are demand driven, market oriented, and bypassing the old cooperative unions in favour of new networks. Farmer cooperatives are meeting a growing demand from supermarkets for fresh fruit and vegetables. Coffee marketing cooperatives are gaining high prices through fair trade. Electricity cooperatives show that the cooperative model can work in rural areas where the private sector does not want to go. Small dairy cooperatives are growing rapidly in Eastern Europe, Latin America, and Africa to provide raw milk to private dairies. There has been a major resurgence of marketing cooperatives in Ethiopia, Zambia and Honduras.

Telecommunications cooperatives are strong in Poland, Albania, Argentina, Bolivia, and electricity cooperatives in the Philippines and Bangladesh. Credit unions are growing in many countries and extending access to credit, savings and remittance services by poor people and migrant workers. In Bolivia cooperatives are a serious alternative to privatisation of water services to urban consumers.<sup>20</sup> Health professionals also sometimes find it useful to organize through a cooperative, as in Brazil where the biggest cooperative medical system in the world has 367 local member cooperatives operating in over 80 per cent of Brazil's counties with 98,000 doctors in membership, serving 12 million service patients. In Argentina 58 per cent of rural electricity is supplied by cooperatives, and they are also strong in telecommunications. In 2001, workers in Argentina from some 200 failed enterprises were taken over by the workers to form workers cooperatives.<sup>21</sup>

The reform of the basic rules by which cooperatives are registered, regulated and held accountable to their members and the wider public has been critical in the growth of strong cooperatives. In the case of Tanzania, for example, a Presidential Commission met in 2000 to analyse the problems faced by the sector. It was followed by a new cooperative law, new by-laws that ensured primary cooperatives were run properly, and a process of re-elections to societies vetted by the Registrar to ensure that ineffective and corrupt board members are removed. This reform has led to strong growth in the savings and credit movement and in coffee cooperatives in particular. In another example, an Ethiopian reform process which began in 1997 with US development support, has led to growth of cooperatives. Now more than 85 per cent of Ethiopia's total inputs in rural areas are distributed through cooperatives, and over 75 per cent of its coffee is exported by cooperatives.

### **Threats and challenges faced by cooperatives in developing countries**

The preceding optimistic view has to be tempered with awareness of the constraints that cooperatives in developing countries face. A recent study of 450 cooperatives in Tanzania and Sri Lanka reports that cooperatives lack access to loan finance to help them expand their business. Other constraints include lack of technical knowledge and access to new technology, and training in business and leadership skills; lack of access to markets beyond their locality; and lack of knowledge about opportunities for fair trade. These cooperatives are still held back by issues like over-regulation from governments and poor internal governance which can lead to lack of trust in their own elected officials<sup>22</sup>. Farmer cooperatives need assistance to improve the quality of produce for export in a global economy that puts the responsibility on producers to meet quality standards. Credit cooperatives need strengthened capacity to do banking and manage risk.

The low level of participation by women is a challenge faced by many cooperatives, a problem that is worse in agricultural cooperatives compared to other types such as credit cooperatives. One way to address this problem is through setting up women's cooperatives like the women's cooperative banks in the South of Sri Lanka. Awareness campaigns, as in the Women's Dairy Cooperative leadership programme in India, helped double the participation rates of women.<sup>23</sup> In addition, the challenge of low level of involvement of young people and the need to provide them with decent work could be addressed through setting up specialised youth cooperatives and running awareness campaign in existing cooperatives.

In Africa, cooperatives face the specific threat from HIV/AIDS.<sup>24</sup> The cost in human resources – loss of trained employees and committed members – adds to those imposed by the difficult business environment. In particular, credit cooperatives face increased risks from default on loans, and need to provide insurance that may, in the long run, be costly. One challenge is to meet the needs of members with HIV/AIDS and their families, and this can only be done by businesses that are sound. Nevertheless, cooperatives are an ideal setting for increasing awareness and HIV education. For instance, in India cooperative networks are being used for health education, while in Ethiopia 400 cooperatives with a total family membership of 2.5 million are developing educational materials with help from ACDI/VOCA. In Calcutta and West Bengal the sex workers of Usha Multipurpose Cooperative Society, with more than 7000 members, have started a microcredit scheme, help with supply and marketing of handicrafts, and a peer education programme. One opportunity provided by the crisis is to develop new types of cooperatives for home care provision, such as the Soweto Home-based Care Givers Cooperative, which is supported by the Canadian cooperative movement.

Civil wars and ethnic conflicts have caused major disruptions and destroyed cooperative infrastructure and social capital. Yet there is some evidence that even during conflicts cooperatives can survive. In Sri Lanka and Nepal, they have been the only independent organisations allowed by both sides in the civil war zone. In post conflict areas, cooperatives also play a crucial role in restoring both the economy and civil society. In East Timor, with help from the National Cooperative Business Association of the USA, a network of 20,000 farmers has been formed, processing one third of the coffee for export.<sup>25</sup> In Rwanda, a credit union system was rebuilt by the World Council of Credit Unions without regard to ethnicity, and now there are 149 unions with nearly 400,000 members. In Bosnia cheese cooperatives, and in Montenegro dairy cooperatives, have encouraged

displaced refugees to return, while in El Salvador electricity cooperatives have boosted the local economy so ex-combatants can find work. Similar stories can be told of Guatemala, Lebanon, Azerbaijan, Serbia and Montenegro. There is also evidence of cooperatives bridging longstanding ethnic divides; electricity cooperatives in Bangladesh have a common membership among the 28 million users, and in India dairy cooperatives treat members of different castes as equals.

### **Considerations for a UN International Year of Cooperatives**

The United Nations supports cooperatives. There is a growing consensus among international agencies about their importance. The World Bank recognises the role of cooperatives in revitalising the agricultural sector and the rural economy. In addition, an IMF survey in 2007 showed that “cooperative banks have become important parts of many financial systems, with attendant potential financial stability issues”.<sup>26</sup> Cooperatives may not be the solution to the world’s problems, but they are certainly part of the solution. An International Year of Cooperatives can firm up the international will to strengthen cooperatives and in so doing help achieve the MDGs and alleviate world crises.

As part of the International Year of Cooperatives, governments could consider what they can do to strengthen their own cooperative sectors. The following issues could be considered during the International Year of Cooperatives:

- There is a need for a public awareness campaign to make people more aware of the potential of cooperatives and for their current contribution both in social and economic terms, and for the embedding of cooperative studies in the school and university curriculum.
- There is a need for information to be made available in the form of basic statistics on the cooperative sector.
- There is a need to make sure that the legislation applicable to cooperatives in each country recognises their unique nature, and provides a level playing field with other types of business.
- Governments in the developing countries have to develop a strategy for helping cooperative sectors, as part of their wider poverty reduction strategies, while making sure they do not imperil cooperative autonomy.
- Governments might ask whether they can work more through consumer cooperatives to pursue public policy aims such as tackling unhealthy eating, safeguarding rural services, and promoting local economies.
- Governments could explore the possibility of involving patients and medical staff more in the governance of their health care systems, so as to maintain the advantages of mutuality.
- Governments might take the opportunity to examine the role of housing cooperatives in their urban policies.



- Governments might consider whether they are providing enough support to cooperative forms of utility provision, and whether there are new opportunities to involve customers as members, particularly in the move towards sustainable energy.
- Governments might consider whether they are providing enough encouragement for worker-owned businesses in social care.
- Governments might consider whether they might provide more help to farmers to market their produce in this way.
- Governments could consider measures to help cooperatives and mutuals facing hostile bids to demutualise them, for example, by changing rules to make the debate more equal and the decision more transparent.
- Micro-insurance needs to be built on to existing cooperatives in order to cut down on the risks co-op members face in their everyday lives.
- As part of the International Year of Cooperatives, governments engaged in state-building in post-conflict areas could be more aware of the potential of cooperatives for bridging divides.

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- <sup>1</sup> By Global Finance Magazine. It is also the only privately-owned bank with the highest possible credit ratings (see OCDC, 2007)
- <sup>2</sup> Figures quoted by US Overseas Cooperative Development Council (2007) *Cooperatives: pathways to economic, democratic and social development in the global economy*, at [www.coopdevelopmentcentre.coop](http://www.coopdevelopmentcentre.coop)
- <sup>3</sup> See Birchall, J (2003) *Rediscovering the Co-operative Advantage: Poverty reduction through self-help*, ILO, p20-25
- <sup>4</sup> See Birchall (2004) *Co-operatives and the Millennium Development Goals*, ILO, Ch.4 for case studies, and Simmons, R and Birchall, J (2008) 'The role and potential of co-operatives in poverty reduction' ICA Research Conference, Trento, October, for findings from a survey of cooperatives in Tanzania and Sri Lanka
- <sup>5</sup> Smith, S and Ross, C (2006) *Organising out of Poverty: how the Syndicoop approach has worked in East Africa*
- <sup>6</sup> See World Bank (2007) *Finance for All*, Washington
- <sup>7</sup> See International Co-operative Alliance website, [www.ica.coop](http://www.ica.coop)
- <sup>8</sup> See ILO (2007) Fact Sheet *Cooperatives and Rural Employment*
- <sup>9</sup> The 'Rochdale' system is characterized by adherence to the principles of one member one vote, granting dividend on purchases, and is based on the vertical integration of retail and wholesale cooperatives.
- <sup>10</sup> See Birchall (2003) *Rediscovering the Co-operative Advantage: poverty reduction through self-help*, International Labour Organisation, Ch.3 'Tenant takeovers of abandoned housing in New York'.
- <sup>11</sup> See Rodgers, D on 'Co-operative Housing' in Birchall (ed, 2001) *The New Mutualism in Public Policy*, Routledge
- <sup>12</sup> They do not need to be regulated like investor-owned pensions providers, so as to determine which part of the profit goes to members and which to investors
- <sup>13</sup> See HM Treasury (2004) *Myners Review of the Governance of Life Mutuals*
- <sup>14</sup> Co-operatives UK (2008) *Co-operative Review 2008*, Manchester
- <sup>15</sup> Merrett, C and Walzer, N (eds, 2001) *A Cooperative Approach to Local Economic Development*, Quorum Books
- <sup>16</sup> Helped by a USAID programme
- <sup>17</sup> OCDC (2007)
- <sup>18</sup> United Nations (2001) *Report of the Secretary-General on cooperatives in social development*, A/56/73-E/2001/68 annex, p17, and International Labour Organisation (2001) *Recommendation 193 Concerning the Promotion of Co-operatives*, Geneva
- <sup>19</sup> Develtere, P, Pollet, I and Wanyama, F (2008) *Cooperating out of Poverty: the renaissance of the African co-operative movement*, Geneva: ILO forthcoming
- <sup>20</sup> See Birchall (2004) Ch.4, case study on water co-op in Bolivia
- <sup>21</sup> Howarth, M (2007) *Worker co-operatives and the phenomenon of empresas recuperadas in Argentina*, Manchester: Co-operative College
- <sup>22</sup> Simmons and Birchall (2008)
- <sup>23</sup> See OCDC (2007)
- <sup>24</sup> Bibby, A (2006) *HIV/AIDS and Co-operatives*, Manchester: Co-operative College
- <sup>25</sup> Bibby, A and Shaw, L (eds, 2005) *Making a Difference: co-operative solutions to global poverty*, Manchester: Co-operative College
- <sup>26</sup> <http://www.imf.org/external/pubs/ft/survey/so/2007/RES0925B.htm>, accessed 10 December 2008.