

May 31, 2007

## **Promoting Corporate Governance in Co-operatives**

Global Corporate Governance Forum

Co-operatives are differentiated from other enterprise structures by their dual nature: they are business enterprises based on a membership-owned model. The associate aspect of a co-operative helps members to pursue their social goals. As such, co-operatives form an integral part of the private sector, pursuing successful commercial business practices based on the values of self-help, self-responsibility, solidarity, and democracy.

Hence, good corporate governance is fundamental to co-operatives' existence. Co-operatives are founded on trust and credibility, and work for the benefit of their comprising members and the communities in which they are rooted. Good corporate governance is also essential to maintaining an edge in a competitive global economy. Globalization has created both opportunities and risks for co-operatives, which must adapt their values, principles, and structures to the changing global economy. As business enterprises, co-operatives constantly reassess and reexamine their operations to meet the challenges of today's business world. As a significant sector of the global economy, and as part of the private sector, co-operatives hold great promise for attaining development goals. International donors should work with co-operatives to enhance their profile in development activities and improve their sustainability and efficiency.

*This article is based on the report of the Corporate Governance and Co-operatives Peer-Review Workshop, held in London in February of 2007. The full report can be found on the Global Corporate Governance Forum website, [www.gcgf.org](http://www.gcgf.org).*

*To comment on this article, visit CIPE's Development Blog: [www.cipe.org/blog](http://www.cipe.org/blog).*



published by the  
**Center for International Private Enterprise**  
an affiliate of the U.S. Chamber of Commerce  
1155 Fifteenth Street NW · Suite 700 · Washington, DC 20005 · USA  
ph: (202) 721-9200 · web: [www.cipe.org](http://www.cipe.org) · e-mail: [cipe@cipe.org](mailto:cipe@cipe.org)

## Introduction: Co-operatives are Private Sector Enterprises

*“Co-operatives are an alternative way of doing business, but an equally profitable way of doing business.”*  
- Iain Macdonald, ICA Director-General

The co-operative movement represents a significant sector of the world's economy. According to International Co-operative Alliance (ICA) and UN estimates, 1.1 billion people are members of co-operatives, and their economic activity employs 100 million people. This means that they provide 20 percent more jobs than all of the world's multinationals combined. ICA's Global 300 Project, which examined the top 300 co-operatives worldwide, showed that their annual output was over \$1 trillion, making the group the 10th-largest economy in the world.

The unique characteristic that differentiates co-operatives from other enterprise structures is its dual nature: they are business enterprises based on a membership-owned model. The associate aspect of a co-operative helps members to pursue their social goals. As such, co-operatives form an integral part of the private sector, pursuing successful commercial business practices based on the values of self-help, self-responsibility, solidarity, and democracy. Co-operatives can be viewed as an alternate way of doing business – but at equally profitable levels as other enterprises. The model is successful at both the level of small-credit co-operatives, as in West Africa, and within large global co-operative banks, such as Rabobank in the Netherlands.

Experience shows that strong economies require a “biodiversity” of business structures and ownership forms, a rich ecology to which co-operatives contribute. The economic power of the co-operative movement has untapped potential to contribute to sustainable economic growth and to address the problems of poverty. As this vibrant sector increases the competitiveness of national economies, it also depends on the countries' integration in global markets.

Globalization creates both opportunities and risks for co-operatives, which must adapt their values,

principles, and structures to the changing global economy. This process is facilitated by the fact that the accepted values and principles of the sector are by nature very flexible. As business enterprises, co-operatives constantly reassess and reexamine their operations to meet the challenges of today's business world.

As part of the private sector, co-operatives hold great promise for attaining development goals. International donors should work with such organizations to enhance their profile in development activities and improve their sustainability and efficiency.

## Re-empowering Members

*“One of the most important things for co-operatives in governance is learning techniques of membership renewal.”*  
- Mervyn Wilson, The Co-operative College

The essence of cooperation is that individuals can achieve their goals by combining efforts with other people – one can achieve far more in concert than alone. Mutual aid, collective action, and self-help come naturally to people. A co-operative enterprise is a business expression of this natural human instinct. Members, then, are the very essence of what makes a co-operative possible. The seven co-operative principles of the 1995 ICA statement attest that members are the heart of the co-operative model (see box on page 5).

In developing countries, where the individual feeling of helplessness to improve one's own life is acute, there is a strong impetus to work together. Individuals form co-operatives not only for altruistic reasons, but because that may be the only method open to them. In such situations, a member's role in good governance is crucial. Members are acutely aware that directors or those who lead them have a direct impact on the members – failure affects everyone. Membership renewal supports the mechanisms by which members hold directors accountable.

In the United Kingdom, the development and adoption of a corporate governance code of best practice followed a series of high-profile governance scandals

in the early 1990s. ICA's review of co-operative values that led to the 1995 principles of identity revealed that a core factor in governance discussions is the need for co-operatives to be genuinely member-owned and member-controlled. More recently, Co-operatives UK highlighted that "an active and involved membership that has available to it open and fair information is the absolute essential ingredient of good co-operative governance."<sup>1</sup> The democratic regeneration of these enterprises lies with building and renewing the membership base.

Co-operatives have a special challenge to ensure that members are rewarded for their individual effort and individual entrepreneurial drive. Members should never think that in joining a co-operative, their individual entrepreneurship disappears. For example, co-operatives must create incentives for individual farmers to produce a better coffee or cacao crop; while crops are sold in one batch, it matters that individuals strive to produce a high-quality product.

There is a difference between the collective entrepreneurship of the co-operative and the individual entrepreneurship of its members. It is important to balance collective and individual entrepreneurship issues and to strive for equilibrium, even as co-operatives adapt to changing market forces and consumer preferences. This is a key issue that must be addressed by each organization and by the co-operative movement as a whole.

For corporate governance reform, greater member awareness of the purpose of co-operatives will lead to greater demands for accountability and transparency. Just a decade ago, training courses for co-operative directors did not include issues such as risk, ethics, and auditing. Today, however, whole modules are delivered on these topics. There is a strong connection between actions that support membership renewal and those that seek to strengthen co-operative governance frameworks.

Membership also involves asking what co-operatives can do for members as well as what members can do for co-operatives. A short-term perspective (i.e., do I elect the person who can give me the most today rather than the one who looks at long-term viability) undermines

a co-operative's economic success. As members and directors learn more about a co-operative – its central mission as well as the benefits it can provide – they can take a greater role in building and sustaining their organizations through self-regulation that checks government interference.

## Size and Diversity of Co-operatives

The complexity and power of the co-operative movement stem from the great diversity in size and type. On one end of the spectrum, there are large co-operative groups with thousands of stores and millions of members, such as those from the Global 300 Project. On the other end, there are small associations, such as the snake catcher's co-operative in Madras, India, whose few hundred members make important contributions to the development of venom antidotes. The most common types of co-operatives are:

- **Consumer (retail) Co-operatives:** buy and sell to members
- **Producer (agricultural) Co-operatives:** buy from members
- **Manufacturing (supply) Co-operatives:** make and sell to members
- **Service (credit) Co-operatives:** supply to members
- **Labor Co-operatives:** members supply to others
- **Supply Co-operatives:** members purchase inputs and use to supply services to others

Financial co-operatives can often be regarded as a special category because of their special regulatory requirements as financial institutions. The debate regarding this special category is not on the appropriate regulatory role of government, but on whether such regulation applies to the co-operative sector as a whole or only under the regulatory framework of financial institutions. The unanimous consensus, as expressed by the Consultative Group to Assist the Poor (CGAP), is that financial co-operatives are, and should be treated as, financial institutions. Still, within the regulatory framework of financial institutions, there should be a distinction between commercial banks and co-operative banks. At the operational level, when members constitute a homogeneous group in terms of

their financial services requirements, it is easier to make decisions on the direction of the financial co-operative. When the target group becomes heterogeneous, the task of meeting diverse expectations and creating service products becomes very complex for both managers and boards.

Co-operatives are often viewed through a prism of traditional and new generation organizations. The characteristics most commonly associated with traditional co-operatives are: open and direct membership, long-term affiliation, one person-one vote, equal pricing for all members, and cost averaging in serving members. New generation characteristics stem from the challenges of operating in a competitive global market: differentiating voting power as needed to bring in outside equity, separating the price for goods supplied from the return on capital, valuing shares at “fair” market value, and removing cross-subsidies by paying the price differentials among members. New generation co-operatives also face the challenge of adapting co-operative values and principles to business practices that resemble investor-owned companies. Experience and practice reveals that there are ways to make this adjustment.

## Values, Principles, and International Standards

*“The issue is not just to talk of co-operative governance or corporate governance, but the better corporate governance of co-operatives.”*  
- Karugor Gatamah, Centre for Corporate Governance

Why would anyone prefer to invest in a co-operative over an investor-owned company? One answer is that co-operatives are rooted in the community – and trust and credibility within the community are key assets for investors. In the context of developing countries, the close contact between members and managers, which is fundamental to the existence of a co-operative generally, becomes absolutely crucial to maintaining trust and credibility. It matters to a member who holds an equal stake in the success of the firm to know what actions are being taken by managers. Accountability is immediate and tangible in smaller organizations (though in large co-operatives it proves to be more

difficult as the connection between member and manager is more distant), and it resonates because it knits together members and managers.

While governance issues can be quite complex, the movement has achieved a significant degree of consensus on what defines and constitutes a co-operative. The 1995 ICA statement on identity is widely acknowledged as the authoritative pronouncement of co-operative values and principles. The definition captures the dual entrepreneurial and associative nature: “a co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.”<sup>2</sup> The values of a co-operative are based on self-help, self-responsibility, democracy, equality, equity, and solidarity. The 1995 statement also establishes seven principles that guide the manner by which co-operatives put their values into practice (see box on page 5).<sup>3</sup>

The emerging international framework on co-operative identity – as represented by the International Labour Organization (ILO) Recommendation 193 (2002) and the UN Guidelines on Co-operative Development (2001) – is based on the 1995 ICA values and principles. Many state-level co-operative laws in Latin America have incorporated the 1995 ICA statement.

Understanding and clarifying a co-operative’s identity helps managers and members to develop their governance practices. There must be: (1) a clear statement by the board on the co-operative’s vision and mission, (2) a clear understanding on the part of managers and employees of operational practice, and (3) members’ loyalty and sense of ownership.

The values and principles of the movement provide a firm base on which to build a corporate governance framework, and they form an action plan, with built-in flexibility to adapt to the size and diversity of existing co-operatives. Even with the added element of the new generation co-operatives, corporate governance increases compliance with established principles and values and distinguishes a co-operative from an investor-owned company.

## Principles of the Co-operative Identity

### 1st Principle: Voluntary and Open Membership

Co-operatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

### 2nd Principle: Democratic Member Control

Co-operatives are democratic organizations controlled by their members, who actively participate in setting policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member-one vote) and co-operatives at other levels are also organized in a democratic manner.

### 3rd Principle: Member Economic Participation

Members contribute equitably to and democratically control the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.

### 4th Principle: Autonomy and Independence

Co-operatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

### 5th Principle: Education, Training and Information

Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of co-operation.

### 6th Principle: Co-operation among Co-operatives

Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional, and international structures.

### 7th Principle: Concern for Community

Co-operatives work for the sustainable development of their communities through policies approved by their members.

However, while some enduring values do transfer globally (e.g., participation, empowerment, and local culture), it is important to recognize that co-operative governance codes in developed countries tend to adapt mainstream corporate governance codes, or extrapolate from small data sets (e.g., a particular type of agricultural co-operative in a particular geographic location). Such standards and principles may not work in all situations.

Indeed, it can be difficult to achieve even the central tenant of co-operatives – that they exist to improve the living conditions of members. In Central America, there are many agricultural co-operatives that produce corn at costs too high to compete with foreign producers, which are often highly subsidized. Such conditions undermine the sustainability of the local corn co-operatives, making competitiveness and globalization hot topics.

## Documenting and Disseminating the Success of the Co-operative Sector

ICA's Global 300 Project was launched to raise public understanding of the significant role played by co-operatives in the global economy. So far the co-operative sector has done a poor job of communicating its relevance and significance to economic and social prosperity. In the future, it must do a better job of writing its history, communicating its success, and explaining its dual role as social and economic. A key objective of the ILO Co-operative Facility for Africa (to be launched later in 2007) will be to disseminate success stories, to make co-operatives more visible, and share best practices.

A general lack of interest in co-operatives is reflected in the scant nature of academic analysis of the sector, though this is now beginning to change. Dr. Panu Kalmi at the Helsinki School of Economics tracked the references to co-operatives in economics textbooks going back to 1905 and found that they were commonly cited in early 20th-century textbooks and then declined dramatically over time. His conclusion is that there is a trend for economists to stress top-down solutions instead of locally and institutionally sensitive ones, diminishing support for co-operatives.<sup>4</sup> Latin America has seen recent growth in research dedicated to governance and co-operatives, though this is mostly accessible only in Spanish.

Governance problems that plague co-operatives also account for their poor reputation and neglect by policymakers and the wider public. Among the most salient governance problems often found in co-operatives are: confusion regarding the role and mission of the organization, entrenchment of leaders ("power sickness"), conflicts between profitability and the social objectives of the co-operative, opaque decision-making, weak oversight and control mechanisms, and lack of clear rules on how to adapt strategic objectives to changes in the market environment. When these problems emerge publicly in corruption cases, they have a direct impact on the image and reputation of co-operatives.

The crisis experienced by the co-operative movement, therefore, can be largely explained by poor governance frameworks. In the post-colonial world, co-operatives were used as instruments of government, rather than as independent enterprises to reduce poverty. The ILO has documented decades-long state-controlled co-operatives engaged in various agricultural experiments that did not achieve their potential. It is not surprising that the co-operative image was tarnished by these failed experiments, even though the poor results were a failure of countries' broader governance. It is not difficult to understand why the movement has not been more widely embraced by those trying to fight poverty. Fortunately, the renaissance of the co-operative movement is refocusing the development debate on the important role that co-operatives can play to achieve development goals.

## Technical Assistance to the Co-operative Sector in Developing Countries

*"Governance is central to making sure that we do have co-operatives that are organized in the right way for the benefit of the very poorest people."*

*- Gareth R. Thomas, DFID Under-Secretary of State*

If co-operatives in developing countries are to improve their governance frameworks and enhance their role in development activities, it is imperative to build the capacity of individual co-operatives to conduct self-assessment. A toolkit could promote corporate governance reforms in a neutral and de-politicized fashion. Such a toolkit would be adaptive and not prescriptive to local contexts, and reflective of changes in practice over time.

Co-operative practitioners are well aware of the problems and challenges that they face; assistance should come in the form of practical tools to tackle governance problems. In creating a governance toolkit and defining the components of a good corporate governance framework, it is important to address three key elements: (1) recognition of the essential problem of corporate governance – in an enterprise, many people act with equal powers but delegate authority to a small group, (2) accountability for the people to

whom power and authority have been delegated, and (3) agreement on “the rules of the game” of how risks and rewards will be shared among members.

Overall, the co-operative movement can expect a bright future. It is enjoying a renaissance based on a better understanding of how co-operatives contribute to economic and social prosperity. To further this progress, there is a need to better educate the public and policymakers, document and disseminate best practices, re-empower members, create an enabling regulatory environment, and revive co-operative values and principles in the economy. This support must go hand in hand with technical assistance that co-operatives can use to improve sustainability and competitiveness as private-sector enterprises. The combined efforts of practitioners, champions of change, and international donors – in the same spirit that underlies the co-operative movement – is of particular importance in developing countries where co-operatives can serve as a primary means to alleviate poverty and achieve development goals.

---

#### Notes

<sup>1</sup> Co-operatives UK, “Corporate Governance: The Code of Best Practice”, May 2005.

<sup>2</sup> The Statement on Co-operative Identity is available from the International Co-operative Alliance at: [www.ica.coop/coop/principles](http://www.ica.coop/coop/principles).

<sup>3</sup> Ibid.

<sup>4</sup> Dr. Panu Kalmi, “The Disappearance of Co-operatives from Economics Textbooks,” Helsinki School of Economics Working Paper W-398, (Helsinki, 2006). Available at: <http://helecon3.hkkk.fi/pdf/wp/w398.pdf>.

---

*The full report can be found at [www.gcgf.org/ifcext/cgf.nsf/AttachmentsByTitle/CG+and+Cooperatives/\\$FILE/Final\\_Report\\_of\\_London\\_Cooperative\\_and\\_Corporate\\_Governance\\_Workshop.pdf](http://www.gcgf.org/ifcext/cgf.nsf/AttachmentsByTitle/CG+and+Cooperatives/$FILE/Final_Report_of_London_Cooperative_and_Corporate_Governance_Workshop.pdf).*

**Participants:** Tony Baldwin, Consultant; Faustine Karrani Bee, Moshi University College of Co-operative and Business Studies; Dante Cracogna, University of Buenos Aires; Geraint Day, Institute of Directors; Karugor Gatamah, Centre for Corporate Governance; Mo Girach, Independent Consultant; M.A. Baqui Khalily, University of Dhaka; Mumtaz-ur-Rahman Khan, Government of Sindh (Pakistan); Antonique Koning,

*Consultative Group to Assist the Poor (CGAP), World Bank; Iain Macdonald, International Co-operative Alliance; Manuel Mariño, International Co-operative Alliance-Americas; Juliet McKee, Broad Horizons Limited; YRK Reddy, Academy of Corporate Governance; Oumou Sidibé Van Hoorebeke, Caixa Comunitária dos Operadores de Microfinanças; Arild Skara, Norwegian Agency for Development Cooperation (NORAD); Stirling Smith, The Co-operative College; Gareth R. Thomas, Member of Parliament (United Kingdom); Paulo Conte Vascellos, ProxyCon; Mervyn Wilson, The Co-operative College. **Organizers and sponsors:** Ghita Alderman, Projects Coordinator, GCGF; Philip Armstrong, Head, GCGF; Rosario Bartolome, Program Assistant, GCGF; Jose Cruz-Osorio, Consultant, GCGF; Andrew Wilson, Senior Program Officer, CIPE.*

*The Global Corporate Governance Forum is a multi-donor trust fund co-founded by the World Bank Group and the Organisation for Economic Co-operation and Development to promote global, regional, and local initiatives that aim to improve the institutional framework and practices of corporate governance. It is housed in the joint International Finance Corporation/World Bank Corporate Governance Department.*

*The views expressed here are the authors' own and do not necessarily represent the views of the Center for International Private Enterprise. The Center for International Private Enterprise grants permission to reprint, translate, and/or publish original articles from its Economic Reform Feature Service provided that (1) proper attribution is given to the original author and to CIPE and (2) CIPE is notified where the article is placed and a copy is provided to CIPE's Washington office.*

*The Center for International Private Enterprise is a non-profit affiliate of the U.S. Chamber of Commerce and one of the four core institutes of the National Endowment for Democracy. CIPE has supported more than 1,000 local initiatives in over 100 developing countries, involving the private sector in policy advocacy and institutional reform, improving governance, and building understanding of market-based democratic systems. CIPE provides management assistance, practical experience, and financial support to local organizations to strengthen their capacity to implement democratic and economic reforms. CIPE programs are also supported through the United States Agency for International Development.*