

# **DISCUSSION PAPER**

## **Overview of Corporate Governance Issues for Co-operatives**

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# 1. Co-operative identity and corporate governance

## A changing agenda

Good governance is now accepted as vital to achieving the Millennium Development Goals and as a pre-condition for sustainable economic growth. Ensuring better governance of corporations, financial institutions and markets is increasingly recognised for developing countries despite the limited number of firms there with widely traded shares (Oman and Blume 2005). For developing countries, significant benefits can be linked to higher corporate governance standards in the private sector. These include better access to external finance, lower costs of capital and better firm performance (Claessens 2003).

The corporate governance agenda has also been broadened by the recognition of the reach of corporate models characterised by different forms and structures to the Anglo-American model of an investor owned firm. However until now little attention has been paid to the governance needs of other institutional forms of business such as co-operatives despite their considerable presence in many developing countries. The co-operative sector as a whole remains poorly understood and its specific governance challenges remain as yet largely unexplored.

This aim of this paper is to begin to remedy this absence. Taking as a starting point the distinct nature of co-operatives, relevant trends and issues within corporate governance are explored within the framework of the co-operative sector.

## Defining corporate governance

Research into corporate governance in developing countries, especially comparative studies, typically is based on a broad definition of corporate governance which includes the relationships a company has with its wider stakeholders as well as its shareholders. According to Claessens, corporate governance would include:

The relationship between shareholders, creditors, and corporations; between financial markets, institutions and corporations; and between employees and corporations. Corporate governance would also encompass the issue of corporate social responsibility, including such as aspects as the dealings of the firm with respect to culture and the environment” (Claessens 2003:5).

The recent revision of the OECD Principles of Corporate Governance reflects this broader agenda with a greater emphasis on the institutional and policy framework for corporations. This paper utilises this broader definition of corporate governance as one that is more relevant to the distinctive governance features of co-operatives. It is also important to note that developing countries face a set of challenges in improving corporate governance standards which are unknown to many OECD

countries. In many developing countries, systems of corporate governance are frequently 'relationship-based' which can foster insider trading and corruption (Oman and Blume 2005). The challenge is to develop a more 'rules-based' system. Is it possible to identify a similarly distinct set of issues and challenges for co-operatives in the developing world?

## **Co-operative identity**

Despite the existence of a considerable literature on co-operatives, all too frequently they remain poorly understood institutions (Cuevas and Fischer 2006). Co-operatives have succeeded in being both familiar and yet little understood for the general public and the academic world alike. There are many reasons for this. All too frequently the co-operative sector has been viewed through the prism of a specific enterprise, institutional form or a single country. Many studies have failed to capture the heterogeneous and diverse nature of co-operatives and downplayed their position as part of a sector with global reach and frequently operating as part of a global movement.

It can be argued that it is the dual entrepreneurial and associative nature of co-operatives that has contributed to their current low profile within research and policy agendas. As member owned businesses they are generally not subject to stock market listing and consequently less reported on and analysed. Within the developing research agenda on the third sector, co-operatives have been specifically omitted from the Johns Hopkins research programme.

This duality has been variously characterised as both a fatal flaw and a creative tension. In contrast to the single financial bottom line that has characterised investor owned businesses until very recently, co-operatives have always combined different interests and aims within a single enterprise. It is captured within the following internationally accepted definition of a co-operative:

An autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through jointly owned and democratically controlled enterprise (ICA 1995).

Deriving from their dual identity, co-operatives have always faced complex governance challenges and there is a well established institutional framework to deal with this. However the starting point has been not a common legal basis but rather shared principles which have provided guidelines as to how co-operatives should be owned and governed. These guidelines have evolved through time.

The current statement on identity, values and principles was adopted in 1995 at the World Congress of the International Cooperative Alliance (ICA). The Congress endorsed a revision of the seven core co-operative principles and agreed on a basic statement of co-operative identity for the first time. In addition two sets of related values (basic and ethical) to underpin the principles were also agreed upon.

The revision was adopted in response to the rapidly changes stemming from globalisation especially trends of liberalisation and deregulation, marketisation, and political changes. The restatement was also viewed as an opportunity to promote harmonisation within the co-operative sector in providing a general framework whilst also recognising diversity within the sector (MacPherson 1995).

The 1995 Co-operative Principles are listed below:

**Voluntary and Open Membership:** Co-operatives are voluntary organisations, 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.

**Democratic Member Control:** Co-operatives are democratic organisations 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 organised in a democratic manner.

**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.

**Autonomy and Independence:** Co-operatives are autonomous, self-help organisations controlled by their members. If they enter to agreements with other organisations, 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.

**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.

**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.

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

Co-operative values are as follows:

Self-help; self-responsibility; equality; equity; democracy; solidarity.

Plus ethical values of honesty, openness, and social responsibility.

A second tradition with a related but separate set of co-operative principles has been developed by banking and credit co-operatives originating from in Germany and Austria during the nineteenth century. Under the leadership of Friedrich Raiffeisen, financial co-operatives were developed in rural areas which in turn helped to promote the development of other types of co-operatives (Birchall 1997). These co-operatives also have a global reach with a separate international apex body, the Raiffeisen Union.

Raiffeisen co-operative principles are similar to the Rochdale ones. They can vary but normally include: self reliance; solidarity among members; voluntary participation; flexible organisation; self administration and internal democracy.

The Rochdale and Raiffeisen principles remain the dominant ones within the co-operative movement though other versions have been suggested. In the USA, the Department of Agriculture adopted just three principles in 1987 – those of user ownership, user control and user benefits. These relate primarily to the ICA principles which are concerned with the internal running of the co-operative rather than any wider community role or relationships with other co-operatives (Birchall 2005). Many inside the movement would challenge this, arguing that co-operative principles should not be divided but used in their entirety as guidelines by which co-operatives should judge their adherence (MacPherson 1995:13).

It is difficult to assess the global impact of the 1995 ICA Statement of Identity, Values and Principles on governance as no comprehensive studies have been done. Birchall argues that they have been an 'outstanding success' at the international level (Birchall 2005). They have been utilised by the UN Guidelines on Co-operative Development in 2001, and a year later provided the basis for a new International Labour Organisation (ILO) Recommendation 193 on The Promotion of Co-operatives. They were also cited in the European Commission in its Communication on The Promotion of Co-operative Societies in Europe in 2004. As co-operative legislation is remodelled along the lines of ILO 193, then the Principles are beginning to provide the basis for new co-operative legislation in developing countries.

This has been aided by the publication by the ILO of a revised version of its Guidelines for Co-operative Legislation. Using the Principles as their base, the guidelines set out core legal and governance standards such as the composition and powers of the board of directors, audit provision and membership rights (Henry 2005). A stated aim is to promote harmonisation of co-operative laws so as to facilitate competitiveness of

co-operatives in the context of regional and international economic integration. Shared rather than heterogeneous co-operative legal forms will also help to promote more transparent standards for good governance.

Different versions of core co-operative principles also reflect different understandings of the nature of co-operatives and their vision. Many co-operatives and their members have shared an agenda which emphasises a broader transformatory social and economic role. This has been well covered in the historical literature but it also remains a live concern today. In this sense two separate, sometimes competing co-operative models can be discerned. In the USA, for example, co-operatives are often viewed primarily as a form of private sector ownership whereas co-operatives in Europe often keep their links to wider social movements for economic and social justice.

Two examples serve to illustrate this point. In a recent study of Financial Co-operatives for the World Bank, deriving from the USA traditions, their key features are defined as their user ownership, benefits and control rather than their core principles/values or any wider agendas. In contrast, the role of financial co-operatives over the border in Canada, is situated within a wider transformatory agenda:

“Canadian credit unions in Canada emerged as social and economic movements, not as some kind of off-the-shelf model to be ‘replicated’ (CCA 2006:7) .

However the gulf between the limited and wider versions of co-operative principles diminishes when they are translated into actual governance structures and institutional practices. Typically the framework adopted has remained relatively simple – there is a General Assembly of Members held annually which elects the Board of Directors from amongst the membership. The position of Director is normally held in a voluntary capacity without salary though with payment of expenses. The paid management reports to the Board. Many but not all co-operatives reward economic participation by payment to members based on the amount of trading with the society. This, of course, is dependent on the achievement of a profit or surplus on trading. A further distinctive feature is the ‘one member, one vote’ rule regardless of the size of shareholding. This is clearly in marked contrast to the investor owned model – though it is interesting to note that neither model rewards democratic participation by individual shareholders and members. The principles linked to wider engagement with other co-operatives and their communities have not normally been reflected within governance structures of individual co-operatives. In addition for the majority of co-operatives in North America and Europe, maintaining autonomy and independence has not been a major issue but is rather an assumed feature.

A distinctive feature of co-operative governance relates to the participation of co-operatives in wider unions, federations and networks. These can vary from loose knit trade based business associations to representative structures similar to those found within the trade union movement. Several co-operative federals in Europe have links to political parties and social movements. The governance implications of these different

layers of co-operatives remain complex and are currently the subject of internal debate and review.

In terms of the embedding of the 1995 Principles within a typical co-operative governance framework, there does appear to be an implementation gap – member democratic participation, as we have seen, is rarely rewarded. For many co-operatives in developing countries, there is a further major challenge to the implementation of the Principles - autonomy and independence have yet to become a reality.

At the same time, the name ‘co-operative’ continues to be used by enterprises and organisations which diverge significantly from the 1995 values and principles. Some commentators seek to differentiate ‘genuine’ co-operatives from others. In the absence of a benchmark of widely accepted co-operative standards and performance indicators this remains primarily a personal judgement as to how ‘co-operative’ an institution really is.

Where co-operative performance indicators have been developed they remain very much in their infancy and confined to the developed world. Two pioneering initiatives in this area originate within Canada and the UK (Quarter et al 2002, Nembhard 2004, Co-operativesUK 2005). The recently adopted UK Co-operative Performance Code, for example, comprises ten indicators which include some on governance (member economic and democratic engagement) as well as those for commercial and environmental issues. No similar indicators for co-operatives in the developing world appear to have been developed.

## **2. A growing co-operative presence?**

As highlighted previously, the lack of current and comparative data on the co-operative sector makes definitive conclusions about its global size and scope difficult. Until recently there was a general consensus that the co-operative sector has been in overall decline especially during the past two decades. Today, however, a new consensus is emerging within the co-operative sector and among some policy makers that co-operatives globally are entering a period of renewal and growth. We have seen a reappraisal of the role of co-operatives emerging at the global policy level albeit resting on a limited evidential base. To address this problem, several large scale comparative studies of the co-operative sector are now underway or have recently been completed. This paper draws on preliminary findings of these studies, where possible, together with existing literature to explore the changes in the global co-operative sector.



## Membership figures

Evidence for the size and shape of the sector globally are normally derived from membership figures. The most commonly used estimates originate from the membership of co-operatives affiliated to the three global co-operative apex bodies. The International Co-operative Alliance (ICA) claims via its affiliates a total membership of 760 million members, the World Council of Credit Unions has a membership of 118 million and the International Raiffeisen Unions have a total of 190 million members.

Even allowing for a considerable degree of caution regarding these figures, it is clear that membership of a co-operative still can be viewed as a significant global phenomenon. National and regional statistics can provide better data but the prevalence of different legal and institutional structures make comparative analyses difficult even in regions such as Europe.

However, current data on the co-operative sector in Europe reveals a total of 235,000 cooperative enterprises with 5.4 million employees and 140 million members in 33 countries ([www.coopseurope.coop](http://www.coopseurope.coop)). The sector is a very heterogeneous one with co-operatives varying hugely in terms of scale, history and lifecycle, economic sector, etc. They can range from the retail societies typical of the UK with membership running into millions, to small farmer co-operatives in Spain or Italy, large insurance providers and banks, small and large credit unions. This heterogeneity of the sector is a common feature of co-operatives throughout the world with very different patterns of ownership and membership, variations in size, geographical base and democratic structures. Cuevas and Fischer, for example, emphasise the diversity within the financial co-operative sector with institutional, legal, governance, scale and product portfolio subject to huge variation (Cuevas and Fischer 2006).

However besides the membership estimates for co-operatives, other evidence as to their overall economic and social impact remains very thin. A frequently quoted UN Report of 1994 suggested that co-operatives contribute directly to improving the living standards of half the world's population (ILO 2000:31).

The most recent data available on the size of the co-operative business sector globally was produced in 2006 by the ICA. This is a list of the top global 300 co-operatives measured in terms of turnover for 2004. Their combined total turnover reaches an estimated at \$1,000 billion and with a concentration in the following sectors: agriculture, finance, together with retailing and wholesaling (available online at <http://www.global300.coop/>). Co-operatives from 28 countries are to be found in the list of which the majority originate from the developed world. Co-operatives from India, Brazil, China and Mexico are also included and though US co-operatives appear in the list they only comprise only 11 of the top one hundred.

The global reach of co-operatives remains undisputed but their presence is uneven, with those based in agriculture and finance being the most prevalent. Agricultural marketing co-operatives supply 15% of the total of farm output in the USA whilst

agricultural co-operatives handle 50% of the supply and marketing of food stuffs in the European Union (Munckner 2006). One in four consumers in the USA obtain their electricity supply from a co-operative. Consumer co-operatives hold only around 5% of the food retail market in the UK but in Sweden the total is around 20% and in Finland have recently grown to become the country's largest retailer. The presence of financial co-operatives also varies widely – measured by the ratio of members to active population, market coverage varies from 1% in Asia to 41% in North America (Cuevas and Fischer 2006).

The reach of co-operatives is also reflected in ICA structures which are divided along sectoral lines with nine apex global bodies representing fisheries, agriculture, banking, health, housing, insurance, tourism, consumer and workers. Each apex organisation is democratically owned and financed by its member organisations.

However even within these sectors, there can still be variation in the type of co-operative institutional form adopted. Setting aside financial co-operatives, there is a generally accepted typology of co-operatives with four major forms:

Consumer - owned by the people who buy the goods or use the services of the co-operative. Almost any consumer needs can and have been met by a co-operative.

Worker - are owned and governed by the employees of the business. They can operate in all sectors of the economy and provide workers with both employment and ownership opportunities.

Producer - are owned by people who produce similar types of products, often by farmers who grow crops, raise cattle and milk cows, or by craftsmen and artisans.

Shared services - Purchasing and shared services cooperatives are owned and governed by independent business owners, small municipalities and, in some cases, state governments that band together to enhance their purchasing power, lower their costs and improve their competitiveness and ability to provide quality services. They operate in all sectors of the economy (Source <http://www.ncba.org/abcoop.cfm>).

The emergence of a type of co-operative reflecting the needs of more than one group of stakeholders has recently been noted with the development of social co-operatives in Italy, for example. Educational co-operatives which involve not just workers in the co-operative but also the users of the educational services provided are another innovation. In the USA new agricultural co-operative models are emerging and have been the subject of much debate since several have adopted a form which allows for investor as well as member ownership together with related voting rights. Some work is being done to chart the development of these non-traditional co-operative forms and to develop an appropriate typology (Chaddad and Cook 2003). In 2006, the enactment of

the European Co-operative Statute enables the development of cross border co-operatives with membership in two or more countries for the first time. A cross border co-operative can either be formed as a new entity or as a result of a merger between existing co-operatives. Up to 25% of shareholding is permitted for non-member investors, though without voting rights. The implications for corporate governance remain to be explored.

## **Signs of renewal**

Evidence for widespread co-operative renewal is now emerging but its coverage remains uneven. A recent review of the situation for co-operatives in the European Union identifies two major trends. To meet the challenge of operating successfully in increasingly competitive global markets many of the larger co-operatives have moved towards more capitalist forms either by creating commercial corporations as flexible forms of growth or by merging with companies outside the social economy. However a parallel development has been the rapid growth of newer co-operatives in most member states, often originating at the micro enterprise level. They operate in education, health and rural development together with other forms of shared services and have played an important role in community economic development (Guadano 2006).

We have already noted similar trends within the 120 million member co-operative sector in the USA . There, conversions to investor owned firms have occurred at the same time as the development of 'new generation' co-operatives (USDA 2002). In Canada, while the older established consumer co-operatives have faced increasing market challenges, newer types of consumer co-operatives have developed. The most notable example is the Mountain Equipment Co-operative, with strengths in online as well as shop-based retailing and over 2 million members in 192 countries.

A further dimension to co-operative renewal has been identified within Europe. Here several studies have linked the process of renewal within specific co-operatives to a reassertion of the importance of core co-operative values and principles. Long established co-operatives in the UK and Belgium, for example, have been developing strategies to promote active membership engagement, implementing better standards of governance and developing ethical trading strategies (Develtere et al 2005, Croft 2006). In the UK, the increasing centrality of co-operative values has been linked to business success initially by the Co-operative Bank but also by other consumer co-operatives (Co-operative Commission 2001).

Little research has been done on the ways in which co-operatives have tried to integrate their values into their business practices at operational and strategic levels. However one recent study of the co-operative sector and Fair Trade in Europe has indicated that support for Fair Trade by both the UK and Italian consumer co-operative sectors is perceived as a way of putting their co-operative values into practice (Shaw 2006).

## Co-operatives and international development

There have been a number of case studies on the ways in which co-operatives contribute towards the Millennium Development Goals (Birchall 2004). Responses to a UN survey in 2005 by 35 countries and 38 apex co-operative organisations indicated that almost 90% of respondents viewed co-operatives as having a contribution to make to poverty reduction though this was not reflected in levels of participation in Poverty Reduction Strategy Programmes (UN 2005). Responding member states were overwhelmingly from the developing world.

Data on the credit union sector indicates that in the period between 1996 and 2003, membership has grown by 40% and the number of institutions has grown by 10% (Cuevas and Fischer 2006). However common perception remains that Co-operative Financial Institutions (CFIs) are primarily associated with middle class clients. A recent World Bank/CGAP donor brief challenges this assumption and highlights the ways in which savings and credit co-operatives provide financial services to millions. It emphasises their capacity to reach rural people, local ownership, sustainability and their offer of savings as well as credit to members (CGAP 2005). The most recent review of the work of CFIs argues that the evidence base supports the contention that they serve larger numbers of poor people than special 'targeted to the poor' microfinance institutions (Cuevas and Fischer 2006:54). There is also a growing interest in the role of co-operatives as providers of basic services such as water and electricity in several developing countries (Ruiz-Meyer and van Ginneken 2006, UN 2005).

Pollet, Develtere and colleagues have recently completed the first large scale review of the co-operative sector in Africa for over ten years. Their preliminary findings indicate a total of 30 million co-operative members in an 11 country sample with a penetration rate of 7%. They argue that these figures reveal that the co-operative sector still has a substantial presence in many countries and there is evidence of a renaissance taking place especially for at the level of primary societies. Village level co-operatives are enjoying a rise in numbers involved while the different types of co-operatives are emerging reflect a willingness to venture into different sectors. For many poor people, co-operatives are the only group they belong to which helps them to make a better living. Co-operatives are able to "build on existing institutions of self help and mutual help but also develop new systems of risk pooling and social security such as social benefit funds, micro insurance and mutual health organisations" (Pollet and Develtere 2006:34).

It remains difficult to easily categorise the global reach and scale of co-operatives. The nature of the heterogeneous and changing co-operative sector globally has yet to be reflected adequately in the data available. Divergent trends are apparent even within countries and regions. However there is sufficient evidence to suggest that at the very least the decline of the co-operative sector appears to have halted and that there are signs of a renaissance. This is not just linked to rising membership and business turnover but also to a renewed confidence in the importance of value led business

practices in the 21<sup>st</sup> century and of the co-operative as a proven and sustainable value-based business model.

### **3. Corporate governance issues for co-operatives in the OECD countries**

Co-operatives, like other private sector enterprises, have not remained untouched by the recent corporate governance scandals nor by the development of codes of good practice. In the UK, the recent development of a corporate governance code linked to relevant performance indicators was prompted by external governance scandals and a recognition that the co-operative sector needed to adopt “cutting edge practice in corporate governance” (Co-operatives<sup>UK</sup> 2005). As in other business sectors, improving governance standards for co-operatives is now becoming a priority and is increasingly debated within the movement.

However the development and implementation of good corporate governance practice for co-operatives remains very much in its early stages. The few co-operative codes adopted so far have been modelled on the codes designed for investor-owned companies, typically adding in further provisos concerning membership but not substantively reworking them. This would appear to endorse the view that corporate governance issues facing co-operatives remain in large measure the same as those for investor owned firms.

This section will explore whether this approach to corporate governance is supported in the literature. Firstly, issues from the wider governance agenda relevant to co-operatives will be discussed, followed by review of the studies that specifically address corporate governance issues.

Within the field of economics, recent studies on co-operative forms of business have remained relatively limited. A recent survey of economic textbooks, for example, reveals the invisibility of co-operatives within standard economic textbooks and relates this to dominance of neo-classical economic theories (Hill 2006). A substantive critique has developed of the embedded assumptions in these theories as to the fixed nature of institutions and markets together with the view that a firm’s inner structure does not affect its economic performance. Within the literature of the New Institutional Economics, for example, the relationship between the nature of governance patterns and economic performance has been explored in some depth (Cuevas and Fischer 2006). There have been a number of seminal studies on the governance modes of firms, including labour managed firms and co-operative business models. Several studies have addressed the question of why co-operative and other worker owned business models are relatively rare (Hansmann 1996, Dow 2003). Typically the failure of the co-operative model is explained by its democratic governance structures which prevent effective control over managers and profit distribution systems that lead to shorter time horizons. The potential of co-operatives to meet multiple needs is also seen as a failing.

Many studies draw primarily on US examples but some do consider evidence from co-operatives based in different sectors (e.g., agricultural, consumers, housing). Hansmann, for example, contends that the costs of sustaining forms of economic democracy become too high where there is a lack of homogeneity and conflicting interests among the owner members. This is reflected in the relative rarity of member-owned businesses within the private sector. Where member-owned enterprises are smaller and have more homogenous membership, they can and do survive as evidenced by the presence of co-operatives in agricultural marketing, rural utilities and housing (Hansmann 1996).

This study is based on case studies derived solely from the USA and does not include the large consumer, worker and agricultural co-operatives that can be found in Europe. Dow, however, does consider European case studies and identifies a range of factors that contribute to the relative rarity of member owned businesses. He emphasises the importance of exploring the historical context and the ways in which legal institutions and codes have ensured the dominance of investor-owned firms and restricted the development of other models. Co-operatives need a supportive policy framework to be sustainable. This support has been enjoyed by Legacoop in Italy where an enabling legislative and financial framework has helped to create a large and vibrant co-operative sector. He comments that the “Lega experience also refutes the idea that such firms suffer from deep organizational flaws that predispose them to failure” (Dow 2003:75).

Cuevas and Fischer identify the principal source of failure for CFIs as deriving from member/owner conflict with management. The growth of a co-operative inevitably expands (or dilutes) ownership and managers become subject to weaker controls. This results in rent-seeking behaviour and wasteful expenses. This tendency is reinforced by the fact that co-operatives have frequently faced weak external competition through subsidised financing from government which has also enabled inefficient managers to survive (Cuevas and Fischer 2006).

The development of managerial dominance within co-operatives has been a strong theme within the literature on non-financial co-operatives as well. An influential model has linked co-operatives to a process of democratic degeneration. Meister, for example, identified four stages in the internal transformation of democratic organisations into manager-led enterprises. This relates to the growth in size and complexity of the enterprise which enables management to take advantage of growing member apathy and distance from the original core co-operative values (Meister 1984).

Another recent study has proposed a model of five management and governance roles within co-operatives. It also links the tendency for the diminishing role of membership in governance to the expansion of the co-operative and a growing domination of commercial values fostered by a professional management distanced from co-operative values (Malo and Vezina 2004).

Spear also identifies this problem as prevalent within larger co-operatives in the UK. He argues that the co-operative systems of governance contribute to the development of powerful and entrenched managers who have more control than in similar private-sector companies. He attributes this to managers' greater degree of insulation from pressure from external stakeholders together weaker signals from external markets. Internally, pressure on managers is also weak because of low levels of member participation as evidenced by the situation in UK consumer co-operatives (Spear 2004). On the other hand, others have argued that the empirical evidence for the hypothesis of a tendency towards increasing management control is mixed (Chaves and Sajardo-Moreno 2004).

Two recent studies have suggested some strategies to help co-operatives counter these tendencies. One study proposes that, although the co-operative enterprise continues to innovate and grow, it does this by offering a greater range of services to its existing members rather than by breaking out of a niche market position. This allows for the retention of a simple set of participative governance structures allowing for engagement of various stakeholders and the development of a project rather than a product focus. A second set of strategies is proposed for larger enterprises related to the development of innovative and better systems of participative governance that are based on shared co-operative values:

The value-creation propositions must be linked to social, societal and humanist values supported by the social, solidarist economy – this becomes the best means of differentiating the collectivist enterprise from the capitalist entrepreneur. These values allow the creation of a value, no longer merely of use, nor just in relation to an immediate community, but also at the macro level (Malo and Vezina 2004:130).

Chaves and Sajardo-Moreno emphasise the importance of the selection and training of managers in tune with core social enterprise values. This process could be aided by the development of appropriate training courses and educational institutions together with a code of conduct. These processes are critical to the survival of the democratic enterprise (Chaves and Sajardo-Moreno 2004). Spear also suggests a series of measures to limit managerial power by enhancing the commitment to and involvement in the running of the co-operative by the wider membership (Spear 2004).

In terms of investor-owned enterprises, strategies to tackle management control have typically focused on improving and enhancing the responsibilities and role of the board. Overall findings from the studies reviewed above also support this focus on boards, as they also provide the most important mechanism available to co-operative members for controlling management behaviour.

An important proviso to this is related to the elected nature of co-operative boards. Cornforth points out that the nature of co-operative corporate governance is relatively under-researched compared to that of investor-owned corporations and especially in relation to elected boards. Drawing on work into the role of boards in the private sector, he proposes a conceptual framework for co-operative boards based on a multi-

paradigm paradox perspective which takes into account the diversity of goals that characterise co-operatives.

He identifies three key tensions that influence the operation of co-operative boards:

The tension between board members acting as *representatives* for particular membership groups and *experts* charged with driving the performance of the organization forward

The tension between the board roles of driving organizational performance forward and ensuring conformance ie that the organization behaves in an acceptable and prudent manner

The tension between the contrasting board roles of controlling and supporting management (Cornforth 2004:13).

Particular issues for co-operative boards derive from their elected status which provides no certainty that the director will hold the rights skills mix and knowledge to effectively scrutinise management decisions. This situation is worsened by low levels of member participation in the democratic processes which could be ameliorated by better education and training of board members. The use of co-opted members is also suggested as a solution to address skills deficits. Finally the development of new forms of co-operative models with multi-stakeholders may help to address board deficiencies. More comparative studies are needed to systematically compare the governance of organisations across different sectors and the impact of factors such as size on board composition and performance (Cornforth 2004:27).

The need for effective education and training for co-operative and mutual boards is now generally accepted within the UK. It forms an important element in the Corporate Governance Code of Best Practice finalised in 2005 by Co-operatives<sup>UK</sup>. Consumer societies in membership of Co-operatives<sup>UK</sup> are expected to commit to the implementation of the Code and to provide information annually on the extent to which the provisions of the Code have been adopted. Taking as its starting point the 1995 ICA Statement, the Code also includes comprehensive guidelines on the rights and responsibilities of members, board roles, performance evaluation, audit procedures, elections and accountability to wider stakeholders (Co-operatives<sup>UK</sup> 2005). Many consumer societies, in conjunction with the UK Co-operative College, run education programmes for members and directors on a wide range of corporate governance issues (see [www.co-op.ac.uk](http://www.co-op.ac.uk)). Moreover, in the UK, a focus on increasing member participation and voice in their co-operatives is occurring in the context of a growing emphasis on user participation and voice within public services (Johnson and Simmons 2004). In the co-operative sector in North America, a wealth of educational materials and resources aiming to improve the effectiveness of boards are also available.

However, this analysis derives from the unitary board structure typical of Anglo-American traditions. The agenda for further research into co-operative boards, could be



extended to include an analysis of the governance implications for different types of elected boards. Many co-operatives in mainland Europe have adopted a dual board system with both a supervisory board and a board of directors, both formed by members. In certain of the larger consumer co-operatives, the question of who should sit on the supervisory board is influenced by party politics. This can introduce the potential for conflicts of interest between members and an outside agency. The pitfalls of a multi tier structure would also seem to include a lack of clarity concerning the division of roles and responsibilities between the different tiers, leading to potential agency conflicts (Pellervo 2000).

Several studies have called for more work to be done on strategies to increase membership involvement, though as yet little has been developed in the way of successful case studies (Spear 2004, Develtere et al 2005). The only major research carried out into a member of the top ten listed co-operatives has been that into the case of Mondragon. Based in the Basque region of Spain, Mondragon Co-operative Corporation (MCC) has demonstrated sustainable commercial success linked to innovative governance systems that have allowed its co-operative identity and values to remain at its core. The MCC operates as a democratic federation of more than 100 businesses operating in four divisions: financial, distribution/retail, manufacturing and research/training. The current governance structures date from the early 1990s and operate through a complex multi-tiered system best characterised as a network governance system. The system does involve grassroots co-operatives ceding some democratic control to the federal bodies and a representative rather than participative form of democracy. Several studies have cited the federal structure as key to its success while recognising that considerable challenges still face MCC as it seeks to retain its core values (Bakaikoa et al 2004). In addition, although Mondragon has been the focus of much attention within the co-operative movement, its success has not been replicated within the worker co-operative sector. Dow argues that federations are essential if worker co-operatives are to become self-replicating (Dow 2003:273).

## **Co-operative Financial Institutions**

As we have seen earlier, co-operative financial institutions have a global reach and are also characterised by high levels of heterogeneity in scale, regulatory regimes and range. CFIs include banks, credit unions, saving and loans societies, and insurance providers.

The research deficit into CFIs is currently being addressed by an ongoing research programme originating from the Financial Sector Operations and Policy Department of the World Bank. An overview of the sector has recently been presented focusing on governance, regulation and supervision. Their key findings for governance issues are presented below (Cuevas and Fischer 2006).

The research identifies agency conflicts between members and managers as the principal source of failure for CFIs. However this is as a 'rather complex' phenomenon

in the context of co-operative governance structures and especially elected boards. In particular, they point out that co-operatives can also be the site of conflict between members and their boards in addition to member/manager tensions. Co-operative boards can pursue their own interests at the expense of members as well as be inclined to interfere with the operational responsibilities of managers. However they also argue that more research is needed into the role of elected Boards in order to develop sound and testable hypotheses.

As in other co-operatives, studies on CFIs also indicate a correlation linking an increase in size with an increase in the severity of the owner-manager conflict. This hypothesis has been supported by other studies into CFIs. The governance of credit unions, co-operatives and wider stakeholder models of co-operative governance is characterised by an emphasis on trust, co-operation and informal contracts. These governance characteristics can help reduce transaction costs and lessen problems related to moral hazard and adverse selection. The study argues that these informal systems of governance are more effective in small and locally rooted credit unions by comparison with larger co-operative banks and financial mutuals (Amess and Howcroft 2001).

Cuevas and Fischer also explore the ways in which CFI macro-level organisations such as alliances and networks can make a contribution towards supervision, governance and regulation of their member organisations. This level of organisational capacity is unique to the co-operative sector and can deliver a competitive advantage for the co-operative model by providing a mechanism not only for managing agency conflicts but also for improving economic performance.

## **Wider Stakeholders**

Co-operatives, alongside other businesses, have begun to address the challenge of becoming more accountable to wider stakeholders. However this change has not yet been studied to any extent and co-operatives have not found a place within debates in relation to stakeholder approaches to corporate governance. In recent years, several large European co-operatives have begun to change their business practices to reflect the interests of wider stakeholders. The Co-operative Bank in the UK, for example, has become a recognised leader in developing ethical policies and practices after consultation with its wider stakeholders. European consumer co-operatives have strongly supported Fair Trade and been vital to the mainstreaming of Fair Trade products (Shaw 2006). Consumer co-operatives in Italy, Spain, the UK and Finland now require their suppliers in developing countries to comply with international standards on labour and environmental issues. The UK Co-operative Group, for example, is a leading member of the Ethical Trading Initiative – a multi stakeholder agency working to improve labour conditions in the supply chain. Co-operative performance indicators in the UK now involve ethical supply chain issues, a move which appears to command member support.

Studies on co-operatives in OECD countries have identified the central role that member/manager conflicts play and the important role of elected boards in providing a means of addressing the issue of managerial control. Co-operative corporate governance strategies need to strengthen the capacities and role of the board. There has also been growing emphasis on the need to develop higher levels of member participation in governance structures especially within the European context. This has also been accompanied by the recognition that co-operative values and principles are fundamental to effective governance within a co-operative. Corporate governance has to reflect the multiple bottom lines of a co-operative and not just their economic and commercial performance.

#### **4. Corporate governance issues for co-operatives in developing countries**

Specific studies into corporate governance issues as they impact on co-operatives in the developing world are very few and this, of course, presents considerable difficulty in reaching any definitive conclusions. However there are some clear starting points for an analysis of the key issues which can be derived from existing studies of the co-operative sector in general, several useful case studies, and discussions with co-operative leaders from the developing world. Given the nature of the evidence, and the general characteristics of co-operatives in the developing world, a region by region approach has been adopted.

Implicit in many of the studies on co-operatives in OECD countries has been the assumption that governments have not adopted an interventionist role with regard to co-operatives. The experience of the majority of co-operatives in developing countries has been very different. A starting point for a discussion of corporate governance issues therefore has to begin with the legacy of government control and intervention into the co-operative sector.

This legacy, of course, derives from the colonial origins of the co-operative sector which involved a regime of government control and influence with damaging results that are still evident today.

A recent ILO report comments that:

The developing world experienced several decades of working with state-sponsored and state controlled co-operatives – which had been introduced by the colonial powers as development tools and subsequently used by governments of the independent states for similar purposes. Unsuccessful and costly experiments were carried out on the basis of joint agricultural production, collectives and state farms as way of increasing peasant production and productivity (ILO 2000:11).

This has been aptly described as a system of co-operatives without co-operators. There is an extensive literature on the ways in which co-operatives were provided with special support and often afforded monopoly positions. They frequently became sole suppliers to State Marketing Boards for commodity crops and were subject to price controls. In many cases co-operatives also became vehicles for political patronage and nepotism and were subject to capture by local elites. Co-operative ministries had the power to, and frequently did, intervene in board matters by appointing directors and managers, controlling all business operations and making membership of a co-operative compulsory. The detrimental effects of these interventionist policies have been well documented. However, as a seminal World Bank study on co-operatives pointed out, these policies were in part the result of donor support (Hussi et al 1993). Indeed even within the co-operative movement, there was support for a directive and even coercive role for governments *vis-a-vis* co-operatives in developing countries (ICA 1966).

This situation began to change with the advent of Structural Adjustment Programmes and related liberalisation programmes. Their impact has been considerable if uneven and in many countries liberalisation for the co-operative is still in its early stages. In Africa, single-channel marketing systems and regional parastatals were dismantled, many co-operatives stopped receiving product or credit subsidies. Trade liberalisation policies placed sudden and considerable burden on many co-operatives by exposing them suddenly to high levels of competition whilst at the same time they lost market access. Co-operatives frequently lost their pre-eminent position in the economy and faced the problem of restructuring with fewer resources (ILO 2000).

A new balance between the power and role of the State with the co-operative has yet to be reached in many countries. To aid this process, a major revision was undertaken by the ILO of its earlier Recommendation on the Promotion of Co-operatives. The aim was to provide an appropriate framework which was universal in its application, recognised co-operatives as private sector institutions controlled by their members and operated within competitive markets whilst sustaining their identity (ILO 2000). In 2002, the passage of Recommendation 193 provided an international framework based on the ICA 1995 Statement of Identity and Principles. A key feature is the emphasis on the role of governments in providing an enabling rather than a controlling framework, respecting the autonomy of co-operatives and ensuring they receive equal treatment with other forms of private sector enterprises.

The impact of the Recommendation has yet to be comprehensively assessed. The ILO has listed activities carried out since 2002 linked to the Recommendation, the majority of which have been in developing countries. Legal and policy changes have occurred in more than 30 countries (ILO 2006). Both China and India, for example, are currently in the process of legislative and policy revisions in the light of Recommendation 193.

The ILO also developed a revised set of Guidelines for Cooperative Legislation. They propose that cooperative legislation needs to be situated in private not public law to reflect the fact that the legislature should not seek public involvement in the activities of

cooperatives (Henry 2005). Any legislation also needs to include the 1995 Statement of Co-operative Principles, not as legal norms, but as a sanction against any abuse of the name co-operative. The Guidelines also include rights and obligations of membership for the individual together with the powers and composition of the general assembly and board of directors. It also suggests that audit procedures include a review of the ways in which the democratic rights of members are respected (Henry 2005:49).

Whilst a revised international policy framework and more detailed legal guidelines have been developed, the literature on their impact on co-operatives in developing countries remains sparse. It has undoubtedly contributed to the predominantly negative perception of co-operatives still current among many international agencies, governments and NGOs.

Two large scale comparative research programmes have recently been initiated that begin to address this weak evidential base: Firstly, as mentioned earlier, on CFIs; and secondly, on the co-operative sector in Africa. Preliminary findings from both will be used. It is clear from these and other studies that the landscape for co-operatives is in a state of rapid change, especially with regard to the legal and regulatory regimes and related forms of governance. These changes have yet to be adequately reflected in many donor policies on co-operatives and their governance.

## **Africa**

As occurred elsewhere in the developing world, co-operatives across Africa were introduced by the colonial powers and typically ignored existing social and economic structures, many of which were based on informal co-operative organisations especially at the village level. The last major study of the co-operative sector in Africa was published over ten years ago and emphasised that government intervention had tended to reduce member participation and had prevented rural co-operatives from becoming commercially viable. The report called for changes in the legal framework and for donor support for capacity-building measures such as member education, staff training and management systems (Hussi et al 1993).

The forthcoming study of the African sector has its primary focus on mapping the extent of the co-operative sector and its related impact on employment, poverty reduction, social protection and representation rather than matters of governance and specifically corporate governance (Pollet and Develtere forthcoming). However, the research provides some much-needed baseline evidence and their findings will help to clarify some of important issues and challenges facing co-operatives in governance matters.

In particular the authors' identification of different co-operative models raises some important implications for the development of appropriate strategies for corporate governance. Across Africa four separate models are proposed which are derived from the different colonial powers and their spheres of influence. They are as follows:

The first model is typical of the British-derived tradition and is based on a single co-operative system underpinned by a common legal form. This involves primary and secondary societies with a single apex body. The sector is controlled by a government department which is headed up by a Registrar with considerable powers and functions.

By contrast, the French-developed co-operatives are one of several rural institutions for development alongside mutuals, associations and trusts. Starting with Native Provident Societies, these semi-public institutions had compulsory membership and were controlled by civil servants. Over time they evolved into mutual societies for rural development but remained centrally orchestrated.

A third tradition is linked to social movements and was embedded in central Africa by the Belgians. Here co-operatives are linked to a lead social movement agency such as a trade union, women's association or farmer's organisation, with the co-operative being viewed as an instrument of collective action.

A fourth tradition situates co-operatives as vehicles primarily for agricultural producers to help their social development and is rooted in the Portuguese cooperative systems. Finally, some co-operative traditions have been 'home-grown' within countries such as Ethiopia, with only a limited experience of colonisation.

The researchers argue that these different models are now merging and that the strength of the unified model is fading. Instead, trade based federations are emerging as part of a broader social economy sector. The need for developing best practice examples in governance is identified as a priority. As yet there is no analysis of the governance implications within each of these models. Some key questions emerge: Is it possible to develop a set of shared corporate governance standards applicable across all types of co-operative? How does the role of elected boards vary? Unfortunately the research raises but does not answer these and related questions.

The study reveals that government involvement in the co-operative sector is slowly reducing but remains inconsistent and erratic. It ranges from no interference and support at all for co-operatives in Cape Verde and Uganda to high levels of direction and interference in Nigeria and Egypt. Legislative liberalization is recent or current in South Africa, Ghana, Kenya and Rwanda. Kenya provides an example of a liberalisation process partially rescinded when co-operatives proved themselves ill prepared for the new era and the withdrawal of government regulatory powers in 1997. The results were largely negative with corruption and mismanagement all too common, including failure to hold elections, illicit payments, theft etc., so much so that the government intervened in 2004 with a new Act which reintroduced state regulation through the office of the Commissioner for Co-operative Development (Wanyama 2006). In Uganda the complete withdrawal of state support and regulation in 1991 also had negative consequences for the co-operative sector which was similarly unprepared for the new era, also resulting in large scale mismanagement, corruption, theft etc. As a result in Uganda, a large number of co-operatives collapsed as, unlike Kenya, the government did not re-engage with the sector (Mrema 2006). The co-operative

movement has been steadily rebuilding itself with support from foreign donors being channelled to primary societies via the Uganda Co-operative Alliance (UCA). The UCA changed from its role as an apex body to focusing on development and training programmes for village-level societies, with UCA membership open to any primary society.

Democratic governance and accountability are key factors for success in the co-operatives studied. This has been aided by the emergence of a better educated membership which has resulted in the election of directors with higher levels of literacy and related skills. As a result, the overall quality of co-operative boards has improved. However many co-operatives still struggle with a unpredictable and changeable policy framework at both the local and national level.

Other governance related issues raised in the research highlight gender issues. In almost all countries, levels of participation by women remains extremely low and male dominated co-operatives are the norm. This is evident in membership at the primary society level and in leadership positions throughout the sector. Case studies on co-operatives from South Africa and Ghana provide evidence of more women's engagement. The Ghanaian model is a particularly interesting one as higher participation of women has been achieved as the result of the promotion and implementation of gender equity policies. This is reinforced by support for gender equity from external stakeholders in the co-operative – notably the Fair Trade organisations who buy some of the products of the co-operative.

Referring to wider debates over governance, Pollet and Develtere argue that the inference that agency problems are more “prevalent, disturbing and acute” in cooperatives than in other businesses is a mistaken one and argue that there is no conclusive theoretical basis or empirical evidence for this view. They recognise that the different co-operative stakeholders have to find ways of interacting that minimise decision making costs but that good governance practices such as transparency, democratic governance, internal accountability and control can effectively counter this. They contend that the case studies:

Confirm that the institutional set up of the cooperative model with its general assemblies, elected and co-opted boards of directors, management committees and different controlling agencies is well suited to make these interaction patterns conflict low and to a certain extent predictable (Pollet and forthcoming).

The Ghana case study, for example, provides a good example of an effective and large scale co-operative. Here the cocoa farmers co-operative Kuapa Kokoo (KK) is cited as an example of a successful enterprise in its commercial and governance aspects and one which has benefited from liberalisation of markets and co-operative laws in Ghana during the early 1990s (Tsekpo 2006).

Started in 1993, Kuapa Kokoo now has 45,000 members in 1,650 village level societies and is democratically run throughout its three-tier system. A system of reserved seats

for women is operational at village and area committee levels and there is a specific commitment to encourage women's membership and participation. Kuapa Kokoo has developed strong external partnerships especially within the Fair Trade network and currently holds more than half the shares in the UK-based Day Chocolate Company – with one in four of the Board meetings held in Ghana and KK receiving shareholder dividend. The Day chocolate company has a unique governance structure with the board of directors including two people from KK (Managing Director of KK Ltd and the Farmers Union President), two people from Twin Trading and one person each from The Body Shop and the NGOs Christian Aid and Comic Relief (<http://www.divinechocolate.com/>). Given the size and scale of operations, the operational costs of running elections can prove considerable. KK has in fact used the Fair Trade premium money to help offset the costs of elections (personal communication).

An additional regional study surveyed farmers' organisations in four Southern African countries and was conducted in 2005 on behalf of the Swedish Co-operative Centre (SCC 2005). The study reveals a heterogeneous co-operative sector comprised of co-operatives at very different stages of their life cycle and faced with different challenges, even within the same locality. The study paints a bleak picture of the governance of small-scale farmers organisations:

Almost all small-scale farmers' organizations have low membership, weak organizational structures and lack capacity to address the needs of their members (SCC 2005:2).

In addition, at the regional level, many co-operatives simply inherited area structures based on existing government systems without changing them. These may be appropriate for public administration but they frequently do not meet the requirements of enterprise development. Additionally many co-operatives have problems in meeting the financial costs of member participation. This is particularly apparent at the regional and national levels where effective consultation and communication with members demands too many resources. Meeting the costs of transport, interpretation and meeting expenses are cited as particular problems.

A further disturbing trend identified in the report is the failure of newer farmer organizations to learn from the experience of long-established ones. This applies especially in matters relating to governance such as tenure of office bearers, conflict of interest, affiliations, how to deal with leaders on assuming political office, codes of conduct, external funding, voting rights and other obligations of corporate members, provision for co-opted members, which decisions require simple majority, consensus etc. Finally the challenge of working towards gender equity in the sector has yet to be tackled seriously. This is evidenced by the lack of women's participation in decision-making structures together with failure to address inequalities confronting women at the household level (SCC 2005).



Only one study specifically addresses the situation of corporate governance within a co-operative sector. This is a report based on research into corporate governance practices in the co-operative sector in Kenya undertaken by the Centre for Corporate Governance. The findings were based on a national survey which involved two national co-operative societies, four secondary co-operative unions, 12 district unions and 24 primary societies. The results indicate a mixed picture with regard to standards of good governance practice.

A majority of the co-operatives surveyed simply utilised the basic constitutional frameworks and by-laws provided by the government without adapting them for the specific needs of their society. Over 90% of those interviewed claimed they understood the beliefs and philosophy of the co-operative movement, however a similar percentage appeared not to understand the governance role of the board. A common perception among members was that management committees/boards took advantage of their situation in convening meetings, for example, primarily to claim for an attendance allowance. Overall many committee members lacked adequate skills and experience and less than 10% had received any training on governance issues though in practice committee meetings were adequately supported in terms of agendas and minutes. In line with other studies, gender equity remained a serious problem. A significant under-representation of women in decision-making structures was reported with half of all management committees having no women members. The study also provides evidence of agency conflict between members and boards as a feature of the co-operative sector in Kenya.

Following on from its research, the Kenya Corporate Governance Centre has produced a set of guidelines on corporate governance in co-operatives, reproduced below. Their primary concern is with the role of the board and enabling it to cover its roles and responsibilities in a comprehensive manner especially in relation to management. Unlike its counterparts in Europe, the code does not include provision to encourage higher levels of participation in the co-operative by the members. In addition the code appears to lack adequate provision for dealing with conflict between members and boards.

- Exercise leadership, enterprise, integrity and sound judgment in directing the cooperative so as to achieve continuing prosperity. In so doing, directors shall act in the best interest of the co-operative society while respecting the principles of transparency and accountability.
- Ensure good corporate governance in co-operative societies.
- Determine their cooperative society's purpose, values and the strategy to achieve its purpose and to implement its values, including the review of appropriate technologies and skills.
- Approve and review overall business strategies, significant policies and the structure of the cooperative society.
- Be absolutely responsible for the performance of the co-operative society in meeting its stated objectives and obligations.

- Ensure effective accountability to the regulatory authorities for proper management of the affairs of the state co-operative society.
- Provide oversight and guidance to the senior management so as to enhance the efficiency and effectiveness of the co-operative society.
- Ensure that effective systems of control are in place to manage major risks faced by the co-operative society and to safeguard the assets of the co-operative society.
- Appoint the CEO and participate in the appointment of senior management in the co-operative society. By the same token, participate in the dismissal of these officers whenever deemed necessary.
- Regularly assess its own performance and effectiveness as a whole and that of individual directors, including the CEO.
- Ensure that the shareholders and stakeholders are effectively informed of the performance of the state co-operative society.
- Assess managerial performance by evaluating key performance indicators and monitoring the effectiveness of the internal control systems.
- Take due regard of, be responsive to, and deal fairly with other stakeholder interests, demands and expectations, including those of employees, suppliers, creditors and the general community.
- Ensure that the co-operative society complies with all statutory and legal requirements, including prescribed codes of best practice.
- Ensure that remuneration is set at an attractive level to motivate, attract and retain highly competent persons both on the Board and in the management.
- Ensure that the co-operative society has sufficient and appropriate resources to achieve its strategic goals.
- Ensure on an annual basis that the co-operative society will survive, thrive and continue as a viable going concern.

In neighbouring Tanzania, governance standards in many co-operatives have also found to be lacking. A recent survey of village-level coffee co-operatives also reported that low levels of education hindered the effective management of the co-operative and was linked to lack of democratic control. In many cases the secretary lacked sufficient education, while the ability to act independently and the lack of control by members meant high levels of fraud and theft committed by the secretary. Financial controls and record keeping were often very weak. Members called for education and training not only on production but also in co-operative affairs. Committee members and secretaries also needed training in financial management (Boekhold 2005).

The Tanzanian government is currently engaged in the Co-operative Reform and Modernisation Program (CRMP) which is aimed at enabling co-operatives to become member owned and controlled as well as economically viable. A specific aim is to promote good governance in co-operatives. Among the key challenges identified are several related to governance including inflexible legal environment, weak leadership and management together with lack of member engagement and participation. Lack of internal controls and checks have contributed towards high levels of dishonesty and corruption. A code of conduct for co-operative management has now been introduced and each SACCO will now have a supervisory board. Other proposed interventions

include measures to promote greater participation by members. Education and training will be restructured to meet the needs of members so as to encourage them to become more involved in the process of promoting good governance in their co-operative societies. Active and empowered members will participate in the running of their societies in terms of decision-making, planning and control (CRMP 2005).

## Asia

As in the case of Africa, studies relevant to corporate governance and co-operatives in the region remain limited and focus mainly on South Asia. However the majority of co-operatives in Asia share a similar legacy of government intervention and colonialism. The co-operative model developed by the British within India has received the most attention. This derives in part from the fact this co-operative model was then replicated in other British colonies and was based on unified system with strong central control. The latter feature was not modelled on the UK experience of an autonomous co-operative sector and indeed the Indian co-operative system was, in important respects, modelled on the German system.

This was because the British colonial authorities identified indebtedness as main problem holding back rural development in India. The 1904 Co-operative Credit Societies Act was passed to set up credit unions along Raiffeisen principles. This has been characterised as an “interpretation of a British Colonial Office of a German Institution that presented organizational characteristics that were strange even to British business” (Cuevas and Fischer 2006:27).

In 1912 a second Act allowed for the establishment of other types of co-operatives. This tradition was later exported to other colonies and characterised as mentioned above by tight control from a central government department for co-operatives whose registrar had considerable powers of intervention (Johnson 1997). The co-operative tradition in South Asia was not fundamentally altered after independence with the state retaining a large degree of control over the co-operative sector. The law was meant to serve as an instrument for achieving economic and social development in rural areas.

Unlike Africa, the co-operative sector in South Asia has been noticeably less affected by the impact of Structural Adjustment Programmes and until recently by liberalisation packages. In India, the co-operative regime in the majority of the states remains characterised by high levels of government control and intervention. Ramesha reports that “dormant membership, lack of active participation of members in management, lack of professionalism (and absence of corporate governance) undue political and bureaucratic intervention have made majority of the cooperatives at the primary level almost moribund” (Ramesha 2003:3). There has been much criticism of levels of state intervention at district and regional levels and there is an extensive literature discussing the negative economic and social impacts of the current regime.

The co-operative sector in India is currently undergoing a reform process initiated by the government. In 2004 a Task Force was established to develop a reform strategy for the Co-operative Credit Structure (CCS) which consists of over 100,000 Primary Credit Societies (PACS) which also provide other services such as public food distribution and supply of agricultural inputs. These are linked to 361 District Co-operative Banks and 30 State Co-operative Banks. The proposed reforms will impact considerably on governance structures and practices of the co-operative sector with a dedicated government department (the Department for Co-operative Revival and Reforms) to lead the process. The Task Force Report emphasises the need to address widespread governance failures including the “non-conduct of elections for a long time, frequent supersession of Boards, delay in audit, states’ intrusion in administrative and financial management” ([http://www.nabard.org/whats/rcci/rcci\\_task\\_force.htm](http://www.nabard.org/whats/rcci/rcci_task_force.htm)).

The financial position of the CCS is weak and deteriorating with many societies and banks generating huge losses and with a rapidly diminishing share of the provision of rural credit. The aim of the reform process is to enable the development of a democratic, self-governing financial co-operative sector. The agenda for change includes legal reform and a revival process starting with the PACS. The covering of financial losses (but not loans yet to be paid back by borrowers) will be made contingent on the adoption of the reform package. State governments will be encouraged to issue Executive Orders to bring in the reforms in the short term while the existing Co-operative Acts are revised in line with a new model Co-operative Law. States are to be given two years to bring about the changes. As of September 2006, seven states have indicated their acceptance of the Revival Package. Training and education modules are being developed for the members, elected directors and staff of the PACS.

Indian co-operatives also have remained male dominated with many women excluded from participation as membership is on a household basis, typically limited to the male head. This is apparent in the dairy sector where membership in most of India’s 70,000 village-level dairy co-operative societies is heavily dominated by men. The picture is now gradually changing with the establishment of all-women societies. Some 2,476 all-woman DCS are now functioning and out of 9.2 million total membership in Dairy Co-operative Societies, 1.63 million are women (18 per cent). However, women constitute less than three per cent of total board members. The National Dairy Development Board has launched a special training programme for women ([http://www.indiadairy.com/info\\_women.html](http://www.indiadairy.com/info_women.html)).

No comparative study exists of co-operatives across Asia but a series of commentaries on the sector points out that at the beginning of the 1990s “the grand edifices of officially registered and supported co-operatives could be seen in all countries in the region” (Taimni 2001:36). In Asia, the legal and regulatory environment for co-operatives appears not to have changed as rapidly as in the African situation. Taimni reports that even a decade later many Asian co-operatives remain dependent, externally structured and linked to parastatal enterprises.

The central challenge for co-operative governance remains how to balance the principle of democratic control and retain the imperative of professional management. The continuing and purposeful education of membership is vital to the development of a successful co-operative. In addition, corporate governance measures for primary co-operatives need to address the following issues;

- An open and easily understandable election procedure; contested elections to the board are desirable and should be encouraged;
- Elected office bearers should be made fully aware of their duties and responsibilities through education and training, and involvement in the management of their co-operative;
- Clear cut division of legal responsibilities between the board of directors and paid managers should be set in bylaws if not already provided for in the law;
- Internal and external audit should be conducted on a regular basis and the audit reports should be thoroughly evaluated by the board;
- New ways should be developed and introduced of information, consultation and control so as to increase members' participation;
- A 'co-op code of best practice' with the objective of helping a cooperative redefine the duties and responsibilities of the governing bodies and management, to make governing and control issues more transparent and to formulate this should be developed and adopted (Taimni 2001:150).

A considerable barrier to change derives from weaknesses within education and training providers. Co-operative training institutions in Asia face major challenges in reorienting their provision and moving away from complete dependency on government funding. The majority provide a narrow knowledge-based training that is frequently outdated in its approaches and with the focus primarily on staff and management rather than members.

Though their origins are very different to co-operatives in India, co-operatives in China also developed essentially as part of the state apparatus. A co-operative reform process in China is underway stemming from market liberalisation and the dismantling of the centralised purchase and supply system. A recent study explores the characteristics of the new forms of co-operatives emerging at the village level in Zhejiang province (Hu et al 2005). The province was chosen as the first in China to enact a specific co-operative law in 2005. China still has no laws for co-operatives at the national level though this has not prevented the emergence of over 150,000 new co-operatives, and as a result of market liberalisation programmes, two basic types of farmer led organisation have emerged – specialized associations and specialized co-operatives. Data from a sample of 66 farmer co-operatives revealed considerable disparities in size and a move away from the one member one vote principle to voting rights linked to shareholding, with a maximum of twenty votes per member allocated in relation to their shareholding. Typically the co-operatives have both a supervisory board and a board of directors though formal decision making powers rest with the General Assembly. Evidence as to whether this trend towards governance based on a hybrid

form of co-operative is replicated elsewhere in China is not available. The authors point out that the governance structures of Chinese co-operatives vary substantially in terms of equity, membership structures and size.

## **Latin America**

For Latin American countries, co-operatives were also subject to strong government influence except for the countries of southern cone (Argentina, Chile, Brazil and Uruguay) where European immigrants established more autonomous forms of co-operatives. There are few studies available in English on the co-operative sector in Latin America and no comparative studies were located. Findings from two detailed case studies of co-operatives in Bolivia and Mexico, however, provide some useful insights. Both emphasise the centrality of good corporate governance practices to the commercial sustainability of the co-operative enterprises involved and can provide some valuable examples of good practice.

In Bolivia, a World Bank study considers the experience of the Sanguapac consumer co-operative which provides water supply and sanitation services. The research findings conclude that a co-operative model for utilities can and does possess advantages over private and public sector models. Indeed this ownership and governance model has the capacity to provide sustainable services at affordable costs. Sanguapac has complex but effective democratic structures and strong accountability mechanisms. The paper concludes that:

Successful co-operatives are normally those able to attract capable and committed board members, achieve a high degree of participation, isolate their decisions from political influence, and maintain an environment in which cooperative values thrive (Ruiz-Meyer and van Ginneken 2006).

In the case of Sanguapac, good quality management and governance have enabled it to overcome the problems faced by other co-operative water services providers, of whom the majority are conflict-ridden, inefficient and have financially weak.

The second study looks at coffee co-operatives in the Chiapas region of Mexico. It explores the impact of access to Fair Trade markets in both commercial and governance terms for the co-operatives. In a review of the experience of agricultural co-operatives in developing countries, Milford argues that the co-operative models can have benefits in terms of innovation, economies of scale, improving competition and increasing social capital. The danger of external financial support and externally-driven development is that it can reduce levels of participation among the members, inhibit the development of social capital and make free riding more likely (Milford 2004).

However Milford finds that support from Fair Trade has proven a more effective form of external support for co-operatives than that provided by governments or NGOs. This appears to be due to the market-related nature of the support plus the fact that the

economic costs of membership for the co-operative do not outweigh the wider social benefits. Many viewed the meeting obligation for members not as a waste of time but as a way of generating information and support. Co-operatives in Chiapas deliberately adopted several measures to ensure member participation by making members' meetings regular and community based. Members are required to attend the monthly meetings and repeated non-attendance results in expulsion from the co-operative. Ensuring member engagement and loyalty remains essential since, due to lack of working capital, co-operatives cannot afford to pay members at the time they deliver their produce. Milford also argues that issues such as costs, democracy and multiple activities are best dealt with in organisations that are smaller in size.

### **Cross-regional studies**

Two cross-regional studies touch on governance issues. Parnell reviews the role of co-operatives in post-disaster recovery and in crisis resolution and argues they can help to rebuild social capital in a several ways including acting as 'schools for democracy' (Parnell 2001:18). He concludes that co-operatives can play a valuable role in capacity building programmes, facilitate local ownership and reduce the impact of crisis situations. Examples are given of such a role played by co-operatives in Somalia, Papua New Guinea, Botswana and Palestine.

An analysis of community-based good governance practices in South Africa, the Philippines, Romania and Poland also emphasises the importance of involving members in decision-making processes, but linked to a clear demarcation of the responsibilities of the different structures present within a co-operative. Transparent information flows aid the building of shared decision-making and of trust between members and leaders. However levels of member participation in general assemblies needs to be improved (Ortega 2006).

### **Financial co-operatives**

Financial co-operatives in developing countries have also suffered like other co-operatives from a top down approach and government control. The financial co-operative model derived from the British-designed Co-operative Society Act of India was replicated throughout Asia and Africa. The model was even emulated throughout Latin America where similar co-operative legal models were adopted. As Cuevas and Fischer report, the consequences were similar to those experiences across all co-operative sectors: state dependence, corruption, inefficiency and rent seeking. CFIs also had a high exposure to credit risk (Cuevas and Fischer 2006). Unsurprisingly donors lost interest in CFIs as an institutional tool.

The exception to this experience in Africa has been the financial co-operatives and especially Savings and Credit Co-operatives (SACCOs). As relatively new institutions, started in the 1980s, they have not suffered from excessive state control – often starting

as informal sector organisations (ILO 2000). The same period also witnessed the huge growth in micro finance institutions linked to NGOs. The attention of policymakers, academics and donor agencies has been predominantly focused on NGO micro finance institutions.

Fortunately this is now beginning to be evidenced by the ongoing research programme into CFIs mentioned previously and a smaller initiative to survey co-operative provision of micro gap insurance commissioned by CGAP. This research is still very much in its early stages.

However CGAP has recently produced a briefing note outlining the main governance challenges facing credit unions in the developing world. They include a lack of adequate participation in decision-making structures by members. This can result in dominance of the co-operative by community elites who then use the funds to secure their own position. The case of a railway SACCO is cited where the directors facilitated privileged loans to their own supporters. A second problem occurs when board members continue to exercise operational control even after professional managers have been appointed (CGAP 2005).

The absence of clear and distinct roles for paid management and boards is also cited as a major problem in a separate paper for GCAP, 'Micro Insurance Series Good and Bad Practice', submitted by the International Cooperative and Mutual Insurance Federation. Worst practices among insurers have happened when there has been conflict or collusion with management by boards. A further paper in the same series reviews the insurance services provided by the Malawi Savings and Credit Co-operatives. Here there is also an emphasis on effective training for members as well. Training sessions typically cover issues such as what is a co-operative and the rights and responsibilities of members (ICMIF 2005).

Co-operative development agencies and sectoral bodies such as the World Council of Credit Unions (WOCCU) are working to improve governance standards among credit unions. A series of good practice guidelines and governance codes have been developed and relevant training programmes developed and delivered (WOCCU 2006). They also promote the formation of national associations to advocate on behalf of their members, influence policy and demand responsive governance from local and state entities. WOCCU shares CGAP's concern with the need to raise standards of governance for boards:

Good governance stems from clearly defined roles and responsibilities of the board of directors, committees and senior managers. It also stems from codes of conduct which directors and staff at every level of the institute sign on to and respect in the completion of their tasks. Sound bylaws and policies seek to avoid conflicts of interest and provide mechanisms for dispute resolution where they do arise. While many factors contribute to the governance of an institution, good governance begins and ends with the board

[http://www.woccu.org/best\\_practices/index.php?sec\\_id\\_view=12](http://www.woccu.org/best_practices/index.php?sec_id_view=12))



However Cuevas and Fischer identify some problems with the model proposed by WOCCU which contains a bias towards the Anglo-Saxon credit union experience rather than those of financial co-operatives which operate within a different set of co-operative traditions (Cuevas and Fischer 2006)<sup>‡</sup>. This view is endorsed in a recent paper from the Inter America Development Bank. Recognising that European and North American countries have functioning delegated credit union systems, they point out that for the developing world this strategy has not proved successful, with a high number of failures. Self regulation, while attractive on budgetary grounds, carries within it an inherent conflict of interest as federations find it hard to discipline their own powerful members, for example (Janssen et al 2004).

The nature of appropriate supervisory and regulatory frameworks for financial co-operatives in developing countries is the primary focus of the paper by Cuevas and Fischer. They review the literature and debates but note the absence of sufficient documented evidence to reach any definitive conclusions on what should be the nature of the regulatory and supervisory framework. However there is a pressing need to develop core principles to underpin the framework for CFIs in developing countries analogous to those already in place for investor-owned banks.

The overall lack of research does make definitive conclusions difficult but it is possible to identify some governance challenges specific to co-operatives in the developing world. Major changes are occurring to the overall governance framework through the reform and liberalisation of co-operative legislation in an growing number of countries. The arrival of an enabling rather than controlling legal framework undoubtedly provides an unprecedented opportunity for co-operatives. However it also presents a major challenge and many co-operatives remain unprepared and ill-equipped to meet the changes.

The studies also confirm that good governance is central to the success and sustainability of co-operatives in the developing as much as the developed world. Improving board performance and accountability remains a central issue together with improving engagement from the wider membership. However there are some issues and challenges in terms of corporate governance that are specific to co-operatives in developing countries. These include extremely low levels of participation by women as members and in the governance structures in their co-operative. Secondly, there is a need to develop appropriate training and support for directors in the context of relatively low levels of literacy and related skills. In addition, conflict between members and their boards also appear to be present. This has been fostered by long established practices of placing of government nominees on co-operative boards and related patterns of corruption.

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<sup>‡</sup> In referring to WOCCU's model law, Cuevas and Fischer state: "In some aspects it reflects the United States, or perhaps more generally the Anglo Saxon, credit union experience rather than that of financial co-operatives under a more diversified cultural context. This makes the model unsuitable for other systems that respond to a different cultural tradition or present organizational features that are in conflict with this law. Although WOCCU is careful to insist that this model is just a guideline it is nonetheless very detailed in presenting a particular type of organization and regulatory regime".

On a positive note, there is also a growing recognition within the co-operative movement of the need for internal reform and change. The studies have also revealed the remarkable resilience of the co-operative sector despite years of neglect by donors and international agencies. In Africa, there is evidence of a co-operative renaissance.

It is clear that co-operatives in developing countries are going through a period of massive change. Many questions and issues as to the implications of these changes for the policy development and capacity of co-operatives in developing countries remain as yet unresolved. Some of these issues are summarised below.

## **5. Overall conclusions and recommendations**

### **A growing consensus?**

Firstly we have seen how co-operative traditions and definitions vary enormously with no standard institutional and legal model. The term 'co-operative' is currently used by a hugely diverse range of organisations.

Nonetheless, during the past decade, a growing consensus has emerged around the 1995 definition of the International Co-operative Alliance, the UN guidelines and the ILO Recommendation 193. The model of government controlled co-operatives has been rejected in theory, if not yet in practice, by all governments. In the developing world, there is a clear tendency of convergence between the different co-operative traditions drawn from colonial frameworks. The ICA Principles are increasingly being used as a basis for legislation and for codes of good practice. In some instances they are being utilised as a basis for co-operative performance indicators.

This poses a fundamental question for both co-operators and those interested in governance: Does the convergence and consensus of the last decade provide a platform for one common set of governance principles for co-operatives, if not one corporate governance code? And if such a set of principles can be agreed, who should 'own' them at national and international levels? Crucially, could a set of principles be used to separate real from false co-operatives?

### **Owning good governance?**

Secondly, if good practise in corporate governance in co-operatives is a public good, who should develop standards and promote them?

The co-operative movement itself has begun to address governance issues and accepted the need for change. As this paper shows, in some countries, and not just

developed ones, governance codes have been developed. Some resources to promote good governance can reasonably be expected from within the co-operative movement itself. What types of support are best generated from within the co-operative movement itself? What kinds of support are best obtained from external agencies?

Should the role of co-operative federations and apex bodies be to sustain a governance and supervisory role for member co-operatives in the developing world? Or should they prioritise advocacy and representation on behalf of co-operatives?

Both governments and inter-governmental organisation play a role in driving good governance in investor-owned and state-owned enterprises. The OECD code (and the variants for non investor-owned enterprises) is promoted by the OECD itself through research, publications and events. However, as an inter-governmental body, it has limited experience of working with co-operatives unlike the ILO which is the lead UN agency in work with co-operatives. Is the ILO a more appropriate vehicle for actively promoting good practice in co-operative governance?

Governments play a role through adopting and amending Company Law and also play a promotional role. Do they have a similar role in promoting good governance in member-owned enterprises and co-operatives? However government support has all too often meant government interference. How can new models of support from governments be developed?

What other means of support at the local and national levels are appropriate to facilitate the development of better systems of governance?

### **Target groups and sectors**

Thirdly, co-operatives vary from tiny enterprises of a few dozen members to huge organisations. To roll out new governance standards across such a diverse sector will take some time, and 'winners' may need to be selected. It may be that those co-operatives that have become most involved in global supply chains could be among the first to adopt new governance practices. Research on the market-driven interventions of Fair Trade and other external stakeholders indicates they have already made an impact on aspects of governance for producer co-operatives in particular.

Two consistent findings across the literature are that members can become disempowered in co-operatives and that when this happens, the absence of democratic controls and engagement can lead to rent-seeking behaviours by elected directors and appointed managers. The latter group can also take control by manipulating directors who have a poor grasp of the business.

This implies that three groups require clearly defined rights and responsibilities: members, directors and managers. In the developing country context, where education and literacy levels can be low, how do members and directors exercise these rights and

responsibilities? How can accountability be embedded when stakeholders may be unable to exercise it?

Capacity building in the form of education and training for members and directors is generally acknowledged as a high priority to ensure understanding of good governance principles and their application. This has implications for existing patterns of donor support which has traditionally concentrated on technical business skills for managers, rather than empowerment for owner/members. How can this be changed to take account of the emerging governance agenda?

### **Knowledge sharing**

Given the huge diversity amongst co-operatives of businesses, economic sectors and sizes, how can more information about best practice in governance be researched and disseminated?

New forms of co-operatives in Europe and North America have developed. How will they impact on co-operatives in the developing world? What are the implications of this for governance structures?

### **Gender equity**

Women have traditionally been excluded from membership of many co-operatives, despite making a contribution to the enterprise. At the same time, a small number of women-only co-operatives have emerged, often in new sectors and the informal economy. Do these provide a model to promote women's engagement in the co-operative sector? Or should mechanisms to promote women's participation be a part of a governance model? Other strategies to improve gender issues in co-operatives also need to be addressed.

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