

REVISION OF CO-OPERATIVE LAW AS A REACTION TO THE CHALLENGES OF ECONOMIC, SOCIAL AND TECHNOLOGICAL CHANGE

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ABSTRACT

The paper deals with problems of revision of co-operative law as a reaction to economic and social change and identifies two options of lawmakers: emphasis on strengthening the co-operative society as an enterprise or as a self-help organisation of its members. Consequences of approximation to the company model and of strengthening the typically co-operative profile are considered and the consequences of partial revision of co-operative law are discussed, underlining the danger of dealing with symptoms rather than with the causes of adjustments to new conditions. Some operators perceive the tested co-operative values and principles as burdens of the past while others see them as tested sources of strength.

KEY WORDS: Clear versus blurred co-operative profile; emphasis on co-operative enterprise or on self-help in groups, new models: co-operative company, multi-stakeholder co-operative, social co-operative, legal framework for large and small co-operatives, organic versus external growth.

LA REVISIÓN DE LA LEGISLACIÓN COOPERATIVA COMO REACCIÓN ANTE LOS RETOS DEL CAMBIO ECONÓMICO, SOCIAL Y TECNOLÓGICO

RESUMEN

Este trabajo aborda los problemas de revisar la legislación cooperativa como reacción ante los retos del cambio económico, social y tecnológico e identifica dos enfoques alternativos que pueden adoptar los legisladores: el reforzamiento de la sociedad cooperativa como empresa, o como organización de apoyo mutuo de los socios. Se analizan las consecuencias tanto de la aproximación al modelo empresarial como del reforzamiento del perfil típicamente cooperativo, así como las repercusiones de una revisión parcial de la legislación cooperativa, subrayando el peligro de atender a los síntomas más que a las causas de la adaptación a las nuevas condiciones. Existen agentes que perciben los principios y valores cooperativos como una rémora del pasado, mientras otros los consideran como probadas fuentes de fortaleza.

PALABRAS CLAVE: perfil cooperativo claro o borroso; énfasis en la empresa cooperativa o en el apoyo mutuo grupal; nuevos modelos: empresa cooperativa, cooperativa mixta (multi-stakeholder co-operative), cooperativa social; marco legislativo para cooperativas pequeñas y grandes; crecimiento orgánico o externo.

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1. Introduction

Economic change is expressed in various ways:

- Global markets, high mobility of labour, capital and knowledge.
- Concentration and networking of enterprises across national boundaries and
- Trans-national and international co-operation.

Rapid technological change is confronting enterprises including co-operatives with new tasks and need for new investments, requiring flexibility and mobility.

Effects on enterprises are the need to grow or to fall out of the market, grow or perish. Other effects are search for new sources of capital and outsourcing of less profitable units.

Effects of economic change on labour are expressed by new concepts of work, calling for life-long learning, increasing mobility of labour, temporary employment and exclusion of the less qualified and less mobile.

Social change includes demographic change meaning in Europe: less young people and more old people living longer. The opposite demographic trends can be seen in Africa and Asia. Value change includes weakening conventional systems like family and community which are losing strength and importance. High and long-term unemployment and care for an increasing number of elderly people without family support are driving the social welfare state to its limits.

To deal with these new challenges individuals and enterprises have to find new answers. New fields for organised self-help develop:

- Search for new patterns of secure, locally rooted workplaces being integrated into systems of self-help organisations (SHOs).

- Organized self-help in the service sector, where neither the market nor the public sector offer solutions, opening co-operatives for the less qualified and integrating them into the work process with public support as co-operatives for social solidarity, multi-generation housing and multi-stakeholder co-operatives (MSC) bringing all stake-holders in a community of a region together in community co-operatives and
- integration of the socially weak and excluded into society and into the labour market.

By forming or joining co-operatives, people can use the chance of organised self-help by pooling talents and resources to solve problems together, practicing solidarity of the strong with the weak.

Local roots, small scale operations, people- and need-oriented enterprises are means to react to high mobility and unlimited growth of anonymous global players. Organic growth combined with horizontal and vertical integration are an alternative to external growth by merger and acquisition, keeping local organisations in a manageable size, while at the same time benefiting from the advantages of large scale in vertically integrated systems.

2. Concentration and co-operation beyond national boundaries

During the last decades many co-operatives have grown into large enterprises (ICA Global 300 (2011), listing the biggest 300 co-operatives around the world, generating 1.6 trillion US \$ revenue). Trans-national co-operation is promoted by new trans-national co-operative laws, the European Union Regulations governing the European Co-operative Society (SCE R) of 2003 and the Mercosur law for trans-national Co-operatives in Latin America (2009) as an answer to growing competition in a global economy.

The *effects on enterprises* (including co-operatives) have been external growth by merger and acquisition, the search for new sources of capital to finance modernisation and the use of new technologies and outsourcing of less profitable units. To meet these new challenges, the “old” models of organisation and co-operation have to be reconsidered.

Internationally recognized co-operative values and structures are gaining new importance:

- Small units as part of networks with local roots and personal co-operation based on trust versus high mobility of labour and capital, boundless growth and dependence on anonymous global players.
- Vertically integrated structures allowing the small to benefit from closeness to members and customers without renouncing to the strength of large scale, being members of integrated systems, according to the Rabobank slogan “Small in front – big in the back.”

These trends can be summarized in the slogan “Glocalization”.

Revision of co-operative law is called for mainly by large co-operatives and their federations as a reaction to the challenges of economic, social and technological change. These development trends are also affecting co-operative enterprises. To meet the new challenges, the “old” models have to be reconsidered and new fields of organized self-help emerge, where neither the market nor the public sector offer solutions: maintaining village infrastructure, alternative energy co-operatives, medical professions co-operating to offer their services together, housing co-operatives with social services and community co-operatives in the form of Multi-stakeholder Co-operatives (MSC).

For revision of co-operative legislation there are two venues of reform:

- Strengthening co-operative societies as a self-help organisations of their members and
- strengthening co-operatives as enterprises which have to be economically efficient before they can offer member-promotion.

When trying to adjust co-operative law to present-day conditions, this may require changes which in sum amount to a fundamental change of the co-operative model, with effects on its practicability. How much adjustment can the co-operative model afford without losing its identity and without leaving the co-operative concept? When does quantity of change turn into change of quality?

To answer these questions, the principle of identity of owners and users can be used as a starting point. According to this principle meaning that those who contribute capital, who decide and who use the facilities of the co-operative enterprise are the same (identical) people:

- Identity of owners, decision-makers and users helps to keep conflicts of interest between these groups low.
- Emphasis on conscious and active membership, participation with own resources leading to individual and collective benefit are incentives to join and to remain a member.

- The 3 S – self-help, self-administration and self-responsibility – to reach a co-operative advantage for each and all members, make co-operatives an attractive model for dealing with special types of problems suited for a co-operative solution, i.e. by working together, pooling talents and resources, supply and demand, operating with low risk and without requiring high initial capital.

To allow deviation from the principle of identity means:

- To lay the ground for increasing internal conflicts.
- To change the position of members and leaders and
- to limit the suitability of the legal pattern for giving the object of member-promotion priority.

Programmes for a reform of co-operative law can choose between two options:

Option 1: Strengthening the co-operative society as a self-help organisation for member-promotion and as a group of co-operators. This means going back to the roots, stressing the identity of owners and users as a distinctive feature – a brand – while doing business differently, in a specific co-operative way. (UN Guidelines of 2001, par. 12 (1 (a)). This also means: promotion mainly of the members (strict application of the principles of identity), strengthening the internal democratic structure (and the role of members) and additional social functions, if the members decide (ICA 7th co-operative principle). Such “social” co-operatives can be promoted/supported by the state.

Option 2: Co-operatives are seen primarily as enterprises which need to be fit for meeting the requirements of the market. Deviations from the principles are allowed to strengthen their economic efficiency. Economic success is the main concern. E. g. by admitting investor-members and professional leadership recruited from outside the membership group, transactions with non-members to increase turnover and economic results. In short: dropping “old” co-operative principles as burdens of the past in order to succeed in the future and to survive on the market. The Regulations governing the European co-operative society (SCE R) are a model for the choice of option 2. Another problem is the classification of co-operative variable share capital under international auditing standards as equity or debt.

There are two other opposing trends:

- Economisation and “companisation” of co-operative law, borrowing from the tool-box of company law, following a trend to harmonize the law for all business organisations and
- the trend to broaden the objectives of co-operatives from mainly economic promotion to furthering social and cultural aspirations of their members. This trend is reflected in special laws for “social co-operatives”, co-operatives for social solidarity (Portugal) or “general interest co-operatives” (Italy) and for co-operatives as part of a social economy or a third sector between the public and the private sector (Portugal, France, Italy, Spain). Multi-stakeholder co-operatives bring together all interested actors in a community or region, combining personal and collective interest in the development of living and working conditions in the respective community or region.

3. Role of the lawmakers – three basic models

In Europe, the legal framework for co-operative societies can be found in three different patterns:

Co-operatives as a special legal form (Germany, Austria). In this case, reaction to economic change means amendment of the original co-operative model in direction of the Option 2: dropping historic weaknesses, allowing deviations from the principle of identity to increase the economic efficiency of co-operative enterprises. These amendments were made in laws applicable to all co-operatives, also to those preferring Option 1. E. g. the autonomous board of directors in German co-operative law (§ 27 (1) GenG) which may be suitable for large co-operatives also applies to small and mid-sized co-operatives. If the legal form of co-operative society is turned into an organisation for reaching mainly economic goals, this forces self-help organisations with economic and social objectives to look for other legal patterns (e. g. in Belgium: association sans but lucrative (a.s.b.l.) and Social Purpose Company (SPC) (Coates 2013, p. 253); in the United Kingdom: Community Benefit Society (BenCom) or Community Interest Company (CIC) (Snaith 2013, p. 737, Footnote 3).

Co-operatives as a modified form of a general pattern, e. g. association (Netherlands) or company (Italy and Spain) adjusted to the special requirements of co-operatives.

There are also **special co-operative laws or decrees for different types of co-operatives** (France, Italy). Such arrangement has the advantage that tailor-made legal forms can be offered corresponding to their special needs and without effects on other types of co-operatives. But parallel special co-operative laws can also be confusing, e. g. in France, where the collection of legal texts concerning co-operatives contains more than 700 pages.

Free choice of legal form (United Kingdom, Denmark): Co-operators decide which form to use: association, company or partnership with adjustments made in the by-laws.

Reform of co-operative law can also have a **political dimension**, making rules for better collaboration with organisations of social economy (Italy, France, Spain, Portugal).

Partial revision of certain provisions only, while maintaining the general rules for co-operatives as a legal form means to adjust the law/decrees to new challenges by introducing new legal structures or instruments. Such amendments are attempts to solve problems of some groups of co-operatives, e. g. large co-operatives in international competition with companies, by introducing autonomous management, new instruments for raising more capital than user-members are willing or able to contribute, without regard to a reduced role of members and weakened member-solidarity.

The problems of partial revision of laws are often overlooked. Co-operative law is a legal framework designed for a special type of organisation. The provisions of this law are (or should be) a carefully balanced equilibrium of interests and relationship of different elements. By changing elements of this system there is the risk to destroy this equilibrium. Amendments of certain provisions of the co-operative law for practical reasons – often proposed by lobby-groups – means to deal with symptoms of problems rather than solving the underlying problems and dealing with their causes.

Coming back to the two basic Options, which are:

- **Either** counting on a strong co-operative profile as a self-help organisation oriented towards and supported by its members, without losing the capacity to compete, using the unique features of co-operatives as strengths rather than levelling them step by step.
- **Or** increasing the capacity of co-operative enterprises to compete, even at the risk of weakening the co-operative profile, e. g. neglecting the membership group and concentrating on the co-operative enterprise

with the effect of turning members into simple customers and share holders like in the case of companies.

In discussions on amendment of co-operative laws in Europe the following fields are considered as being especially due for reform:

Facilitating the formation and development of small co-operatives by reducing the minimum number of members, e. g. to three (Belgium, Germany) or five (France), by reducing formation and organisation cost by introducing a one-tier structure, i.e. work with a one-person board and without a supervisory council (Belgium, Finland, Germany) and reducing audit cost by longer intervals of mandatory audit (Germany) or the possibility of opting-out (United Kingdom). There are also special laws (Italy) or special provisions in co-operative law for small co-operatives (Germany).

Decision-making, management and control: Introducing plural voting in general meeting of primary co-operative societies (Germany, France). Allowing voting rights in proportion to the volume of business of the member with the co-operative enterprise or share contributions (Austria), setting a ceiling, e. g. of ten percent of total votes that one member can hold. Introducing meetings of delegates means changing from direct democracy to representative democracy, with members' rights being reduced to election of delegates, often from lists of candidates prepared by the board of directors.

Extension of control rights of members to counterbalance increased autonomy of the board of directors. E. g. preserving the right to decide important matters (amendment of by-laws, allocation of economic results, merger, conversion and dissolution) to the members, even in co-operatives having a meeting of delegates by preserving the general meeting side-by-side to the meeting of delegates (e. g. Germany). Giving individual members or minorities of members more rights of information and control.

4. Proposals how to strengthen the co-operative profile

Extended rights of members in general meeting

Membership can be made *more meaningful and attractive* by extending co-determination rights, two-way communication and information, e. g. by giving members veto against high payment of board members or offering exclusive co-operative advantages for members, e. g. in form of patronage refund. Other innovations are:

- Definition of the autonomous *board of directors also as trustee of the members*.
- *Deviation from self-administration* by admitting external directors either via non-using “promoting members” coming from outside the membership group (Germany) or direct recruitment of external directors.
- *Limiting transactions with non-members* in the law or in the by-laws. E. g. by laying down a maximum percentage of non-member transactions of total turnover (Italy, France) or prescribing in the law that non-member transactions may not become the main concern of co-operative management (Netherlands, Switzerland).
- Making *rules for measuring success in member-promotion* mandatory: promotion plan and promotion report, social report, which are currently not regulated in co-operative laws and rarely applied in practice.
- *Financial structure*: Allowing admission of non-user investor-members without limitations or restricted to certain persons like former employees, family members of members or business partners, to retain a relationship (beyond a “cash-nexus”) between those contributing capital and the co-operative society. The liability of members for the debts of their society is usually reduced to their share contribution.

5. New problems with regard to protecting the co-operative profile

When abandoning the classical co-operative principles by amendment of provisions of the co-operative law, it becomes necessary to solve new problems created by such amendments.

Where *different categories of members* can be admitted, this means a change from the ideal of a homogeneous membership group to a heterogeneous one. This also means to abandon clear and simple rules like “one member – one vote” and the general meeting as the supreme authority in the co-operative structure by plural voting and an autonomous board of directors. This creates new problems for the co-operative organisation. User-members have to remain in control (voting in general meeting, representation on the board of directors). Investor-members are given preferential treatment and special control rights, e. g. in case of non-payment of interest or dividend on non-voting shares over an extended period of time investor members receive voting rights to protect

their interests (France). In this way, co-operatives are offered access to the capital market, apart from weakening the co-operative profile, finding buyers is a problem. To protect such contributors of capital, additional provisions are required e. g. introduction of special general meetings, access to internal information, allowing representation of investor-members in the ordinary general meeting.

Introduction of *different categories of shares* (France) with and without additional liability, preferential, withdrawable, etc. (France, United Kingdom, Germany, Finland) and freely transferable certificates (Genussrechte) by primary co-operatives or by their integrated systems turns co-operative law into a complicated system of rules, exceptions to the rules and provisions to limit the effects of the newly introduced exceptions. In Finland, provisions on new financial instruments and their application introduced in 10 amendments between 2002 and 2014 account for one quarter of all of the 282 sections of the Finnish co-operative law, still growing to 365 sections by the next amendment. Regulations of the financial structure are filling 8 of the 24 chapters of the Finnish co-operative Societies Act (Henry 2013, pp. 376, 383).

Where co-operative societies may establish *daughter societies and subsidiaries* to which part of the business of the co-operative enterprise can be transferred, co-operative societies risk to turn into mere co-operative holdings, which may call their official recognition and registration as a co-operative society into question.

Group concepts (Rabobank, Crédit Mutuel) as an intermediate form between merger and vertical integration allow to retain small co-operative units close to members combined with a strong regional or national organisation in a mother-daughter relationship.

Accumulation of collective fund from undistributed surplus as a sign of solidarity (Italy).

Audit: There is a trend to approximate co-operative audit to company audit, i.e. requiring only financial audit as mandatory external control (option 2). This means to neglect or ignore the special co-operative objective of member-promotion and the need for a comprehensive management audit by specially qualified auditors for measuring success in member-promotion. Control follows money. Extending the rights of investor-members reduces the role of user-members.

6. Conclusion

Those perceiving co-operative values, principles and structures as a source of strength and not as a burden of the past, are warning against approximation of co-operative law to the company model (option 2) and recommend a policy of differentiation using a strong co-operative profile as a trade mark or brand (option 1). Those revising co-operative legislation have not always followed this advice.

Where co-operative law is revised to increase the economic efficiency of large co-operatives by approximating their legal framework to the company model, co-operatives are losing their clear profile especially if such revised laws are applicable to all co-operatives, big and small. As a result small and mid-sized co-operatives and those having social objectives, have to look for other, more appropriate legal frameworks, e. g. United Kingdom: BenCom, CIC; Belgium: a.s.b.l, SPC).

In 1995, Axel Bialek proposed to introduce a new form of “Co-operation Society” with two categories of members: user-members and investor-members, to avoid to approximate general co-operative law to the interests of large co-operatives, making such amended law unsuitable for small co-operatives with strong member-orientation and socio-economic objectives (Bialek 1995, pp. 176 f.).

Another possibility to adjust the co-operative model to the needs of enterprises requiring high initial capital would be the “co-operative company”. Instead of amending the general co-operative law which should remain applicable to all co-operatives in direction of company law, the needs of large co-operatives requiring substantial equity from the beginning (e. g. dairy and sugar factories) could be met by applying the company model in a way following the principle of identity of owners and users: Only producers of the raw material processed in the joint factory could become shareholders and the economic results of the co-operative company could be distributed among shareholders in proportion to business done with the co-operative factory.

The importance of a special legal framework for co-operatives should not be overestimated. In Denmark it can be studied, how a strong co-operative movement has developed without special co-operative law. On the other hand, making co-operative law in line with internationally recognised co-operative principles, which are the fruit of long experience rather than a burden of the

past, is chosen in many countries. But deviations from established co-operative principles are spreading.

The arguments of the Norwegian lawmakers, introducing a co-operative law after fifty years of work and experiments without co-operative legislation, are interesting:

- To offer citizens a tested model of organisation.
- To save consultancy cost for founder-members and
- to offer co-operators protection of the law.

However, these arguments are only valid if the law follows the co-operative concept and option 1. When following option 2 and revising general co-operative law by approximating it to the company model, the lawmakers set up signboards pointing in the wrong direction.

In recent years, revision of co-operative laws in Europe have had the following effects: from clear and simple rules to complex and complicated, detailed sets of regulations deviating from the original concept together with limits of such deviations and special regulations to preserve the co-operative essence of the organisation.

Many co-operative laws abandon the clear profile of the co-operative society as a self-help organisation with the objective being mainly economic member-promotion, in which members are owners and users (principle of identity) and opt for a blurred profile of co-operatives as efficient enterprises in a pluralistic market economy or a special type of social enterprise, following own rules when doing business with their members and with non-members or as agents of their members. Where different categories of members can be admitted, the rights and obligations of these different categories of members have to be described and eventually limited in the law or in the by-laws.

The fact that co-operatives should work on an equal level playing field with their commercial competitors and should not enjoy special treatment or privileges is stressed but at the same time, it is claimed that transactions of co-operatives with their members or on behalf of their members are special “co-operative transactions” and exempt from trade tax.

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