AN INSTITUTIONAL ANALYSIS OF SOUTH AFRICA'S NEW COOPERATIVE ACT: EVIDENCE FROM SELECTED CASE STUDIES IN KWAZULU-NATAL

BY

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DECLARATION

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ABSTRACT

Cooperatives are a means through which farmers may gain economic power by reducing unit transaction costs associated with production, marketing and distribution of products. In South Africa, cooperatives are promoted as a means of advancing economic development in rural areas through empowerment, development of income generating activities, improvement of human resource capacity, and increased savings and investment.

The new Cooperatives Act 14 of 2005 was enacted in August 2005 to promote the role of cooperatives as organisations for pro-poor development in South Africa and to increase their chance of survival in the economy. This study uses a New Institutional Economics (NIE) framework to analyse the Cooperatives Act and its worth as a vehicle for promoting pro-poor development. A hypothetical cooperative, predicated by the new Act, was analysed using the NIE to identify institutional problems likely to constrain the collective efforts of small producers. A case study approach was then used to analyse three production cooperatives in KwaZulu-Natal that were registered post August 2005 and still operational in 2008. Interviews were conducted with individual members, directors and project managers (where applicable) between May and July 2008. Open-ended questions provided the flexibility needed to explore the institutional roots of problems identified by respondents.

Free-rider, horizon, portfolio, control and influence problems were identified in the case studies. These problems, which stem from ill-defined voting and benefit rights, resulted in low equity investment, low investment in long term assets, a preference for current cash flows rather than future investment, and social conflict – all of which constrained the competitiveness and growth prospects of the cooperatives studied. In an attempt to mitigate these problems, two of the cooperatives shed their poorest members, a solution which is not consistent with the objective of pro-poor economic development. Additionally, two cooperatives opted to create their own rules to reward investors with capital gains - an institutional arrangement that is not permitted by the new Act.

It is concluded that the new Act should be amended to give cooperatives greater flexibility in their institutional arrangements. In particular, cooperatives should be allowed to issue tradable equity shares that offer benefits proportional to shareholding. If these tradable equity shares carry voting rights and are offered to non-patron investors, aggregate voting *rights conferred on these non-patron investors should be capped to prevent loss of control by patron members. It is further recommended that the same level of start-up support should be made available to all producer groups that formally register their business, regardless of the business model chosen, and that member empowerment should be an essential requirement for registration and public funding.*

Keywords: Agricultural Cooperatives, Cooperatives Act, New Institutional Economics, Case Study

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INTRODUCTION

Cooperatives have been promoted in many developing countries as a mechanism for driving agricultural growth and rural development. The International Cooperative Alliance (ICA, 2005) defines a cooperative as an "autonomous association of persons united voluntarily to meet their common economic and social needs through a jointly owned and democratically controlled enterprise organised and operated on cooperative principles". This definition is adopted in the Cooperatives Act of South Africa (RSA, 2005). From a New Institutional Economics (NIE) perspective, cooperatives are a form of horizontal integration in which members surrender use rights to a manager in exchange for benefit and voting rights (Lyne and Collins, 2008). This enables members to gain collective economic power and achieve degrees of vertical integration through size economies in storage, processing, and transporting, unattainable by a single owner business (Fulton, 2000). In particular, they can serve to reduce unit transaction costs associated with producing, marketing, and distributing products (Smith, 1979), and can mitigate some risks such as low farm prices faced by farmers (Zeuli, 1999). In the rural development context, cooperatives are often driven by the anticipation that horizontal integration will reduce average fixed *ex ante* transaction costs that keep small farmers out of product markets (Poulton and Lyne, 2009).

The post-apartheid South African government identified cooperatives as a significant means to empower the rural poor with respect to the development of income generating activities, human resource capacity, and increased savings and investment (Knight, 2006). The government deemed the Cooperatives Act of 1981 to be unsuitable for this objective, in part because it focused on larger and commercial agricultural cooperatives (Ortmann and King, 2007). Further, many cooperatives registered under the Cooperatives Act of 1981 were not operational. For example, a study by Van der Walt (2005) on all registered cooperatives in Limpopo showed that 65 per cent of cooperatives in Limpopo Province were not operational.

In its effort to facilitate and support the cooperative movement in South Africa, the government embarked on crafting a new Cooperatives Act to replace the Cooperatives Act of 1981. In 2001, a draft Cooperatives Bill was prepared by the Department of Agriculture (DoA). This Bill introduced provisions to help cooperatives source additional capital. For example, it introduced a provision that would allow investor shares in a cooperative to be purchased by non-members. These provisions were, however, contested by the Congress of

South African Trade Unions (COSATU) as being contradictory to cooperative principles (Lyne and Collins, 2008). In 2003, following a Presidential Growth and Development Summit, responsibility for cooperatives was transferred from the DoA to the Department of Trade and Industry (DTI). This was purportedly done to ensure that cooperatives are promoted as businesses in all sectors of the economy. The DTI drafted a new Cooperatives Bill, which excluded the provisions contested by COSATU. This revised Bill was enacted in 2005. The new Cooperatives Act (Act 14 of 2005) - hereafter referred to as the Act, or the new Act - applies to all cooperatives in South Africa. Previously existing cooperatives were granted a period of three years to either become compliant with the provisions of the Act or to restructure as an alternative type of organisation (e.g., a company). In general, the new Act promotes institutional arrangements typical of Traditional Cooperatives (TCs).

It has been recorded that the worldwide decline in growth of TCs is principally due to fundamental flaws in their institutional arrangements such as: returns to members are proportional to patronage and not financial investment; shares are not traded at market value and are redeemable at par value when the member leaves the cooperative; and voting rights are egalitarian and not proportional to investment (Cook, 1995; Cook and Iliopoulos, 2000; Lyne and Roth, 2002) As a result, TCs are faced with the Free-rider Problem, Horizon Problem, Portfolio Problem Influence Cost Problem and Control Problem, all of which are symptoms of their institutional flaws (Cook, 1995; Cook and Iliopoulos 2000; Sykuta and Cook, 2001; Lyne and Roth, 2002). Lyne and Collins (2008) strongly criticised stipulations of the Act that force cooperatives in South Africa to adopt institutional arrangements that are typical of TCs, and argued that the Act is therefore unlikely to achieve the objective of promoting the development of sustainable cooperatives in South Africa. Lyne and Collins (2008) conjectured that the architects of the Act succumbed to political pressure and discounted important trends in international legislation. These could have made South African cooperatives more versatile in South Africa's dual economy, where development-oriented cooperatives could benefit from strategic alliances with reputable firms in the formal economy.

It has often been reported that poor management is responsible for the past and ongoing failures of agricultural cooperatives in the developing regions of South Africa (e.g., Van der Walt, 2005). This study challenges that view and instead focuses on institutional arrangements that discourage members from growing their cooperative business. The specific objectives of this study are to: (a) analyse the type of cooperative model predicated by the Act and assess its worth as a platform on which cooperatives can grow and compete sustainably in product markets in the formal economy, and (b) use case study methodology to identify those provisions in the Act that constrain the ability of cooperatives to develop.

According to Bates and Brown (cited by Stanford, 2006), in 2006 there was still insufficient information about the survival of newly formed cooperatives and the performance of established cooperatives to compare cooperative organisations with other business organisations in South Africa. Post 2005, economic research on the performance of agricultural cooperatives in South Africa includes studies by Sikuka and Karaan (2008) and Chibanda *et al.* (2008). Sikuka and Karaan (2008) studied cooperatives established under the previous Act, some of which opted to restructure as private companies rather than become compliant with the Act. They identified dynamism as an important indicator of performance and compared the dynamism of cooperatives that adopted new organisational structures with cooperatives that remained cooperatives following the promulgation of the Act in 2005. Dynamism refers to the changes an organisation undertakes in response to, or in anticipation of market changes. Their finding that organisations that remained cooperatives are generally more dynamic than those that restructured as companies is, however, misleading because the Act gave existing cooperatives three years to comply with its terms or to convert into non-cooperative business organisations.

A study of ten agricultural cooperatives in KwaZulu-Natal by Chibanda *et al.* (2008) used cluster analysis to demonstrate that good governance and good institutional arrangements are positively related to the performance of agricultural cooperatives. An important aspect of that study is that it highlighted that even within the constraints of the Act, there is some heterogeneity in the institutional and governance arrangements of agricultural cooperatives, and that these institutional and governance arrangements of cooperatives, which are determinants of their performance, were consistent with assertions of NIE. This study builds on Chibanda *et al.* (2008) by examining three ‘emerging’ production cooperatives in KwaZulu-Natal. Traditional production cooperatives are afflicted by all of the institutional problems that undermine the performance of traditional marketing cooperatives, but may also encounter a ‘labour problem’ depending on the arrangements made to reward members who contribute labour to the cooperative enterprise. Information gathered in the case studies is compared with propositions drawn from the NIE to highlight aspects of the Act that critically influence the ability of cooperatives to attract capital, grow and compete. According to Section 2 of the Act, its first purpose is to promote the development of economically sustainable cooperatives.

The first chapter of this dissertation contains a brief discussion of New Institutional Economics (NIE) theory relevant to the study. Cooperatives are organisations governed by a distinctive set of institutional arrangements. Some of these institutional arrangements are specified externally (e.g. by the Cooperatives Act) and others internally (e.g. by the Cooperative's own constitution and operating policies). The NIE helps to explain both the positive and negative implications of these institutional arrangements for cooperative performance. The second chapter describes traditional cooperatives and new cooperative models that have emerged in countries where legislation allows cooperatives to adopt institutional arrangements that are more investor-friendly. Chapter three discusses cooperative legislation including the role of government in formulating cooperative legislation and examines trends in cooperative legislation internationally. Chapter four examines the evolution of cooperative legislation in South Africa, introduces the New Cooperatives Act 14 of 2005 and presents a hypothetical cooperative model predicated by the Act. The case study research methodology, data collection and the case study cooperatives are presented in Chapter five. The results of the study are discussed in Chapter six, which is followed by a discussion, conclusions and recommendations for further research.

CHAPTER 1

Cooperatives: Origin, Principles, Flaws and New Models

This chapter gives a brief introduction to cooperatives, discussing briefly their origin and principles. It is the principles of cooperatives that distinguish them from any other business organisation. Given the nature of cooperative principles, traditional cooperatives suffer from institutional flaws. These flaws are discussed in the third section of this chapter. The problems inherent in traditional cooperatives have forced cooperatives to restructure into new cooperatives types. These are discussed in the last section of this chapter.

1.1 Definition of cooperatives

To cooperate means to work together for a common goal. Cooperatives, according to Evans and Meade (2005) may be defined in various ways depending on the relevant jurisdiction. According to section 1(1) of South Africa's Cooperatives Act, 14 of 2005, a cooperative is defined as an autonomous association of persons united voluntarily to meet their common economic and social needs through a jointly owned and democratically controlled enterprise organised and operated on cooperative principles (RSA, 2005). In South Africa, a cooperative is a stand-alone legal entity that is managed by the board of directors elected by the cooperative's members (Competition Commission, 2006). According to section 10(2)(a) of the Act, a cooperative is required to identify itself as such (RSA, 2005).

Cooperatives are important means by which farmers gain economic power, assured supplies and market outlets, and achieve various degrees of vertical integration (Fulton, 2000). Cooperatives perform the following functions: provision of credit, guaranteed market for farm products, storage facilities to prevent loss of products, incentives (for example, to adopt new technology), management techniques, and supply of production inputs cheaply and on time (Machethe and Van Rooyen, 1983). In Canada, for example, the key benefits of cooperatives are to help producers compete, promote local ownership and control, build social capital, develop community leaders, and serve rural and remote communities (Canadian Cooperatives Secretariat, 2007).

1.2 Origin and principles of cooperatives

According to Smith (1979), Barratt (1989) and Evans and Meade (2005), cooperatives originated in England at the end of the eighteenth century. This was during the time of the Industrial Revolution, which brought many social, economic and political changes. Before the changes, most people practised farming to make a living. As many factories grew during the Industrial Revolution, many peasants were forced off the land, and had to work in the factories and mines to buy food. The Industrial Revolution resulted in widespread exploitation of workers, as the new industrialists sought wealth through increased productivity that the then-recently developed high-speed machinery was providing. In their struggle against poverty and exploitation, poor people formed cooperatives as a means to survive.

The first cooperative was set up in the small town of Rochdale in England in 1844. Twenty-eight weavers formed a society called the Equitable Society of Rochdale Pioneers. The 28 workers, who were poorly paid, tried to get more for their money by opening a cooperative shop. This shop bought foodstuffs wholesale in big quantities and sold them to members of the society at cheaper prices than other shops. Each member helped in running the shop.

Since the inception of the first cooperative in 1844 in Rochdale, the cooperative movement has extended its bounds universally, become larger and more diversified (Smith, 1979). Smith (1979) noted that there are those who adhered to the belief that “cooperatives are the children of distress” and thus approached the cooperative from a social-reformative point of view. However, as seen from an economic point of view, due to the ever changing and competitive environment, cooperatives can be described as the “children of development”.

Like all forms of business undertakings, cooperatives are also guided by principles. The Rochdale Society of Equitable Pioneers first set out the cooperative principles in 1844. Some of these principles have been altered and some are still in use today. These principles referenced from Barratt (1989), Evans and Meade (2005), ICA (2005) and Competition Commission (2006) are:

a) **Open and voluntary membership.** Open membership means that membership is open to everyone who fulfils the requirements for membership and who can contribute and can attain an advantage from the activities undertaken by the cooperative on a voluntary basis.

b) **Democratic control.** Cooperatives are democratic organisations controlled by their members. Every member has one vote regardless of how much equity capital they invest in, or business they conduct with, the cooperative. Members elect directors to a board that makes policy decisions and which holds management accountable for its strategic and operational decisions. The directors, in turn, are accountable to members - ultimately through the exercise of their voting power at annual general meetings.

c) **Limited interest on share capital.** Members do not usually receive market related returns on the equity capital they contribute to the cooperative. This makes a cooperative different from a company. A shareholder in a company buys shares in the hope of earning competitive returns from dividends and capital gains.

d) **Member economic participation.** To become a member of a cooperative and to share in the advantages that membership brings, a person must invest in the cooperative. These investments can be compared to the membership fees a person has to pay to join a private club. At least part of that capital is usually the common property of the cooperative. At the end of every financial year, if capital is not urgently required for other purposes, the members may decide to divide the profit that was made during the year. This is done as a percentage of business that a member has done with the cooperative.

e) **Business with members only.** A cooperative is established by the members to service their mutual needs. It is therefore an organisation established by its members for their mutual benefit. Theoretically, therefore, a cooperative should conduct business with members only.

f) **Education and training of members.** Cooperatives provide education and training to their members, elected representatives, managers, and employees so that they can effectively contribute to the development of their cooperative.

g) **Cooperation among cooperatives.** Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national and international structures. It should teach all of its members about the administration and management of the co-operative, the rights and duties of membership, and the business of the co-operative.

The social and economic environment that existed during the time of the Rochdale pioneers in 1844 is absent today. The cooperative movement started in England at a time when there was a campaign for universal suffrage. Workers, who were denied representation in government affairs, insisted that there should be no discrimination among members in the control of their own organisations (Royer, 1992). Moreover, the cooperative members of those days differ from present day members as regards economic status, economic ability, way of life, or knowledge. Conditions that were applicable in the early times will not necessarily be valid in the present period, especially in the case of certain principles (Smith, 1979). For example, the democratic control principle under which one man has one vote worked best for most local farm supply, service and consumer cooperatives because of the homogeneity of their memberships. However, as the cooperative movement grew, the size and nature of producer operations become heterogeneous (Royer, 1992).

Traditional cooperatives (TC) subscribe to the Cooperative Principles. A TC thus has the following features: members receive limited returns for their capital invested; it exists for the benefit of its members; each member has one vote regardless of the size of the member's investment; membership is open to anyone who can use its services; and benefits are proportional to patronage (Cook and Iliopoulos, 1999, 2000; Sykuta and Cook, 2001). Cook *et al* (2008) describe traditional cooperatives as being defensive in nature in that their primary objective is to transfer risk bearing to the cooperative level so that individual members could maintain their on-farm rent generating capacity. Not all cooperatives necessarily adopt all of the Cooperative Principles. For example, following arguments that agricultural cooperatives operating in global markets need to focus on fewer, more self-centred principles to survive, US cooperative legislation was relaxed to enshrine only three of The Cooperative Principles; user ownership, user benefit, and user control (Birchall, 2005 cited by Ortmann and King, 2007). Similar trends in cooperative legislation that allow cooperatives to adopt fewer of The Cooperative Principles are also evident in other countries (Lyne and Collins, 2008). This has given rise to new cooperative models that are more closely aligned to the principles of investor-owned firms (IOFs) than are TCs (Chaddad and Cook, 2004; Cook, 1995). According to Lyne and Collins (2008), cooperatives in New Zealand, Netherlands and NSW in Australia have deviated from awarding profits to patrons to allocating profits to investors. Lyne and Collins (2008) go on to say that in 1992, New South Wales amended its cooperative Act formalising quasi-equity shares as cooperative capital units (CCU). A CCU is defined as an interest issued by the cooperative conferring an interest in the capital, but not in the members' share capital of the cooperative. The following sections draw attention to institutional flaws inherent in TCs, the symptoms of these problems, and briefly explain how the new models of cooperatives are restructured away from the traditional model to avert some of these problems.

1.3 Institutional flaws of traditional cooperatives

Cook (1995), Cook and Iliopoulos (2000) and Sykuta and Cook (2001) discussed five key criticisms and institutional flaws that constrain the growth of traditional cooperatives. The root causes of the problems associated with traditional cooperatives are linked to poorly defined property rights, and because the residual rights of control and residual return rights are poorly aligned in traditional cooperatives.

Residual rights of control mean that in a traditional cooperative, ownership is restricted to those who patronise the organisation either by supplying it with inputs such as milk from dairy farms, or by buying outputs such as fertilizers from agri-chemicals cooperatives. An implication of this feature is that traditional cooperatives have constrained access to equity capital, being able to raise it only from owner-patrons (Chaddad and Cook 2004). *Residual return rights* refer to the rights of owners to receive any surplus generated by the cooperative once its committed or contracted payments have been met. In the case of traditional cooperatives, this right is expressed in terms of the right to receive some share of the cooperative's surplus, where share is determined by the extent to which the relevant owner has patronised the cooperative (Chaddad and Cook 2004). The five problems associated with traditional cooperatives are as follows:

a) **Free-rider problems.** These arise when property rights are untradeable, insecure, or unassigned (Cook, 1995). It exists when the gains from cooperative action can be accessed by individuals who do not fully invest in developing the gains (Cook and Iliopoulos, 1999). Because equity in TCs is collectively owned, it is difficult to exclude the benefits of collective action from those who did not contribute (Borgen, 2004). If non-members are permitted to transact with the cooperative at the same prices offered to members, then there is an external free-rider problem. The internal free-rider problem occurs when new members obtain the same patronage and residual rights as existing members (Cook, 1995) thus diluting the return of the existing members (Nilsson, 2001). Also, members who do more business with the cooperative get a greater share of benefits even if they are small investors. This therefore creates a disincentive for existing members to invest equity capital in their cooperative (Cook, 1995).

Another type of internal free-rider problem exists when members of a production cooperative are not remunerated for their individual labour effort. This labour problem is particularly evident in farming cooperatives that naively reward all members equally irrespective of the work they do. In this case, the threat of free-riding discourages member labour effort.

The free-rider problem occurs particularly in open membership cooperatives (Cook, 1995). Cooperatives that adopt a closed membership policy tend to foster a higher degree of member commitment, thus promoting equity investment by members (Cook and Iliopoulos, 2000; Hardesty, 2005). A closed membership policy means that individuals who want to join the cooperative must buy their shares from other members at the market price as in a New Generation Cooperative (NGC) and not at par value as in a TC. If new members pay the appreciated share price they are not free-riders and membership is closed in an economic sense.

b) **Horizon problem.** This problem occurs when residual claims on the net income generated by an asset are shorter than the economic life of the asset (Porter and Scully, 1987). This problem arises in TCs because ownership rights cannot be transferred or traded at market value (Cook, 1995). As a result investors cannot realise capital gains in the cooperative when they leave the cooperative. [Capital gains from investments in TCs are ultimately captured by free-riders in the form of new members who benefit from improvements without paying market prices for their shares (Lyne and Collins, 2008) as explained in the paragraph above]. Therefore, an investment environment is created in which there is a disincentive for members to contribute to growth opportunities (Cook, 1995).

Consequently, members will tend to prefer current cash flows to future investments (Gripsrud *et al.,* 2000), and the cooperative's executive committee is often pressured to make payments rather than retain earnings for future investment (Cook and Iliopoulos, 2000).

A solution to the horizon problem in cooperatives is to establish a secondary market for cooperative shares. This strategy has been adopted by New Generation Cooperatives where cooperative members are required to purchase delivery rights (that are marketable and appreciate according to the performance of the cooperative). This creates a two way obligation between a cooperative and a member for a specific amount of product each year (Hardesty, 2005). When shares are transferable and appreciable, inactive members and members near the end of their patronage horizon possess the ability to retrieve a portion of their equity capital through the sale of their equity stock (Iliopoulos, 2003; Borgen, 2004).

c) **Portfolio problem.** In a cooperative, members hold a variety of assets (a "portfolio") such as land, cattle, implements, savings, and investments. The portfolio problem arises when members are unable to structure their investments in ways that best suit them. This problem leads to sub-optimal investments by members because they are unable to transact shares, and cannot diversify their own portfolios to reflect personal risk preferences (Lyne and Collins, 2008). The cause of the portfolio problem in TCs is that the investment decision is "tied" to the patronage decision (Iliopoulos 2003), implying that risk aversive member-owners will exert influence on the management to carry a reduced risk portfolio even if it means lower expected returns (Gripsrud *et al.,* 2000). Borgen (2004) describes the portfolio problem as one in which members have diverse risk/reward profiles, and as long as cooperative members have unequal time horizons there will be different viewpoints with respect to their cooperative's risk/reward-profile.

d) **Control problem.** The control problem arises due to the divergence of interests between the members of a cooperative and its managers. The costs associated with trying to prevent or minimize divergence of interests are known as agency costs. TCs are prone to the control problem because their shares cannot appreciate nor can they be traded (Cook, 1995). Changes in the (externally audited or market determined) price of shares provide a good reflection of the performance of management. This enables members to make well informed choices when they vote for their representatives, or directors, at the annual general meeting. Ultimately, the accountability of management requires transparency (e.g., an independent audit of the organisation's financial statements, sound procedures for meetings and elections, access to annual reports and minutes of Board meetings), a sound electoral process and members' ability to disinvest by selling their shares (Lyne *et al*., 2007). Another reason that TCs are prone to the control problem is because cooperative owners lack the means to enable managers to share in cooperative returns, and thus to align their respective interests (Cook, 1995).

e) **Influence cost problem.** This problem arises when institutional decisions affect the distribution of benefits among members of different groups within an organisation and when individuals or groups attempt to influence the decisions to their benefit. For example, entrepreneurial members of a cooperative might want to invest more into the business to finance value adding operations; but may face the prospect of their money being spent on other, less risky assets preferred by risk averse members who hold majority voting power. Investment is therefore not attractive to these investors because they have little influence over the way their money will be spent (Gripsrud *et al.,* 2000). Also the cooperative's creditworthiness is reduced as lenders know that entrepreneurial investors have little influence over the cooperatives' investment decisions (Hendrikse and Veerman, 2001).

   The root cause of the influence cost problem in TCs is that voting rights are democratic and not proportional to individual capital contributions. Members with equity capital to invest in the cooperative want assurance that they will be able to influence the investment decisions of the cooperative towards profitable investments, and that this will not be undermined by risk–averse members who have not made significant contributions to the enterprise. The principle of one-share, one-vote aligns a member's influence with their investment in the enterprise – a fair system for commercial enterprises that require substantial capital to develop and operate (Lyne *et al*., 2007).

This section has demonstrated how the Cooperative Principles of (a) open and voluntary membership, (b) democratic control, (c) limited interest on share capital, and (d) member economic participation give rise to problems in organisations that espouse these principles, such as TCs. In an attempt to mitigate these problems, cooperatives have restructured ownership rights. Ownership in the form of secure property rights is the most effective mechanism for providing economic agents with appropriate incentives to create, maintain and improve assets (Chaddad and Cook, 2004). These new cooperative models are discussed in the following section.

1.4 New cooperative models

According to Chaddad and Cook (2004), agricultural cooperatives have recently had to face challenges especially with agricultural industrialization. In order to cope and operate suststainably with these challenges, cooperatives require substantial capital investments in non-tangible and long-term assets. Chaddad and Cook (2004) go on to note that cooperatives are adopting organisational innovation as a strategy to remain competitive. These include but are not limited to new generation cooperatives, base capital plans, subsidiaries with partial public ownership, preferred trust shares, equity-seeking joint ventures, and permanent capital equity plans. Fulton (2000) gives the reason behind the formation of new cooperative models as the need for market information and coordination, and the need to restructure existing markets to provide producers an increasing share of the consumers' food dollar.

In a study by D'Haese and Bostyn (2001), managers of agricultural cooperatives identified policy changes that have had an impact on their organisations, hence prompting transformation to other forms of organisation. These include: deregulation of the marketing system, abolition of subsidies, abolition of internal borders as far as the activities of individual cooperatives are concerned, opening of the market to international competition, and loss of participation in the policy formation process. D'Haese and Bostyn (2001) go on to say that the consequences of these changes have been that agricultural cooperatives have lost their economic rent arising from their institutional role and they are confronted with increased competition in their markets, urging them to aim for greater cost efficiency.

Figure 1 on page 15 identifies five non-traditional cooperative models. The variation in these models is in the ownership structure of the firms. Ownership in the form of secure property rights is the most effective mechanism for providing economic agents with appropriate incentives to create, maintain, and improve assets (Chaddad and Cook, 2004). These new cooperative models are:

a) **Proportional Investment cooperative model.** Just like in traditional cooperatives, ownership rights are restricted to members and are non-transferable, non-appreciable and redeemable. They differ from traditional cooperatives in that owner-patrons are required to invest in proportion to their patronage.

b) **Member-investor cooperative model.** Members receive returns that are proportional to shareholdings and patronage. This is achieved either by allowing the cooperative shares to appreciate or by distributing dividends in proportion to shares.

c) **New generation cooperative model (NGC)**. Ownership rights, which are restricted to current member-patrons, can be traded and can appreciate. In addition, it is required that members acquire shares or delivery rights in proportion to their investment.

d) **Cooperatives with capital seeking entities.** An external investor is allowed to participate indirectly through strategic alliances or subsidiaries. This enables access to outside capital, but restricts participation of the outsider.

e) **Investor share cooperatives.** Here, non-members are allowed to invest directly in the cooperative and receive ownership rights. However, these ownership rights are different to those held by member patrons.

The first three of these five models, like traditional cooperatives, preserve patron control of the cooperative at the expense of restricting the cooperative's access to external capital. The last two models enable access to external capital but at the expense of diluting patron control to some degree. Conversion to an investor-oriented firm would be a diversion away from the cooperative model (Evans and Meade 2005).

Fundamental institutional differences exist between cooperatives and various other types of business organisations. Table 1 compares the organisational forms of TC, NGCs and IOFs. Cooperatives differ from other business forms in the purpose of membership, distribution of profits, value of shares, and voting power.

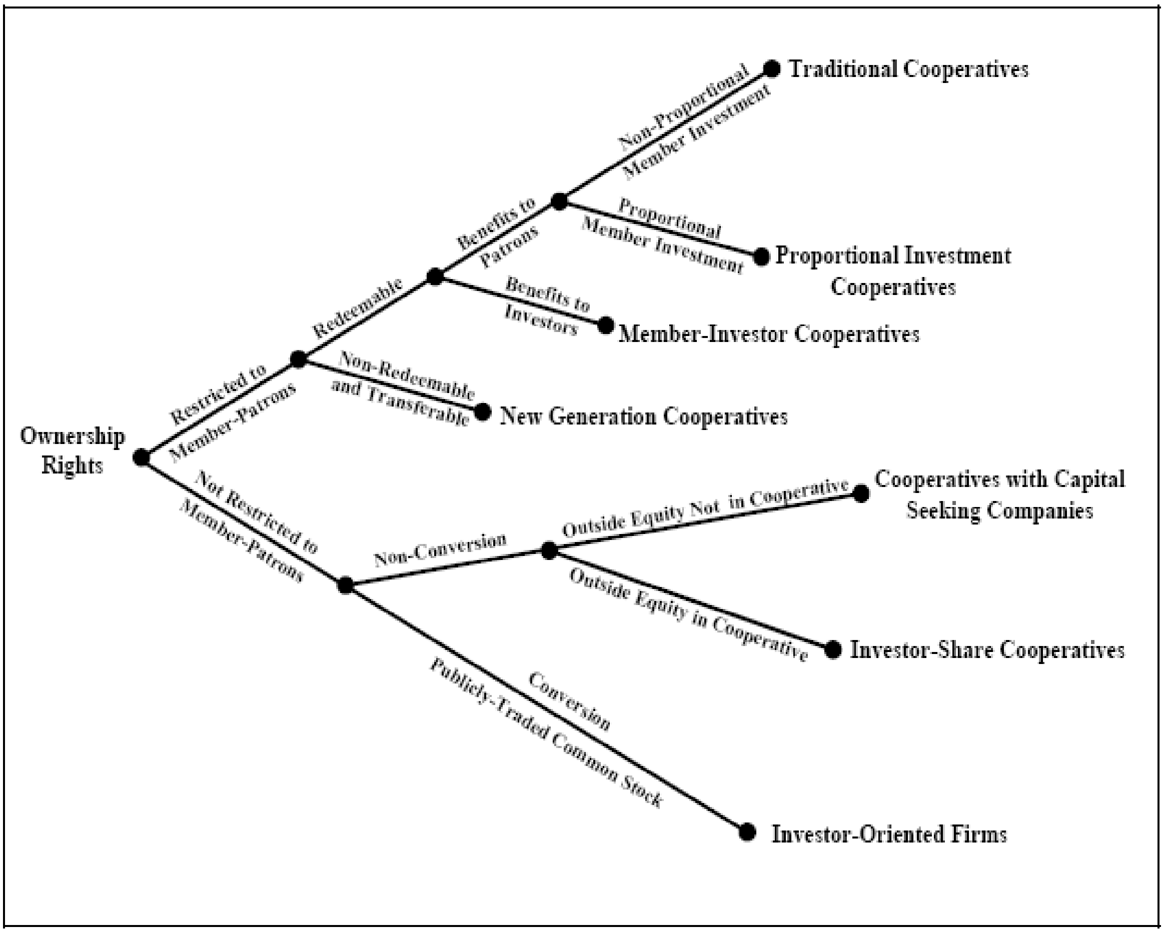

Figure 1: Alternative cooperative models: an ownership rights perspective

Source: Chaddad and Cook (2004)

Table 1: Comparison of key institutional arrangements of traditional cooperatives, new generation cooperatives and companies

Characteristic	**Traditional Cooperative**	**New Generation Cooperative**	**Company**
Net asset ownership	Members	Members	Shareholders
Appreciation of share value	No	Yes	Yes
Ownership rights restricted to patrons	Yes	Yes	No
Ownership rights tradable	No	Yes	Yes
Ownership rights redeemable	Yes	No	No
Benefits proportional to investment	No	Yes	Yes
Investment proportional to patronage	No	Yes	Yes
Voting rights proportional to investment	No	Yes	Yes

Source: Cook (1995), Evans and Meade (2005)

According to the National Cooperative Business Association, NCBA (2005), cooperatives empower people and improve the quality of life of the members. Philip (2003) argues that cooperatives can play a major role in job creation and poverty reduction. According to NCFC (2005) cited by Ortmann and King (2007), "cooperatives were, or are being, formed to: strengthen bargaining power, maintain access to competitive markets, capitalise on new market opportunities, obtain needed products and services on a competitive basis, improve income opportunities, reduce costs and manage risk.

In South Africa, one of the reasons for the formation of cooperatives is to take advantage of the support programs such as funding and training that the government has made available for cooperatives registered under the new Act 14 of 2005 (Ngubane, 2007). This support is accessible to cooperatives that are composed of previously disadvantaged persons, women, youth and persons with disabilities. As cooperatives are institutional arrangements, the following chapter seeks to understand institutional arrangements, institutional environments and the aspects of new institutional economics related to cooperatives.

CHAPTER 2

New Institutional Economics Theory Relevant to a Study of Cooperatives

New Institutional Economics (NIE) is an attempt to incorporate a theory of institutions into economics (North, 2000). It is an interdisciplinary endeavour combining economics, law, organisational theory, political science, sociology and anthropology to understand the institutions of social, political and commercial life (International Society for New Institutional Economics, 2007). Although the phrase "New Institutional Economics" was coined by Oliver Williamson in 1975, the origins of NIE may be traced back to the article "The Nature of the Firm" by Coase in 1937 (Coase, 1998). The new evolution in economics takes into consideration, among other things, transaction costs and property rights, which are important for organisational economic development and growth. The legal, political and social institutions therefore determine the economic performance of a nation and hence the importance of NIE. NIE explains what institutions are, how they arise, what purposes they serve, how they change and how (if at all) they should be reformed (Klein, 1999).

Institutions are the structures that human beings impose on human interaction (North, 2000). "They can be defined as collective action in control, liberation and expansion of individual action. The individual action is participation in bargaining, managing and rationing transactions, which are the ultimate units of economic activity. The control by custom or concern consists in working rules which govern more or less what the individual can, must, may or may not do" (Commons, 1931:649). In other words, according to North (2000) institutions determine the incentives that direct economic activity.

The NIE builds on, modifies and extends the neoclassical theory of a *laissez-faire* economy. As Kherallah and Kirsten (2002:111) put it, "some of the unrealistic assumptions of neoclassical economics such as perfect information, no transaction costs, and full rationality are relaxed". According to Doner and Schneider (2000), NIE is neoclassical because it focuses on choice, and begins with an appreciation of the power of the neoclassical price theory. It is extended because it relaxes the assumption of a perfect market, and it is modified because it recognises the potential benefits of institutions for overcoming the consequences of imperfect information and bounded rationality.

The basic idea of NIE is that success of a market system is dependent upon the institutions that facilitate efficient private transactions. It does not suggest that the neoclassical theory is wrong but that it is incomplete (Brock, 2003). In a nutshell, the purpose of NIE is to explain the factors that determine institutions and the evolution of institutions over time, and also to evaluate the impact of institutions on economic performance, efficiency and distribution (Nabli and Nugent, 1989, cited by Kherallah and Kirsten, 2002).

2.1 Branches of New Institutional Economics

The NIE literature does not provide consensus on the exact components of NIE. However, all attempts to characterise the field note four sets of theories: Collective action theory, transaction cost economies, agency theory and property rights theory. However, before these branches are defined, it is important to note the difference between the 'institutional environment' and 'institutional arrangements'.

The institutional environment is the social, political or legal constraints that govern economic and political activities. They include national constitutions, property rights, laws, social conventions and norms (Davis **a**nd North, 1971). They are the "rules of the game" that guide individuals' behaviour (Klein, 1999). Institutional arrangements, however, are guidelines or arrangements between economic parties that govern the ways in which the parties involved compete or cooperate (Davis **a**nd North, 1971). The branches of NIE relevant to cooperatives are explained in the following sub-sections.

2.1.1 Collective action theory

Collective action refers to activities that require coordination of efforts by two or more individuals to accomplish an outcome. Therefore, collective action involves group actions intended to further the interests or well-being of the members (Klein, 1999). Poulton and Lyne (2009) take the view that collective action entails some degree of collective decision making. Members of a cooperative assign decision making power to their elected directors and its management team. Well before Williamson coined the term "New Institutional Economics" in 1975, Olson (1965) provided the following insights on collective action: collective action is influenced by the size and the distribution of costs and benefits. These in turn are influenced by the size, homogeneity, and purpose of the group and the extent to which the organisation's institutional arrangements eliminate problems such as the free-rider problems (see section 2.3). For example, some types of organisations (e.g., private and public companies) tend to conduct collective action more successfully than others (e.g., Traditional Cooperatives). NIE provides a framework for researching problems associated with common property and collective action, and provides solutions with performance linked incentives.

2.1.2 Transaction cost economics

NIE stresses that transactions have a potential of being costly. "A transaction occurs when a good or service is transferred across a technically separable interface" (Williamson, 1981). It is generally agreed among New Institutional Economists that institutions endeavour to minimise transaction costs that arise and change due to changes and innovations in the source of transaction costs. In his 1937 article on the nature of the firm, Coase introduced the theory of transaction costs by posing the question of why firms exist. According to Coase (1937), transaction costs are the information costs of gathering, bargaining, monitoring and enforcement. Transaction costs increase with the frequency of transactions, asset specificity, and uncertainty (Williamson 1981). They also increase with increased information asymmetry. According to Doner and Schneider (2000), it is transaction costs that generate market imperfections and contribute to market failures, and generate demand for institutions to redress them.

The wave of thinking behind transaction cost economics (TCE) is that all transactions require a mechanism of some sort to protect the units involved from various hazards associated with exchange (Klein, 1999). TCE was made popular by Williamson (Sykuta and Cook, 2001), who, "combined the concepts of bounded rationality and opportunistic behaviour (which manifests itself as moral hazard, cheating, adverse selection) to explain contractual choice and ownership structure of firms" (Kherallah and Kirsten, 2002:116). TCE seeks to understand the different aspects involved in a transaction, and then considers different institutional arrangements to conduct the transactions (Ortmann and King 2007).

2.1.3 Agency theory

Agency theory focuses on information asymmetries and incompatible incentives between economic units. Agency theory does not only apply to the principal-agent relationship (whenever an individual or organisation (agent) acts on behalf of another (principal) (Ortmann and King, 2007), but also in situations where one party has information benefit over another that can be taken advantage of (Sykuta and Cook, 2001). In a typical agency model, a principal assigns an agent to do a certain task, but does not have a perfect signal of the agent's performance (Klein, 1999). Principal-agent problems, according to Doner and Schneider (2000), arise when principals have difficulties in controlling agents, and where managers exploit information asymmetries to further their interests.

Agency theory studies the structure of principal/agency relationships in order to reduce agency costs associated with moral hazard of agents (Klein, 1999). Ortmann and King (2007:54) noted that "agency theory is relevant to the institutional structure of cooperatives because employed agents (managers) may not act in the best interests of the cooperative members (principal)."

2.1.4 Property rights theory

Property rights are the legal and social rules under which economic and social behaviour takes place. For each physical or conceptual good or service, there exists a bundle of rights to various uses of the item (Veseth, 1982). According to Demsetz (1967), if a man owns property rights he is allowed by fellowman to act in a certain manner. Demsetz (1967) goes on to say that a property rights owner expects the community to prevent others from interfering with his actions, provided that these actions are not prohibited in the specifications of his rights.

According to Kherallah and Kirsten (2002) and Ortmann and King (2007), property rights concerns also form part of the "incomplete contract theory" developed by Grossman and Hart (1986), Hart and Moore (1990) and Hart (1995). Its assumption is that due to the asymmetric information between economic or transacting units and bounded rationality, a contract is incomplete. According to Sykuta and Cook (2001:1275), "incomplete contract theory builds on property rights themes in an attempt to prescribe optimal asset ownership based on residual and control rights of an asset."

Contractual incompleteness exposes the contracting parties to certain risks (Klein, 1999). Incomplete contract theory indicates that ownership rights to an asset have an effect on the incentive of the involved parties to invest. Without properly defined and identified ownership structures, there will be under-investment (Kherallah and Kirsten, 2002). Contractual difficulties generally arise from weak property rights, bilateral dependence, measurement difficulties, and weakness in the institutional environment (Klein, 1999).

Cook (1995) used property rights theory to defined five problems associated with traditional cooperatives (see section 1.3). It is also on the basis of property rights that Chaddad and Cook (2004) characterized non-traditional cooperative models (see section 1.5).

2.2 Application of New Institutional Economics to cooperatives

Cooperatives are institutional arrangements whose main purpose is to offer advantages to members that they otherwise would not enjoy outside the cooperative. Their main function is to reduce transaction costs associated with producing, marketing, and distributing products. For example, farmers who have very little bargaining power individually and have to depend on buyers to purchase their products can form cooperatives (horizontal coordination) that can negotiate a better contract with the buyers (vertical coordination). These types of coordination among farmers increase the competitiveness of farmers in the economy. Farmers could alternatively decide to form a cooperative and pull resources together to invest in their own processing plants. This form of vertical integration will benefit farmers by lowering transaction costs. However, cooperatives suffer from a number of problems associated with weak or insecure property rights and agency issues that suppress the ability of the cooperative to attract capital to finance investments. The NIE branches of TCE, agency theory, property rights theory and contractual incompleteness can be used to analyse and understand these problems.

In this study, the new South Africa Cooperatives Act will be analysed using NIE theory to show how the problems of ill-defined property rights suppress the growth and competitiveness of traditional cooperatives. Property rights in a cooperative refer to voting and benefit rights, i.e. residual rights of control and residual return rights defined in section 1.3. Having defined NIE, discussion can now focus on cooperative legislation-the institutional environment within which cooperatives operate.

CHAPTER 3
A Discussion of Cooperative Legislation

The purpose of this chapter is to highlight the importance of cooperative legislation in providing a conducive environment in which cooperatives can operate. Government plays an important role in promoting cooperative growth and success. The last section of this chapter traces the trends of cooperative legislation in a few countries in the world.

3.1 Why a cooperative law?

Some cooperatives prosper without being ruled by their own law, but there is no cooperative movement that can prosper without any legal rules applicable to them (FAO, 1998). Henry (2005) gives some reasons for the relevance of cooperative law as follows:

- Cooperative law is necessary though not a sufficient condition to get cooperative policy to work.
- Law is a reference point and a guide mark.
- Law is a suitable and testable means to represent and maintain a just balance between the autonomy of the co-operators and the cooperatives, on the one hand, and the powers of the state on the other.
- In complex societies, where social control can no longer be based on close personal relationships, regularization of social relationships, through laws, is an adequate means of regulating the activities of economic agents, especially where economic relations are not represented by physical persons but by legal persons.
- Law adds to stabilizing the political system.
- National laws are a necessary means to implement the public international cooperative law.

3.2 The objective of cooperative law

The purpose of enacting cooperative law should be to give cooperatives a legal status to facilitate their working. It should also be to ensure that cooperatives work as genuine bodies in accordance with the universally accepted cooperative principles. The legal framework for cooperatives consists of an Act, rules made under it, and the bylaws adopted by members of cooperatives in accordance to the Act and rules. This together makes up procedures and rules for the organisation and work of cooperatives to protect and preserve their cooperative character. In case of conflict among the three legal frameworks, the Act is supreme, followed by the rules, and then by laws (FAO, 1998).

3.3 The nature of cooperative legislation

Cooperative legislation is a reflection of economic, social and political circumstances. Therefore, in order to survive, cooperatives need a favourable socio-economic and administrative framework (FAO, 1998). Co-operative legislation is a necessary and suitable means of maintaining an appropriate balance between the independence and autonomy of co-operatives and the powers of the state (Griffiths, 2006). Cooperative legislation is part of cooperative law. Cooperative law consists of all national and international administrative and judicial Acts commonly accepted among cooperators as they bear on the formation, structure, operations, and dissolution of cooperatives. Therefore, the rules of other laws such as private law, competitive law, labour law, credit law, etc, must all be conducive to and supportive of genuine cooperatives if cooperative legislation is to be effective (Henry, 2005).

According to the Committee for the Promotion and Advancement of Cooperatives (COPAC) (1999), a number of countries do not have any special cooperative legislation and cooperatives are subject to general laws such as the tax law, competition law, labour law and land law governing all business organisations. Cooperatives choose the appropriate legal form for their cooperatives and make by-laws according to their needs and on the basis of internationally recognised cooperative principles. In some countries, where cooperative law is general and sets out only main cooperative principles, it is supplemented by detailed rules and regulations. These rules and regulations are supposed to be in conformity with the laws on which they are based.

The choice between the different legal instruments, i.e. the laws, regulations, government orders, etc, is not a free choice. The principle of cooperative autonomy and the rule of law determine the choice. Only matters which surpass the competence of an individual cooperative, which are of a democratically defined public concern or involve third party interests may be regulated through public norms, while everything else must be determined through by-laws. The cooperative law should be sufficiently detailed to avoid its character being altered through government rules (Henry, 2005). Cooperative legislation also includes a constitution – a legal document governing the operation of the cooperative as well as the behaviour of the cooperative members. In many cases, the Cooperative Act sets the standard against which cooperative members write out their own constitutions.

According to Fischer (2002), cooperative legislation needs to be flexible enough to cater for the individual nature of cooperatives because one size does not fit all. The organisational structure of a cooperative is dictated by the needs of activities it undertakes and the economic and physical environment in which it operates.

3.4 The role of government in cooperative legislation

Cooperative law making may be a prerogative of governments, of states, or of autonomous regions. In federal states (e.g., USA), cooperative legislation is rather a state matter, but there are cases where laws governing cooperatives are regulated at the state level (COPAC, 1998). Governments should provide a positive legislative environment and policy framework that enables cooperatives to explore and achieve their potential while maintaining a high standard of operations to protect public interest (Fischer, 2002). According to Henry (2005), government should be concerned with providing a well-functioning business milieu at all levels; for example, effective and efficient tax administration, an independent judiciary, an efficient banking and insurance system.

The attitude of the state or government towards cooperatives varies, depending on the economic system, government resources, the level of development of the country and the degree of maturity of the cooperative movement. Some governments view cooperatives as valuable and desirable structures worth promoting and supporting as contributors to the achievement of governmental objectives and policies. Others view cooperatives as just one form of economic organisation, among others, which work on equal terms with commercial firms and public enterprises without undue restrictions (COPAC, 1999).

According to the DTI (2004) the role of government in cooperative legislation is to establish legislation that will provide an enabling framework for the development of cooperatives. The legislation will allow simple and affordable registration and deregistration of cooperatives and will also provide supervision for the compliance of cooperatives to cooperative regulations. In particular, the legislation will allow the Minister of Trade and Industry to establish the Cooperative Advisory Board, to provide for deregistration and winding up of co-operative enterprises, and to provide other regulations.

3.5 International trends in cooperative legislation

In Europe the cooperative movement started with common organisations in the middle of the 19th century. Since then, cooperatives have become a major economic force. The cooperative sector is well represented in banking, modern industrial and service companies, in agriculture and in small and medium-sized craft enterprises. In these countries, cooperatives have a considerable market share and have proved to be competitive in a market economy. Cooperatives were set up solely through private initiative and were, and still are, sometimes independent of government, based on the principle of self-administration. In some countries, they operate as private sector companies in a market system, just like other companies (COPAC, 1999).

In the United Kingdom, the government has provided a solid legislative framework for cooperatives since 1893. The main legislation currently in force is the Industrial Provident Societies Act of 1965, which has various pieces of supporting legislation. The Central Government, through the Ministry of Labour and Social Affairs, supports and empowers cooperatives and provides incentives for the formation of new cooperatives and the training of cooperative leaders (Cooperatives UK, 2007).

In Iceland, the legal framework for cooperatives is provided by the Act on Cooperative Societies; however, tax provisions for cooperatives do not differ in substance from those for limited companies. The 1991 Act on Cooperative Societies was amended in 1997. The new law is more extensive with more than just the tax provisions similar to those embodied in the Acts on public limited companies. For example, cooperatives which experience financial difficulties or need more capital for other reasons have an opportunity to increase their wealth by issuing shares similar to those issued in a company (COPAC, 1999).

According to Bouckova (2002), differences in the legal framework of the cooperatives functioning in Europe are explained by the way in which the European countries approach cooperatives differently. For example, the countries which do not define cooperatives by any specific legal act are mainly those with very open legislation which include cooperative principles into business law. Bouckova (2002) noted that there are those countries with specific legal rules for cooperatives but without a special cooperative legal form such as France and Belgium. Other countries, like Portugal, Spain and Italy have a strong cooperative identity and their cooperatives are subject to special legislation. However, the one man one vote principle is applied to almost all countries in Europe.

In the United States of America, cooperatives are subject to state rather than federal laws. State laws are written in broad, general terms and law does not usually mandate mechanisms for cooperative affairs. The members are free to decide how they will operate their business, so long as regulatory statutes are not violated (COPAC, 1999). According to Cook (1994), during the evolution of U.S cooperative legislation, the two most frequently used economic justifications for forming cooperatives were (1) the need for an institutional mechanism which individual producers needed to bring economic balance under their control and (2) Individual farmers needed countervailing power when faced with monopolistic market structure.

In March 1997, the Canadian Government introduced a new Cooperative Associations Act to modernise the existing legislation and to place cooperatives in a better position to respond to challenges facing rural communities. Changes were made to allow cooperatives access to alternative means of financing, including raising capital from non-members while maintaining cooperative principles such as democratic control by members. The provision in the current Act stipulates that a federally incorporated cooperative must operate in more than one province. Cooperatives have the option of issuing investment shares for transfer to members and non-members (Canadian Cooperatives Secretariat, 2007).

In 2006, the People's Republic of China (PRC) adopted new cooperative legislation providing formal recognition of a new cooperative model forged to boost China's economic growth. This new law is the first codification of cooperative enterprise in post World War 2 China. Before the new law, cooperatives in China were loosely regulated or supervised by three PRC ministries: Agriculture, Science and Technology, and the Commerce and Industry Bureau. Under the new law, registration and incorporation of cooperatives is the sole responsibility of the Commerce and Industry Bureau (Dunn, 2007).

Cooperative legislation in Australia is state and territory based. State and territory governments agreed to a national scheme, which would make cooperative legislation and regulation uniform throughout Australia by including core consistent provisions into the Acts they administer and control (Griffiths, 2006). According to Cooperatives Victoria (2009), changes have been made to the cooperatives act of 1996, which among other things introduces cooperative capital credits as an additional form of capital fundraising to support the trading operations of cooperatives

In Tanzania, since 1967, the government has taken the lead in management of cooperatives via legal provisions and in the conduct of changing development policies. Cooperatives are run under the Cooperatives Act of Tanzania, 2003. This Act has made cooperatives in Tanzania stronger legally to perform as modern member driven organisations (Larsen *et al.,* 2003). Trends in the cooperative legislation of South Africa, and the new Cooperatives Act, 14 of 2005, are discussed in the chapter that follows.

CHAPTER 4

Cooperatives and Cooperative Legislation in South Africa

This chapter provides a discussion on the history of cooperatives in South Africa and a history of South Africa's cooperative legislation to date. The first section highlights briefly the history of cooperatives in South Africa. The second section follows the trend of the various Cooperatives Acts that governed cooperatives in South Africa. The third section presents a hypothetical cooperative model predicated by the new Act, 14 of 2005. This hypothetical cooperative model gives an understanding of the type of cooperative that would be formed under the new Act, highlighting its advantages, omissions and potential problems associated with the new Act.

4.1 The history of cooperatives in South Africa

Different ways to cooperate in the production and distribution of goods and services across different types of economic systems have been established by people all over the world. However, the formalization of such cooperation did not occur until the nineteenth century in Europe (Philip, 2003).

South Africa's agricultural cooperative movement was born in the nineteenth Century to provide commercial farmers with collective buying, marketing and organisational power (Competition Commission, 2006). According to the Small Enterprise Development Agency (SEDA) (2007), white Afrikaner farmers organised themselves into agricultural co-operatives which not only marketed their produce, but also supplied inputs like seeds, fertilizer and livestock. These co-operatives were strengthened when the Land Bank was formed in 1912 and the Co-operatives Act was passed in 1922. By the 1940s, white farmers' co-operatives were able to benefit from a system of marketing that fixed the prices of agricultural goods - through the 1937 Agricultural Marketing Act. In the 1970s, black farmers' co-operatives were promoted as part of the apartheid plan to boost 'homelands'. However, they did not enjoy the type of support that the state provided to white agricultural co-operatives and so they remained weak (SEDA, 2007).

According to Philip (2003), the cooperative movement focused on input supplies and joint marketing of production, and it established processing cooperatives such as in the wine and spirits sector. They became a powerful lobby for agriculture, holding a virtual monopoly in key agricultural sectors backed by the ready access to finance through the Land Bank and with effective control of the Control Boards that regulated prices until the system was dismantled after 1997.

In a historical sense, it can be said that the process of development of agricultural cooperatives in South Africa was characterised by periods of distress with the accompanying support from government as a result (Smith, 1979).

The total number of agricultural cooperatives registered has increased over the last few years (Competition Commission, 2006; Ortmann and King, 2007). Table 2 adapted from CIPRO (2005) illustrates this increase in registered agricultural cooperatives.

Table 2: Statistics for agricultural cooperatives 2001-2004

	2001	2002	2003	2004
Total number of registrations at the end of the previous year	220	256	290	369
New Registrations	49	41	87	98
Struck off register	13	7	8	8
TOTAL	256	290	369	459

Source: CIPRO (2005)

Van der Walt (2005), cited by Ortmann and King (2007), reports that it is difficult to establish how many of the registered cooperatives are actually active and thriving.

A significant number of agricultural cooperatives have transformed into companies (D'Haese and Bostyn, 2001). D'Haese and Bostyn (2001) go on to say that the main reasons for opting for such a transformation are the need for attracting additional capital, the wish to unlock value for members/investors, and concerns regarding political intervention. According to Ortmann and King (2007), a lot of "controversy revolves around the question of whether farmers' interests are better served by remaining members of a cooperative owned by them or by an Investor Oriented Firm (IOF) that is managed and owned by shareholders."

Many factors have shaped and influenced the development of cooperatives over time (Ortmann and King, 2007). According to Ingalsbe and Groves (1989) cited by Ortmann and King (2007), there are three main interrelated factors that influence the development of cooperatives. These are economic conditions caused by depression, technology, and government policy; public policy as influenced by government interest and legislative initiative; and farmer organisations including leadership quality, and enthusiasm about cooperatives.

4.2 The evolution of cooperative legislation in South Africa

This section on the evolution of cooperatives in South Africa is referenced from Van Niekerk (1988), (1993) and Competition Commission (2006).

The first cooperative in South Africa was the Pietermaritzburg Consumers' Cooperative, which was registered in 1892 under the Companies Act because the Natal Colony at the time, no Cooperatives Act existed. The nonexistence of an own Cooperatives Act had a retarding effect on the establishment of cooperatives as the provisions of the Companies Act did not suit the supporters of cooperatives.

In 1904, the Agricultural Development Act of the Natal Colony was enacted and it is generally accepted as the first legislation in South Africa to offer financial help to farmers for agricultural and cooperative development. However, very little or no use was made by cooperatives of this provision and the influence on agricultural cooperatives was very limited

In 1907 the Transvaal Land Bank Act of 1907 was passed by which a Land Bank was created for the Transvaal with the power to grant loans to cooperatives. This Act also promoted the establishment and development of agricultural cooperatives since it enabled cooperatives to regulate financial affairs easily.

In 1908 the Cooperative Societies Act of 1908 was enacted for the Transvaal and can be regarded as the first Cooperatives Act in South Africa. The main provisions of this Act were that: (1) there would be jointly unlimited liability of members, and (2) a superintendent would be appointed to do regular inspections of cooperatives. These provisions contributed to the healthy development of cooperatives in the Transvaal, although many members lost financially because of the unlimited liability when some of the cooperatives were wound up.

In 1909, a committee was established to investigate agricultural cooperatives. The committee came up with a number of reasons responsible for the failure of agricultural cooperatives. The following are the most important reasons for their failure: the lack of proper legislation for the regulation of the activities of cooperatives, the domestic demand especially for certain products was extremely limited and there was difficulty in finding other markets abroad, and lack of knowledge by farmers on successful management of cooperatives.

In 1910 the Orange Free State cooperatives were placed under the control of the Transvaal Registrar, with the establishment of the Union of South Africa. This was not the case in Natal and the Cape Province although farmers repeatedly asked for it. Because there was universal control of all cooperatives in the Transvaal and Orange Free State, the Registrar was able to distribute his influence over more cooperatives and therefore led to the healthier formation of cooperatives.

When the Land and Agricultural Bank was established in 1912, the functions of financing cooperatives was transferred to the Land Bank under the Land Bank Act of 1912. However, the Land Bank made provisions to provide credit only to commercial farmers (Ortmann and King 2007). The Land Bank was also empowered to investigate the financial position of cooperatives. The first world war of 1914-1918 had a particular influence on the economic development of the country as well as on cooperatives.

In 1922, the Cooperative Societies Act, Act 28 of 1922 was passed. It repealed and consolidated all previous cooperative legislations. The Act gave cooperatives a new pattern of national recognition. The most important characteristics of the Act were the following:

- It made a provision for the establishment of agricultural cooperatives with unlimited liability, so both forms of liability would be made possible
- The cooperative movement was not restricted to agricultural cooperatives, but provision was made for the establishment of trading cooperatives with limited liability

- The Act gave cooperatives, which were registered under the Companies Act, the opportunity to apply to be registered under the 1922 Act, irrespective of whether their statutes clashed with the Cooperatives Act.
- The Act introduced the principle of conditional liability by which members could undertake to accept liability for a specific amount, which would then serve as security for the cooperatives to obtain loans.

The Act was successful in developing the cooperative movement although it caused serious friction leading to great dissatisfaction because the Cooperatives Act of 1922 now admitted cooperatives, which for example, enjoyed wide powers under the Companies Act, with their existing powers. In 1925 the Cooperative Societies Amendment Act, Act 38 was enacted. It was established that shortly after the Cooperatives Act of 1922, the maximum price was not realised for certain products although a larger percentage of the farmers in a particular area belonged to a cooperative. This was because the other non-member farmers would disrupt the bargaining position. The Act 38 of 1925 was passed in order to strengthen the bargaining power of cooperatives and to give them full control over the products in the interest of all farmers.

The number of agricultural cooperatives grew considerably after the 1922 Cooperatives Act. However, during the period 1929-1932, South African Agriculture and the cooperative movement experienced difficult times. There was a world depression and the effect on agriculture was stronger than any other economic sector, as prices of agriculture products dropped faster and further than the prices of non-agriculture products. The financial position of more and more farmers became critical and as such, they sought refuge in cooperatives. However, the depression significantly affected cooperatives as their total turnover decreased. Several financially weaker cooperatives disappeared during the depression years.

In 1939, the Cooperative Societies Act, Act 29 was enacted. This Act consolidated the Act of 1922 and subsequent amendments. One of the most important provisions of this Act was the development of a new type of cooperative with limited liability, i.e. a special cooperative farmers' company. This type of cooperative would have the right to deal with non-members and accept persons other than farmers as members. The passing of Act 29 of 1939 introduced a new period of growth in the total turnover of agricultural cooperatives, even though provisions had been made for the general increase in price levels.

According to Vink (1993), the South African economy was growing steadily until 1970, when a number of problems occurred. The most important of these from an agricultural perspective were the inflation of the early 1970s and growing concentration in various parts of the agro-industry. The latter was largely a result of policies aimed at industrialization through import substitution. Vink (1993) goes on to say that the features of white agriculture during this period were mechanisation of the commercial agricultural sector and a growth in the level of subsidies to white farmers. There were also extensive forced removals of the black population into consolidated homelands.

According to Kirsten (1993), cooperatives were used in the homelands during the 1970s and 1980s as tools to fight unemployment and provide power to those disempowered by the apartheid regime. Anti-apartheid donor agencies, corporate enterprise, trade unions and community organisations generally supported these cooperatives. Many of these cooperatives were created with good intentions to empower the marginalized communities. However, because it was done without context and culture, most of these cooperative initiatives failed. The root of the cooperative problem was that cooperatives were often started for social rather than business reasons. They were based on the need to create jobs rather than start a business. The survivors were dependent on strong leadership. The Cooperatives Act at the time and the Marketing Acts of 1937 and 1968 provided an integral part of the legislative framework that was designed to advance the interests of the white agricultural sector at the expense of the black farming sector.

In the 1970s cooperatives in the homelands failed because of lack of expertise, public sector support to the cooperatives and farmers/members losing faith in the cooperative movement. During 1971, a regulation was propagated in which all cooperatives in the homelands would be registered and controlled. This implies that government played a leading role in the establishment and registration of cooperatives with little or no community involvement, which led to lack of loyalty and ownership. Farmers generally regarded cooperatives as government's business (Kirsten, 1993).

The Cooperatives Act of 1981 (Act 91 of 1981) provided for the establishment, incorporation, functioning, winding up and dissolution of cooperatives as well as the appointment of a Registrar of Cooperatives. This Act allowed for trading cooperatives, which showed growth during that time, but it was still agriculturally oriented. However, cooperatives experienced serious problems with certain clauses of the Act, which had a strong effect on the operational adjustment to the changing environment. South Africa's demographic, economic and technological realities also affected cooperatives since they formed part of the business sector.

Committees and Commissions of Inquiry concerning cooperatives' policy highlighted several matters such as development, overlapping and strategy, which affected the proper functioning of cooperatives. In 1986, the Cooperative Council and the Cooperative Congress, with the help of various expert working groups, accepted a series of policy documents on various matters concerning cooperatives. As a result, the Cooperatives Act of 1981 was drastically amended in 1993. From the time the Cooperatives Act of 1981 and the Amendment Act of 1993 were passed, the economic and social structure of South Africa had changed to such an extent that cooperatives also had to change continuously in order to adapt to modern demands. However, the adjustment and advancement of cooperatives is only possible when the Cooperatives Act makes it possible for them to do so.

South Africa's past policies on the economy and society negatively impacted on cooperative development especially among the black majority of the population, resulting in a dualistic cooperative sector, i.e. there was a relatively successful and established white controlled cooperative movement on the one hand, and a small emerging cooperative movement dominated by the black population, which lacked financial and human resources (DTI, 2003). According to SEDA (2007), government has been supporting the growth of co-operatives since 1994, especially among historically disadvantaged South Africans, as a strategy to alleviate poverty and create jobs. Certain aspects of the Co-operatives Act of 1981 were considered unsuitable. Some of these include: too much focus on large, commercial agricultural co-operatives, an inadequate definition of a cooperative, compliance with co-operative principles was not explicitly required from co-operatives, an assumption of a highly interventionist role for the state, a complicated registration process, and insufficient protection of the members' interest.

"New strategic initiatives into the development of cooperatives were initiated by the development of a new Act based on the ICA principles. The process started with the publication of a draft Bill in 2000 and a further revised draft in 2003 for comment. Comments were received from a wide range of organisations, interest groups and individuals. The revised Bill culminated in the Cooperatives Act, 2005 (No. 14 of 2005)" (Ortmann and King, 2007:45).

Responsibility for cooperatives was transferred from the Department of Agriculture to the Department of Trade and Industry (DTI) to ensure that cooperatives are promoted as businesses in all sectors of the economy and not only in the agriculture sector as had been the case historically (Philip, 2003). The Department of Trade and Industry had to develop a new policy and legislation that would: promote the development of sustainable co-operative enterprises in all sectors, ensure simpler registration processes and management of co-operatives, ensure accessibility to the poor, be user friendly, be developmental rather than administrative, and promote equity and greater participation of targeted groups (SEDA, 2007).

Since the Registrar of Cooperatives moved to the DTI, "the agricultural sector has lost considerable intellectual and administrative capacity", because the "DTI has adopted a centralization approach with only one department dealing with all cooperatives" (Doyer 2005, cited by Ortmann and King, 2007:48). According to Mpalwa (2005) the DTI has been successful in drafting the new cooperatives legislation. The policy review document by the DoA (2000) points out that the main goal of the new cooperatives legislation should be to achieve more effective participation which is all inclusive, but remains business oriented within acceptable cooperative principles, and which will have a positive impact and contribution to the development of South Africa's economy.

Section 2 of the Cooperatives Act 14 of 2005 (RSA, 2005) outlines the purpose of the Act as:

- Promoting the development of economically sustainable cooperatives, hence increasing the number and variety of economic enterprises operating in the formal economy
- Encouraging persons and groups who subscribe to values of self-reliance and who choose to work together in democratically controlled enterprises, to register cooperatives in terms of the Act

- Enabling such cooperative enterprises to register and acquire legal status separate from their members
- Promoting greater participation by black persons, especially those in rural areas, women, and persons with disability and youth in the formation of and management of cooperatives
- Establishing a legislative framework that will preserve the cooperative as a distinct legal entity
- Facilitating the provision of support programmes that target cooperatives, specifically cooperatives that target and create employment or benefit disadvantaged groups
- Ensuring the design and implementation of the cooperative development support programmes by agencies of national departments including Khula, SEDA, etc.

The Act provides for cooperatives to be legal entities with limited liability and with the explicit understanding that they are to be underpinned by sound business principles. This legislation applies to all types of cooperatives, including agricultural, transport, financial, and others. According to Knight (2006), the government has allocated R500 million to assist emerging black farmer cooperatives. Knight (2006) maintains that the DTI and DoA have embarked on a programme to boost sustainable cooperative strategies that support local economic development and empowerment.

Although the Act is based on The Cooperative Principles, it does not necessarily enforce all of The Cooperative Principles. For example, Section 3(2)(a and b) of the Act allows for restricted membership; a departure from the principle of open and voluntary membership. In the section that follows, NIE theory is used to determine the type of cooperative organisation predicated by the Act.

4.3 A hypothetical model of a cooperative predicated by the cooperatives Act 14 of 2005

The Act, although passed in August 2005, only came into operation towards the end of 2008. New cooperatives that registered after 2005 but before 2008 registered under the previous Act of 1981. According to Konkwa (2009), the reason for this was the delay in transferring the registry of cooperatives from the Department of Agriculture to the Department of Trade and Industry. Cooperatives that registered under the Cooperatives Act of 1981 are currently being re-registered under the Act of 2005. A hypothetical cooperative, fully compliant with the provisions of the new Act, was synthesised and its ability to promote the business interests of emerging farmers was tested against the NIE propositions. The objective of this section is to examine the extent to which the Act permits cooperatives in South Africa to deviate from TC principles in order to avoid the free-rider, horizon, portfolio, control and influence cost problems. The hypothetical cooperative assumed in this analysis is an agricultural production cooperative. This choice was motivated by the fact that cooperatives that have a high need for capital, require a substantial amount of cooperation and collective action among the members, and are therefore more likely to suffer the consequences of weak institutional arrangements.

Assume that XYZ is a production cooperative established under the new Act by 50 small farmers to produce and market vegetables on State owned land. The members agree to contribute equally to the labour requirements of the cooperative and therefore receive an equal share of the surpluses distributed by the cooperative because patronage is measured by labour effort in a production cooperative[1]. In other words, in a production cooperative, members are rewarded according to their effort in the cooperative activities, such as number of hours worked or acreage planted, which is proportional to the value of transaction stipulated in the Cooperatives Act. Finally, assume that the cooperative is financed with a contribution of R100 from each member[2] and a government grant of R45000.

In accordance with the Act the original members can, and probably will, insist upon a restricted membership rule[3] to protect their government grant being divided amongst new members who were not involved in applying for the grant. This will also prevent new members from benefiting from the hard earned profits of existing members. However, over time, new members will have to be admitted. These members are likely to become free-riders

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[1] Section 44(1) of the Act states that a cooperative may allocate and credit or pay its members a portion of the surplus that is not transferred as reserve…in proportion to the value of transactions conducted by a member with a cooperative during a specified period.

[2] According to section 40 of the Act, cooperative members are required to contribute capital either through entrance fees, subscription fees, membership shares, or member loans.

[3] Section 3(2)(a) of the Act stipulates that a cooperative may restrict membership, provided that restrictions reasonably relate to the business of the cooperative set out in its constitution and that the restriction does not constitute unfair discrimination.

because they do not pay market prices for their shares- membership is open in the economic sense because shares are redeemable at par value and therefore cannot be transacted at their market price. This is a binding constraint imposed by the new Act. Given this, it is possible that since one member has one vote irrespective of investment, potential investors will be discouraged from investing knowing that that have little influence over investment decisions taken by a democratically elected board[4]. Furthermore Ngubane (2007) noted that some agricultural cooperatives in KwaZulu-Natal had appointed members to their executive committees with political rather than business objectives – a clear indication of the influence cost problem.

The restricted membership rule protects cooperative members from the external free-riding problem but not from the internal free-rider problem that discourages members' investment. Because the Act specifies that benefit rights are proportional to patronage, there is no incentive for members to invest more than the minimum amount of capital in the cooperative. Clearly, the cooperative will most likely struggle to raise equity capital even if some members could afford to invest more. As a consequence, the cooperative could levy an annual or monthly membership fee to raise capital to fund the activities of the cooperative. Additionally members will demonstrate stronger preferences for cash returns as they will be more acutely aware of the internal free-riding problem that arises because the Act limits cooperatives from adopting arrangements that enable members to realise capital gains on equity investments in cooperatives[5].

The Act does not restrict cooperatives from raising debt capital to finance growth assets. However borrowing will be constrained by low levels of equity capital. In addition, as voting is not proportional to investment, lending (by members and financial institutions) will be constrained as a result of the influence cost problem. Access to equity capital will also be constrained by the control problem. Although the Act promotes transparency and accountability in cooperatives, there is no provision that allows cooperatives to create a

[4] Section 3(1)(b) of the Act specifies that a member has only one vote irrespective of their shareholding.

[5] Section 40 of the Act provides that members' equity investments in cooperatives can accrue interest, but have no bearing on member's relative benefit or voting rights.

market for secondary shares. As a result, there are no share prices to signal the performance of the directors and managers. The absence of a market for equity shares also means that members are subject to a portfolio problem. Despite these problems, which constrain the cooperative's access to capital, liquidity constraints may not be immediately evident in cooperatives that receive generous grants to meet their initial capital requirements. Consequently, institutional problems predicted by the NIE may not become apparent to members until capital does become limiting.

If some members decide to reduce or increase their labour effort and the cooperative is unable to monitor these changes, another internal free-rider problem could emerge that discourages patronage in the form of labour effort. Again, this problem may not be evident in a young producer cooperative where returns, labour effort and investment are all shared equally. Add to this the adoption of good governance practices required by the Act, such as annual financial audit, and the members of XYZ cooperative are likely to express optimistic views about the performance of their young cooperative. However, these views are likely to change once the grant funds are depleted or some members start shirking in their labour efforts. An important feature of the Act is that it does not include a provision that prevents the transfer or sale of a cooperative's assets to private ownership through asset locking[6] (Bates and Brown, 2006 cited by Stanford, 2006). Consequently, cooperatives that become constrained by the Act can convert to, for example, private company status.

The synthesis presented in this section is used to guide the analysis of the case study cooperatives presented in the chapters that follow. The chapter 5 provides an overview of the case study approach and introduces the cooperatives that were used as case studies for this research. Chapter 6 presents the results of the case studies.

[6] Asset locking involves legislative restriction on the extent to which cooperative members can benefit individually by selling their equity share when they leave the cooperative, or when it closes or converts to another type of business (Bates and Brown, 2006 cited by Sanford, 2006).

CHAPTER 5
Research Methodology and Data Collection

The purpose of this chapter is to explain the approach used to collect and analyse information regarding the suitability of the new Act as a means to drive growth and promote development of cooperatives. Case study method was used to study three production cooperatives.

5.1 Research methodology

Case study methodology was used to investigate the institutional arrangements of selected agricultural cooperatives registered post August 2005 (i.e. after the new Act was enacted). These cooperatives may have existed before the new Act and adopted the principles of the Act, or may have been established after the Act was passed. Case study is a qualitative research method. Qualitative research methods involve the use of qualitative data such as interviews, documents, and participant observation data to understand and explain social phenomena (Myers, 1997). Yin (1994) defines a case study as an empirical inquiry that investigates a contemporary phenomenon within its real life context, especially when the boundaries between phenomenon and context are not evident. The case study inquiry typically deals with technically unusual situations in which there are more variables of interest than data points (Kennedy and Luzar, 1999).

Case study offers a multi-perspective analysis in that the researcher does not only consider the voice and perspective of the respondent but also of the relevant groups of respondents and the interaction between them (Tellis, 1997). It relies on multiple sources of evidence, requiring data to converge in a triangulating fashion (Kennedy and Luzar, 1999). Triangulation is confirming or deepening understanding by using multiple sources all focusing on the same process or event (Myers, 1997). By providing information from a number of sources, case studies permit a more holistic study of social networks, social action and study the stability and change in social patterns (Kennedy and Luzar, 1999). In this study, the primary sources of information were interviews with the managers, the executive committee and members of the cooperatives under study.

Yin (1994) describes case studies as being exploratory, explanatory and descriptive, focusing not on the discovering of a universal cause and effect relationship, but on descriptions and reasons. Case studies are useful in answering “how” and “why” questions (Yin, 1994). Case study, like other methods of inquiry, benefits from prior development of theoretical propositions to guide data collection and analysis (Kennedy and Luzar, 1999). In this study, the interviews were guided by the hypothetical example of a cooperative predicated by the Act in Section 4.2 of this dissertation. The hypothetical cooperative model identified the free-rider, portfolio, horizon, influence and control problems. The results of these problems, as discussed in the previous sections, are a disincentive to invest in the cooperative.

Questions surrounding the causes, symptoms and effects of these problems were asked. The interviews were also designed to elicit information about the current and expected future operations of the cooperatives and investment behaviour of their members. The hypothetical cooperative model identified a type of internal free-rider problem, not mentioned in the theory of cooperative flaws, which discourages labour effort of the members. Questions to investigate this further were included in the interviews. An unstructured open-ended set of questions (Appendix A) was used in the interviews. This is a flexible method, as new questions are built on the findings of the previous questions. Open interviews also leave considerable room for respondents to volunteer information regarding the issues being discussed.

5.2 Data collection

Three case studies were identified for this study: a poultry cooperative near Pietermaritzburg (Case Study A), a cooperative involved in the production of peanut products, carbonated soft drinks and animal feed on the KwaZulu-Natal South Coast (Case Study B), and a sugarcane producing cooperative on the KwaZulu-Natal North Coast (Case Study C). Only three cooperatives were used in this study due to time, access and resource constraints. The intention of this study was to analyse smallholder agricultural cooperatives that were bound by the provisions of the new Act. However, this was not possible because cooperatives registered between 2005 and 2008 were still registered under old Act (of 1981) with the provisions of the new Act taking effect only from 2008. Care was taken to identify practices adopted by the study cooperatives that were not consistent with the provisions of the new Act as such deviations would help to identify institutional problems and possible solutions.

Case Study A was selected from a list of ten active cooperatives recommended by extension officers of the KwaZulu-Natal Department of Agriculture and Environmental Affairs. Case Study B was identified as a suitable cooperative after learning about it at an agricultural exhibition and so was purposefully selected. It was deemed suitable because it had plans for expansion and therefore required substantial capital investment. Case study C was selected from a list of three cooperatives suggested by extension officers from Lima Development Foundation. The reason behind the use of extension officers in this research was in order to gain trust of the cooperative members who are well-known to them by extension officers and so encourage greater participation. The case study cooperatives were recommended by the extension officers based on accessibility and the reliability of the members to provide accurate information.

Production cooperatives were selected because they typically have a large need for capital, and are thus likely to suffer the consequences of weak institutional arrangements. The cooperatives were of varied size and organisational structure, and had different innovative solutions to the institutional problems. All three cooperatives were operational at the time of the study, and their memberships were comprised of small-scale farmers.

Cooperative members interviewed were randomly selected from those available, and all interviews were conducted on an individual basis. In addition to interviews with ordinary cooperative members, executive committee members, and project managers (where applicable), a copy of the constitution of each case study was requested from their respective executive committees. Interestingly, none of the constitutions examined complied completely with the requirements of the Act (refer to Appendix B). Case Study A's constitution contains only seven out of 32 provisions required by the Act, and Case Study B and C's constitutions contained only 26 of the 32 provisions[7]. This suggests that DTI did not strictly enforce the Act when registering these agricultural cooperatives.

[7] Important provisions that are absent from the constitution of Case Study C: the rights and obligations of members, a provision relating to the distribution of surplus, relating to the distribution of assets on dissolution of the cooperative, and use of surplus in the reserve.

Case Study A's core business is raising and selling broilers. Mature birds are sold to the local community at a market related price (R40 per bird, at the time of the survey). The cooperative's members are required to contribute equally to the business with respect to both financial resources and labour. They pay a monthly subscription fee of R20. Surplus is divided equally amongst the cooperative members. Members' voting rights in Case Study A are aligned with the democratic one-man-one-vote principle. Case Study A initially operated as a *small group*[8] of 35 members. The group size had declined to 14 members when it registered as a cooperative in May 2006. At the time of this study, its membership had shrunk further to eight members, two of whom are male. All of the members have a similar socio-economic background.

The members of Case Study A were involved in writing the constitution of their original small group. This constitution was only slightly modified when the business was restructured as a cooperative. According to its members, the small group was established *to fight poverty and create employment opportunities*, and was registered as a cooperative *on hearing that funding and other benefits from the government were available for registered cooperatives*. The provisions that changed when the cooperative was formed are the membership policy and subscription fee. Accessibility to loans (through Ithala Bank) and extension support are the two most significant benefits they have received since registration. When the cooperative was registered it also received a donation of 200 chicks and 20 bags of feed from the KZN Department of Agriculture and Environmental Affairs.

Profits accrued from the business are distributed in three ways: A certain percentage of the profit is used to repay a bank loan, another percentage is used to run the business (i.e. buy feed, medication, chicks, gas, etc), and the rest of the profit is divided equally among the members. According to one of the members of the cooperative, the business was more profitable before it restructured as a cooperative; however, other members pointed out that restructuring the business had little impact on its business operations.

This cooperative was selected for this study because it has plans to expand its activities to include egg production and goat farming. The ability of this cooperative to raise capital to finance its planned growth is an important indicator of the strength of its institutional

[8] An informal business structure that does not acquire legal status separate to its members.

arrangements. Another interesting aspect of this case study is the opportunity to explore whether its institutional arrangements were strengthened or weakened when it voluntarily restructured as a cooperative in order to access government grants.

Case Study B is an agribusiness cooperative involved in processing peanut products such as peanut butter, oil and porridge, growing sugarcane and growing vegetables. Their products are sold in the local community and they are currently extending their clientele to big cities. It was formed in 2005 as an initiative to create employment and a way out of poverty. The cooperative was registered in 2006 in order to operate as a legal entity and gain funding from government.

The cooperative, which started with a total membership of 11, is currently made up of 5 males. The membership of the 6 was terminated because they were not committed to the cooperative and did not take part in the cooperative's activities. They were given a 21 day period in which to appeal but they never did. Their membership fees were forfeited.

Members paid a joining fee of R250 and are required to pay an annual subscription fee of R1000. The fees may be paid in equal monthly instalments. Currently new members are required to pay a joining fee of R2000. This was decided upon after an annual audit and appraisal of the cooperative. The surplus is divided equally among the members as each of the members has an equal share in the cooperative. However, the cooperative members are paid a wage for the work they do.

The cooperative has received a number of benefits as an advantage of registering with the DTI. These benefits include a loan of R324,000 from Itala Bank, a grant of R17,000 from the Department of Agriculture, and machines worth R120,000 from Utungulu Community Foundation. Other benefits received were training from the Department of Agriculture and the Department of Trade and Industry.

Case Study C, a *joint farming* cooperative, was selected because it has a relatively larger and more heterogeneous membership (105 members), and therefore is less likely to achieve successful collective action. The combined sugarcane farming cooperative model is in itself an institutional innovation designed to overcome free-rider problems inherent in sugarcane production and marketing cooperatives[9]. It provides for consolidation of the cooperative members' arable land allocations to provide economies of size necessary for sugarcane farming to be competitive. In essence, members exchange exclusive use rights over land (typically 1 – 7 hectares each) for a fixed rental income (R800 per hectare per annum) as well as voting and benefit rights in the cooperative for a set period of time (the length of the lease[10] – usually 8 years). Members' benefit rights are proportional to patronage (where patronage is measured as the area of sugarcane land rented to the cooperative); however, members have equal voting rights. The cooperative's management committee appointed a project manager to manage collectively the many tracts of land rented from its members as a single farm. The project manager does not necessarily have to be a member of the cooperative. Members are not required to provide labour to the cooperative, but are hired in preference to non-members by the cooperative. Members of Case Study C are required to pay a joining fee of R20 and an annual subscription fee of R20.

Of the three *joint farming* sugarcane cooperatives, only one raised debt capital, secured by a cession on their sugarcane deliveries at the mill. Despite this ability to overcome problems of raising capital that are common to many traditional cooperatives, all three suffer from problems of collective action, for example, poor attendance of members at meetings of the cooperative.

Responses from the persons interviewed in Case Studies A, B, and C were analysed and interpreted with reference to the hypothetical model and the constitutions of the respective cooperatives. The results of the analysis are discussed in the following chapter.

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[9] In sugarcane production and marketing cooperatives members have little incentive to invest in improving the quality of the sugarcane that they produce because farmers are paid according to the average quality of sugarcane marketed by the cooperative.

[10] The lease agreements are sanctioned by the relevant traditional authority, therefore the property rights transferred by the lease are relatively secure.

CHAPTER SIX
Results

Previously, the free-rider, horizon, portfolio, control and influence cost problems were identified as symptoms of weak institutional arrangements of business organisations, and therefore threats to the growth and sustainability of these organisations. In this chapter, information gathered during interviews with cooperative members together with information taken from the cooperatives' constitutions is used to identify and explain the extent to which these problems currently and potentially exist in each of the case studies.

6.1 Case Study A

Case Study A had adopted some institutional arrangements that were not consistent with the traditional institutions favoured by South Africa's new Cooperatives Act. In particular, it had an unwritten rule that members who exited the cooperative would be paid out their share of the cooperative's net asset value (but only if they exited after the cooperative had settled its bank loan). This arrangement partially addresses the horizon and control problems that confront traditional cooperatives because it (a) allows members to realise capital gains proportional to their investment, and (b) generates objective signals about the performance of management. Members created this rule when they first established and operated the business as a *small group* because they appreciated the need to reward investors with capital gains. The arrangement is in direct conflict with Section 40 of the new Act and is therefore not sustainable. Compliance with the Act will make it more difficult for Case Study A to attract equity capital (and hence debt capital) to finance its proposed egg and goat farming enterprises.

On registering as a cooperative, Case Study A adopted a policy of screening prospective members because existing members felt that they had "*built the business from scratch and were not going to let anyone take it from them*". Presumably this means that membership will be restricted in the economic sense, i.e. new entrants must buy shares at their appreciated prices. Although restricted membership encourages investment, it does little to solve the liquidity problem that arises when members terminate their membership and redeem their (appreciated) shares. Members acknowledged the gravity of this redemption risk when they agreed to forfeit their investment if they exited the cooperative before it had settled its debt. In countries with more liberal legislation, cooperatives can avoid redemption risk by issuing non-redeemable shares that can be traded at their market price. Although Section 43(2) of South Africa's new Act allows members to invest in transferable quasi-equity capital credits, transferability of these shares is unlikely to translate into tradability because capital credits are redeemable (Lyne & Collins, 2008).

During the interview process, it became evident that members were reluctant to invest in the cooperative despite its provision for capital gains. In particular, they were unwilling to invest equity capital in the cooperative over and above the required subscription fee because it would not benefit them personally. This statement might reflect concerns that members could not realise capital gains until after the cooperative had settled its loan or, more likely, that increased capital investment is not rewarded by an increased share of profits or increased voting rights. It is reasonable to conclude that, like a traditional cooperative, Case Study A suffers from an internal free-rider problem.

Members also stated that they received an equal share of any surplus distributed by the cooperative regardless of the amount of labour contributed by each member. This creates a labour problem as members have an incentive to shirk and free-ride on the effort of others. This problem has obvious implications for the performance of the cooperative, and members had agreed to impose penalty payments on those who shirked. Although the fines are large enough to discourage absenteeism, labour effort is not easy to monitor accurately.

The cooperative had secured a medium-term loan from Ithala Bank, a development finance institution (DFI). Members stated that access to government and DFI funding was a key reason why they had agreed to register their business as a cooperative. One of the objectives of the new Act is to facilitate the provision of support programmes for cooperatives, specifically cooperatives that target and create employment or benefit disadvantaged groups.

Members attributed the decline in membership (from 35 to 8) to (a) reluctance to make monthly capital contributions, (b) unrealised expectations, and (c) social conflict within the group. These responses could indicate the earlier presence of portfolio and control problems in the larger group (see section 4.2). However, there was no evidence of these problems (despite the absence of tradable equity shares) or an influence problem (despite egalitarian voting rights) at the time of the study - possibly indicating greater homogeneity of interests in the surviving group. If the cooperative takes on more members, or broadens the scope of its activities, this homogeneity may weaken, adding these problems to the internal free-rider and labour problems that already threaten its long-term sustainability.

6.2 Case Study B

Although this cooperative shares profits equally between its members, it avoids internal free-rider problems by insisting that members contribute equal amounts of capital, and by paying wages for labour provided by members. In addition, it alleviates the horizon problem by adjusting the joining fee (i.e. share price) to reflect growth in the cooperative's net worth. The joining fee had increased to R2000 at the time of the study but no new members had been admitted.

At present, members do have an incentive to invest in the cooperative as they had agreed to redeem shares at their audited value when a member left the group. As in the case of Cooperative A, this rule had been devised by the members themselves who appreciated the cooperative's need for capital and the need to reward investors with capital gains. One of the members remarked "*how can we expect the business to grow if we do not put money into it?*" while another acknowledged that "*the more money we invest in the business, the more money we get out of it*". Again, this provision to redeem shares at their appreciated value rather than at their par value was at odds with the new Act.

Of course, the proportionality between individual investment and profit shares holds only while all of the members are both willing and able to contribute the same amounts of capital. Six of the original 11 members were obliged to leave because they were unwilling to invest their money and time in the cooperative. In the absence of truly proportional benefit rights, the threat of internal free-riding was removed by excluding members who were either unwilling or unable to invest amounts agreed by a majority of the members.

Surviving members claimed that former members were unwilling to invest because they expected quicker returns on their investments in the cooperative. This suggests a divergence of interests and risk aversion in the larger group, which - in the absence of tradable equity shares – tend to manifest as portfolio and control problems. The threat of these problems reemerging may explain why the surviving members were reluctant to admit new members to their cooperative. Members stated that "*new members may cause a lot of problems*" and "*it will be difficult when new members join the cooperative*".

Like Cooperative A, this cooperative had introduced an (illegal) institutional arrangement to alleviate the horizon problem. It 'solved' an internal free-rider problem (and potential influence problem) by shedding members who were unable or unwilling to make capital contributions large enough to preserve proportionality between individual investment, benefits and voting power in a cooperative that shared profits equally between members and assigned egalitarian voting rights to them. Portfolio and control problems that tend to emerge in the absence of tradable equity shares were avoided by keeping membership small and homogeneous.

6.3 Case Study C

Case Study C avoids the labour problem by employing its members and paying them a market-related wage for work done. It countered the internal free-rider problem by making benefits proportional to land invested in the joint farming cooperative. However, both ordinary members and members of the executive committee complained that they were "*breaking their backs for less concerned members*" who refused to pay the annual subscription fee, did not participate in the cooperative's activities or attend its monthly meetings, and yet expected high returns at the end of each season. Clearly, there is still some internal free-riding when it comes to contributing cash and service to the cooperative.

Committee members' responses to questions about plans for future expansion of the cooperative revealed a horizon problem in this cooperative. For example, cooperative members indicated a strong preference for the use of contractor services rather than purchasing tractors, machinery and implements as they were concerned that current members would carry the burden of financing assets that would benefit future members who did not pay market-related share prices to join the cooperative. Members also expressed a preference to finance current expansion using debt rather than equity capital or reinvested profits, presumably because some of the debt servicing obligations could be shifted to future members without harming their own interest in the cooperative.

The absence of market-related share prices may also have contributed to a control problem that was evident in Case Study C. There was conflict between ordinary members and the executive committee. Members accused the executive committee of misusing funds and claimed that the project manager was using cooperative funds for personal gain. According to the executive committee and project manager, all payments made to the project manager are supervised by the South African Sugar Research Institute (SASRI). Ordinary members appeared to be poorly informed of the cooperative's day-to-day operations, and none of the members interviewed - apart from those on the executive committee - were aware that the cooperative had taken a loan from First National Bank. The loan was secured by a cession on cane delivered by the cooperative to the mill.

Although there was no compelling evidence of an influence problem in any of the cooperatives studied, the problem was not anticipated in the first two cases because their small groups of surviving members were willing and able to make equal investments. This created proportionality between their levels of investment and their democratic voting rights (at the expense of a rigid and small membership), thereby reducing the likelihood of an influence problem. However, Case Study C has 105 members whose land contributions are not proportional to their equal voting rights. The apparent absence of an influence problem may, of course, only show that evidence of an influence problem is difficult to collect. Interviewees did report that monthly meetings were typically attended by only 30-40 per cent of members.

Some of the blame for low levels of commitment shown by members must be apportioned to agencies that facilitate and register new cooperatives. Ordinary members of Case Study C complained that they did not participate in designing their cooperative's institutional arrangements. Many claimed that they did not have access to the cooperative's constitution, and some were unaware that it had a constitution. None of the members received any form of training, which clearly contravenes cooperative principles and raises questions about the registration process (and hence the provision of public grants). The extension officer overseeing Case Study C stated that a cooperative was not the farmers' first choice of business model. The cooperative model was chosen because it was a precondition for government support. The implication is that members would have preferred a different set of institutional arrangements.

CONCLUSIONS AND RECOMMENDATIONS

The case studies reported support the contention that emerging producer cooperatives are constrained by institutional problems. One of the 'solutions' adopted by these cooperatives has been to exclude individuals who make the membership more heterogeneous in terms of income and risk aversion. In particular, relatively poor members face exclusion if they are unable to match the capital contributions of other members. Another has involved rules that provide member-investors with some measure of capital gains. These rules will not be legal once the provisions of the new Act are enforced, and serve to heighten a cooperative's exposure to redemption risk. It is clear that respondents would have preferred other forms of business organisation but selected the cooperative model because it was seen as a precondition for government support.

In conclusion, the new Act is expected to aggravate problems that make it difficult for emerging cooperatives to raise the equity and debt capital needed to finance growth, and will encourage them to shed their poorest members. This is not consistent with the objective of pro-poor economic development. It is therefore recommended that the new Act should be amended to give cooperatives more flexibility in their choice of institutional arrangements. In particular, cooperatives should be allowed to sell quasi equity shares that are appreciable, non-redeemable and tradable to members, including strategic partners. This would mean changing section 43(2) of the Act to make 'capital credits' in a 'fund of members' non-redeemable, section 44(1) to allow surpluses to be distributed in proportion to investment rather than patronage, and section 3(1)(a) to allow non-patrons to join the cooperative as investor members. A simpler option would be to allow cooperatives to issue a class of tradable 'investor shares' that offer benefits proportional to shareholding. If these shares do not confer any voting rights, the influence problem will persist but the cooperative will retain some of the transaction cost advantages of contracting with its own residual claimants. Similarly, if these tradable equity shares do carry voting rights, aggregate voting rights conferred on non-patron investors should be capped to prevent loss of control by patron members.

In addition, it is recommended that the same level of start-up support should be made available to all producer groups that formally register their business, regardless of the business model chosen. Evidence showed that the case study businesses registered as cooperatives to capitalise on the available funds provided by the government. Also, member empowerment should be an essential requirement for registration and public funding. This empowerment should include the issue of share certificates, including certificates for tradable 'capital credits' or investor shares with clear information about the rights attached to these shares.

SUMMARY

Cooperatives are potentially an important driver of agricultural development, especially in rural communities and are one of the ways through which subsistence agriculture can be transformed into more sustainable and rewarding commercial agriculture. Cooperatives make agricultural development possible by spreading transaction costs through horizontal and vertical relationships between independent producers. Cooperatives give a competitive edge to small rural farmers against large scale commercial farms and hence aid in the development of a country's economy.

Cooperative models are evolving from traditional models to New Generation Cooperative models. Traditional cooperatives are those that subscribe to the Rochdale of: Open and voluntary membership; democratic control; limited interest on share capital; member economic participation; business with members only; education and training of members; and cooperation among cooperatives. Due to weak institutional arrangements, cooperatives are likely to suffer from the free-rider problem, horizon problem, portfolio problem, control problem and influence cost problem. The newer cooperative models address the institutional flaws of traditional cooperatives that arise from ill-defined property and benefit rights, which hinder the growth and competitiveness of cooperatives. The characteristics of the new generation cooperatives are: restricted membership; appreciable and tradable shares; and acquisition of delivery rights in proportion to investment. However, cooperatives can evolve only as far as the law allows. The legal and legislative environment within which cooperatives operate is therefore crucial for the performance, growth and sustainability of development-oriented cooperatives. For cooperatives to successfully compete in the agricultural economy, they should be able to raise sufficient capital to finance value-adding processes and operate in a way that offers large incentives for investment, either by members or outside investors.

In South Africa, the government has increased its involvement in cooperatives. One of the ways it has done so is through the establishment and passing of the Cooperatives Act No 14 of 2005. This Act is intended to provide an environment in which cooperatives can develop. The Act promotes greater participation of the previously disadvantaged persons in South Africa, who were not favoured by the preceding Cooperative Acts. This study uses New Institutional Economics (NIE) theory to analyse the worth of the new Act as vehicle to

promote cooperative growth. NIE is an interdisciplinary approach to explain the factors that determine institutions and the evolution of institutions over time, taking into account, transaction costs, property rights, collective action theory and agency theory. Cooperatives are institutional arrangements whose main purpose is to offer advantages to members that they would otherwise not enjoy outside the cooperative. NIE theory was used to analyse the Act and show how the problems of ill defined voting and benefit rights suppress the growth and competitiveness of traditional cooperatives.

The first part of this study involved modelling a hypothetical cooperative predicated by the new Act. The hypothetical model indicated the presence of the free-rider problem, horizon problem, influence problem and control problem in the long run because the Act constrains the extent to which cooperatives avoid these problems. In the short run the hypothetical cooperative was unlikely to exhibit the classic symptoms of weak institutional arrangements. The cooperative is also unlikely to experience problems raising capital because the government has undertaken to provide grants to agricultural cooperatives. The findings from the hypothetical cooperative model were used as a guide the analysis of cooperatives registered under the Act.

Case study methodology was used in this study to investigate the institutional arrangements of selected agricultural cooperatives registered post August 2005, i.e. after the new act was enacted. Three case study production cooperatives were selected for the study. Production cooperatives were selected because of their large capital requirements and thus likelihood to suffer the consequences of weak institutional arrangements. Individual interviews were conducted with the cooperative members, board of directors and project managers where necessary. Unstructured open-ended questions were used in the interviews. As such considerable room was left for respondents to volunteer information regarding the issues being discussed and new questions were built on the finding of the previous questions.

The first case study, Case Study A, a poultry cooperative operated as a small group before registering as a cooperative. Membership is restricted in the economic sense in that new members must buy shares at their appreciated value. The cooperative experienced the labour effort free-rider problem and horizon problem. The labour effort free-rider problem arose because the cooperative members are not remunerated for the work they do in the cooperative. Members who exit the cooperative are paid out their share of the cooperative's net asset value, an arrangement which although in direct conflict with the new Act, partially addresses the horizon and control problem. The horizon problem arose because there was a lack of confidence in the cooperative to reward the members for their investments. The portfolio, influence and control problems were not evident in the cooperative at the time of study. This was a reflection that collective action tends to be more successful in relatively small homogenous groups.

Case Study B is an agribusiness cooperative involved in the processing of peanut products, and growing sugarcane and vegetables. This cooperative structured as an Investor Owned Firm (IOF) in order to prevent the free-rider, horizon and portfolio problem. Members are paid a wage for their labour, and new members pay an appreciable joining fee that is a reflection of the cooperative's net worth. On exiting the cooperative, member shares are redeemed at an audited value. This, although is at odds with the new Act, is an attempt to solve the horizon problem. The internal free-rider and potential influence problem is solved by shedding those members unwilling or unable to make capital contributions. The portfolio and control problems were not prevalent in this cooperative at the time of study.

Case Study C was a joint farming sugarcane project. Members of the cooperative had on average 1-7 hectare farm size holdings, which were leased to the cooperative for an annual rental fee per hectare. The sugarcane was collectively farmed by the cooperative, and the members were paid their share of surplus according to the hectares of land leased to the cooperative thus countering the internal free-rider problem. The labour problem is avoided by employing members and paying them a market related wage. This cooperative displayed clear signs of the horizon problem in that those members of the cooperative preferred using debt rather than equity capital to finance investments and also tended to prefer contracting over purchasing heavy machinery.

A summary of the manner in which the case study cooperatives addressed the different problems typical of traditional cooperatives is shown in table 3.

Table 3: Solutions devised by the case study cooperatives to address the typical institutional problems of traditional cooperatives

	Solution		
Problem	Case Study A	Case Study B	Case Study C
Free Rider	- Screening new entrants - Penalty payments for misconduct	- Members contribute equal amounts of capital - Payment of wages for labour - Excluding members who are unwilling or unable to invest resources into the cooperative **(Not consistent with pro-poor objective of the new Act)**	- Paying members a market related wage - Making benefits proportional to the land invested in the joint farming cooperative
Horizon	- Existing members are paid out a share of the cooperative's net asset value **(In conflict with Section 40 of the new Act)**	- Adjusting the joining fee to reflect growth in net worth - Members permitted to redeem shares on exiting the cooperative **(In conflict with Section 40 of the new Act)**	
Portfolio		- Reluctance to admit new members	
Control	- Existing members are paid out a share of the cooperative's net asset value **(In conflict with Section 40 of the new Act)**	- Reluctance to admit new members	
Influence-cost		- Shedding members who are unwilling or unable to make large enough contributions to maintain proportionality **(Not consistent with pro-poor objective of the new Act)**	

A common thread running through these cooperatives is the fact that they registered their businesses as cooperatives in order to take advantage of the available government funding.

Case study A operated successfully as an informal group. Case study B and C wanted to form other business entities but were limited by capital and so formed cooperatives. As such, it is recommended that government extend its resources to other forms of cooperative-styled business organisation

The problems identified in the case study cooperatives arise because according to the cooperatives Act, benefit rights are in proportion to patronage and not investment. In addition, shares in a cooperative are not transferrable and do not appreciate in value. A result of these provisions is that relatively poor members face exclusion if they are unable to match the capital contributions of other members. Also, some of the cooperatives have adopted arrangements that are in conflict with the new Act. It is recommended that the cooperative Act is amended to offer more flexibility to cooperatives to adopt institutional arrangements that are conducive to achieving sustainable cooperative growth. Future research on the performance of cooperatives registered under Act 14 of 2005 is necessary since the Act only came into effect in 2008.

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APPENDICES

Appendix A: Interview questions

Open ended questions were posed to the respondents during the interview process. This allowed flexibility as new questions could be asked depending on previous responses. Below is a list of some of the guiding questions that were asked.

- How was the cooperative formed?
- Were you operating at first as small groups?
- Were the small groups successful?
- Why was a cooperative formed and registered?
- Why did you join the cooperative?
- How many members are in the cooperative?
- How many members have left the cooperative since inception?
- Why did they leave the cooperative?
- Are they paid out anything when they leave the cooperative?
- Are new members permitted to join the cooperative?
- Is this written in the cooperative's constitution?
- Why did you choose the enterprise that you are doing?
- What types of assets are owned by the cooperative?
- How did they obtain these assets?
- Who decides what needs to be done? Who dictates how a cooperative should run or operate?
- How do you choose who joins the cooperative and who does not?
- What type of expansion do you expect in the next 5-10 years?
- Would you vote for that expansion? Why would do so?
- How do you deal with those members who do not want to invest into the cooperative but want to receive benefits?
- Are there cases where some members influence the decisions causing other members not to agree to invest in whatever project?
- Currently, each member of the cooperative has only one vote. Is that a suitable arrangement for you?
- Would a limited vote according to patronage be a good option?

- Would additional votes based on patronage in addition to the one man one vote be an option you would consider having in the cooperative?
- If the decision to expand the business is taken, how would the project be financed?
- If finance were by member equity, would the members contribute equally? According to patronage?
- If finance were contributed by both member equity and debt, what percentage would be contributed by member equity?
- If finance is through a bank loan, which one? Has a loan been obtained from the bank before? Are the bank loans subsidized? What are the interest rates?
- Other than loans do you have other sources of income?
- Do you receive any tax exemptions or tax rebates as a cooperative?
- Would you consider partnering with another business organisation in the form of a joint venture to provide equity and expertise?
- Can equity be provided by outside investors who have no voting rights?
- If yes, would you be comfortable with this arrangement?
- How would you receive the benefit of your investment?
- Would you invest more in the cooperative if you were receiving a return on your investment not only through patronage refunds but also through direct equity returns?
- What do you do with the profit? How is it divided?
- Are you paid according to the hours worked or the work you do in the cooperative?
- Were you involved in writing the constitution of the cooperative?
- Has the constitution been amended since it was written?
- What are some of the benefits that the cooperative has received since it registered?

Appendix B: Constitutional audit of the case study cooperatives

Provision required in terms of Act 14 of 2005	Compliance		
	Case Study A	Case Study B	Case Study C
Name of the cooperative	Yes	Yes	Yes
Whether it is a primary, Secondary or tertiary cooperative	No	Yes	Yes
Main objectives of the cooperative	Yes	Yes	Yes
Description of the business, including any restrictions	Yes	Yes	Yes
Provision stipulating that each member has only one vote	No	Yes	Yes
Minimum period of notice of general meetings	Yes	Yes	Yes
Place where the registered office of the coop is located	No	Yes	Yes
Minimum and maximum number of directors	No	Yes	Yes
Term of office of the directors, which may not be >4 years	No	No	No
Powers and restrictions on the directors of the coop	No	No	Yes
Requirements for membership subject to section 3(2) of the Act	No	Yes	No
The requirements for withdrawal of membership	No	Yes	Yes
Provision relating to the use of the surplus in the reserve	No	Yes	Yes
Provision for distribution of the assets on dissolution	No	No	No
The financial year of the cooperative	Yes	Yes	No
Procedures for the application of membership	No	Yes	Yes
The rights and obligation of members	Yes	No	Yes
Transfer of membership, member loan, membership share	No	Yes	Yes
Conditions and processes for membership termination	No	Yes	Yes
Conditions and processes for suspension of membership	No	Yes	Yes
Structure for decision making where by members can participate in decision making democratically	No	Yes	Yes
Annual general meetings and special general meetings	No	Yes	Yes
Tabling and adoption of resolutions	No	No	No
Determination of quorums for general meetings and must ensure that that quorum provide for member control	No	No	Yes
The manner in which voting may be conducted	No	Yes	Yes
Conditions under which a resolution is held and passed	No	Yes	Yes
Conditions for requesting a general meeting	No	Yes	Yes
A provision for the appointment of directors	No	Yes	Yes
Conditions for vacation of office by directors	No	Yes	Yes

Conditions for appointing a chairperson, vice and acting	No	Yes	Yes
Conditions under which a board of directors may delegate functions to a director	No	Yes	Yes
Provision relating to the utilisation of surplus not transferred to the reserve	No	Yes	Yes