The Enduring Relevance of the Co-Operative Model

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I. Introductory Remarks

Can I start by stating that I am a strong believer in the enduring relevance of the co-op model. That relevance can be measured in two ways. Firstly global statistics show the co-op to be a very resilient business model in many diverse sectors. Secondly, it is clear that economic conditions continue to prevail in the Irish agri-food sector and in other sectors, that provide a clear economic justification for using the co-op model of doing business.

However, I do have some reservations. I believe that the co-op model will only continue to endure if, co-op leaders;

- more effectively communicate to farmers the economic justification for co-ops in the agri-food sector and
- adapt and apply the internationally accepted co-op principles to the ever growing and changing competitive forces that farmers face.

II. Enduring Relevance

The following sampling of facts attests to the enduring relevance of co-ops at an international and national level;

(1) Globally there are now almost three million co-ops or mutual societies employing almost 300 million people and serving over 1.2 billion members.

(2) The top 300 co-operatives and mutuals report a total turnover in excess of 2 trillion usd.

(3) These co-operatives operate in different sectors: insurance (41%), agri-food (30%), wholesale and retail trade (19%), banking and financial services (6%), industry and utilities (1%), health, education and social care (1%) and other services (1%).

(4) ICOS serves co-ops and their subsidiaries that collectively have over 169,000 individual members and employ approx. 15,000 people in Ireland and have a combined turnover of almost 15 billion.

(5) Approximately half of ICOS's agricultural cooperative affiliates are over 50 years old and there are approx. 20 dairy milk purchasing and processing co-operatives whose roots are now over 100 years old.

III. The Continued Economic Relevance of Co-ops

Why do farmers continue to organise, finance, become members of and patronise co-ops? They do so because:

- The co-op model can provide a remedy to market failure. Markets fail where an effective monopoly of one or a few investor owned firms controls a particular market sector. Markets also fail where certain investor owned firms have exclusive or advance access to and exploit in their own interest critical market intelligence.
- The co-op model can assist farmers pool certain resources to achieve economies of scale.

- Co-ops can assist in capturing profits from another level. through upstream and downstream vertical integration. This has been a common co-op strategy for over one hundred years.
- Having an efficient co-op competing in any given sector ensures that competition in that sector is maintained through the co-op providing a 'competitive yardstick with which to measure the performance of investor- owned firms in the sector.

In summary; where a co-op is functioning in a competitive manner, farmers will continue to have trust in that co-op. They will trust it to deliver, over the long run, goods and services of at least the same as, but preferably of a better quality and price, than would be delivered from any alternative business model that they do not own or control.

IV. Interpreting and Applying the Co-op Principles

Earlier, I referenced the importance of correctly adapting, and applying the internationally accepted Co-op Principles. There are seven co-op principles. **Open Membership; Democratic Control**: **Member Economic Participation**: **Autonomy and Independence**: **Education of Members**: **Co-operation between co-ops**; **Concern for the community**.
These principles are not without their critics but there is a large degree of unanimity as to their value in maintaining a co-op model of doing business.

The Principles are open to some interpretation. Different co-ops accord different priorities and interpretations to each Principle. This is one reason why boards should communicate to members what their particular co-op policy is . All of the Principles are worthy of comment but time limitations only allows me to make a few comments on three Principles: Open Membership: Economic Participation and Education of Members.

Open membership

This Principles states that **"….co-ops must be open to all persons able to use their services and willing to accepts the responsibilities of membership…"**.
Here are some of the questions on this Principle some of which I hope will be explored more deeply in the discussion to follow.

- How many co-ops have published a written membership policy explaining the conditions of admission and the benefits of membership?.
- Are all members recorded in your co-ops Share Register, to quote the Principle, "**able to use the co-ops services and willing to accept the responsibilities of membership**"?
- If they are not, why are they still permitted to continue as members?
- Do members understand that the rule book constitutes a written legal contract between the member and the society with reciprocal obligations and benefits?
- How does a milk processing co-op comply with the open membership principle if its current members are utilising its full processing capability?

Economic participation

Similar questions arise in interpreting and applying the **Economic Principle** which states that; "**Members contribute equitably to and democratically control the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any of the following purposes:**

a) setting up reserves, part of which at least would be indivisible. b) Benefiting members in proportion to their transactions with the co-operative. c) Supporting other activities approved by the membership. "

So, again, questions that need to be discussed and debated are;

- Does a co-op's equity financing policy distinguish between; members who are expanding, contracting or static in their use of the co-ops services? What about new members and members who have ceased?
- Does your co-ops equity financing policy fairly apply the principle of members financing in proportion to use?
- Is the provision in the Economic Principle of **"providing limited compensation, if any, on capital subscribed** "a workable business model for your co-ops in its current competitive market situation?

Having adequate risk capital is the life blood of any business. The source of that risk capital is also what determines who controls the business and who most gains (or loses) from the profitability of the business. Where the active trading member is not investing his fair share of the co-ops equity two negative outcomes arise;

- the co-op either; cannot pursue its optimum growth strategy for want of sufficient equity capital or must source that equity capital elsewhere;
- where a significant amount of risk capital has to be sourced from inactive members or from external investors, there is a risk of the active trading member losing control of the co-op.

Capitalisation of the business is a critical issue for those few but strategically important co-ops that have a large capital requirement, ambitions to expand value added and grow international market share as a key part of their strategy? Such strategic ambition demands a financial strategy that permits the co-operative to meet its capital requirement without unduly diluting farmer control. Over the last thirty or so years we have seen a range of financing strategies being used by these co-ops. One of the ways these co-ops financing strategies have diverged is in the extent to which some have relied on external investors rather than their active trading membership to supply the equity portion of those capital requirements.

Retention of profits, share drives, issuing of convertible loan stock, investment by external investors via plc's , where the plc is a subsidiary to a parent co-op and full blown conversion to a plc are among the financing strategies pursued to acquire equity capital. With each of these strategies their success or failure could be judged on; how effectively the capital subscribed was invested; and to what degree the return on investment benefitted trading members or external investors?. The history of the last thirty years has shown that there have been successes and failures with all of these financing models. There has also been a greater leakage of member control with some financing models more than others.

I would make two general observations here;

- high growth oriented co-ops that require either a very high level of capital from members by direct subscription or by retention of significant reserves, must strive to provide greater clarity and certainty to members in regard to the return, the security and the liquidity of that investment, compared to the return a member might get from investing his money in an alternative investment.

- Where it is deemed necessary to source some of that equity from external investors, the financing instruments used should endeavour to minimise any loss of control by active members.

For co-operatives with low capital requirements per member and thus modest reserves per member on the balance sheet member financing, as an issue, is less critical.

Member Education

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

I would make the following observations. There is a member education deficit in some co-ops where;

- Ordinary members have a greater understanding of their rights and their obligations
- Boards do not accord sufficient priority to member education and training and to their own development as board members.
- Some executives and staff are by background and education more exposed to a company than a co-op mind set and this needs to be offset by more training.

V. Summary

In summary;

- Co-ops will continue to be needed by farmers in the agri-food sector so 'continuous resilience' is a must!
- Where a co-operative has a low to medium capital contribution per member, it should not be to complex a task for the Board and Executive Management to adopt a fair member financing model.
- Where a co-op has a large capital appetite it should strive in the first instance to develop fair and attractive financing policies that attract the maximum amount possible of equity and bond type instruments from members
- When that source of equity has been optimised a financial plan inviting investment participation from external investors must be considered but a plan that minimises the extent to which member control is diluted.
- Considerably more effort and resources are required of co-operative leaders to communicate more effectively and provide co-op education opportunities to the newest generation of potential members. ,

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