

# Why do co-operatives fail as co-operatives?



***Seeking advice from experts  
who will not see, speak or  
hear about co-operation.***

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It is important to understand why co-operatives fail as co-operatives - why they cease being co-operatives.

In addressing this, it is necessary to differentiate between economic and co-operative failure.

- Economic failure is when a co-operative fails as an ongoing and viable business - it is unable to compete, generate profits and survive as a business.
- Co-operative failure is when a co-operative ceases to practice co-operative values and principles irrespective of its economic viability. The business may continue to operate and generate profits but its adherence to co-operative values and principles has become legalistic and token.

Of course, there is no such thing as a perfect co-operative - as there is no such thing as a perfect economy. The ingredients of failure exist in all co-operatives and what matters is how co-operatives recognise this on an ongoing basis.

To identify the ingredients of failure, it is necessary to be clear about what is the nature of a co-operative. Obviously, to understand co-operative failure it is necessary to understand what is being failed - what constitutes the nature of a co-operative.

The starting point for co-operative failure lies in the formation decision and the formation process. **The formation decision** is when a decision is being made about whether or not to form a co-operative. **The formation process** is the process undertaken to form a co-operative.

## **Member Owned and Controlled**

A co-operative is member owned and controlled. The members of the co-operative are the users and the beneficiaries of the co-operative. It is critical that this fundamental characteristic of co-operatives is understood and accepted. What, then, does this exactly mean? It means that each and every member actively uses and participates in the co-operative. This has two inter-related dimensions - economic and political.

On the economic dimension, members must purchase and use the products and services of the co-operative. The nature of this purchasing and use will depend on the nature of the co-operative e.g. selling products to the co-operative, purchasing from a co-operative shop, purchasing energy through a co-operative's buying group,

participating in the production and/or distribution of a newspaper.

On the political dimension, members must participate in the governance of the co-operative e.g. nominating for the board, voting for directors, attending general meetings, reading the co-operative's newsletter and responding to surveys.

A co-operative must begin and continue with an economically and politically active membership.

Inactive members are a threat to a co-operative because their inactivity demonstrates their lack of commitment to co-operative values and principles and this creates explicit and/or implicit contradictions and conflicts between active and inactive members.

In Australia co-operatives are governed by State legislation that requires active membership provisions. These provisions focus on economically active membership. Members may, therefore, be economically active but politically inactive. Co-operatives may also have a majority of users who are not members.

The greater the proportion of economic and/or political inactivity, the greater the risk to the survival of a co-operative as a co-operative. These risks can be characterised as follows:

	<b>Economic activity</b>	<b>Political activity</b>
Extreme risk	Minimal or absent	Minimal or absent
High risk	Medium activity	High or Medium
Medium risk	High	Low or Medium
Minimal risk	High	High

These risks are further aggravated by legal co-operatives with a significant number or majority of users who are not members. These co-operatives are legally incorporated as co-operatives and the members may meet their economic and political activity obligations, but the majority of the users are not members. In these situations, there is a legal co-operative that is not observing co-operative values and principles.

A significant or majority of non-member users creates contradictions and conflicts not only between member users and non-member users but also challenges priorities and choices for management about the competing needs of members and non-members.

These legal co-operatives are typically established and/or owned and controlled by individuals and/or organisations to provide services but over time the users either did or were not encouraged to become members and the co-operatives have persistently failed to address the issue.

## Co-operative Governance

The extent and nature of the economic and political activity of a co-operative's members critically determines the governance of the co-operative and how this impacts on the co-operative remaining a co-operative.

The greater the proportion of economic and political activity, the greater the co-operativeness of the co-operative. The lesser the proportion of economic and political activity, the lesser the co-operativeness of the co-operative.

The relevant indicative economic and political health indicators of a co-operative include as follows:

	<b>Healthy Indicator</b>	<b>Unhealthy Indicator</b>
User members	High to 100%	Below 75%
Non-user members	Nil	20% plus
Trade turnover	80%plus members	20%plus non-members
Board elections	Contested	Not contested
Board attendance	100%	Below 90%
Member capital	High proportion	Low proportion
Consultation meetings	High attendance	Low attendance
Postal ballots	Over 85%	Below 85%
Member survey response	Over 85%	Below 85%
Board voting	High	Low
Director duration	Short-term	Long-term
AGM attendance	Quorum plus	No quorum
AGM debate	Encouraged	Discouraged
Web site	Yes and updated	No or static
Manager gender	Proportionate	Disproportionate
Director gender	Proportionate	Disproportionate
Staff co-op ed	Ongoing	Irregular or absent
Director co-op ed	Ongoing	Irregular or absent
Member co-op ed	Ongoing	Irregular or absent
Newsletter	Yes and regular	No or irregular

A system of governance must reflect and reinforce co-operation. A co-operative cannot assume its self-evident value to existing and new members and, therefore, the automatic loyalty of members. Co-operatives must continuously earn the loyalty of their members and the nature and evolution of the co-operative's governance is critical to this development.

# Co-operative Difference and Advantage

The key to the formation and the ongoing development and success of any co-operative is understanding, accepting and practicing the co-operative difference and advantage.

It is the recognition that there is a co-operative difference - that the structure of a co-operative is unique and different from private and public business enterprises. In accepting the co-operative difference, it logically follows that this difference creates a co-operative advantage.

The Co-operative Difference and Advantage has five interdependent dimensions:

- A clear philosophy of co-operation.
- A governance practice that reflects and reinforces co-operation.
- A management practice that reflects and reinforces co-operation.
- An ongoing co-operative renewal program.
- An ongoing member education program.
- An ongoing member participation program.

A co-operative in its formation must establish the pre-conditions for ongoing adaptation and renewal as a co-operative. Co-operatives will invariably change due to internal and external processes, pressures and dynamics and critical to a capacity of a co-operative to cope with and survive change as a co-operative is the capacity to maintain its co-operative identity.

## A clear philosophy of co-operation.

A co-operative does not exist in a vacuum and without an explicit philosophy of co-operation that provides a framework for the business activities, then, there will be implicit and divergent interpretations of the philosophical meaning and significance of the co-operative.

Unfortunately, co-operatives can under-estimate the values and principles and mistake their application as a business weakness. **The International Co-operative Alliance's Statement on Co-operative Identity** must inform co-operative practice.

## A Governance Practice that reflects and reinforces co-operation

The governance practice of co-operatives must be based on co-operative values and principles.

What this means is the governance practice must reflect and reinforce; for example:

- Member Control
- Active Membership
- Co-operative education
- Co-operation between co-operatives

## **An Ongoing Co-operative Renewal Program**

As a co-operative moves from its formation there are challenges to its growth and success and new actors become involved in the co-operative's development - mixing co-operative and private values and interests. Issues will increasingly arise about who is managing the co-operative, who is making what decisions and what is the nature of the co-operative's entrepreneurship.

How, then, do co-operatives maintain their co-operative identity? If co-operatives do not build-in the ingredients of continuous co-operation, then, they will in time not be readily distinguished by its own members, and others, from private enterprises. When there is a point that this distinction is not apparent co-operatives are ripe for demutualization.

Once they are formed, co-operatives have two development options - maintaining and strengthening or weakening co-operative values and principles. None of these developments are inevitable but it is at the point of formation that a co-operative can choose to strengthen or weaken co-operation. Of course, this is dependent on recognising and understanding what strengthens or weakens co-operative values and principles.

### **A management practice that reflects and reinforces co-operation.**

Co-operative boards appoint managers to manage co-operatives on behalf of the members. The board needs to be careful that it does not assume that it's role is to manage the co-operative and that the managers role is to manage the business.

This creates an unhealthy division that will not necessarily be noticeable in the short-term but will have long-term unintended consequences. There should be no separation between "co-operative" and "business". Instead, there is a need to recognise that co-operative managers need to integrate co-operative values within their management practice.

Without this integration, there will invariably be conflicts between "co-operative" and "business" success - potentially exacerbated by long-serving managers whose longevity could reinforce this separation.

This is not to be confused, however, with the division of responsibilities between a board and a CEO or manager.

### **An ongoing member education program.**

A co-operative is owned by its members and ongoing member education is critical to ensuring member control. Member education is the continuous process by which members see the connection between their individual interest and group interest.

The board is responsible for determining the direction and scope of member education and management is responsible for its implementation.

Member education should not be ad hoc. It should be planned, budgeted for and followed through and include:

- Co-operative democracy and its practice
- History of the co-operative
- The co-operative identity
- Members' role and involvement
- The co-operative difference
- Co-operative management

With growth and age and increased complexity members find it increasingly difficult to judge its effectiveness and the activities of managers and directors. Co-operative education, therefore, increases in importance.

### **An ongoing member participation program.**

The problem for a growing and long-established co-operative is the loss of power by members and the need, therefore, to have:

- Ongoing processes that limit the power of managers
- Continuing provision of available information
- Maintaining flexible and open dealings between members and managers

Organisational growth and change must be based on reinforcing the relationship between the needs of members and the co-operative's processes and activities. This is not automatically achieved. It will have to be striven for to remain achievable. There are three key ingredients for ongoing member involvement - information, training and consultation.

A co-operative cannot force its members to be involved. What it can do, however, is create the conditions for member involvement through involving structures, processes and practices.

Members will become and remain involved if they have a sense of accomplishment, a sense of belonging, a feeling of control and the ability to satisfy personal ideas. The ongoing challenge for a co-operative, therefore, is to create and maintain these conditions.

### **Conclusion**

Co-operatives, then, fail as co-operatives when they cease practicing co-operative values and principles. They may continue as a successful business - competitive, profitable and growing and **open to demutualisation.**

The ingredients of failure exist in all co-operatives. What matters, therefore, is whether the members, directors and managers take the opportunity to do something or nothing. A failure to act will mean that the ingredients of failure will become an increasingly significant factor in the future development of the co-operative.

Co-operative failure is not inevitable. It is, however, the inevitable outcome of the failure of a co-operative to recognise the importance of co-operative values and principles and making decisions that are incompatible with these values and principles:

- A co-operative may choose, for instance, not to recruit as new members its non member users yet allow the non-members to become an increasing proportion of users. This was an important element in what happened to the **Victorian Producers Co-operative Co Ltd.**
- A co-operative may decide to raise capital through non-member shareholders and, therefore, create a conflict of interest between the member and non-member shareholders and could contribute towards the **co-operative's demutualisation.**
- A co-operative may decide not to provide ongoing co-operative education and training for its directors, members, managers and staff. Co-operative values and principles, therefore, are expected to be the product of osmosis.
- A co-operative may market its products and services but its marketing does not identify the co-operative as a co-operative - denying that **the co-operative difference is a marketing advantage.**

The choices are there to be made for all co-operatives. It is a democratic and voluntary choice and decision.

