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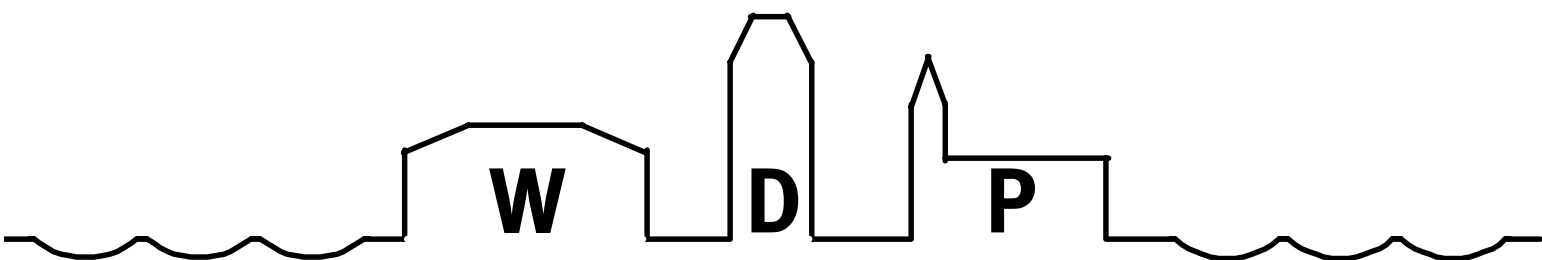
University of Technology, Business and Design

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Co-operative Development and Corporate Governance  
Structures in German Co-operatives  
– Problems and Perspectives

Heft 14 / 2006



**Wismarer Diskussionspapiere / Wismar Discussion Papers**

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Homepage: <http://www.hws-wismar.de/11.html>

ISSN 1612-0884  
ISBN 3-939159-04-2

JEL-Klassifikation D23, M21, L22

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Printed in Germany

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## 1. Introduction <sup>\*</sup>

The tasks as well as the types of co-operatives within an economy have continuously been discussed for nearly two hundred years. Since the days of Owen, the principles as well as the appearance of co-operatives have been heavily disputed. This became evident by the controversy between Huber, Schulze-Delitzsch, and Lassalle (Faust 1977: 255ff) on whether co-operatives are self-help instruments and whether or not governmental help should be applied for or avoided. So far, this question has not been answered in a generally accepted way.

During the last thirty years, however, the discussion on the optimal co-operative model has not only lost some momentum, but has changed very much in substance. In the meantime, fundamental decisions dating from the very beginning of co-operative history have been accepted far and wide. Namely the disappearance of socialist co-operatives that was caused by the failure of socialist economies has led to a certain harmony.

Even on this basis, however, there exist differences of opinion on the optimal structures within the accepted framework. The controversy within the discussion is increased by the requirements imposed on co-operatives that have been changed by the development of markets and competition within a capitalist society.

Currently, two facets of co-operatives are simultaneously regarded as problematic: the corporate governance system within German co-operatives and the promotion principle – the obligation of a co-operative to improve the economic situation of its members with the help of its services. If these two focal points are considered simultaneously, the question arises whether German co-operatives are still member-driven and -oriented organisations. At the same time it needs to be asked, what steps can be taken to bring organisational requirements and members' interests closer together.

## 2. Co-operative Ideologies in Capitalism

The historical development of co-operatives was the result of activities from both practitioners and scientists. These joint efforts, however, did not prevent fundamental disagreements, especially concerning the role and the aims of co-

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<sup>\*</sup> This publication is an extended and revised version of a paper that has been submitted for presentation at the XIV International Economic History Congress in Helsinki, 21<sup>st</sup>-25<sup>th</sup> August 2006. It has been prepared as part of the research project „Mitgliederförderung und Erfolgsmessung in Genossenschaften“ (promotion of members and measuring success in co-operatives), carried out by the Forschungsgruppe für Kooperation, Netzwerke und Unternehmenstheorie” of Hochschule Wismar and Institut für Genossenschaftswesen an der Humboldt-Universität zu Berlin. Gratefully I acknowledge the financial and organizational support of Forschungs-GmbH Wismar.

operatives. As a result of the disputes and inability to agree, co-operative ideologies evolved, that tended to “take up ideal-type dedications as well as utopias” (Engelhardt 1994: 136), even though the very core of modern co-operative development was more a question of pragmatical help as was shown by the Rochdale Pioneers (Brazda 1994).

### *2.1. Motives for the Development of the First Co-operatives*

Starting point of the modern co-operative movement was the so-called “social question” that arose together with industrialisation (Hasselmann 1971: 129; Boettcher 1983: 93f). The craftsmen were unable to withstand the competition of factory-made goods. In the new manufacturing plants, goods were produced faster, cheaper, and in a better quality. Many craftsmen were forced out of business and either became dependent workers or had no employment at all. The social impact was disastrous: Due to the absence of a social security system, a large percentage of middle class people were endangered to plight and pauperisation.

Considering the social impacts of industrialisation on the losers of this development process, Schulze-Delitzsch declared in 1858: “Considering that not only a few formerly independent master craftsmen are forced to look for employment in factories, it may well be assumed that the whole group of craftsmen will degrade to plain workers in those large entities and will enlarge the wretched factory proletariat. These aforementioned facts lead to the conclusion that the plight of the working classes is the result of the developing process of the new industries” (Schulze-Delitzsch 1858).<sup>1</sup>

Based on this analysis, pioneers of co-operation like Owen, Schulze-Delitzsch, and Raiffeisen considered the co-ordinated self-help of the afflicted people as the only chance for improvement either with or without governmental help. Consistently, the first co-operatives were founded in England (Digby 1971: 12), Germany, and France – the countries most affected by industrialisation at that time. Even though these very first co-operatives were established under similar conditions, they differed greatly as far as their economic and political goals were concerned.

### *2.2. Social Aims of Early Co-operatives*

A major distinction can be drawn according to the co-operatives' view of the capitalist system (Neumann 1975: 32). Right from the start, two different concepts evolved and found followers and supporters among the early co-operators:

- a) “that of the free co-operative association based on self-help, self-respon-

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<sup>1</sup> Quoted according to Boettcher (1983: 95); translation by the author.

sibility and independent organization for the autonomous formation of savings from below, while remaining neutral as far as politics and religion are concerned; and

- b) that of a politically regimented co-operative association within the conceptual context of theoretical and idealistic socialism.” (Müller 1994: 436f)

The early co-operatives in England, influenced by the example of Owen and the Rochdale Pioneers, were aimed at overcoming the capitalist system (Hasselmann 1968: 22), while the co-operatives in Germany, founded by Schulze-Delitzsch and Raiffeisen, focused on improving the situation of the co-operative's members within the existing system (Steding 1994: 11; Koch 1994: 25).

These ideological differences became obvious in the preferred type of co-operative: consumer co-operatives and worker's co-operatives on the one hand (Watkins 1969: 22), credit co-operatives, purchasing associations, and retail co-operatives on the other. It should be mentioned, however, that there were exemptions to this rule of thumb, e. g. the "bourgeois" consumer co-operatives (Brazda/Todev/Schediwy 1996).

Even after all the years that have passed since the Rochdale experiment in 1844 (Hasselmann 1968: 9), it is not only possible but fairly easy to recognise the fundamental differences between the different social aims, as they are pursued by individual co-operatives (Boettcher 1985: 32-35). Responsible for this development are not only the two different concepts, but also the continuing differences in the political beliefs of the co-operators that still exert their influence on the development of the co-operative movement.

### 2.2.1. Overcoming Capitalism

One source of co-operative thought and political beliefs can be traced to Owen, who had been labelled by Marx as an “utopian” socialist (Hasselmann 1971: 130) and is regarded as the “father of the co-operative movement” (Digby 1971: 13). He recognised that industrialisation endangered the livelihood of the workers and thereby the society in its entirety. He was in favour of “self-supporting colonies” as a suitable solution, a system of colonies of workers with joint production co-operatives at their core. Hasselmann characterised these as “elements of a new economic order” (1971: 138). In England as well as in Germany, consumer co-operatives were of major importance (Digby 1971: 45ff; Novy/Prinz 1985: 18ff; Kaltenborn 1993: 20ff). They were not only supposed to act as reservoirs for funds but also as instruments of transition towards a different society (Brambosch 1985: 34ff).

In this context, it needs to be remembered that Owen, as well as other early socialists, was not aiming at a revolution or a forced overthrow of the existing order but at economic improvements and free self-determination outside of the

capitalist system. From an overall perspective, these attempts were not very successful, however, this "train of thought" influenced the "économie sociale" school of thought in France, Italy and other countries in the South of Europe. It has also left its marks in the concept of commonweal economy which is predominantly supported by the labour movement and (post-)socialist political parties.

The idea of using co-operatives as instruments of establishing socialist economies was primarily tried out in the so-called second world, where they were based on Lenin's co-operative approach (Hartwig 1985: 220; Todev/Brazda/Laurinkari 1992: 37ff). He considered them suitable schools for improving socialist consciousness. Due to this view, however, these co-operatives differed greatly from their namesakes in capitalism, as they were primarily oriented towards political goals and tended to neglect their members' interests (Todev/Rönnebeck/Brazda 1994). In consequence, the principle of self-help was not obeyed. This could be observed in all socialist countries, in Eastern Europe as well as in Africa or Asia (Kleer/Laurinkari/Brazda 1996: 38ff; Steding/Kramer 1998: 35ff; Degineh/Kramer 1996: 9ff; Chennamani/Eisen 1998: 13f).

### 2.2.2. Reforming Capitalism

The opponent opinion leaders were Raiffeisen and Schulze-Delitzsch (Faust 1949; Heuss 1956; Koch 1988). Their co-operative ideas, however, were quite different. While Owen's efforts focused on dependent workers, German co-operatives were meant for farmers and craftsmen. For that reason, these co-operatives "bore the imprint of the middle classes" (Hasselman 1971: 134). Even the joint production co-operatives that Schulze-Delitzsch saw as the "climax" of his co-operative system (Schulze-Delitzsch 1909: 235) showed the characteristic features of workshop mergers.

The inability of craftsmen and farmers to compete with industrialists was regarded as the main problem (Albrecht 1965: 33). Schulze-Delitzsch therefore considered it his duty to improve the competitive situation of the craftsmen. "This means offering him the same opportunities for his economic performance as are available to industrialists. This method does not shake the foundations of society; on the contrary, it prevents 'the dreaded rupture' and offers 'stability for the social structure from within'."<sup>2</sup> Raiffeisen, who lived in the Westerwald region, was more concerned about the rural communities. Based on his experience as mayor of small Westerwald villages, he saw co-operatives as helpful instruments for farmers and other people in similar regions. He was especially in favour of establishing credit co-operatives as a

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<sup>2</sup> Albrecht (1965: 33); translation by the author.



step against usury (Bauer 1993).<sup>3</sup>

In opposition to early and utopian socialists, Raiffeisen and Schulze-De-litzsch considered the market economy as a way to solve problems; predominantly those of the small-scale producers that required support to conquer the market barriers. The necessary help was to come from within their own group by organising co-operatives as self-help organisations.

### *2.3. Current Social Ideology of Co-operatives*

By now, this view of co-operatives as instruments to reform capitalism is widely accepted in those European countries that follow a market-oriented development path. Nowadays, some politicians and co-operators even deny that they are an attempt to reform capitalism, at least to a certain degree. Co-operatives as a stage of transition towards socialism are existent only in countries with a planned economy, in which case they have lost their character as self-help organisations. Instead, they are used as instruments to control as well as fulfil the economic plans, set up by the government.

Market-oriented co-operatives have become the predominant type. Nevertheless, they still differ from each other, even though the most obvious differences are by now limited to their legal status and form (Münkner 1984: 197ff). As far as their economic duties and the promotion task of strengthening their members' economic capacities are concerned, they are very much alike.

The co-operatives continue to follow the principles of self-help, self-administration, and self-responsibility. At their core, they still try to fulfil the needs and wants of their members, thereby carrying on with a special ethic tradition within the co-operative movement (Faust 1968: 36), even though during the last centuries market influences have caused tremendous changes in the original co-operative concept. The internal structure as well as the responsibilities of a current market-oriented co-operative are different from its predecessors.

## **3. Co-operatives in a Market Economy**

Taking into account that modern co-operatives appeared on the stage nearly 150 years ago and are still in existence today, the concept of co-operative societies seems to possess some incentives of its own. Otherwise, co-operation would have lost its appeal and co-operatives would have vanished in the meantime.

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<sup>3</sup> A current example for a similar type of organisation is the Grameen Bank in Bangladesh (Yunus 1997, Yunus/Jolis 1999).

### 3.1. *Definition of the Co-operative Concept*

Reviewing the concept of co-operation, Boettcher (1980: 1ff) considers three elements to be the main characteristics of a modern, market-oriented co-operative:

1. A group of economically engaged individuals,
2. a joint undertaking,
3. the duty of promoting the co-operative's members.

While the first two criteria are valid for numerous enterprises, the obligation to promote its members makes the co-operative society stand out from the wide range of business entities and other organisations. This promotional duty defines the main purpose of the co-operative: offering goods and services for the members' economies, for households as well as for enterprises (Boettcher 1980: 2; Dülfer 1976: 304; Henzler: 1970: 196ff), thereby increasing the economic welfare of their members.

In this respect, the co-operative may be defined as a society with an unlimited number of members, established for the purpose of promoting the livelihood or the enterprises of their members with the help of a joint business (Sellien/Sellien 1980: 1678). In order to do so, it is based on a certain set of general ideas and follows widely accepted principles and practices (Münkner 1995a: IIIff; cf. annex I), namely

- Self-help based on solidarity,
- member promotion,
- identity,
- democratic management and control,
- economic efficiency,
- voluntary association,
- autonomy,
- fair and just distribution of the results,
- open membership,
- indivisible reserve fund, and
- promotion of education.

It should be mentioned, however, that the individual co-operatives are free to emphasise some of these principles stronger than others, according to the aims of their members and their promotion duty.

### 3.2. *The European Co-operative Discussion*

Over the whole period of their existence, co-operatives have been under two-fold pressure. On the one hand, they are integrated into the capitalist market economy, where they have to withstand competition and distinguish themselves from capitalist enterprises. These requirements are shown in the princi-

ples of member promotion and economic efficiency. On the other hand, they fulfil social responsibilities and are based on the principle of solidarity (Flieger 1996: 20ff) which means that they are not only group-oriented but also have to consider the values, norms, traditions, morals, and the ideology of the group (Patera 1994: 822). The result has been that some practitioners and scientists consider co-operatives to be a part of a commonweal economy (Zerche/Schmale 1994: 123ff), which has caused heated disputes regarding the ranking and the importance of the principle of solidarity as opposed to the other co-operative principles, namely the principles of self-help and economic efficiency.

### *3.2.1. Distinction from Capitalist Enterprises*

The history of co-operative societies shows that there exists a certain tension between co-operatives, on the one hand, and capitalism or precisely capitalist enterprises, on the other hand. The need to distinguish themselves from such enterprises still plays an important role in the way co-operatives see themselves; primarily in France, where the co-operative movement seems to be closer to its ideological roots and where this distinction is emphasised (Boettcher 1980: 2).

According to the French view, as summarised by Boettcher (1980: 3), “enterprises” are always of a capitalist nature, while co-operatives only establish a “business” as a technical unit that has to cover its costs. Such a co-operative business is not oriented towards a market. Only enterprises are market-oriented and aim at gains or profit. The latter may by chance achieve a surplus; however, this surplus has to be given back to the members as “reimbursements” as soon as possible.

From the German point of view, such a distinguishing line loses its clarity. This is mainly due to the co-operatives’ embeddedness in a society which is strongly influenced by a market economy.<sup>4</sup> In the German view, it is doubtful whether a co-operative without autonomous orientation towards markets is able to exist at all (Boettcher 1980: 3). This implies that co-operatives are not only permitted to be enterprises; but, in most cases, they definitely are enterprises. This is due to the circumstance that the “business” term cannot be applied in a narrow sense, if the co-operative is integrated in a market in order to fulfil its tasks.

Philosophical as the point may seem it nevertheless has caused not only numerous heated discussions, but is also one of the reasons why co-operative

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<sup>4</sup> Exceptions to this rule are some workers’ co-operatives that were founded as alternatives to traditional business and employment. Regarding their goals and the way they see themselves they are closer to the concept of “*économie sociale*” than most other co-operatives (Kramer 1997a: 110f; Münkner 1995b).

federations in Western Europe have been unable to find a joint perspective regarding the concept of an “*économie sociale*”. Even though the day-to-day activities of the co-operatives in Western Europe do not seem to be influenced by this facet of their concept, the different business philosophies are still in existence and lead to misunderstandings regarding the role of co-operatives within a market economy. Solidarity with non-members of the co-operative, as emphasised by supporters of commonweal co-operatives, is easier to realise from the French point of view. If the co-operative is not aiming for a profit but only trying to cover its costs, it may be able to offer its goods at a lower price than its competitors, thereby increasing market pressure.

The actual business behaviour of co-operatives, however, indicates that capitalist as well as co-operative enterprises aim for profit in the market, even if only to maintain their economic substance. Nevertheless, important distinctions between co-operatives and capitalist enterprises do exist, mainly in the way the profits are spent because co-operatives have to follow their promotional obligations.

### 3.2.2. Co-operative Goals

The duty of promoting the co-operative’s members determines the business goals the co-operative is aiming for, since the promotional duty has to be defined by the members themselves. It needs to be mentioned, that these goals depend on the needs of the members. The goals may well serve the common good, however, co-operatives are not primarily intended to be part of a welfare system. Instead, they are self-help organisations; therefore, the economic promotion of their members is of primary importance in comparison to any other goals (Engelhardt 1976: 290). This is true even for workers’ co-operatives (Kramer 1999). There exists, however, some tension with regard to other economic goals (Dülfer 1972: 324, Dülfer 1995: 191ff):

In general, co-operative market activities are beneficial to non-members and/or the general public as well. This is even more true if the co-operative is a newcomer in the market. Neumann outlines several of the economic effects that are not only advantageous for the co-operative’s members; but, at the same time influence the complete market (Neumann 1972: 6f):

1. new functions via increased competition,
2. eliminating monopolistic tendencies (Fleischmann 1972: 161ff),
3. offer of new goods and services.

It may be assumed that accepting new functions in order to realise economies of size will probably have only a limited influence on the market, whereas eliminating monopolistic tendencies and offering new goods and services are of greater importance and tend to increase competition. It is to be expected that, in the first case, the former monopolist will lower his prices, while, in the

second case, the competitors will change their range of products<sup>5</sup> to avoid losing customers.

Due to these favourable market influences, co-operatives have for some time and by a minority of their supporters been regarded as public utilities (Granichstaedten-Czerva 1911: 43; Schnorr von Carolsfeld 1982: 7) or even as being in the public interest (Sonnemann 1977: 151). Such an understanding, however, is wrong it does not reflect the co-operative's character of an economic self-help organisation by the members and for the members (Kramer 1997c).

The market activities of co-operatives may even be disadvantageous for the economy. This happens in those cases when the co-operative achieves the role of being the dominating enterprise in a market or even becomes a monopolist (Fleischmann 1972: 159ff; Hamm 1997: 59ff). If this happens, either the competitors or the anti-trust authorities need to take charge. Due to the federative system within most co-operative branches, such a situation is more likely to occur on the secondary or even on the apex level than for a primary co-operative.

#### **4. Structural Economic Types of the Co-operative According to Dülfer**

During the past decades, co-operatives have become increasingly aware of market forces (e. g. Bundesverband der Deutschen Volksbanken und Raiffeisenbanken 1999: 13ff). Correspondingly, the need to adapt to the market forces rose, leading to the evolution of new organizational types and structures (Dülfer 1957: 62). Due to these developments, the term "co-operative" currently covers a considerably broader range of co-operative structures than it used to do. It is necessary to distinguish the main types before entering into a discussion of conceptual co-operative problems.

Dülfer (1995: 93ff) offered an approach that has proven very helpful in this context and is therefore widely accepted (Zerche et al. 1998: 79). He distinguishes between three main structural types of modern co-operative societies: "Executively Operating Co-operatives" (traditional co-operatives), "Market-Linkage Co-operatives" (market co-operatives) and "Integrated Co-operatives".

##### *4.1. Executively Operating Co-operative (traditional co-operative)*

The executively operating co-operative has developed from collective order-

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<sup>5</sup> Such a restructuring of the range of products need not happen, e. g. if the new product opens a market that is of no economic interest to the competitors, e. g. in the banking market (Neumann 1972: 7). The Ökobank eG proved to be such an example (Rommel 1992, esp. pp. 19ff).

ing. Two types of this co-operative may be distinguished: a primitive version and a higher developed one. Dülfer characterizes the primitive type as follows: “In this type, ... the group specially elects an executive board that only has to collect the members’ wishes and later on distribute the acquired goods among the recipients. This board is not permitted to make own decisions. It only transforms the received information into collective information which is passed on as an order to the supplier.”<sup>6</sup> The types of goods as well as their quantities are well defined; there is no need for additional control through a promotional obligation, as this kind of co-operative only allows for promotional activity.

The higher developed type of the executively operating co-operative developed with the necessity of stock-keeping. Co-operative warehousing evolved as a way to reduce costs through quantity discounts and decreased risks of deferred shipment. In this way, the co-operative shows the first signs of a real business enterprise, e. g. leasing warehouse capacities. As opposed to the primitive type, the stock-keeping aspect of the higher developed executively operating co-operative disables the members from influencing the co-operative’s services in the short run. However, the co-operative still bears the significant features of an executive instrument for the members’ interests (Dülfer 1995: 94).

Due to the co-operative’s independence which goes hand in hand with stock-keeping, a divergence of the co-operative’s activities and the members’ wishes is possible. However, defining the goals is comparatively simple if the principles of efficiency and profitability are obeyed. It needs to be mentioned, though, that such an implementation causes a certain change of meaning as far the promotional obligation is concerned. With regard to market relations of the co-operative, it may be stated that no market relations exist between the members and their co-operative. These exist only between the co-operative and the opposite side of the market, regardless of whether that is the demand side or the supply side.

#### 4.2. *Market-Linkage Co-operative (market co-operative)*

Market-linkage co-operatives and executively operating co-operatives differ mainly in the weaker ties between the co-operative and its members. The market-linkage co-operative has developed typical features of an enterprise, e. g. hired staff, management structures, an internal hierarchical structure. This formalization of the enterprise, which is quite typical for all higher developed organizations, leads to a certain distance between members and hired managers. In the special case of a market-linkage co-operative, this distance is increased due to the considerable amount of business that is done with non-

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<sup>6</sup> Dülfer (1960: 12f); translation by the author.

members (Zerche et al. 1998: 93).

A result of these transactions with non-members is the reduced economic importance of the members. The members identify themselves with their co-operative less strongly than in the case of a traditional co-operative. The ties that bind co-operative enterprise and co-operative member have weakened. Due to this slack, the relations between the co-operative and its members have changed into relations similar to those between a capitalist enterprise and its customers (Dülfer 1960: 18).

In comparison to the executively operating co-operative, the market-linkage co-operative is influenced to a greater degree by the “disturbing influences of competition”<sup>7</sup> that require a more pronounced management and control system. Therefore, professionals from outside the co-operative are hired for the co-operative’s top management positions and even for the executive board. Their know-how is necessary for the market success of the co-operative. Such integration of outsiders, however, may create conflicts because the goals and preferences of hired experts are different from those of members (Kramer 1997b: 29ff).

The co-operative society gains more independence from its members and becomes more of an enterprise than before. With the hiring of management professionals, members lose an important part of their control and their influence in the co-operative. Due to these developments, the relationship between the co-operative and its members shows even more similarities to the relationship between a customer on the market and an enterprise. Therefore, the promotion task gains additional importance in order to avoid the transformation of the co-operative society into a commercial enterprise. In spite of the increased importance of the promotion duty, it becomes harder to define for organizational as well as informational reasons.

### 4.3. *Integrated Co-operative*

While the market-linkage co-operative (e. g. a credit co-operative) is characterized by a weaker relationship between co-operative and members, the features of the integrated co-operative (e. g. a taxi co-operative) are to the contrary: the strength of the relationship has increased. The closer co-operation between the co-operative and its members is a result of the higher degree of concentration on the market. This can be observed on the retail market for food products, where co-operatives compete with retail outlets that belong to big chains or wholesalers. A loose relationship, such as the one between a member and a market linkage co-operative, would be highly disadvantageous (e. g. no corporate identity; no common public relation concept; a high degree of non-uniformity among the co-operatives, even though they belong to the

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<sup>7</sup> Dülfer (1960: 18); translation by the author.

same federation and act on similar markets).

The management of the co-operative enterprise therefore has to accept new responsibilities which have evolved from the co-operative's duties with regard to information (Dülfer 1960: 22). One responsibility of the existing relationship is market research. This is absolutely necessary in order to stabilize and increase the members' competitive abilities, however, for cost reasons it cannot be carried out by the members themselves. Therefore, the co-operative has to offer this service. The co-operative's duty to keep its members informed, in this case, is closely connected with an increased integration of the members into the co-operative society. At the same time, a "reversal of the steering system" happens. Due to these development trends, the co-operative's management does not only influence the production process of the co-operative with regard to goods and services; but, at least partially, it also governs the activities of their members' own enterprises (e. g. retail stores with a joint marketing strategy).

The formal structures of power and influence are reversed: The members are no longer able and competent enough to give orders to the co-operative's management regarding the promotion task. Even defining their individual interests proves to be very difficult. Consequently, the members engage professionals for the co-operative's board of executives which in turn provides them with recommendations on how to improve their own, individual situation. The management staff does not only act in an advisory capacity but is permitted to enforce orders (Münkner 1978: 108).

This reversal of roles makes it fairly difficult for members of the co-operative to decide whether certain business ventures were necessary and part of the promotion duty or whether they happened due to particular managerial interests.

Describing today's situation is not enough, however; for a better understanding of the current structure of co-operative governance, the application of a suitable instrument for analysis seems necessary. Such an instrument can be found, e. g., in property rights theory.

## **5. Property Rights Theory and Co-operatives**

While other parts of the new institutional economics (e. g. principal agent theory, transaction cost theory) have already been applied to co-operative research with some success, property rights theory has as yet been only rarely used in this regard. At the same time, the traditional structure of co-operatives, namely of co-operatives in Germany, has found itself to be in the middle of a somewhat controversial discussion. Especially subscribers to the shareholder value philosophy have criticised the co-operative structure as lacking in incentives and being outmoded. Maybe property rights theory has some input to offer for the proposed reforms.



Property rights theory is a concept which focuses on a person's or an institution's rights to act. As a rule, it may be said that no one has either the permission or the ability to enforce all rights that exist regarding a specific property. Awarding the rights of one specific property to different persons is called "attenuation" (Furubotn/Pejovich 1972: 1146). As a rule of thumb it may be said that the higher the degree of attenuation, the lower the interest of a person to enforce his or her rights.

The existing limitations to an individual's property rights are to a large extent due to the requirements and barriers imposed on the individual by its socio-economic environment. Therefore, Alchian/Demsetz (1973: 17) regard property rights as "socially recognized rights of action".

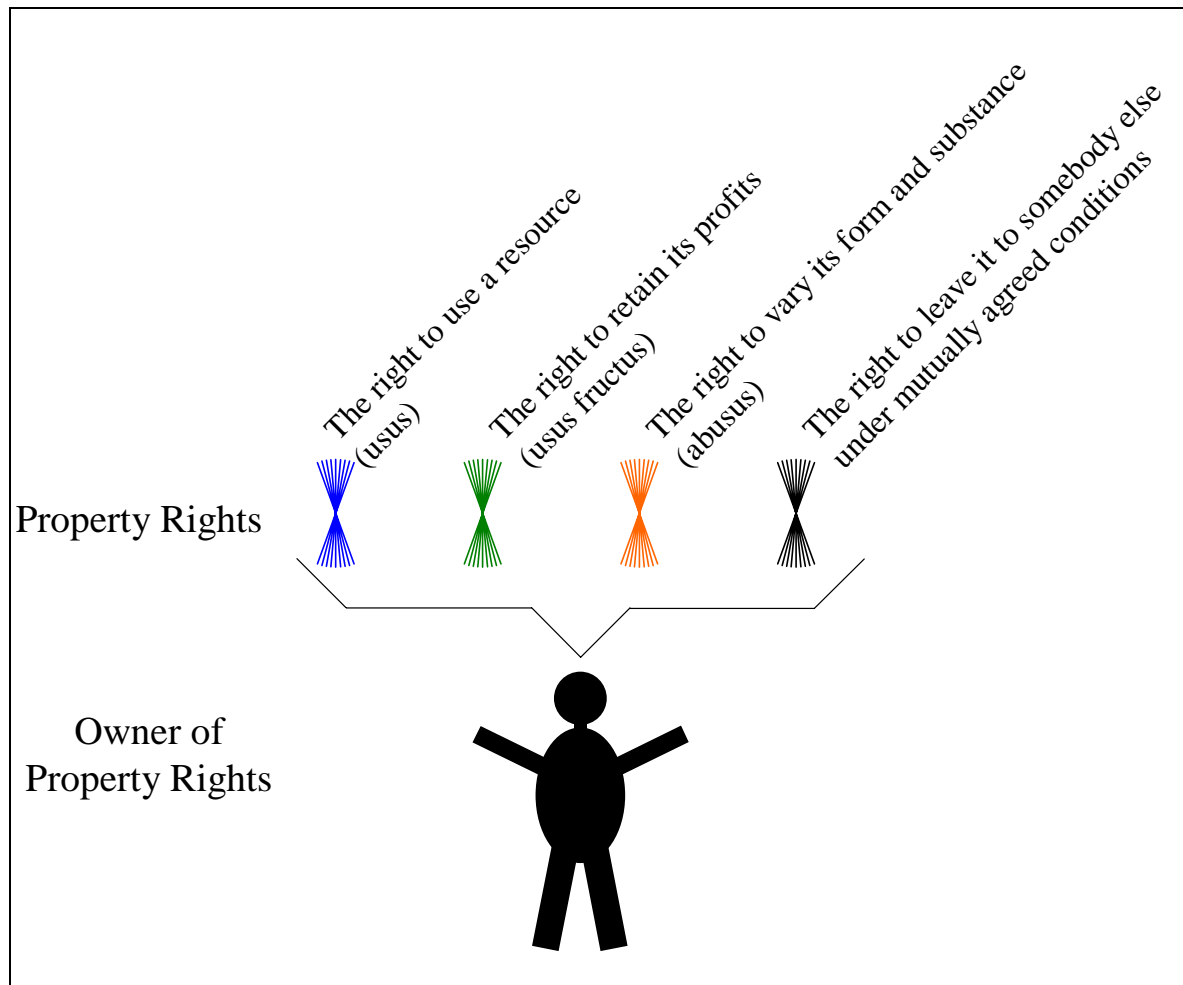
Property rights exist not only regarding material goods, but also regarding services. Currently, even intellectual property rights are being discussed (Albach/Rosenkranz 1997). Still a matter of dispute is whether property rights require a good to be in existence or not. While Dunn et al. (n. n.: 2) are in favour of the first view, when defining goods as everything that creates a benefit, Castle emphasises a different aspect. From his standpoint, "property rights are defined in the law and serve as rules governing the utilization and transfer of rights to wealth" (Castle 1978: 2). The second concept even includes rights against people, e. g. the rights as well as the obligations of employees in their relationship towards their employer, their colleagues, the labour union, the government etc (Kramer 1996: 10). From this point of view not the good itself is being owned, but a collection of property rights that may vary depending on socio-economic conditions.

The form in which property rights exist depends to a large extent on societal institutions, like traditions, conventions, ethics, and written or unwritten law: Different institutional frameworks lead to different sets of property rights. According to Tietzel (1981: 210), a complete formulation of property rights allows the exclusive but not unlimited use of a resource and contains four major categories of (sub-)rights:

1. The right to use a resource (*usus*),
2. the right to retain its profits (*usus fructus*),
3. the right to vary its form and substance (*abusus*), and
4. the right to leave it to somebody else under mutually agreed conditions.

Theoretically, there exists a definite allocation of all rights, preferably to one person. This person then is permitted to exercise all rights from all four categories whichever way he wants.

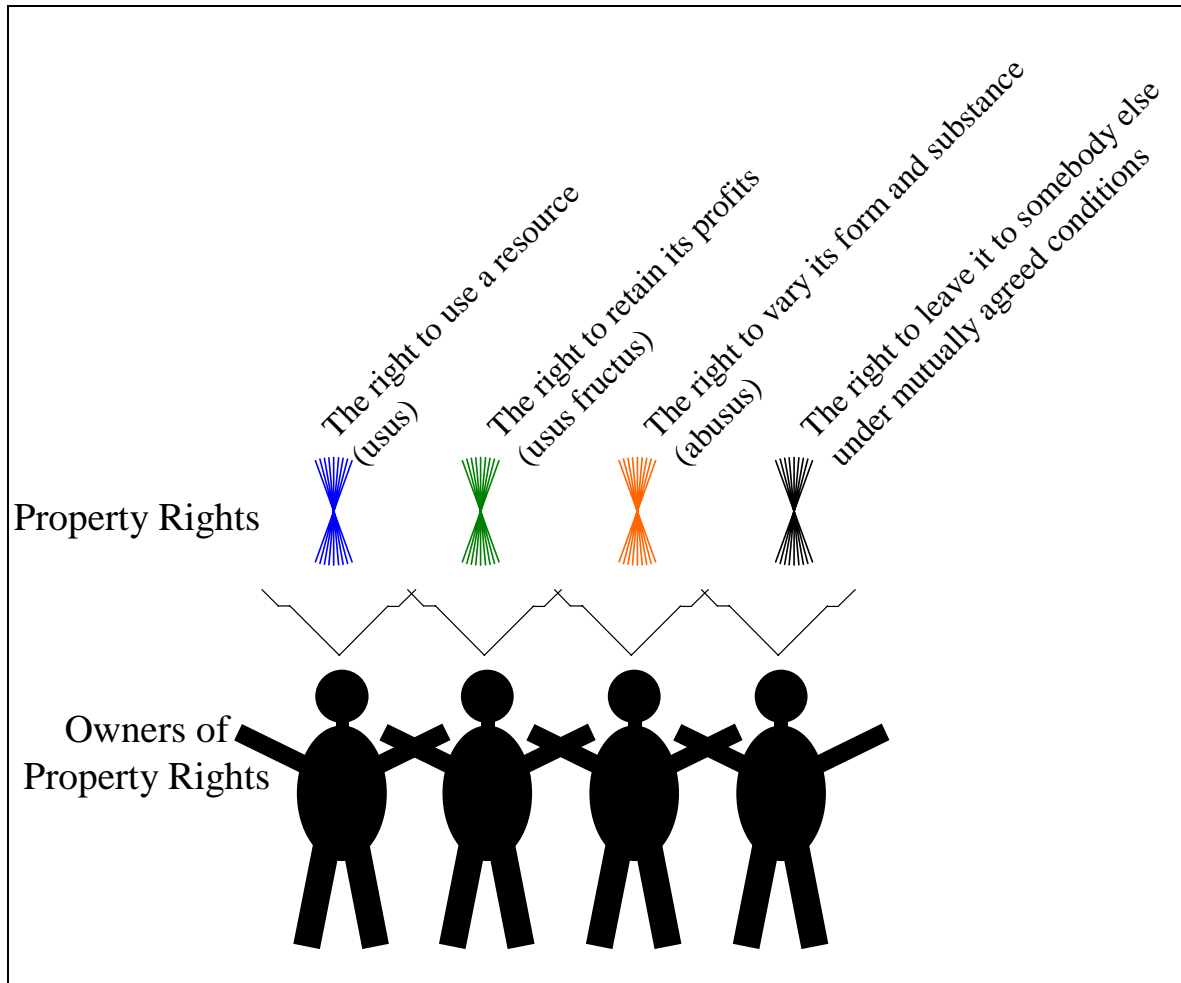
Figure 1: Ideal Allocation of Property Rights



Source: By Author.

In reality, however, the allocation of property rights is far from this hypothetical situation. There are cases where each category of rights is allocated to a different person. This requires a lot of communication whenever a specific action concerns the rights of different persons.

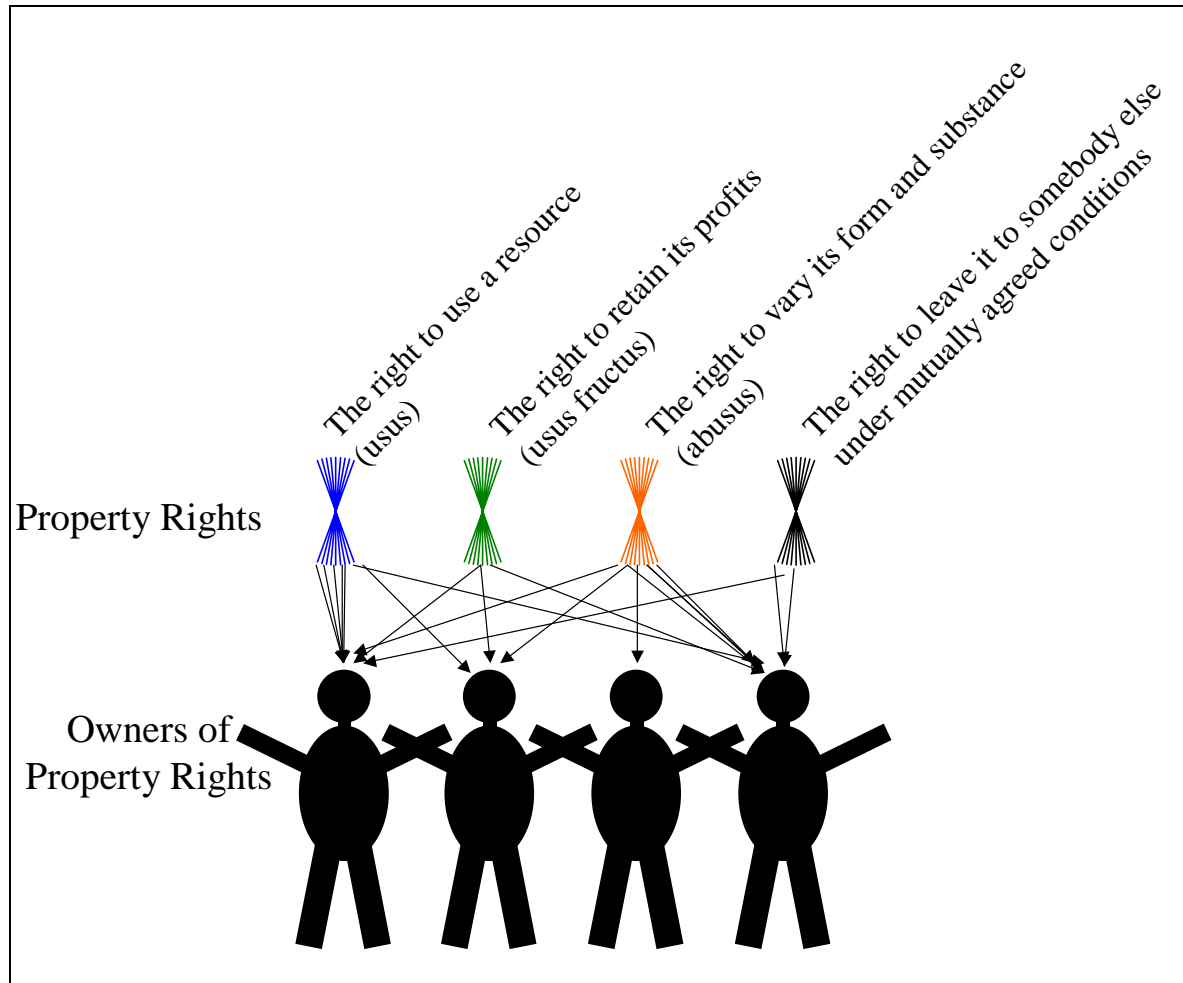
Figure 2: Clear Allocation of Property Rights



Source: By Author.

It becomes even more complicated if the rights of one category are allocated to more than one person. According to the subrights that a specific person owns, this may enable him to veto a broad variety of activities. In extreme situations, the rights may even have been allocated to (groups of) persons with opposing interests and/or economic influence and power.

*Figure 3: Highly Attenuated Allocation of Property Rights*



Source: By Author.

## 6. Attenuation of Property Rights

It has already been mentioned that in the real world a complete allocation of all property rights to a single individual or institution is extremely unlikely. Instead, the property rights regarding a specific good are divided into different sets and allocated to various individuals and institutions, based on law, power, force, or other ways of gaining ownership. The reasons for this attenuation may be due to legal, moral, similar restrictions, or transaction costs.

The term “transaction costs” in this context covers all costs that evolve in the process of definition, exchange, surveillance, and enforcement of property rights (Leipold 1983: 57). Increasing these costs for exercising and enforcing the property rights of an individual or an institution decreases the range of possible actions (Leipold 1983: 57) while simultaneously reducing the incentives for economic activity and the enforcement of property rights (Kramer 1996: 16). Similar reactions may be caused by restrictions based on the socio-

economic environment, which are opposed to or even prohibit certain activities. Examples for such behaviour are drug-pushing, driving while intoxicated, or allowing stores to conduct business on Sundays or holidays. The higher the transaction costs and the fewer the allowed activities, the higher is the degree of attenuation, thereby increasing the development of positive or negative externalities (Tietzel 1981: 212).

Incomplete specification of property rights and the evolution of external effects will happen whenever the enforcement costs do not enter into the calculation of the acting individual or institution. Such external effects may be advantageous as well as disadvantageous for third parties, as shown in the example of a supermarket parking lot. If parking is free of charge, not only will the customers benefit from it, but also other car owners who are more than likely to use the parking lot without making any purchases in the supermarket. The costs for the parking of non-customers are included in the prices of the goods bought by the customers, no matter if they use the parking lot or not. Such “free rider effects” are more likely to occur in cases of common property when it is impossible to exclude someone from its use. To a certain degree, it can also be observed in the case of co-operative property (Kramer 1996: 17).

The distribution of property rights within an organisation is influenced by two parameters: The formal rules that have been laid down in writing, like statutes, by-laws, and general business law, and the more informal structures of influence, based on status, power, superior information, and similar aspects. In the next paragraph, the formal rules – as laid down in the German co-operative law, will be examined.

## **7. Structural Influences of the Legal Form, the Registered Co-operative**

Based on the legal form of a registered co-operative in Germany, two important aspects of its structure may be distinguished. The first of these is a general structure which is mandatory for all registered co-operatives.<sup>8</sup> Secondly, a large number of structural details of the co-operative are influenced by or originate from its activities, its branch, its size, and/or similar factors.

### *7.1. General Structure*

All registered co-operatives in Germany consist of an executive board, a supervisory board, and a general assembly or a representative assembly, depending on the size of the co-operative.

Since 1974, the executive board is directly responsible for all business ac-

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<sup>8</sup> Co-operatives that are organised as joint stock companies, limited liability companies, or in any form other than a registered co-operative are not taken into consideration within this paper.

tivities of the co-operative (§ 27 (1) GenG (co-operative law)). Only extraordinary decisions with a great impact on the future development of the co-operative (e. g. mergers) require the assent of the supervisory board or even of the general or representative assembly. In all other aspects, decisions of the executive board can not be vetoed before they are realized. In general, the executive board is responsible for all decisions concerning the day-to-day-business of the co-operative enterprise.

The supervisory board in most regards acts, as the name implies, as a supervisory institution and therefore is no real counterpart for the executive board. With the exception of those very few transactions where its consent is required for its realization, the supervisory board may be informed before the act, but without the rights to prevent activities or transactions. Only after the fact the supervisory board may evaluate the effect and the usefulness of a given activity. If it is dissatisfied, it may act accordingly. In severe cases, the board may even suspend members of the executive board. In general, the supervisory board is responsible for the supervision of the executive board and those decisions concerning the business of the co-operative enterprise that are not part of the day-to-day-business.

In principle, the most important body is the general assembly. Theoretically, it not only elects the members of the board, but also carries out the annual closing of the accounts, and evaluates whether the co-operative's members have been sufficiently promoted. A closer look at the typical proceedings, however, reveals a somewhat different situation in which the assembly accepts the suggestions of both the executive and the supervisory board without much discussion.<sup>9</sup> The general meeting is responsible for the supervision of both the executive and the supervisory board, for decisions of an extraordinary nature with regard to the co-operative enterprise, and for decisions concerning the co-operative as a society (Münkner 1982: 70ff).

In addition to these inner-co-operative bodies there is a fourth body in existence which is not a part of the co-operative itself, but mandatory for all registered co-operatives: The annual audit by a co-operative auditing association (Münkner 1982: 76ff).

## 7.2. *Structural Details*

While the above mentioned requirements are imposed on all registered co-operatives in Germany, co-operatives are nevertheless required to find an organizational structure within the legal framework that fits their individual needs. Even though this organizational structure is greatly dependent on the co-operative in question it nevertheless is possible to discern those tendencies

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<sup>9</sup> In this respect, the situation within the co-operative is quite similar to that in corporations, as analysed by Berle/Means (2003).

that are caused by the discrepancy between member's expectations and market requirements.

These strains within a co-operative are most obvious in worker's co-operatives (Kramer 1997a: 119-121; Kramer 2003a: 17-23) and farming co-operatives but they exist in other co-operatives as well. The main cause of these strains is the dual nature of a co-operative: On the one hand, the co-operative is an enterprise that has to compete in a market; on the other hand, it is a society that has to promote its members. These opposing interests have to be balanced within every co-operative and the way they are balanced depends very much on the stage of co-operative development, the business branch, and the size of the enterprise.

As a rule, it may be said that the larger the enterprise is, the stronger the market pressure will be and the lesser the influence of the members. This is especially true for co-operatives with a very large number of members, e. g. consumer co-operatives and credit co-operatives. In these cases, the boards will not only gain influence at the members' expense, but at the same time there will be a tendency to award market influences a higher significance than member's interests.

The more members there are within a co-operative, the smaller is the influence of an individual member. The less influence a member has the lower tends to be his or her interest in the co-operative, his "feeling of belonging". Therefore, the members of the boards, namely of the executive board, will gain influence, while the general assembly will lose importance.

For similar reasons, the market influence will be of lower importance in the case of an executively operating co-operative (Dülfer 1995: 93) than in either a market-linkage co-operative or an integrated co-operative. Not only does the executively operating co-operative tend to be smaller in size, but also closer to its members. The duty to promote the co-operative's members has a stronger impact.

This becomes obvious by examining more closely the typical market-linkage co-operatives (e. g. credit co-operatives, consumer co-operatives, housing co-operatives) or integrated co-operatives (e. g. taxi co-operatives, retail co-operatives). Either the co-operative tends to do business with non-members as well as with members, or the market pressure causes a centralization of decision power within the co-operative.

## **8. The Allocation of Property Rights within a Co-operative**

For an evaluation of the allocation of property rights within a co-operative, it is necessary to reconsider the four major areas of rights: The right to use a resource (*usus*), the right to retain its profits (*usus fructus*), the right to vary its form and substance (*abusus*), and the right to leave it to somebody else under mutually agreed conditions.

Looking at these major areas of property rights, it becomes obvious that the rights regarding the use of the resource are awarded to the executive board. In this regard, the co-operative is quite similar to other enterprises. The management is supposed to use the resources in the best possible way in order to promote the members.

The right to retain the profits is, at least formally, awarded to the general or representative assembly. In German co-operatives, the general assembly formally passes the balance sheet and the win and loss statement (§ 48 (1) GenG (co-operative law)) (Metz 1997: 771ff). The executive board draws up the balance sheet and the win and loss statement; the general assembly, however, is permitted to change it.

The rights regarding the variation of the co-operative's form and substance are allocated to different bodies. According to German co-operative law, the co-operative has to focus on the promotion of its members. Neither the general assembly nor the boards can vary the core of the co-operative. If such far reaching changes are desired, the co-operative has to be transformed into a different kind of enterprise. At a lower level, the general assembly is permitted to vary the form and the substance of the co-operative, namely with regard to the "society" part of the co-operative. Regarding the "enterprise" part, there is a threefold hierarchy within the co-operative: The executive board has the right to perform minor changes in the form and substance, while the supervisory board may permit moderate changes. The most important changes have to be decided upon by the general assembly or by the representative assembly.

The right to leave the co-operative enterprise to somebody else is exclusively within the power of the general assembly, as it would be of the utmost importance for the future development of the co-operative. Therefore it has to be decided on by the owners, the members of the co-operative.

Assessing the current allocation of property rights within German co-operatives, it becomes obvious that they show a high degree of attenuation. Therefore, the actual allocation is similar to the one shown in figure 3.

## **9. Where are the Problems?**

Even though the allocation of property rights is fairly specified, due to the German co-operative law, there exist several problems regarding this allocation and the attenuation caused by it (Kramer 2002: 295ff). Some of these problems are based on the law itself, some of them have evolved due to lack of enforcement of the rights mentioned above. All of this tends to have some influence on the four characteristic features of a registered co-operative: Promotion principle, identity principle, democracy principle, and solidarity principle (Flieger 1996: 20ff; Kramer 1999: 167). This influence simultaneously affects the corporate governance structure of the co-operative, as we will see.



### 9.1. *The Promotion Principle*

Every co-operative has to fulfil its promotional obligation towards its members. Promotional obligation or promotion principal in this context means: Who will benefit in which way from the co-operative's activities. The main difficulty, however, is defining the exact extent of this obligation. While the promotional obligation was fairly easy to define in the very first (traditional or executively operating) co-operatives, it has recently become much harder to specify how a co-operative is supposed to promote its members. The right to use the resources has been awarded to the executive board, but the members are still required to designate the goals for which these resources should be used.

It is a moot point whether this setting of goals is part of the right to use the resources or part of the right to retain the profits. However, if the members do not define the goals, they are virtually unable to accurately ascertain whether they have been promoted or not.

Theoretically, the members define the goals for the co-operative, thereby simultaneously defining the promotional obligation for the co-operative's management. Instead, a closer look at the proceedings at general assemblies reveals that the members do not define the co-operative goals at all. Therefore, the promotional obligation is in danger of becoming hollow.

Engels (1997: 675) even considers the promotional obligation to be just an empty phrase. He states that all former attempts to fill the concept of a promotional obligation with life have failed. As a consequence, property rights regarding the definition of the promotional obligation have been acquired by the co-operative's management, namely the executive board.

Even though Engels' arguments are somewhat biased since there is not even a hint of differentiation between co-operatives that differ in size, branch, or development stage, it can not be denied that there is a tendency among executive boards to acquire the right to define their own goals. This tendency seems to increase in accordance with the size of the co-operative and the number of its members. It seems to be strongest among market linkage co-operatives, where the general assembly has been replaced by a representative assembly.

Property rights theory offers an explanation for this development: transaction costs for the individual member are higher than the gains he could expect from a definition of the promotional obligation. Therefore, the definition of the promotional obligation becomes similar to that of a communal property, which has been informally claimed by the group with a more favourable cost-gains-ratio. The groups with low transaction costs and a chance for higher profits are the executive board and to a lesser degree the supervisory board. Their transaction costs were lower because they had fewer people to convince to act jointly, and they also had the benefit of superior information. At the

same time, they could profit from a non-defined promotional obligation, as this increased the difficulties to control whether they fulfilled their obligation at all. The fact that the allocation of property rights provided by § 27 (1) in the amendment of the co-operative law in 1973 was demanded by the management professionals (Lenfers 1994: 68-69) is evidence for such a development. The paragraph in its current form states that the executive board is empowered to handle all day-to-day business activities, limited only by the by-laws (Hetrich/Pöhlmann 1995: 140).

If the transaction costs for member's involvement were high before these legal changes, they are close to prohibitive now, at least in those co-operatives with a large number of members. In most of these co-operatives there is no general assembly but a representative assembly, where it is even more difficult (i. e. more costly transaction-cost-wise) for an ordinary member to convince the assembly, especially if he is not a member of the representative assembly.<sup>10</sup> Besides, in many co-operatives the election lists for the representative assembly and the supervisory board are drawn up under the close supervision of the executive board. This enables the executive board with the chief executive officer as its key member, to handpick the persons who are to supervise its activities. The corporate governance structure is kept formally intact, but is weakened in its core.

Another problematic area has been pointed out by Engels, who emphasizes that the increase of reserves tends to decrease the importance of the share capital that is directly owned by the co-operators. If a member decides to leave the co-operative he receives no share of the accumulated reserves (Engels 1997: 676). Therefore, whenever members decide to increase the reserves they vote away a share of their profits without ever having a chance to share in this part of the capital stock, with the notable exception of a liquidation of the co-operative. Employing the terminology of property rights theory, it is obvious that the members decide to surrender a certain part of their set of property rights. It is, however, uncertain what they receive in return – if anything at all.

If the promotional obligation is well defined and obeyed by the management of the co-operative, the real impact of this property rights disclaimer is of comparatively low importance. In this case, members will benefit from the better performance of the co-operative which will become possible due to the higher capital stock. If the promotional obligation tends to be fuzzy, as has been argued above, the members receive no compensation at all. They waive their rights in deference to the executive board – which further weakens the corporate governance structure.

The rights to vary the form and substance of the co-operative seem to be of comparatively low importance. Therefore, hardly any problems can be ob-

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<sup>10</sup> Sparda-Bank West eG in Düsseldorf is an example on how to minimize members' rights (cf. Kramer 2003b: 12).

served regarding this set of rights and its allocation. A notable exception may be found in the banking sector, where numerous mergers have happened during the last couple of years. This development is, for the most part, likely to continue in the foreseeable future. An ad hoc evaluation regarding the impact of mergers on members' rights is very difficult. Therefore, further research is required.

The fourth set of property rights focuses on the right to leave the property to somebody else. In this case, two aspects have to be distinguished. On the one hand, there is the member's right to leave its share to somebody else, on the other hand there is the possibility of leaving the co-operative itself to somebody else.

Engels focuses exclusively on the first aspect and reaches the conclusion that the law creates a severe attenuation of the property rights of members. He states that the only way for a member to leave the co-operative is to terminate the membership, to return the shares and to receive the share in the capital stock. According to Engels (1997: 676), this attenuation of the member's property rights further increase the property rights of the executive board.<sup>11</sup> He points out the absence of a secondary market for co-operative shares and fails to recognize the low necessity for such a market: As a rule, current members of the co-operative can terminate the membership and receive the par value of their shares, while prospective members need only apply for membership, provided they meet the requirements (e. g. owning milk stock for the membership in a dairy co-operative).

Engels claims that the executive board is enabled by these regulations to follow a strategy of member selection, pushing unwanted members out of the co-operative while choosing desired applicants for membership. Theoretically, this could happen, but empirical evidence for Engels' statement seems to be missing.

It has to be admitted, however, that Engels is right insofar as a co-operative member's property rights differ from those of a shareholder in a joint stock company. Whether this is indeed a higher attenuation as Engels claims or only a difference in allocation, is still to be argued. Once again, the promotional obligation is of great importance. If the promotional obligation is fulfilled, disadvantages for the members due to this allocation of rights are hardly no-

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<sup>11</sup> These arguments by Engels require some comments: not only does he neglect the chance to transfer the share to somebody else, as provided by § 76 (1) GenG (co-operative law). He also argues that as a rule members of co-operatives have only one share per capita. This is not only wrong for all those co-operatives where the number of shares per capita depends on the amount of business transacted with the co-operative (e. g. number of cattle in the case of a dairy co-operative), but also overlooks the fact that in many co-operatives the ratio of members versus number of shares indicates a much higher ratio (e. g. in credit co-operatives).

ticeable. If the promotional obligation is not fulfilled, however, the drawbacks for the member are severe.

### 9.2. *The Identity Principle*

The identity principle states that theoretically all members of the co-operative are identical with one well-specified group of clients. These co-operative clients may be customers, either on the supply side (e. g. retail co-operatives) or on the demand side (e. g. consumer co-operatives, housing co-operatives), or employees (e. g. workers co-operatives). Therefore the property rights of the members are supposed to represent an identical influence via their capital share and via their share of transactions with the co-operative.<sup>12</sup>

Reality, however, proves that this theoretical model currently is valid only in very few cases, mainly in supply side co-operatives. For the majority of co-operatives, non-member transactions have become quite typical.

The property rights of the members have been influenced by this development quite drastically, as non-member transactions tend to decrease members' economic importance. While the property rights stay formally the same, they are devaluated economically. The more transactions are carried out with non-members the lower is the importance of the members. This does not only create a certain bias on the part of the co-operative management towards non-members; but, it may even lead to a transformation of the co-operative into a capitalist enterprise or cause an economic failure of the co-operative. The most notable examples for such developments have happened in consumer co-operatives. In both cases the promotional obligation suffered as well.

Farming co-operatives find themselves in a very special situation because they tend to have a very heterogenous membership structure: current landowners, former landowners, current employees, former employees, financial investors, are only five groups of members that can have very diverse interests. At the same time, not all landowners and/or all employees are members of the co-operative. This does not necessarily mean that the co-operative becomes impossible to manage, but it sure makes it difficult to balance members' interests.

### 9.3. *The Democracy Principle*

With regard to the democracy principle, it may be supposed that all members have an equal influence on co-operative matters, as is to be expected by the concept "one man, one vote". Instead, reality proves to be different.

The democracy principle in co-operatives has become somewhat meaning-

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<sup>12</sup> In this context a possible proportional gap between the capital share and the transaction share will be neglected, even though such gaps exist.

less for two different reasons. Firstly, the German co-operative law prescribes for registered co-operatives a mandatory hierarchy of at least three, but in many co-operatives of four levels: Executive board, supervisory board, general assembly or representative assembly, and ordinary members (in case of a representative assembly).

Even though all these levels are exclusively staffed with members of the co-operative, the influence and the access to information varies immensely. Therefore, a certain lack of control can be observed in many co-operatives (Kramer 1997b: 29-34).

The democratic influence of the members is therefore predetermined by the co-operative law, depending on their role within the co-operative. A certain attenuation of property rights is evident.

Secondly, the legal cause for this fact finds a counterpart in kind in organizational theory. As Boettcher (1974: 59ff) points out, it is next to impossible to run any kind of organization that has more than a very small number of members in accordance with a veto right for individual members. Larger organizations require some kind of a hierarchy to enable at least minimum efficiency. For this reason, unequal distribution of democratic influence is unavoidable.

Such an unequal distribution, nevertheless, requires an adequate control mechanism in order to avoid unwanted and unwarranted influence of certain members and of certain levels within the co-operative. A suitable organizational solution is needed.

#### 9.4. *The Solidarity Principle*

Whether or not any difficulties exist regarding the attribution or attenuation of property rights in the realm of the solidarity principle is very difficult to evaluate. This is mainly due to the fact that the solidarity principle itself continues to be somewhat fuzzy in its content. Who is supposed to be the recipient of the solidarity? How is the solidarity to be exercised? How is the solidarity to be measured?

For these reasons, it is very hard to evaluate whether the solidarity principle is put into practice in the first place, not to mention whether or not the individual's property rights are obeyed.

Nevertheless, there are some examples that throw some light on the difficulties of this principle. Typical examples are retail co-operatives that usually offer discounts to customers with large volume orders. In such cases the question is raised as to whether or not such discounts are an infringement of the solidarity principle. The poorer customers that are in a greater need of promotion are denied these discounts due to their smaller orders, while the stronger and wealthier members receive an additional benefit. On the other hand, there is the peril that the stronger members might leave the co-operative (and estab-

lish a co-operative of their own) if they do not receive such discounts. In turn, this may lead to an even worse situation for the smaller members of the co-operative.

## 10. What could be done?

A closer look at the problems mentioned above reveals that the heart of the matter lies in the definition of the promotional obligation. If the current situation is to continue, the promotional obligation is well on its way to becoming an “empty phrase” as stated by Engels (1997: 683). Consistent with such a development, several co-operatives in Germany are in danger of losing their special characteristics. In the end, this might even jeopardize their continued existence as a co-operative.

A possible solution for many problems that are linked to the promotional obligation has already been described by Boettcher (1980: 82ff, 99ff) several years ago. His concept of a promotion plan and a promotion report would solve many of the problems that have mentioned above. For reasons of brevity, this concept shall not be described here as it has received sufficient attention in various publications (Boettcher 1979; Weber/Brazda, 1994: 738)).

The two main reasons why the promotion plan, as well as the promotion report, is used only in a minority of co-operatives are its complexity and its costs on the one hand (Kramer 2006) and the executive boards’ unwillingness to implement it on the other hand. During the last couple of years, the management staffs of the co-operatives, namely the executive boards, have acquired numerous rights that used to belong to the general assembly and/or the supervisory board. To some extent, these rights have been allocated to the boards by the last amendment of the co-operative law. Most of these rights, however, have been obtained because the transaction cost situation was in favour of the managerial interests instead of the members’ interests. Since the promotion plan and promotion report would reduce the property rights of the executive boards, the boards are quite unlikely to support such changes. Transaction costs that would result from the formulation and execution of a promotion plan and promotion report are an additional reason for the lack of implementation.

Currently, there seem to be three ways out of this dilemma:

1. Convincing the boards with arguments from co-operative theory that the promotion plan and the promotion report would strengthen the structure of the co-operative.
2. A change of the co-operative law making promotion plan and the promotion report mandatory for co-operatives, as has been argued in earlier papers (Kramer 2003: 17; Kramer/Brazda 2004: 58).
3. Convincing the boards with business arguments that the promotion plan and the promotion report would increase business opportunities for co-

operatives in a competitive economic environment.

The first path has been pursued for a long time, however, with hardly any noticeable results. Arguing for a promotion plan may not be harmful, but it does not seem to be effective.

The second way seems fairly sensible, especially as the German co-operative law is currently undergoing an amendment process. Unfortunately, promotion plan and promotion report receive only little attention within this discussion. One of the reasons for this neglect may well be the fact that the promotion plan concept as designed by Patera (1981, 1986) and others is fairly complex, complicated, and costly. Therefore it may be assumed that a simplified concept of the promotion plan, structured along the lines of a controlling instrument and influenced by quality management aspects, might be less controversial.

This leaves the third alternative. Its major advantage would be that the implementation of a promotion plan with the help of business arguments would lead to a win-win-situation: The members of the co-operative would win, because their interests become known to the co-operative managers: The co-operative receives information on how its members would like to be promoted and supported. Ideally, this information would enable the managers of the co-operative to offer those goods and services that the members are most interested in, thereby creating a better fit of supply and demand. This may even encourage the co-operative to offer new services in reaction to members' interests – thereby increasing sales, turnover and profitability. In such a situation, the managers might even be willing to accept the additional co-operative governance to which they are submitted by member feedback.

The crucial point, however, is whether such “promise” of additional business opportunities does exist in reality. If there is no “business ad-on” as a consequence of increased member participation and feedback, managers are not likely to accept either additional costs or co-operative governance routines.

To find out whether member feedback on a less complex level than a formal promotion plan and report system contains information of business relevance, a research project has been started in Spring 2006 by “Forschungsgruppe für Kooperation, Netzwerke und Unternehmenstheorie” of Hochschule Wismar and Institut für Genossenschaftswesen an der Humboldt-Universität zu Berlin. Members of the representative assembly of three major co-operative banks were sent a questionnaire on member promotion in their bank. The project has not been finished yet, but some results are already available.

For instance, bankers had assumed that the most important reason for membership in a co-operative bank would be some financial attraction, e. g. a current account free of charge. This assumption, however, did not receive any support from the questionnaire. Instead, members named integrity and honesty of the bank as the most important way of member promotion. All in all, mem-

bers of co-operative banks – given the choice of discount banking and personal banking – seem to prefer personal banking, even if some competitors offer comparable services for a lower price.

This indicates not only that members of co-operatives, even of big market-linkage co-operatives, have specific reasons for becoming and staying a member. It also indicates that co-operative members may have a lower price elasticity regarding the financial services that they require.

## **11. Summary**

In Germany exist a large number of co-operatives that are engaged in a broad variety of business activities. Their organisational structure is determined by co-operative law and to a lesser degree by statutes or by-laws. As has been shown for German rural co-operatives by applying property rights theory the corporate governance structure as determined by law is formally still in existence, while it actually has been shifted in favour of the executive board. This has created an imbalance where on the one hand no longer any corporate governance is actually taking place while on the other hand members' interests may easily be neglected, because it is the executive board that determines the members' interests and also whether they have benefited from the co-operatives activities.

In theory, suitable instruments to improve the corporate governance structure within such co-operative are the promotion plan and the promotion report as developed by Boettcher. However, for transaction cost reasons and due to the current attenuation of property rights, it is unlikely that these instruments will be implemented without outside pressure, e. g. through a change in co-operative law.

A superior alternative to promotion plan and promotion report may be a combination of promotion task controlling and member oriented quality management. While such instruments would indeed improve members' ability to execute co-operative governance, managers' willingness to submit themselves to stronger governance may well be assumed to be very low. Taking into account the current distribution of property rights in big German co-operatives, managers will accept stronger governance structures only if some other incentives exist. An ongoing research project indicates that such incentives might exist in the realm of improved business opportunities due to better information about members' aims and needs.



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