

What will South Africa's new Cooperatives Act do for small producers? An analysis of three case studies in KwaZulu-Natal

P Nganwa¹, M Lyne² and S Ferrer³

Abstract

The new Cooperatives Act 14 of 2005 was promulgated in August 2005 to promote the development of sustainable cooperatives in South Africa and their use as a vehicle to develop small enterprises. This paper uses the new institutional economics (NIE) to highlight problems created by the Act. Case studies were done of three producer groups in KwaZulu-Natal that formally registered as cooperatives after August 2005. It is clear that the cooperative model was adopted because it was seen as a precondition for government support. All of these cooperatives displayed symptoms of institutional problems and two of them had mitigated these problems by shedding their poorest members and creating their own rules to reward investors with capital gains. The first of these 'solutions' is not consistent with the objective of pro-poor economic development; the second is at odds with the new Act. It is recommended that the new Act should be amended so that cooperatives can at least issue tradable equity shares that offer benefits proportional to shareholding. In addition, it is recommended that the same level of start-up support should be made available to all producer groups that formally register their business, regardless of the business model chosen, and that member empowerment should be an essential requirement for registration and public funding.

Keywords: Agricultural cooperatives; Cooperatives Act; new institutional economics; case study

1. Introduction

Cooperatives have been promoted in many developing countries as a mechanism for driving agricultural growth and rural development. The International Cooperative Alliance defines a cooperative as an "autonomous

¹ Master's candidate, School of Agricultural Sciences and Agribusiness, University of KwaZulu-Natal. E-mail: peace.nganwa@gmail.com.

² Associate Professor, Faculty of Commerce, Lincoln University (New Zealand) and Honorary Professor, School of Agricultural Sciences and Agribusiness, University of KwaZulu-Natal. E-mail: michael.lyne@lincoln.ac.nz.

³ Senior Lecturer, School of Economics and Finance, University of KwaZulu-Natal. Tel.: +27 (0)31 260 7558; Fax: +27 (0)31 260 7871; E-mail: ferrers@ukzn.ac.za.

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

The post-apartheid South African government identified cooperatives as a significant means to empower the rural poor with respect to the development of income-generating activities, human resource capacity, and increased savings and investment (Knight, 2006). The government deemed the Cooperatives Act of 1981 to be unsuitable for this objective, in part because it focused on larger and commercial agricultural cooperatives (Ortmann & King, 2007), and a new Cooperatives Bill was drafted by the Department of Agriculture (DoA) in 2001. This Bill introduced provisions to help cooperatives source additional capital. For example, it introduced a provision that would allow investor shares in a cooperative to be purchased by non-members. However, these provisions were contested by the Congress of South African Trade Unions (COSATU) as being contradictory to cooperative principles. In 2003, following a Presidential Growth and Development Summit, responsibility for cooperatives was transferred from the DoA to the Department of Trade and Industry (DTI), purportedly to ensure that cooperatives are promoted as businesses in all sectors of the economy. DTI revised the Bill, taking COSATU's concerns into account, and championed its passage into law (Lyne & Collins, 2008). In essence, the new Act (Act 14 of 2005) specifies institutional arrangements typical of traditional cooperatives (TCs) and gave existing cooperatives three years in which to either comply with its provisions or to restructure as an alternative type of organisation (e.g., a company).

The worldwide decline in TCs has been attributed to fundamental flaws in their institutional arrangements that manifest as free-rider, horizon, portfolio, influence and control problems – all of which constrain their ability to raise equity and debt capital, and hence their ability to finance growth assets (Cook, 1995; Cook & Iliopoulos 2000; Sykuta & Cook, 2001). Chibanda *et al.* (2008) conducted a cluster analysis of institutional and performance indicators collected in case studies of ten agricultural cooperatives in KwaZulu-Natal. Despite the new Act, there were significant differences in the institutional arrangements adopted by these cooperatives, and relationships between their institutional arrangements and performance were consistent with the assertions of NIE. This study builds on Chibanda *et al.* (2008) by examining three ‘emerging’ production cooperatives in KwaZulu-Natal. Traditional production cooperatives are afflicted by all of the institutional problems that undermine the performance of traditional marketing cooperatives, but may also encounter a ‘labour problem’ depending on the arrangements made to reward members who contribute labour to the cooperative enterprise. Information gathered in the case studies is compared with propositions drawn from the NIE to highlight aspects of the Act that critically influence the ability of cooperatives to attract capital, grow and compete. According to Section 2 of the Act, its first purpose is to promote the development of economically sustainable cooperatives.

2. Institutional flaws of traditional cooperatives

Traditional cooperatives suffer from free-rider, horizon, portfolio, control and influence problems that starve them of both equity and debt capital. Cook (1995) and Cook and Iliopoulos (2000) describe these institutional problems and attribute them to poorly defined property rights. Property rights are poorly defined in TCs because they adhere to rules that require member ownership, democratic control, returns to patronage, and redeemable (i.e. non-tradable) equity shares. There is a popular view that these rules uphold the ‘Cooperative Principles’ (Barratt 1989; ICA, 2005; Competition Commission of South Africa, 2006) set out by the Rochdale Society of Equitable Pioneers in 1844.

The free-rider problem arises when property rights are not tradable, insecure, or unassigned (Cook, 1995). It exists when the gains from cooperative action can be accessed by individuals who do not fully invest in developing the gains (Cook & Iliopoulos, 1999). There is an internal free-rider problem because members who do more business with the cooperative get a greater share of benefits even if they are small investors. There is also an external free-rider problem if non-members are permitted to transact with the cooperative at the

same prices offered to members. These free-rider problems create a disincentive for members to invest equity capital in their cooperative.

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

The horizon problem occurs when residual claims on the net income generated by an asset are shorter than the economic life of the asset (Porter & Scully, 1987). This problem arises in TCs because ownership rights cannot be transferred or traded at market value (Cook, 1995). As a result, investors cannot realise capital gains in the cooperative when they exit the cooperative. Instead, capital gains from investments in TCs are captured by free riders in the form of new members who benefit from improvements without paying market prices for their shares (Lyne & Collins, 2008). This creates a preference for current cash flows (Gripsrud *et al.*, 2000) and discourages members from financing growth opportunities (Cook, 1995). As a result, the cooperative's executive is often pressured into paying rebates rather than retaining earnings for future investment (Cook & Iliopoulos, 2000).

Cooperatives that adopt a closed membership policy tend to foster a higher degree of member commitment, thus promoting equity investment (Cook & Iliopoulos, 2000; Hardesty, 2005). A strictly closed membership policy means that individuals who want to join the cooperative must buy their shares from other members at the market price and not at par value as in a TC. If new members pay the fully appreciated share price they are not free riders and membership is closed in an economic sense. A solution to the horizon problem in traditional cooperatives is to establish a secondary market for cooperative shares. This strategy has been adopted by New Generation Cooperatives (NGCs), where cooperative members are required to purchase tradable delivery rights (patronage shares). When shares are transferable and appreciable, inactive members and members near the end of their patronage horizon can recover their equity capital plus (minus) capital gains (losses) by selling them (Iliopoulos, 2003; Borgen, 2004).

Each member of a cooperative holds his or her own portfolio of assets such as land, cattle, implements, savings and equity shares. The portfolio problem arises when members are unable to structure their investments in ways that best suit them. This problem affects members of a TC because they cannot

transact their shares, and therefore cannot diversify their own portfolios to reflect personal risk preferences (Lyne & Collins, 2008). As a consequence, risk-averse member-owners are reluctant to invest in the cooperative and exert pressure on management to carry a reduced risk portfolio even if it means lower expected returns (Gripsrud *et al.*, 2000).

The control problem arises due to the divergence of interests between the members of a cooperative and its managers. The costs associated with trying to prevent or minimise divergence of interests are known as agency costs. TCs are prone to the control problem because their shares cannot appreciate nor can they be traded (Cook, 1995). Changes in the market price of shares send a clear and timely signal of managerial performance. This enables members to make well informed choices when they vote for directors at the annual general meeting. Ultimately, the accountability of management requires transparency (e.g. independent audit of the organisation's financial statements, defensible procedures for meetings, and access to annual reports and minutes of Board meetings), a valid electoral process (e.g. secret ballot), and members' ability to disinvest by selling their shares (Lyne *et al.*, 2007).

Influence problems are likely to arise in TCs because members have equal voting power regardless of differences in their levels of investment. For example, entrepreneurial members of a cooperative might want to invest more in the business to finance value-adding operations, but face the prospect of their money being spent on other, less risky assets preferred by risk-averse members who hold majority voting power. Investment is therefore not attractive to these investors because they have little influence over the way their money will be spent (Gripsrud *et al.*, 2000). The cooperative's creditworthiness is also reduced, as lenders know that entrepreneurial investors have little influence over the cooperatives' investment decisions (Hendrikse & Veerman, 2001). Investors and lenders want assurance that they will be able to influence the investment decisions of the cooperative towards profitable investments, and that this will not be undermined by a majority of members who have not made significant contributions to the enterprise. The principle of one share, one vote (rather than one member, one vote) aligns a member's influence with their investment in the enterprise - a fair system for commercial enterprises that require substantial capital to develop and operate (Lyne *et al.*, 2007). The rapid growth of new cooperative models in the USA, EU, Canada, Australia and New Zealand reflects changes made to avoid the institutional problems facing TCs (Fulton, 2000; Lyne & Collins, 2008).

3. The case studies

Three cooperatives were identified for case study: a poultry cooperative near Pietermaritzburg (Case Study A), a cooperative involved in the production of peanut products, carbonated soft drinks and animal feed on the KwaZulu-Natal South Coast (Case Study B), and a sugarcane-producing cooperative on the KwaZulu-Natal North Coast (Case Study C). Apart from differences in geography and enterprise type, these production cooperatives also differed in size and institutional arrangements, and were recommended by extension staff and others as being accessible and willing to provide rich data. All three cooperatives were operational at the time of the study (2008) and their members were poor, rural smallholders. Information was gathered from each cooperative's constitution, a random sample of its ordinary members, members of its executive committee and, where relevant, their managers. All interviews were conducted on an individual basis. Interestingly, none of the constitutions examined complied with all of the requirements of the new Act, even though all three cooperatives had registered after its enactment (Appendix A).

Case Study A's core business is raising and selling broilers. Mature birds are sold to the local community at a market-related price (R40 per bird at the time of the survey). The cooperative's members are required to contribute equally to the business with respect to both financial resources and labour. They pay a monthly subscription fee of R20. Surplus is divided equally amongst the cooperative members and each member has one vote. Case Study A initially operated as a *small group*⁴ of 35 members. Only 14 members remained when the group registered as a cooperative in May 2006. At the time of this study, group size had shrunk further to eight members – only two of whom were men. The members shared similar socio-economic backgrounds, and had all participated in drafting the constitution of their original small group. The small group was established *to fight poverty and create employment opportunities, and was registered as a cooperative on hearing that funding and other benefits from the government were available for registered cooperatives*. On registration as a cooperative, the group received a donation of 200 chicks and 20 bags of feed from the KZN Department of Agriculture and Environmental Affairs. Since then, it has benefited from extension support and loans from Ithala Bank.

Cooperative A was planning to expand its business portfolio to include egg production and goat farming. The ability of this cooperative to raise capital to finance its planned growth is an important indicator of the strength of its

⁴ *An informal business structure that does not acquire legal status separate to its members.*

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

Case Study B is an agribusiness cooperative involved in processing peanut products such as peanut butter, oil and porridge, growing sugarcane and growing vegetables. Most of these products are sold in the local community, but the cooperative is busy extending its market into urban areas. The business started informally in 2005 with the intention of creating employment and alleviating poverty, and was formalised as a cooperative in 2006 in order to access government funding. Initially, the cooperative had 11 members, but only five remained at the time of the study. The other six had their membership terminated because they did not serve or patronise the cooperative. They were given 21 days to appeal their exclusion but did not do so and forfeited their membership fee. All of the remaining members were men.

Members paid a joining fee of R250 and are required to pay an annual subscription fee of R1 000. The fees may be paid in equal monthly instalments. Currently, new members are required to pay a joining fee of R2 000. This was decided after an annual audit and appraisal of the cooperative revealed growth in the value of its equity. The surplus is divided equally among members, and members have equal shares and equal voting rights in the cooperative. However, they are paid wages for the work they do. On registration as a cooperative, the business benefited from a loan of R324 000 from Ithala Bank, a grant of R17 000 from the Department of Agriculture, and machinery worth R120 000 from the Utungulu Community Foundation. Other benefits included training from the Department of Agriculture and from the Department of Trade and Industry.

Case Study C, a joint farming cooperative, had a relatively large and heterogeneous membership (105 members). Members of the cooperative were small sugarcane farmers who pooled their land to gain size economies. The model adopted by these farmers addressed some of the free-rider problems found in a typical production cooperative where land is owned by the cooperative. In this cooperative, members exchanged their exclusive use rights to land (typically 1 to 7 ha each) for a fixed cash rental (R800 per ha per annum) and voting and benefit rights in the cooperative for a defined period

of time (the lease⁵ usually ran for eight years). Benefit rights are proportional to patronage (where patronage is measured as the area of sugarcane land rented to the cooperative) and members have equal voting rights. The cooperative's management committee appoints a project manager to manage the plots rented from members as a single farm. The project manager does not necessarily have to be a member of the cooperative. Members are not required to provide labour to the cooperative, but are hired in preference to non-members by the cooperative.

Members of Case Study C are required to pay a joining fee of R20 and an annual subscription fee of R20, regardless of their level of patronage. Membership in the sugarcane cooperative is unrestricted, but, in practice, only farmers with suitable land are accepted. Membership is terminated if the farmer withdraws his or her land, in which case membership fees are forfeited. Since land accounts for most of the capital invested by members, the joint farming cooperative is effectively a proportional investment cooperative as benefits are proportional to investment and patronage. This and the payment of wages for labour effort alleviate internal free-rider problems.

4. Results

This section uses information gathered during interviews and from the cooperatives' constitutions to identify and explain the extent to which problems typically associated with traditional cooperatives exist, or potentially exist, in each of the case studies.

4.1 Case Study A

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

⁵ The lease agreements are sanctioned by the relevant traditional authority, therefore the property rights transferred by the lease are relatively secure.

arrangement is in direct conflict with Section 40 of the new Act and is therefore not sustainable. Compliance with the Act will make it more difficult for Case Study A to attract equity capital (and hence debt capital) to finance its proposed egg- and goat-farming enterprises.

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

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

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

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

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

4.2 Case Study B

Although this cooperative shares profits equally between its members, it avoids internal free-rider problems by insisting that members contribute equal amounts of capital, and by paying wages for labour provided by members. In addition, it alleviates the horizon problem by adjusting the joining fee (i.e. share price) to reflect growth in the cooperative's net worth. The joining fee had increased to R2 000 at the time of the study, but no new members had been admitted.

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

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

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

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

4.3 Case Study C

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

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

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

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

Some of the blame for low levels of commitment shown by members must be apportioned to agencies that facilitate and register new cooperatives. Ordinary members of Case Study C complained that they did not participate in designing their cooperative's institutional arrangements. Many claimed that

they did not have access to the cooperative's constitution, and some were unaware that it had a constitution. None of the members received any form of training, which clearly contravenes cooperative principles and raises questions about the registration process (and hence the provision of public grants). The extension officer overseeing Case Study C stated that a cooperative was not the farmers' first choice of business model. The cooperative was chosen because it was a precondition for government support. The implication is that members would have preferred a different set of institutional arrangements.

5. Conclusions and recommendations

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

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

In addition, it is recommended that the same level of start-up support should be made available to all producer groups that formally register their business, regardless of the business model chosen, and that member empowerment should be an essential requirement for registration and public funding. This empowerment should include the issue of share certificates, including certificates for tradable “capital credits” or investor shares with clear information about the rights attached to these shares.

References

Barratt N (1989). *The cooperative model as an instrument in the community economic development process.* Institute of Social and Economic Research, Working Paper No. 41, Rhodes University.

Borgen SO (2004). Rethinking incentive problems in cooperative organisations. *Journal of Social Economics* 33:383-393.

Chibanda M, Ortmann GF & Lyne MC (2008). Institutional and governance factors influencing the performance of selected smallholder agricultural cooperatives in KwaZulu-Natal. *Agrekon* 48(3):293-306.

Competition Commission of South Africa (2006). *The South African agricultural industry in context.* Research Report [Online]. http://www.compcom.co.za/policydocs/agric_cops.doc (Accessed 15 February 2007).

Cook ML (1995). The future of US agricultural cooperatives: a neo-institutional approach. *American Journal of Agricultural Economics* 77(5):1153-1159.

Cook ML & Iliopoulos C (1999). Beginning to inform theory of the cooperative firm: emergence of the new generation cooperative. *The Finnish Journal of Business Economics* 4:525-535.

Cook ML & Iliopoulos C (2000). Ill-defined property rights in collective action: the case of US agricultural cooperatives. In: Menard C (ed.). *Institutions, contracts, and organisations: perspectives from New Institutional Economics.* Cheltenham: Edward Elgar.

Fulton M (2000). *New generation co-operatives.* Presentation to the legal awareness for marketing specialty agricultural products seminar by the

Alberta Agricultural, Food and Rural Development, Edmonton, Alberta [Online]. <http://coop-studies.usask.ca/NCG2.html> (Accessed 3/03/2007).

Gripsrud G, Lenvik HG & Olsen NV (2000). *Influence activities in agricultural cooperatives: the impact of heterogeneity*. Paper submitted to 'The Food Sector in Transition - Nordic Research', June 14-15, Oslo, Norway.

Hardesty S (2005). Positioning California's agricultural cooperatives for the future. *Agricultural Resource Economics Update University of California, Davis* 8(3):7-10.

Hendrikse G & Veerman C (2001). Marketing cooperatives and financial structure: a transaction cost economic analysis. *Agricultural Economics* 26(3):205-216.

ICA (2005). International Cooperative Alliance [Online]. <http://www.ica.coop> (Accessed 10/07/2007).

Iliopoulos C (2003). *Long-term financing in US and European agricultural cooperatives: emerging methods for ameliorating investment constraints*. Paper presented at the NCR-194 conference, October 29, Kansas City, USA.

Knight R (2006). South Africa 2006 - Challenges for the future. South Africa delegation briefing paper at Shard Interest New York [Online]. <http://richardknight.homestead.com/files/SouthAfrica2006ChallengesfortheFuture.pdf> (Accessed 3/03/2007).

Lyne M & Collins R (2008). South Africa's new Cooperatives Act: a missed opportunity for small farmers and land reform beneficiaries. *Agrekon* 47(2):180-197.

Lyne M, Hamman J, Mitchelle K, Ferrer S, Zille P & Thomson D (2007). *Investor friendly organisational arrangements for group-based land reform projects*. Report commissioned by the Maruleng and Bushbuckridge Economic Development Initiative (MABEDI), Mpumalanga, South Africa.

Ortmann GF & King RP (2007). Agricultural cooperatives 1: history, theory and problems. *Agrekon* 46(1):40-68.

Porter K & Scully GW (1987). Economic efficiency in cooperatives. *Journal of Law and Economics* 30(2):489-512.

Poulton C & Lyne M (2009). Coordination for market development. In: Kirsten J & Vink N (eds.). *The economics of institutions: theory and applications to African agriculture*. IFPRI/John Hopkins University Press.

Smith DJG (1979). The cooperative field: an overview. *Agrekon* 18(3):11-15.

Sykuta M & Cook M (2001). A new institutional economics approach to contracts and cooperatives. *American Journal of Agricultural Economics* 83(5):1271-1277.

Zeuli KA (1999). New risk management strategies for agricultural cooperatives. *American Journal of Agricultural Economics* 81(5):1234-1239.

Appendix A: A constitutional audit of the case study cooperatives

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