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"Co-operative Identity" – a Concept for Economic Analysis and Evaluation of Co-operative Flexibility: the Dutch Practice and the Hungarian Reality in the Dairy Sector

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Abstract

Problems of farmers and co-ordination of (agricultural related) activities can not be solved simply by EU and/or government support; instead, private-market co-ordination institutions, like emerging producers' groups and co-operatives seems to be vital in establishing bargaining power. In theory and according to Western European (Dutch, Danish etc.) and US practical experiences, one of the main important private institutions which can strength producers and help to co-ordinate (agricultural) chains is the co-operative form. In order to be able to fulfil the basic co-operative aims and to be able to compete in a more market-oriented environment (e.g. more liberal agricultural policies, opening European and world market, etc.) they will execute new marketing strategies. To be able to implement such new marketing strategies, co-ops have to collect more risk-bearing capital and this is currently precipitating some fundamental financial and organisational changes in Western European agricultural co-ops. To be able to keep the basic co-operative character, they are undertaking internal and external organisational changes, which in a number of cases will create so called new co-operative structures/models.

In this paper, the concept of the "co-operative identity" (consisting from the definition, aims and functions of co-operatives, as well as the so-termed co-operative principles) is proposed to serve as a general theoretical background for the economic evaluation of the flexibility of (agricultural) co-operation. Approaching the concept of the so-termed "co-operative identity", the Dutch (diary) co-operative development is used as an example, which suitable illustrates and represents the processes currently taking place in the European Union. The main goal of our study is to show the Dutch dairy co-operative development, with conclusions for the Hungarian situation. It is necessary to state that the Hungarian agriculture and co-operatives are on a different stage of development, so one can not expect the most recent organisational forms to be established in Hungary, especially taking into account that the Hungarian dairy market have

already dominated by multinational non-co-operative (investment oriented) firms. However, further establishment of the collecting and the bargaining type co-ops and the development of existing dairy producers' groups would be essential for the Hungarian milk producers.

Keywords
co-ordination, integration, agricultural co-operation, dairy co-operatives, co-operative identity, co-operative principles strategies, organisational structures, the Netherlands, Hungary, producers' group

JEL classification: Q13, L14, L22

1. Introduction and background

Problems of farmers and co-ordination of (agricultural related) activities can not be solved simply by EU and/or government support, private-market co-ordination institutions, like *emerging producers' groups and co-operatives seem to be vital in establishing bargaining power* against processors, retail chains etc.. In theory and according to Western European (Dutch, Danish etc.) and US practical experiences, one of the main important private institutions which can strength producers and help to co-ordinate (agricultural) chains is the co-operative form. Agricultural co-operatives used to be considered as the *classical form of co-ordination of different and independent farmers*. Co-ops were founded in order to protect members against the large commercial and/or industrial companies which are often in a monopolistic or oligopolistic position. In Western Europe, for example in Holland and Denmark these co-operatives have emerged through a *voluntary base* (Meulenberg, 2000). They have a so-called "*double character*": toward the market: they are market oriented, but the surplus - made by the co-operative - goes to the farmer-members, in proportion of their product delivered/bought to/from the co-operative, after deducting the costs of the co-operative's operation and funds for reserves.

Generally speaking the main economic aim of the (agricultural) co-operative in a market economy is to *increase the income of its members***.** Mentioning other type of advantages, co-ops can *reduce productions costs and also decrease and internalize transaction (information) costs*, with a better flow of information on consumer demand. Co-operatives can also *lower both economic and technological uncertainties* and therefore *decrease transaction costs* (Harte, 1997; Hendrikse – Verman, 2001b; Ollila – Nilsson, 1997; Royer, 1999; Szabó, 2002; Szabó – Fertő, 2004a,b).

The co-operative is a *partial/hybrid form of vertical integration*, which means that farmers retain a relatively high degree of independence of economic action: "Thus, it is possible to reduce transaction costs and uncertainty through the cooperative and maintain the entrepreneurial incentives through the market at the same time." (Ollila, 1994: 88)

The *basic research problem of present paper* is that fact that the International Co-operative Alliance (ICA) Statement on Co-operative Identity (ICA, 1995) alone is *not a sufficient basis to enable the substance of (agricultural) co-operation to be grasped*, at least not from economic aspect. ICA has got - through member organisations - about 800,000,000 members which number underlines the importance of the statement. In some countries this "declaration" is the basis for legislative purposes and/or distribution of different types of subsidies, tax redemptions etc.

It is also point of importance that public opinion – thus the potential co-operative members form their view about co-operatives according to the widely known ICA statement (especially the

principle of one-member – one vote). Therefore one can get an image of an uncompetitive, inflexible and ideologically influenced organisation without any relevance to the practical (economic) life. In turn, these kinds of opinions *highly influence the public view of the economic justification and competitiveness of the co-operative form*.

In this paper, a new "*co-operative identity" concept will be applied* to be able to carry out *dynamic* and (may be at a later stage of the research) *comparative analysis of* (agricultural) co-operatives. The concept of "co-operative identity", *consisting of a definition, aims and functions of co-operatives,* as well as the so-termed *co-operative principles*, serves as a general theoretical background for the economic evaluation of the flexibility of agricultural co-operation. Developing the concept of "co-operative identity" agricultural *marketing (dairy) co-operative development has been used as an empirical basis***,** which example suitably illustrates and represents the processes taking place in the European Union. Empirical evidence supporting the theoretical results are based on investigations of agricultural marketing and processing co-operatives in the dairy supply chain, focusing on the responses of marketing (dairy) co-operatives to recent changes taking place in the business environment.

The following were *essential to develop the concept* and achieve the goal mentioned above:

- literature research on co-operatives and co-operation, agricultural marketing and agribusiness,
- collecting secondary (statistical) data,
- interviews, discussions of questions and problems on co-operative theory and practice with experts,
- excursions and meetings with people working in the field,
- case study analyses.

The remainder of the *paper is organized as follows*. After Introduction, in the second section the "concept of the co-operative identity" will be discussed; while in section 3 the Dutch dairy co-operation, as a case study, provides empirical evidence concerning strong and flexible co-operative identity. Section 4 summarises recent legislation and regulation regarding Hungarian co-ops. Conclusions are presented in section 5 and some suggestions for further comparative research on the "co-operative identity" according to each country and different branches and sectors in order to see the substance and dynamics of co-operation from different economic and non-economic aspects are proposed as Afterthoughts.

2."Co-operative identity" - a concept for dynamic and comparative analysis

2.1. The elements of the "co-operative identity" concept

The idea of examining co-operative aims, principles and the needs o co-operatives according to each sector in agriculture was mentioned to the author by Zwanenberg (1995). This was in contrast to those who had sought to identify a general set of co-operative principles (ICA, 1995). This was a starting-point for the author's attempts to develop a new concept of "co-operative identity" (Szabó, 1995, 1997).

The *elements of "co-operative identity"* are: the *definition, aims (purposes) and functions (roles)* of co-operative(s), and also the *co-operative principles*, which are also a major component of identity. This concept at first sight seems to be very similar to the new International Co-operative Alliance (ICA) Statement on Co-operative Identity (ICA, 1995), which "...includes a definition of co-operatives, a listing of the movement's key values, and a revised set of principles

intended to guide co-operative organizations at the beginning of the twenty-first century" (MacPherson, 1994: p. 8).

However, there are some *very important differences between the two concepts*. Firstly, on the one hand, it is necessary to underline the sociological and ideological aspects in the ICA case. The whole set of values and principles, even the terms used (value, movement, guide) to describe the identity represent a kind of *ideological atmosphere around the ICA co-operative concept underlining the social characteristics* and social aims of the co-operatives.

On the other hand, *the first concept contains additional elements of the co-operative identity* (besides definition and principles): purposes (aim) and functions (roles). These elements are more relevant to the explanation of the economic substance of (agricultural) co-operation. Developments (changes) in practical economic life with respect to (dairy) co-operatives can be also discussed using these terms.

Secondly, in order to be able to carry out an analysis of the dynamics of practical co-operative life and development, the *aims (purposes) must be distinguished from the functions (roles)* of co-operatives. In the case of a solid co-operative identity, the initial main "co-operative" aims are largely fixed but the *functions of the co-operative are alter* over time, *in order to be able to fulfil their basic task*.

Since, in the case of the ICA statement, only very general aims can be found (including in the definition) and there is nothing written about the functions which are subject to change over time, we have to conclude that the *ICA concept is not a sufficient basis for grasping the substance of co-operation* from economic aspect..

2.2. Definitions of the co-operative

The theory and legislation on co-operatives contain hundreds of definitions that vary, sometimes fundamentally. The authors and "fathers" of those definitions sometimes consider their "child" as a short summary of the co-operative identity. In fact, they are not a sufficient means to find the substance of co-operation**,** particularly from an economic viewpoint. However, it is necessary to define what is meant by the term "co-operative".

In this study, as a starting point, we use the *basic American co-operative concept* which reflects three basic criteria: "A cooperative is a user-owned and user-controlled business that distributes benefits on the basis of use" (Barton, 1989a, p.1). The definition above can also provide the main points of the Dutch and Danish approach.

Three main relations exist between the member and the co-operative: the product, the capital and the democratic managing-control line. The 'economic' co-operative principles (see later) are based on the three main connections mentioned above, as they were formulated in coherence with the elements of the co-operative's business activity with its members.

To be able to compare with the above definition, it is useful to recall here the *definition of a co-operative included in the ICA Statement* which underlines the association character including social and cultural aims: "A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise." (ICA, 1995).

2.3. Co-operative aims and functions

The actual situation and circumstances will determine (at least in a working market economy) which objectives will arise from an economic environment. Basically two main groups can be distinguished:

1. economic and

2. social aims.

In the literature and in practice other basic aims can in places be found such as political, religious, and cultural ones, but these are not particularly relevant in this case. In general, to be able to grasp the co-operative identity from an economic perspective in a capitalist environment, two groups of aims are of crucial importance. As it was mentioned above, generally speaking the main economic aim of the co-operative is to *increase the income of its members*.

The real need for co-operative(s) is a question of importance concerning their long-term. In order to act efficiently in the interests of their members, real (mainly economic) incentives are essential for establishing co-operatives at the primary level and (in some cases) organising them into centres through regional organisations. The Dutch and Danish systems of "practical" agricultural co-operation are very good examples to underline the outstanding real economic necessities for establishment of a viable and flexible co-operative system.

According to the co-operative literature reviewed the *main incentives* for the establishment of *co-operatives as a form of vertical integration* are the following.

First, co-operatives traditionally can provide *access and secure markets* for the long term, therefore give *protection for independent farmers* against the large commercial and/or industrial companies. They can also carry out *services otherwise not or available at very high costs*.

Second, co-operatives *build up countervailing power* and above a certain economics of scale they act as *competitive yardstick* for non-co-operative, conventional firms (CF) and the whole sector with a *better influence on the market and prices*.

Third, co-operatives in some cases can *increase technological and market efficiency* and carry out activities with a *higher added value*.

Fourth, co-operatives can *decrease and internalise transaction (information) costs*, with a better flow of information on consumer demand - closer proximity of consumer to farmer and with a unified decision role between two or more levels of the marketing channel. The co-operative can also *lowering both economic and technological uncertainties*, therefore decrease transaction costs.

Finally, co-operatives can *increase the income of the members* above by lowering transaction and production cost, by *reimbursement of the surplus for the members made at another level* of the marketing channel.

In addition to economic aims, there are *several non-economic reasons*, which can also be important for the successful development of co-operatives (Hakelius, 1996). First, co-operatives used to be considered as organised trusts, which can determinate the success or failure of a certain co-operative: "Trust (between the member and co-operative, author) is a major co-operative advantage" (Spear, 1999). Second, the social and informal network of members or potential members is also relevant as a determining factor in decreasing transaction costs and in the process of establishing and the running of the activity of a co-operative. Better knowledge and confidence (Røkholt, 1999) among members is vital to how co-operatives can be highly efficient in terms of the management of human relations. Stryjan (1989) deals with organisational consequences of different membership and ownership issues in his seminal book, which also emphasises the human or "soft" side/way of organising activities and thus organisations.

As mentioned earlier, in order to be able to grasp and explain the dynamic changes of practical co-operation, the *aims (purposes) must be distinguished from the functions (roles)* of co-operatives. *In the case of a solid co-operative identity*, the initial main *"co-operative" aims* (taking into account that the country, branch and sector in which they are operating remains unchanged) are largely *fixed* but the *functions of the co-operative are alter* over time, in order to be able to fulfil their basic task. For example, in the case of Dutch dairy co-operatives, price

leadership was the function in the past, but - reflecting to changes in the economic and policy environment - it had to change into market leadership to be able to serve the members according to the unchanged main aim, namely to increase the income of the farmers.

2.4. Significance and different sets of the co-operative principles

Although the co-operative identity has involved some other aspects beside the principles, for example the definition(s), aims, functions, etc. of the co-operative and co-operation, for most co-operators the so-called *co-operative principles are the cornerstones of the evaluation of the validity of a co-operative*. They can prove that a co-operative is genuine one or not. It is necessary to distinguish the principles from the policies and practices of co-operatives.

According to Barton (1989b: p.23) *the following terms can be distinguished*:

" A principle is a governing law of conduct, a general or fundamental truth, a comprehensive or fundamental law".

" A policy is a wise or expedient rule of conduct or management. It is not a universal, unchanging truth but a highly recommended course of action, given the situation."

" A practice is a usual method, customary habit, action, or convention; a frequent or usual action. Substantial flexibility exists ... respecting the cooperative definition, principles and policies."

Barton gives a wider explanation of the terms outlined above, but these shorter definitions are appropriate for our purpose. Amongst other points, Barton also states in his (quoted) paper that the co-operative principles with the definition of a co-operative "...preserve the essential objectives and uniqueness of the cooperative form of business" (Barton, 1989b: p.23). From this observation it is clear that the *co-operative principles are essential to grasp the co-operative identity***,** which opinion is shared by other authors (Davis, 1995; MacPherson, 1994; Røkholt,1999 etc.) as well.

According to Craig and Saxena (1984): “The strength of the principles has been that they are stated in a simple, strait forward and easily understood way. This is an important characteristic. Other characteristics include internal consistency and logic applicability to organizations irrespective of the external environment in which function; and long term relevance.” (Craig – Saxena, 1984: vi)

According to Barton (1989b) there are *four distinctive classes of principles* which more or less overlap with the ICA principles (see later) and also with each other. These main groups are the *Rochdale*, the *Traditional***,** the Proportional and the Contemporary class of co-operative principles. However, our main aim is not to examine the whole scale of the optional sets of co-operative principles; therefore, details of this four classes can be found in the book cited above (Barton, 1989b: 26-30).

The elements of the *Proportionality class* of principles of co-operatives are in accordance with Barton (1989b: p.27):

"1. Voting is by members in proportion to patronage

2. Equity is provided by patrons in proportion to patronage

3. Net income is distributed to patrons as patronage refunds on a cost basis ".

The *Contemporary set* is almost the same, but differs from the previous one in the fact that the proportionality basis is not stressed in the first and is absent from the second point.

The performance or proportionality concept means, according to Diepenbeek (1989: p.38), that "...in the distribution of cost and proceeds of the cooperative amongst the members... an economic key is used, namely a distribution according to the economic principle of proportionality - at which the social key of personal need or social claims in redistribution of income is rejected." The proportionality concept (see Barton, 1989b: p. 31) can be considered a

suitable starting-point for the analysis of co-operative identity and the developments currently in progress in European (for instance the Dutch) "practical" agricultural co-operation (van Diepenbeek, 1989: 38; van Dijk, 1994/1995).

Reflecting the recent changes in economic and social life all over the world, the *ICA* had established a working group (Böök, 1989, 1992) to *review the current basic values and principles of co-operation*. The new statement containing the final list of the new principles was made in Manchester in September 1995 (ICA 1995). The seven principles, which have been more or less accepted and implemented in most countries, are the following:

1. Voluntary and Open Membership
2. Democratic Member Control
3. Member Economic Participation
4. Autonomy and Independence
5. Education, Training and Information
6. Co-operation among Co-operatives
7. Concern for Community

In order to be able to exploit economic (and non-economic) advantages, apart from the co-operative principles, the *marketing co-operatives use long, medium and short term contracts* to secure the raw material for themselves and to be able to govern the whole marketing chain (Hendrikse - Veerman, 2001a). The *co-operative*, in the modern sense*, is a hybrid formula*, because above the common property the members sign a special "multilateral contract". The statute or bylaw, which are the formal legal guarantees that the co-operative will never act against the members and that members will enjoy their advantages and fulfil their duties. The bylaws also defend third parties against the co-operative, making it possible to sign contracts and obtain loans and credits in the name of the co-operative. "The cooperative has, in a way, both markets and hierarchies within the same organisation" (Ollila, 1994: 88).

The organisational form and decision-making (control) mechanism of the co-operative and the so-called co-operative principles (ICA, 1995; Hakelius, 1996; Røkholt, 1999) can be taken into consideration as formal-legal securities (guarantees) of trust between the member and co-operative. Hence the so-called hold-up problem (Hendrikse – Veerman, 2001b; Karantininis – Nielsen, 2004; Royer 1999; Staatz, 1984) usually not as significant like in any other contractual relation between a farmer and Investment Oriented Firms (IOF).

Beyond the economic advantages of co-operatives there are exist some *non-economic* ones *connected to member relations and co-operative principles*. Very important advantages of the co-operatives are based on the more closely and informal connection among the members and between members and co-operative. Røkholt (1999, 2000) distinguishes 4 types of member loyalty: power based, habit based, tradition based and solidarity based. These are the basis for the co-operative to be able to use the co-operative rationale as comparative advantage and able to develop strategies utilising strengths instead of eliminating weaknesses of the co-operative form as suggested by economic theories, like transaction cost based considerations. All in all, network of personal relations among the members represented and secured by co-operative principles are very important connections from the point of the co-operative rationale (Røkholt 1999).

However, one has to keep in mind that *co-operative principles* along with the democratic decision making process in co-operatives were/are sometimes *obstacles from the point of flexible business activity*, especially in gaining more risk-bearing capital for more activities with higher added value. Moreover, *1 member – 1 vote principle* which was/is considered as cornerstone of proving whether a co-op a genuine or not, in case (e.g. in marketing type of co-operatives) is *not right from economic point of view*. For example in case of a dairy co-op the member supplying

much more milk to the co-operative processor does take much higher risk than another one with less milk to deliver and the activity of the co-op affects more deeply the farming and income of the "bigger one". Additionally, the *limited if any interest paid* on the capital invested into the co-operative (e.g. co-operative shares) *weakened and limited the financial positions* and possibilities of carry out new (marketing) strategies of the co-ops and their members.

Multiple voting system, might be related for example to proportionality principle, with clear and rational limitation of votes per member can *help co-operatives to able to keep members with higher patronage and also to be able to gain more capital from members*. One of the new features of New Generation type of co-ops is the up-front investments need to be made in proportion of the planned patronage of the members.

We are going to analyse the main relations between various elements of the "co-operative identity" in the following section.

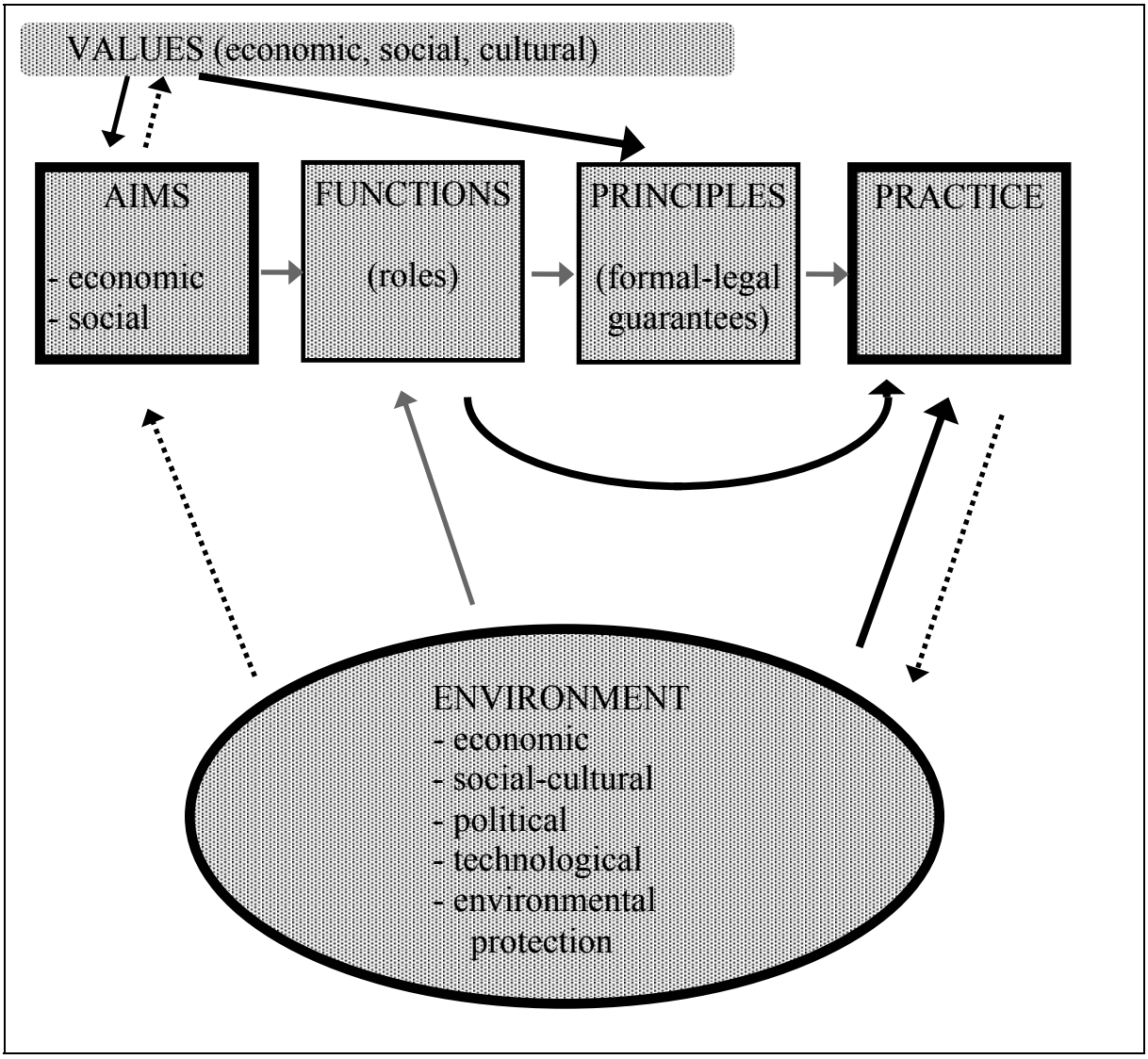
2.5. Relations of elements of the "co-operative identity"

After analysing the concept and the elements of the "co-operative identity" let us examine how these are connected in real life. It is also necessary to underline the main "dangers" awaiting co-operatives without a strong and clear identity. The main connections between the elements of the "co-operative identity" and also their relations to the "mental" and the "real" environment can be seen in Figure 1.

Naturally, in every society there is a quite broad system of "mental" values, which is the basis for every social action in the society, including economic activity. These types of values can be divided into a number of classes. The three most important ones, i.e. the economic, the social and the cultural group of values can be seen in Figure 1. These are cornerstones of a consistent system of social thinking, which is indispensable to the accomplishment of activities such as economic activity. The thin black arrow in the upper part of Figure 1 represents the influence of the values on the basic AIMS of co-operatives. Naturally, these depend on the importance of each value in a society. If there is a consistent system of values, it is easier to set for the co-operatives basic aims, which can be valid for a very long time. The Dutch and Danish systems of "practical" agricultural co-operation are good examples to stress this aspect.

Cataclysm, such as a change from one political-economic system to another, can change the spiritual basis for co-operation. To give an example the transformation process taking place in Eastern and Central Europe at present can be cited. Naturally, if a "co-operative identity" strong enough, the kinds of aims set by the co-operatives can exert an influence on the (economic, social, cultural, etc.) values, but most often this is quite a weak effect (see broken black arrow in Figure 1). Therefore it can simply be stated that co-operatives, similarly to any other organisation in economic or social life, are encased in the invisible spiritual environment of the system of social thinking and ethics of a society. Moreover, the widely observed new trends of globalisation and internationalisation which are emerging all over the world, particularly in Europe, broaden this spiritual environment.

Figure 1 Elements of the "Co-operative Identity" and their Relation



Consequently, the aims of co-operation in a country or society usually depend on a broad-based system of values. There are many types of aims (purposes) which can be set by co-operators all around the world. The two most important types of basic aims, the economic and the social ones, are shown in the first square in the upper right part of Figure 1, which is the starting point of our actual examination process. As stated above, co-operators in every society can define other aims, such as cultural or religious ones, but the basic purpose of the co-operative activity should be the economic one; otherwise co-operatives cannot survive without the aim of the state or the government. If a co-operative has a sound economic and financial basis, it can set other aims, as can be observed in quite a number of countries. However, to be able to remain independent from the state and any other political or economic organisation, it is essential to organise economic activity in an efficient way. This is particularly true in the case of co-operatives with only economic aims.

Members or potential members can define the FUNCTIONS (roles) of the co-operative in order to be able to fulfil the main aims (see the grey arrow in Figure 1). Since research is to be carried out to examine the usefulness of the "co-operative identity" concept for an economic analysis, the case is being dealt with on a deeper level when co-operatives have only economic aim or aims.

In a market economy running in a normal manner, the economic purpose can remain the same, even in a changing business and social life. Naturally, the functions can alter according to changes in the economic, social, political and technological ENVIRONMENT. One can follow this way of influence of the environment on the (altering) functions of co-operatives in Figure 1 (see the grey arrow).

According to the functions within a consistent "co-operative identity" co-operative principles can be formulated as formal-legal guarantees. A grey arrow shows the connections in a normal situation between functions and the co-operative principles.

The "PRACTICE square" can be found at the end of the examination process, as shown in Figure 1. According to the types of the principle(s), co-operatives shape their own and different business in practice. The term "practice" denotes daily operations which are indispensable to the accomplishment of co-operative activity, above all taking economic activity as a basis. It is necessary to underline the fact that, in a strong system of co-operation, with a flexible and clear "co-operative identity", the "practice square" is the final "module" in the process of formulating co-operative activity. The normal way of shaping co-operative business can be followed via the four grey arrows in Figure 1.

However, emphasis should be laid on the point that effects exerted on co-operative activity by the environment are questions of importance. The quite weak connection between the elements of the environment and the co-operative aims is shown in Figure 1 (see the broken black arrow). Naturally, fundamental changes in the economic, social, political or technological circumstances can exert an influence on the basic purposes of co-operatives, but the main line is how the different elements of the environment can influence co-operative activity through the environment- functions connection (see the grey arrow between them).

It is also true that the day-to-day practice of co-operatives has an effect on some elements of the environment, particularly if co-operatives can build up a so-termed countervailing power (Galbraith, 1963; NCR, 1993). However, connections of this type are relatively weak (see the broken black arrow), with the exception of some examples existing in a few "co-operative countries". A common feature of co-operatives with an exceptionally strong and clear "co-operative identity" is the ability to restructure themselves in the adaptation process in response to new circumstances.

Lastly, but by no means least importantly, it is necessary to outline some "dangers" with respect to co-operatives with no sound identity. There are three main lines of potential dangers, as shown in Figure 1 by black thick arrows. When the values, listed above, by-pass the normal way of formulating co-operative activity (as can be seen in Figure 1 along the grey arrows), then there exist the danger that co-operative principles are being set without an examination of why they are indispensable guarantees. This type of misunderstanding can also be observed in the new ICA "Statement on the Co-operative Identity" (ICA, 1995). Neglect of real life economic analysis raises a question: whether it is worth formulating rules (principles) hanging in the air. Naturally, it is quite simple to establish a set of consistent principles based directly on some social, political, cultural values or ethics. But it is not at all certain that co-operatives following these kinds of principles will be viable ones and can survive in the rapidly changing environment. So it is probably better to follow the "grey line" (see the grey arrows from the "aims square" to the

"practice square" in Figure1) on the path of formulating co-operative activity, as can be observed for example in the case of the Dutch system of agricultural co-operation.

Another dangerous by-pass occurs when the "principles module" is absent from the above "grey line" and functions shape directly the day-to-day practice of co-operatives. In this case there exist no formal-legal guarantee according to which it is clear whether an organisation is co-operative or not. Therefore, the co-operative principle or principles are indispensable to the proving of the genuine co-operative substance. But it must be taken into consideration that co-operative principles can alter according to each country, sectors, branches, etc.. Therefore every kind of co-operation forms its own set of principles. One possibility is to accept and use the co-operative principles stated by the International Co-operative Alliance, after setting an aim or aims and a function or functions. It is also possible that one kind of co-operation can actually use only one principle, as the Dutch agricultural co-operatives do (proportionality principle). But these types of formal-legal guarantees are essential to the distinguishing the Investment Oriented Firms (IOF) from the "co-operative type of business".

Finally, it is necessary to analyse the third danger awaiting co-operatives in the rapidly changing world (see the thick black arrow from the environment to the "practice square" in Figure 1). So, there is a situation when there is nothing to do with "co-operative identity" (concept) at all. When elements of the environment, single or together, govern and conduct the every-day practice of co-operatives, there is no meaning if an organisation bears the name co-operative. This is because, when by-passing the normal route (see the grey arrows from the "aims square" to the "practice square" in Figure1), it is absolutely impossible to develop and save a sound co-operative identity. As the environment is changing day by day, "practice" will actually respond without measuring changes which have been made with respect to the co-operative aims and functions. Principles will not serve as guarantees or will be totally absent. These types of action are very dangerous for any type of organisation, but are ultimately fatal for co-operatives. The three main dangers outlined above can be seen in Figure 1, indicated by thick black arrows.

Let us briefly turn to the Dutch example to use the "co-operative identity" concept for an economic analysis of co-operative development.

3. Revolution in evolution - the Dutch co-operative identity in action

3.1. The substance of the Dutch co-operative identity

As we are going to investigate the Dutch co-operatives, it is obvious that we should use the so-called Dutch definition, which with reference to an agricultural and horticultural co-operative is:
"An economic organisation in which farmers or market gardeners collaborate permanently and put together parts of their economic activity (in general the market function), at joint risk and on joint account, in order to make the economic activity concerned as profitable as possible, while maintaining the self-supporting nature of the other functions of the agricultural enterprise." (NCR, 1993: 16)

As we can see from the Dutch definition, in the Netherlands (as in the USA) the co-operative is considered a "pure" economic association, only one of the potential organisational forms of the business activity, without any social aim. In the Dutch case a co-operative is considered mainly a marketing tool of the farmer-members. The main purpose (arising from the real economic need) in the Dutch case is only an economic goal: to increase the income of the members. In this sense,

it is really important to take into consideration (especially in the case of marketing co-ops) two purposes of importance (van Dijk, 1994/1995):
1. the continuity of the market position of farmers and
2. the return on the capital invested by the farmer-members
   - in the farms and
   - in the co-operative firm as well.

It is necessary to emphasise, that there is no direct social or public purpose aim. Of course there are some side effects and the increasing income of the farmers is good for their social position, but the social and the public purpose tasks are basically business of the state (social network). Concerning questions outside of the strictly speaking business activity farmers are organised by farmers' unions. To increase the income of their members is basically different from the basic purpose of the so-called agricultural production co-operatives (to offer working place and/or fulfil direct social aims).

The *basic aim* of the agricultural and horticultural co-operatives in the Netherlands has to be realised by the *extension of the economic activity of the individual farmers*. The expected continuity of the co-operative business connected to the members' activity is also one of the main incentives to establish and belong to a co-operative (Zwanenberg, 1995).

As we have stated above, it is really necessary to differentiate between the basic aims (purposes) and functions (roles) of the co-operatives in order to be able to explain the (economic) success and flexibility of a certain kind of co-operation. The Dutch example is a very good instance to describe the importance of this distinction.

One can find, as a common feature, that *in the past price leadership* was the term we could use to characterise briefly *the function of the co-operative*(s). On the macro level they have been acting as a "countervailing power" and on the micro level they have offered an optimum (milk) price for all products of the members.

The *basic principle*, in the case of the Dutch marketing co-operatives, is that the *product is central*, that is the "principle of the principles".

As a basic point, it is essential to consider that in fact in the practical Dutch agricultural co-operation there is only one principle in practice in order to achieve the "co-operative" aim: the proportionality principle (van Diepenbeek, 1989: p.38; van Dijk, 1994/1995 etc.). According to this, the most important thing is that the surpluses of the co-operative were distributed between them in proportion to the turnover (transactions) of the co-operatives. The members have to make contributions (investments) and they receive voting rights, with a certain limit of course, in proportion to their business with the co-operative.

3.2. Changes in the economic environment and developing new strategies

In order to examine the co-operatives' answers to their challenges we have to take into consideration the economic (market) and political environment they are working in. Fundamental changes in the economic and market environment concerning agribusiness in European Union are the following:

- saturated market for agricultural products in the EU,
- new, more market oriented directions in the CAP,
- enlargement of the European Union,
- changes in the WTO regulations, increasing import,
- health- and environment-sensitive tendencies in consumer behaviour,
- the recent developments in Eastern and Central Europe,

- increasing power of the retail networks and multinational firms in Europe.

Surrounded by these new circumstances, the (dairy) *co-operatives have to develop new marketing strategies*. Basically, in theory, "Agricultural co-operatives can follow two strategies to maintain market position and to gain new market access:
1. develop countervailing power; decrease competition among members; apply open membership policy; democracy; or
2. develop dominant positions in different market systems; manage quality and supply via competitive structures for members; hierarchy." (van Dijk, 1995: p.1)

Dairy co-ops, especially the larger ones, will possibly choose the second way ("Value added" strategy), while cattle and meat co-operatives (in the Netherlands) more or less follow the first one ("Bulk" strategy, cost efficiency).

We can also distinguish *internal and external marketing strategies*. According to van Dijk, (1994/1995), it is necessary to emphasise that the new marketing strategies will fundamentally be based on market-product combination using so-termed business units. That is the new wave of the way of thinking and also the manner of business. The external strategies (e.g. integral chain marketing) are developing and acting in order to come closer to the consumer, therefore co-operatives are going abroad (internationalisation strategy). Cross-border mergers, acquisitions and strategic alliances by co-operatives are all parts of that kind of (external) organisational innovation.

In order to fulfil new marketing strategies (especially brand development, product differentiation, vertical integration strategy), the co-ops *really need a huge amount of additional capital*. For example, to develop a new brand or make an acquisition is really expensive and the financing structure of the co-operatives (Zwanenberg, 1993; van Dijk, 1994/1995) is not fit for this. Therefore, co-operatives have trouble in following the strategies applied by the Investment Oriented Firms. Again, to be able to compete, the co-operatives need additional resources. The role of the so-called risk bearing capital will become very important in the future, as the type of business in which they are engaged requires a high level of risk bearing capital (LEI-DLO, 1995).

There are *two main groups of possible sources of additional investments*. Resources in the first group would be *offered by the members*. This could be limited in the future, because there exist two very important and current questions. Firstly whether the members can, and secondly whether they have the willingness to finance additional co-operative activities which are sometimes not really connected to their original business.

The *other solution* **is** to obtain this additional capital as *external risk bearing capital*. This has happened in Ireland in dairy co-operatives: they have floated co-operative shares on the stock exchange. It is a little strange, but it has been done and maybe that will be the future in the Netherlands and European Union. Another possibility in order to provide the necessary risk bearing capital for the new strategies is: to establish a special fund separately in the co-operative capital.

In order to obtain the necessary additional capital the co-ops *have to make some organisational changes*. Firstly, we shall deal with internal organisational questions. The co-operatives have to separate the first-stage (collecting, sorting the products etc.) and the second-stage activities (Poppe, 1993; van Dijk - Mackel –Poppe, 1993. The main aim of the latter activities is to increase the added value of the products. In order to be attractive for additional risk bearing capital the co-operatives have to make their organisation more clear to outsider investors. It is also necessary to do so for the success of their business activity as well.

In the new co-op models there are additional contracts between members and the co-operative, forcing the members to compete inside the co-op. In fact some of the new co-operative

models are acting as market institutions themselves (Cook, 1995; van Dijk, 1997; van Bekkum and van Dijk, 1997; Meulenberg, 1997; Nilsson, 1997, 1998, Ollila, 1989; Royer, 1999).

Amongst external organisational strategies, the role and methods of the *internationalisation process* of the agricultural co-operation is one of the most up-to-date and interesting questions. Some acquisitions and mergers have already taken place abroad, and we can say that the Dutch marketing co-operatives, especially the dairy co-operatives, are going to other countries. (Bijman, 1998; van Bekkum – Nilsson, 2000a,b; Boon, 1998; van Dijk - Veerman, 1990; Helder, 2000)

4. Recent legislation and regulation regarding Hungarian co-ops

According to Hungarian Central Statistical Office (CSO), on 30 September in the Year 2003 the *number of co-operatives* in the Hungarian economy is *5,561*, of which *1,561* co-ops work *in the agriculture and forestry*. This is the second largest number, after real estate, renting and business activity sector (1,939). Co-operatives are also exist in relatively great number in the wholesale and retailing sector (1,036).

The *definition* of the co-operative, incorporated into the valid co-operative law (CXLI/2000) and it is included also into the new co-operative law (X/2006) which was accepted by the Hungarian Parliament on 19 December 2005. The definition is *very complex*, however it is *in accordance with the international theory and definition(s) of the co-operatives*. The co-operative is an *economic organisation* and a *legal entity*, with *open membership* and *variable capital*, aiming to meet the requirement of *promoting* (complementing) the *members' business* (farming) and *in certain cases* to meet the demands of membership according to their *cultural, educational and social needs*. It is clear from the definition that the main aim is to promote/help the farming of the members, however the law *does not exclude the possibility of the collective (agricultural) production* in the co-operatives.

It is very interesting that the law makes *possible for the co-operative to require personal contribution from the potential members applying for membership*. The only exemption is the so-termed *investor-member* in the new law (60§/X/2006), which is a rather strange and new phenomena in the legislation regarding co-operatives. The members get co-operative shares in exchange for their investments and they are eligible for earnings per share according to the results of the farming of the co-op. The liability of the members is limited, it is only up to their financial contribution. According to the new law, members can be foreign citizens (natural persons) and also (Hungarian) legal persons as well.

Altruism appears in more paragraphs in the law. According to those parts, the co-operation between the members and the co-operative is not businesslike. However, as part of the co-operative's activity the co-operative has also business activities carrying out for third persons or parties. The co-operative is operating *on business at cost principle*, it does not aim to gain profits from the economic relations with members.

The *institutions of the self-governance* (democratic decision making) *are still the same as in the past*. The *one member – one vote principle is still valid*, everybody in the General Assembly has got one vote (democratic control), however the *earnings per share is depends on the transactions with co-operative or on the personal contribution* in the period. The investor-shares of the above mentioned investor-members are also eligible for earnings from the taxed income of the co-operative. Their exact proportion is determined by the general assembly.

The law fixed the *common rules for the organisational* changes, like merger, transformation into (joint stock or limited liability) company, demerger etc. It is a very new rule that in a case of merger, the result has to be in accordance with the relevant regulation of the competition policy. This regulation is aiming to avoid the monopoly position by certain co-operatives on the domestic market.

While there is *no exact data available on the number of dairy co-operatives* in Hungary, their market share from milk intake is probably less than 3% and the picture is even worse regarding the share of equity or turnover in milk processing industry (Szabó 1999). Only *milk-collecting* and later may be *bargaining type co-ops* will possibly to develop in Hungary during the next few years, since the "cards have been already dealt on the table": the Hungarian *dairy market has already been dominated by multinational non-co-operative (investment oriented) firms*.

There is space for the so-termed *Producers' Groups* regulated by *85/2002 (IX.18) Decree of Ministry of Agriculture and Rural Development* according to the European Union legislation in the Hungarian milk sector. The number of such Producers' Groups was 6 provisionally acknowledged and 5 officially certified in the dairy sector in November 2005. From the 6 provisionally acknowledged ones there were 5 co-ops and 1 LTD., while from the 5 officially certified ones there were 2 co-ops and 3 LTDs. Above the fact that the numbers are very low in the milk sector in Hungary, it is interesting to notice that other legal form (e.g. LTD) is also popular in choosing the organisational form, contrary to the Danish and Holland experiences.

5. Conclusions: Lessons for Hungary

The dairy co-operatives in Western Europe are specialised to process and sell the milk and milk products of their members. The most important types are the milk collecting-, bargaining- and marketing-co-operatives. In the latter case, in order to be able to fulfil the basic co-operative aim, new marketing strategies have to be used. To be able to compete in a more market oriented environment (e.g. more liberal agricultural policies, opening European and world market, etc.), some fundamental financial and organisational changes are taking place nowadays in Western European agricultural co-ops. We can conclude that to realise the *new marketing strategies* (dairy) co-ops have *to collect more risk bearing capital*. To carry out this task and also to *keep the basic co-operative character*, it is necessary to make some internal and external *organisational changes*, which in a number of cases will create so called New Generation or Entrepreneurial Co-operative structures.

Conversation process taking place nowadays *is a major challenge for co-operatives and probably more practical types of the new model(s) will emerge*. However, recent empirical evidence is sparse in this regard, and various studies reported controversial experiments on the viability of the co-operatives in modern agriculture. The bottom line is that *until the product/service line is the more important to the capital line* in a co-operative and principles can secure this relation, than *an organisation does act as a co-operative* despite the fact of its actual legal form.

There are some (vertical) co-ordination and market regulation problems in the Hungarian dairy market at the threshold of the EU accession. It must be emphasized that the problems of farmers and co-ordination of the dairy chain cannot be solved simply by EU and/or government support, but it seems to be vital in the case of emerging producers' groups, like co-operatives, to

be able to set up (Meulenberg 2000). However, it is necessary to state that the Hungarian agriculture and co-operatives are on a different stage of development (Fáró and Szabó, 1999), so one can not expect the most recent organisational forms to be established in Hungary, especially taking into account that the Hungarian dairy market have already dominated by multinational non-co-operative (investment oriented) firms.

We have carried out an empirical research on examining contractual relations in the dairy sector in Hungary in 2005 (Szabó and Bárdos, 2005, 2006). Aims of the research were to present a theoretically structured framework of contracting arrangements of milk producers based on Transaction Cost Economics' predictions and to carry out an empirical analysis of the key determinants of governance structure between dairy farmers and processors in Hungary from economic, legal and cultural points of view. With the help of *Hungarian Dairy Product Council,* we carried out a postal survey among milk producers in the second quarter of 2005. With the help of empirical research the following main research questions have been asked: how contracts are arranged, what kinds of diversifications exist in contracting practice and what the driving forces behind the chosen governance structures are. We also tried to find what kinds of coordination means can be used to be able to harmonise producer-processor relationships. As a conclusion, we underline the importance of Western-European experiences and the need for more producer-owned organisations, like co-operatives and producers' group in Hungary since we found that higher volume of milk sold has got an effect of better countervailing power. So, further establishment of the milk-collecting and the bargaining type co-ops and the development of existing dairy producers' groups would be essential for the Hungarian milk producers.

Afterthoughts: extended interdisciplinary research activities on the substance of co-operation needed

Economic co-operative theories alone (which have been used to date) are insufficient to define the substance and advantages of co-operation from all aspects (Røkholt, 1999, 2000). Therefore, it is necessary to *propose new, interdisciplinary research* (including comprehensive theoretical overview) *on the substance of co-operation* and emphasise *the importance of drawing together insights* across *the social sciences***,** using the results and contributions/intersections of the various fields of economics, law, marketing, financing, organisational studies, management sciences ("hard" sciences), and also some elements of philosophy, psychology, sociology etc. ("soft" disciplines). This would be based on a positive (economic-analytical) scientific approach. It would differ from the ideological-normative approach to co-operatives, since it would preserve its *scientific character* and *neutral fashion without* normative judgements or *actual use for political purpose***s** and/or social changes.

To able to analyse the dynamics of co-operative development and to be able to grasp the substance of co-operation, *"co-operative identity"* might be a *useful concept/starting point, especially if comparative research* will be possible to be executed.

It would be important and useful to extend research activities and to carry out *comparative research on co-operative identity according to each country and different branches and sectors of the economy* in order to see the substance of co-operation from an economic aspect. In the sense of the considerations proposed in this paper can be regarded as a preliminary study for further research. The author would be grateful to any comments and/or suggestions, including ones for future collaboration in any issues addressed in the study!

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