Leadership may have decisive influence on successful transition of production type cooperative\textsuperscript{1}

Poster background paper

By

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1. Introduction and Problem Statement

Most of Central East-European countries have had large scale farm structure over decades most of which were broken up after radical reforms. In pre-reform period agricultural coops had decisive share (some 50 \%) in Gross Agricultural Output (GAO) in Hungary. At the beginning of the 90s 7-10 \% of coop members decided to leave the coops. On the other side, number of the traditional production coops decided to maintain cooperation under market conditions.

The research gives an insight into the motivations of individual farmers as well as that of production coop members and underlines those factors pushing individual farmers to cooperate by establishing marketing coop on the one hand and, members of traditional coops to choose the way of maintaining cooperation to adjust on the other.

2. Methodology

The case study based on research in literature and interviews. Field work was done in one traditional coop and in one newly established marketing cooperative. Both coops are located in the same town in Eastern part of Hungary. Besides interviews with directors of two coops and of a key person of the marketing coop 5 members in each coop were asked to answer questions of standardized questionnaire.

More recently social capital has been focused by researchers pointing out it is one of the key elements of economic growth measured by the level of trust. Level of “social capital depends on person’s

\textsuperscript{2} Reserach has been made under IDARI project WP3 coordinated by Humboldt University
connections (whom they know, but also connections through common group membership), the strength of these connections and resources to their connections.” (Sobel, 2002).  IDARI Project WP3 deals with social capital, governance, and institutional innovations by analyzing processes of achieving cooperation, and to understand the failure of cooperative strategies (Murray and Beckmann, 2004). To understand the concept of trust, communication and social learning are focused by case studies. The extent of networks of relationship is determined by prevailing social norms of the group, the necessity for interaction, and motivations of individuals to interact (Murray, 2004).

3. Objective of the Case Study and Hypotheses

In Hungary a mix of centrally panned and market systems have been existing since 1967 when price setting, taxation and wage control were major tools of agricultural policy to regulate supply and demand. Household production of agricultural coop members has been a national characteristic since 1961 and has been deeply integrated by coops since then.

In 1992 a law was passed on coops how to be transformed to meet new requirements. During transformation there was a possibility for any coop member to leave as individual or as a member of a group.

Success of adjustment and restructuring of agricultural coops depended very much on expertise of leaders on one hand and, the trust of members in leaders and institutions on the other.

Focus is given on how a production type coop could manage its adjustment by using social capital on one hand, and insight will be given on how a new cooperation was set up by individuals based on trust established after radical reforms.
Five hypotheses were formulated:

1. *Where trust in formal institutions is low, high transaction costs are experienced in dealing with the state and, actors will rely on informal institutions to solve their problems of collective action.*

2. *The more frequent and complete the communication between agents, the greater the cooperation should be tested.*

3. *Reducing transaction costs generates changes in governance structure.*

4. *Prior to reforms social capital in CEE countries was low.*

5. *Although, market is based on competitive forces, a network of cooperation is nevertheless required for its sustenance.*

### 4. Analysis

Production Coop „BÉKE” (Poór)

Coop „BÉKE” was founded on June 27, 1955 by the poorest peasants in town having 73 ha agricultural area altogether, but within half year time it went up to 570 ha. Both number of coop members and size of cultivated area were increased significantly in 1960. Since 1967 farms became interested in producing profits. Because of enlarged size of production corporate governance of the coop “BÉKE” was changed in 1978. The coop won the award of “Co op of Excellence” several times.

The president being in service for 27 years, retired and new president was elected in 1990. New coop leadership decided to follow an offensive policy and, executed distributing part of the land and assets among members and employees backed by law. After passing the law on transformation face to face negotiations by president were carried out with all members who were thinking of leaving. Finally 64 out of 960 members (some 7 %, below national average) have left the coop.

After being transformed coop leadership decided to follow its own way. In coming years a total 100 % leverage buy out has been carried out in case of Agricultural coop “Zelemért”, a turkey plant was bought and two more beef and one pig production units have also become Coop “BÉKE” ownership.
Finally, the coop merged with Agricultural Coop “Agro-Balmaz” in 2000 and became one of the biggest agricultural coops at national level. Near 600 people work for the coop in 26 different units running business cooperation with more than 100 entrepreneurs and cultivates the land area of 7000 ha owned by 4000 landowners.

Purchasing and Marketing Cooperative of “Hajdú Gazdák” (PMCHG)

Agricultural Association of “Hajdú Gazdák” was established at the beginning of the twentieth century and has played an important role until the communism regime came into force. After 1990 individual farmers wanted to make this Association work again. First, ‘Farmers’ Club was established in 1993 with the objective of “representing the interests of the members improving the skills of producers increasing both the output and the quality of production, promoting marketing the products, increasing the productivity of the soil and protecting the environment.” (Mónus, 1999). Farmers’ Club was succeeded by Purchasing and Marketing Cooperative „HAJDŰ” (PMCH) in July, 1996 focusing on gathering and spreading information, joint purchasing of inputs and marketing the products. In 1999 Purchasing and Marketing Coop of “HAJDŰ GAZDÁK” (PMCHG) was established to access government support.

4. Methodology and Analytical Framework

IDARI Project WP3 deals with social capital, governance, and institutional innovations by analyzing processes of achieving cooperation, and to understand the failure of cooperative strategies. To understand the concept of trust, communication and social learning are focused by case studies (Murray and Beckmann, 2004). Murray (2004) underlined that the extent of networks of relationship is determined by prevailing social norms of the group, the necessity for interaction, and motivations of individuals to interact.
Chloupkova et al (2003) have made a comparison on social capital development between cooperatives in Denmark and Poland and concluded social capital was higher in Denmark than in Poland because during communist regime social capital was destroyed in Poland. Valentinov (2004) pointed out that in all these approaches social capital has played a decisive role concerning the outcomes of the reforms. Each approach was shown to reveal some specific aspects of social capital concept and additional findings were concluded. It is a fact that social capital substantially declined in CEECs following radical reforms.

The leadership issue

After having new agricultural policy introduced in 1990, it was a real challenge for coops to adjust. In Hungary there were only 127 out of 1441 coops that could not meet new legal needs until the deadline and have disappeared. The rest decided to continue cooperation. However, number of them have gone bankruptcy and disappeared in late 90s and early this decade.

It turned out that leadership and the trust of members in leaders played key role in adjustment. Cremer and van Knippenberg (2005) showed that leader self-sacrifice has positive effect on cooperation. Vught (2002) concluded that the effectiveness of leader solutions to social dilemmas depends upon the fit between leader characteristics and member expectations.

5. Visual presentation of actors and their interactions

Figure 1 deals with actors of Coop "BÉKE" at the beginning of transition. Width of arrows in figure 1 reflects the weight of a given link.

In the beginning of nineties social capital in general was a bit stronger among members of Coop "BÉKE" than that in Farmers’ Club due to successful development of collective work achieved, however, in some areas the picture was the opposite. Previous president of the Coop "BÉKE" has had high level of trust of members. Atmosphere between leaders and members have been sufficiently good, legal environment was transparent and stable. High level of trust in leaders remained high after
electing the new president of the coop. However, after radical reforms, trust in state institutions, legal environment and agricultural policy declined as government preference went to supporting family farms but not coops.

Figure 1. Actors and their interactions in Coop „BÉKE” before making decision on future development.

6. Determinants, Effects and Processes of Cooperation and Rural Institutional

Data from interviews will be analyzed and similarities and differences will be discussed.

6.1. Role of trust/mistrust and opportunism

Research question: Are high levels of trust an effective means of reducing transaction costs in the case study?
Trust towards formal institutions differs in the two coops. Members of PMCHG have low level of trust in current government officials and EU institutions. In contrast Coop members of “BÉKE” trust stronger in national government and that in EU institutions was also above average. However, if trust levels in state institutions are low then to reduce transaction costs people look for informal institutions to solve their problems. Hypotheses 1 was justified.

6.2. Role of communication and learning

Research question: Is communication used as a source of power by central actors within the case study, in terms of opportunism by limiting access to information?

All ten interviewees said they were satisfied with the information they had been provided. If not, then additional efforts made has been proved efficient and brought the missing information. As level of communication affects the level of cooperation it can be stated the level of cooperation has not been handicapped by shortage of information.

In the two cases people have used different channels of communication at different intensity to obtain sufficient information. Communication has not been used as power by central actors, but as a bridge through which more help could be given to members. Hypothesis 2 was justified.

6.3. Transaction costs and governance structure

Research question: How do transaction costs affect the choice and changes of governance structure?

Hypotheses 3 was justified as coops in order to reduce transaction costs have decided to change governance structure and have adjusted to new economic conditions and market situation in both coops.

6.4. Role of state and formal institutional environment on cooperation

Research question: to what extent can the state and its formal institutions enhance cooperation?
The state and its formal institutions have helped a lot to improve cooperation in agricultural cooperatives between 1967 and 1989.

The social capital was, indeed, relatively low after organizing cooperatives across the country finished in 1961. However, by putting into practice a new economic mechanism into agriculture in 1967 the picture has changed. Due to the new incentive system social capital has been developed as economic environment has become a mix of centrally planned and market economy. So social capital has not been low in Coop “BÉKE” during the seventies and eighties. **Hypotheses 4 has to be rejected.**

6.5. Role of market and competition in fostering/hindering cooperation

Research question: How does the market environment affect cooperation?

*The hypotheses 5 was justified as people found market forces important and underlined the need for cooperation to become competitive and meeting market needs.*

7. Conclusions

People in the two coops have had different experience from socialist area and gone through different way of development since radical reforms.

Members of Coop “PMCHG” were partly former farmers and former coop members. They started to build up the new house of cooperation using a bottom up approach, backed by experience gained during individual farming and justified by reducing transaction costs. On the other side members of Coop “BÉKE” have had successful development since middle sixties to late eighties and wanted to maintain the high level of coop farming after radical reforms. They have strongly believed in cooperation and high level of trust in leader rooted back many years.

In case of both coops it turned out that high level of trust is an effective means of reducing transaction costs, however higher level of trust be based only on own or partially at least on parents’ experience.
The latter has been proved a stronger factor for members of Coop “BÉKE” and provided evidence that social capital of coop members during socialist system was high.

The role and challenge of leadership was partly different in the two coops. In Coop „BÉKE” the major goal of leaders was to avoid breaking up the coop after political turn. For “PMCHG” the main job for key persons was to persuade individual farmers to start cooperation, first by collecting and sharing information in order to reduce transaction costs. Later on by buying certain inputs, marketing the products, fixing quality for outputs, making post harvest investments together to increase competitiveness.

Key actors in PMCHG were initiators of building the new “COOP HOUSE” while leaders of Coop „BÉKE” focused on to avoid breaking up the “COOP HOUSE”. Leaders of both coops were succeeded which was an evidence that leadership play important role in cooperation.

Based on different experience from the history trust towards formal institutions differs in the two coops. Due to bad experience in agricultural policies during the last 10-12 years members “PMCHG” have lower level of trust in current government officials and EU institutions. In contrast Coop members of “BÉKE” trust stronger in national government and in EU institutions.

People could find their own way to solve problems relying on formal institutions however, if the latter did not work they took the advantage of informal institutions. For members of Coop “PMCHG” informal institutions played more important role at the very beginning of cooperation.

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