



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

281.8
Ag835

IND/DCC

#1478500

Vol. 18 No. 3
JULY 1979

Price 40c

U.S.D.A.
NATL AGRIC LIBRARY
RECEIVED

APR 17 '80

PROCUREMENT SECTION
CURRENT SERIAL RECORDS



Agrekon

QUARTERLY JOURNAL
ON AGRICULTURAL
ECONOMICS

Issued by the Department of Agricultural Economics and Marketing, Pretoria

THE CO-OPERATIVE FIELD: AN OVERALL REVIEW*

by D.J.G. SMITH
University of the Orange Free State

1 INTRODUCTION

Since the inception of the first co-operative in 1884 when 28 needy consumers, out of necessity, gathered at Rochdale, England, to establish this organization so as to gain a better livelihood, the co-operative movement has extended its bounds universally, become larger and according to type, more diversified. There are those who still adhere to the belief that "co-operatives are the children of distress" and thus approach the co-operative from a social-reformative point of view. However, as seen from an economic point of view within a milieu of an everchanging and competitive economic society, the question may well arise as to whether the modern co-operative could not better be described as "the child of development."

The co-operative movement in [South Africa] had its origin in the agricultural sector. These primary agricultural co-operatives (sometimes termed local co-operatives) were and still are the major components in the South African co-operative field. The following account will, therefore, comprise mainly of a discussion on South African Agricultural co-operatives.

As this is common knowledge to most concerned, a full exposition on the historical development of the co-operative movement in South Africa was deemed unnecessary. There are, however, trends in the process of development which should be considered and will be discussed presently. It is important to bear in mind that in the course of development this movement had to evolve within the framework of a changing world.

Conditions such as existed during the time of the Rochdale pioneers in 1884 are by and large absent today. Moreover the co-operative members of those days differ from present day members as regards economic status, economic ability, way of life or knowledgeable-ness. It is thus logical to conclude that conditions which were applicable in the early times will not necessarily be valid in the present time period. This is especially true in the case of certain of the so-called "basic principles."

In an historical sense, it can be stated that the process of development of agricultural co-operatives in South Africa was characterized by periods of distress with the accompanying support from the government accruing therefrom. Such a period of dire need

* Since the submission of the Report of the Commission of Inquiry into Co-operative Affairs (1967) very little change has taken place in the co-operative field, barring the amendment in the Income Tax Act in 1977. The material presented in this paper was mainly derived from this Report.

followed the Anglo-Boer War, as well as the period shortly after World War I (1921-22) when depression was rife. This led to co-operative legislation in 1922. Following the Great Depression of the early thirties and the drought of 1933 was the establishment of a control board system in 1937 and successive amendments include in the Co-operative Act of 1939. Thereafter the South African economy developed rapidly, including the agricultural sector and the co-operatives. In fact agriculture not only become fully commercialised but also a very sophisticated sector fully integrated with and part and parcel of the South African economic system.

From the beginning the initiative, in respect of the co-operative movement in South Africa, emanated from the Central Government. The various Acts with regard to the Co-operative Societies, of which Act No. 28 of 1922 may be looked upon as the first milestone, should be regarded as integral parts of the agricultural policy of the South African Government. It is apparent that progress of the co-operative movement must, to a large extent, be ascribed to the support of the government.

2. SOME FUNDAMENTAL PRINCIPLES

As a starting point it is essential that the agricultural co-operative be identified as a very distinctive institution within the context of the many other types of enterprises, especially with regard to companies with limited liability. Such an identification is important as it, inter alia, could answer the question as to what indeed the task of the co-operative within the economic system entails.

A number of farmers form a co-operative because they are, as a group, more able to perform certain marketing, purchasing and/or manufacturing functions, more efficiently than when done individually. From this follows logically that the bringing together of common interests is chiefly the result of the profit motive; in other words, by co-operation the marketing, purchasing or manufacturing of a product can be done at a lower cost or a higher price could be negotiated. If this goal cannot be achieved, the establishment of a co-operative would, indeed, be nonsensical. Thus, in economic terms, the co-operative functions as an independent economic entity and it is an independent enterprise in its own right. One should, however, be aware of the fact that basic differences exist between the co-operative as a particular type of enterprise and the various other enterprises such as for instance the company. Subsequently attention will be given to the most important of these differences.

Firstly, it can be stated that (in economic terms) a closer relationship exists between members (their farming enterprises) and co-operative than in the case of the other types of enterprises. The profitability of his (the member's) own enterprise is more closely linked with the co-operative than that of the shareholder who invests only a component of his assets (in most cases a small portion) in a company. Thus in the case of the co-operative the emphasis is placed on the farmer as a client rather than that of a capital participant.

This immediately leads to a second important difference namely, the manner of profit-sharing. In the case of the company, profit-sharing is based on capital participation by the shareholder, while in the case of the co-operative it is based on patronage and thus on the basis of the scale of transactions which each member has with the co-operative. Thus the greater the support given by the member to the co-operative, the greater will his share of the profits be. A central co-operative works as an extension in a similar fashion. In this case the local co-operatives are all members of the central co-operative. Profit-sharing is likewise based on a patronage basis and eventually the profits fall into the hands of individual members of a co-operative.

From a basic point of view as regards the company and the co-operative, one can also argue that there are resemblances between these two institutions. In the case of a company, an attempt is made to attain the highest return on the capital of the shareholder, whilst in the case of the co-operative a group of farmers come together in order to perform the functions of marketing, manufacturing and purchasing more efficiently than each individual would have been able to do. Thus it can be reasoned that in the case of the co-operative enterprise an attempt is also made to ensure the highest return on the capital of the farmer within his own enterprise. When taking note of the change in the emphasis of the activities of the co-operatives, this may be more so in the present conjuncture of time than previously.

There exist divergent opinions regarding the so-called basic principles of co-operatives and the Commission of Inquiry into Co-operative Affairs concluded that the following were relevant:

- 1) exclusive dealings with members;
- 2) the division of profits, in the socio-economic sense, on a patronage basis;
- 3) as a corollary to (2), limited payments to the member on his contribution to share capital; and
- 4) voluntary membership."¹

A number of authors still adhere to some of the Rochdale principles, the most important of which are that of one vote per member and the limitation of the number of shares for each member. There are also others such as, that sales should occur only on a cash

basis and that merchandise should be sold at prevailing prices, etc. Rightfully so, the Commission inter alia reasoned that the abovementioned, in the light of changed circumstances, are no longer valid and in actual fact deprive the co-operatives of the necessary flexibility. By and large these also do not take cognisance of the fact that co-operatives can differ a great deal from each other. In this connection, for instance, the limitation of the number of shares per member does not comply with the principle of proportionality. On the other hand, if the right to vote is based on this principle, certain dangers may be involved. In our modern era these aspects cannot be looked upon as basic principles of co-operatives and, therefore, flexibility is advocated. For instance the statutes of the citrus and some wine co-operatives provide for shareholding on a patronage basis. In other cases the principle of "one member one vote" has also been done away with and there are co-operatives providing in their statutes for franchise on a patronage basis. However, legally, a restriction is placed on this principle and the maximum permissible votes that a member may acquire are five, whereas proxy to vote for others is limited to seven.

The Commission was strongly in favour of the principle of exclusive dealing with members, mainly on account of the fact that ".... the whole idea of self-help on a patronage basis is destroyed if outsiders are allowed to enter the fold"². Trading with non-members becomes more problematical when the principle of voluntary membership is accepted as there are then no obstacles to prevent these non-members from becoming members. However, it is still the practice that when a co-operative acts as an agent for a control board, the intake of the products of non-members is looked upon as member transactions. Likewise, when a co-operative enterprise obtains an agency for farming requisites, trading with non-members is permitted, although limits to the extent of this trade are set on a yearly basis. Lastly, the Co-operative Societies Act provides for the case of farmers' special co-operative companies of which approximately 20 are still in existence³. In these special cases, trading of up to 50 per cent with non-members is permitted. This trade, however, is subject to taxation.

3. THE TASK AND FIELD OF THE AGRICULTURAL CO-OPERATIVE

Broadly speaking the aim of the co-operative is not that of replacing other enterprises (or as is sometimes stated, to eliminate the profit of others) but as a particular enterprise to act as corrective in certain instances. This is especially so where other enterprises in our capitalistic system have failed to serve the interests of the community at large. The elimination of "unreasonably high profits" can be justified but in economic terms the complete elimination of profit is unacceptable. If it is in the community's interest to eliminate the profit of another enterprise, it would likewise be in the interest

of the community to eliminate the profit of the co-operative enterprise and thus also the profit of the farmer.

In contrast to the ordinary company, the members of the agricultural co-operative are farmers and, therefore, relatively bound to a specific locality and thus also would the membership be limited. If the co-operative cannot succeed in fulfilling its functions with greater efficiency than other economic institutions with which it has to compete, the interests of its members would be harmfully affected.

As a matter of fact, such a co-operative has no right of existence. It is thus obvious that the quality of management is here of cardinal importance. On account of the special nature of the co-operative, as for instance the close bond between member and enterprise, business management has and especially in the past revealed various shortcomings. This was and probably still is the case with mainly the smaller co-operatives who lack the funds to appoint trained personnel. It can, however, be assumed that these shortcomings are being rectified.

Thus, where it is the task of the co-operative to enhance competition, it should be clear that in the case of marketing and processing of agricultural products and the supplying of farming requisites, the co-operative has an important role to fulfil. A group of people with poor bargaining power on the market has here been brought together. In similar fashion the central co-operatives were established to allow for greater bargaining power by the member co-operatives on the purchasing side. For all practical purposes the Marketing Act and system of control boards took the marketing functions out of the hands of the agricultural co-operatives. As the co-operatives represent the farmers, they normally obtain the agency from a control board. However, acting as an agent is but a low-risk function. All that remains in respect of community interest on the marketing side, is whether the co-operative will fulfil the functions of grading, storing, distribution and processing more efficiently than any other enterprise. Again this aspect must be seen as closely linked to high quality of management.

It is, however, true that the Marketing Act brought about a change in the functions of the co-operatives towards the supplying of farming requisites. Whereas in real terms, the handling of farm products increased by more than 1 400 per cent from 1934 to 1977, the supplying of farming requisites increased by 3 600 per cent⁴. The increase in the latter also manifests the fact that industrial inputs have become of greater importance in the agricultural sector with the passing of time.

Measured by the number of agricultural co-operatives and by membership, it seems that the marketing co-operatives are by far the most important. It is of interest, however, to note that the manufacturing co-operatives show a continued growth in both membership and number, as well as in relative importance since 1934 (in 1977 there were 89 manufacturing co-operatives). As time went by the co-operatives turned more and more towards the manufacturing sector. Barring

the mentioned co-operatives, there were four central co-operatives in 1977 of which one is a known manufacturer of agricultural machinery. Furthermore, it may be noted that in the same year (1977) there were 25 marketing co-operatives which manufactured goods with a turnover totalling R127 million⁵. In recent times voices from co-operative circles have been strongly raised with regard to intensifying the manufacturing processes and that this process be extended into the marketing field, even into the international market⁶.

The abovementioned brief picture denotes the most important spheres of activity of agricultural co-operatives in South Africa. Noticeable here as in other countries and rightfully so, the trading function (from both the selling and the buying points of view) came first as it was in this sphere that the greatest need was felt. By uniting in a co-operative the functions of collecting, storing and distribution as well as buying can be carried out more efficiently than by the number of scattered merchants. Especially in South Africa with a sparsely distributed agricultural population and consequently relatively low membership, it was not possible and also not advisable to enter spheres of activity that initially demanded high capital requirements and risk. The accumulation of large capital amounts, especially at the outset, is an inherent shortcoming that stems from the co-operative as a particular type of enterprise. Against this, entrance into the field of commerce and distribution does not require a vast capital outlay and, as has previously been mentioned, this was the sphere in which the greatest need was felt and where the co-operatives with an initial small scale start can gradually spread out their wings.

The manufacturing industry started off with the processing of dairy products and extended to include fruit, vegetables, wine and spirits, flour and bread, meat, ham and bacon. In more recent times there followed the processing of oils of vegetable origin, animal feed, cotton ginning etc. It was thus in the first stage of processing farm produce that the co-operative had its greatest success. These co-operatives are also situated close to the production areas where the close contact between farmer and co-operative is still in existence.

A question which may arise is whether co-operatives should continue to intensify manufacturing activities into the field of large-scale manufacture which requires a large capital outlay and are normally located in the metropolitan areas. In countries abroad this was the case. The reason, however, is the fact that these countries are densely populated and the co-operatives, inter alia, have a large membership making the procurement of the necessary capital more feasible than in South Africa. A possible way out lies in the formation of central co-operatives but in this connection the Commission of Inquiry into Co-operative Affairs holds the view that some of the agricultural co-operatives are already so large that central co-operatives are not really needed.

Something that has not been mentioned up till

now and representing a field of activity in which the co-operatives have been quite successful, is in the supplying of specialized services such as hail insurance, shearing services, milk recording and artificial insemination. Apart from these facilities some of the agricultural co-operatives also supply services such as machinery repairs, pest and weed spraying, reaping of fruit crops, etc. Here again it is a matter of direct contact between farmer and co-operative, in other words, activities in which the farmer is directly involved.

A function of which co-operatives are becoming increasingly aware and should be mentioned, concerns extension services to the farmer, especially on the economic level. On an increasing scale agricultural co-operatives take up in their employment agricultural experts and agricultural economists to supply the necessary expertise to members. As a matter of fact, it would seem as if this function is being taken over from the Department of Agricultural Technical Services in some regions. Especially in respect of the granting of credit this is a welcome tendency, as it could lead to more rational decision-making by the co-operative management in this regard. It is to be expected that in the case of the large co-operatives the bond between farmer and co-operative has weakened with the lapse of time.

Also important is the fact that the employee behind the counter selling inputs to the farmer, has an important extension task. He should be knowledgeable about the commodities so as to sell those articles which the farmer really requires and desires.

Summarizing the spheres of activity which have been successfully ventured upon by the agricultural co-operatives, with the support of the government, it would seem that these are the spheres in which the farmer has a direct interest: Marketing of agricultural products, purchasing of farming requisites, the supplying of specialized services to the farmer and the first phase in the processing of especially perishable products. The latter has already broadened out into other spheres and the question now remains whether the co-operatives should commit themselves to a larger share of the manufacturing industry or rather apply themselves to those spheres in which contact with the farmer is of a more direct nature. As expounded earlier, it is the aim of the co-operative to increase the efficiency of the capital invested in the enterprise of the individual member. It thus seems logical that the co-operative should rather specialize in those fields where it has proven itself successful. My personal opinion is that the concept of co-operation for selfhelp can be stretched too far. Where specialization still remains the keystone of the competitive economic social structure, it would perhaps be wise to compete in those fields in which bargaining power for the co-operative is most favourable and in those fields in which expertise has been achieved over the years and at best could still be expanded further.

From other sectors of the economy objections are still raised that co-operatives, with government support, compete in an unjustifiable manner in the business

economics field. Some of these objections for instance pertain to trading with non-members, the preferential treatment given to co-operatives as agents of control boards, the exclusive right of co-operatives to pay out bonuses, co-operatives' shareholding in companies, the close link-up between agricultural co-operatives and consumer co-operatives, the automatic lien by co-operatives on the farmers' products, etc. Without much further elaboration it may be stated that the Commission of Inquiry into Co-operative Affairs concluded that a number of these complaints regarding unjust competition were valid, whereas others were wholly exaggerated. Certain solutions for some of these objections were presented. With others it was felt that before any recommendations were to be made further investigation was required. Apart from the fact that a committee is at present in existence investigating the Co-operative Act and that revision thereof can be expected in the foreseeable future, very little has come forth regarding the proposals of the Commission. Far be it the objective of this paper to anticipate any new legislation and it is therefore limited to a general review.

Many of the objections in regard to unfair competition centre around the manner of taxation of the co-operatives. In this regard a change in legislation was tabled in 1977. A brief discussion on this matter now follows. In short, the whole matter boils down to the fact that up till 1978 profits were not taxable at a co-operative. Bonuses received by co-operative members were, however, taxable. On the other hand, accumulated profits which were paid into a reserve fund were exempted from taxation. At present, however, a member is also taxable on bonuses of which payment have been postponed. Nevertheless, these bonuses are deductible by the co-operative. As in the case of a company, a co-operative is now also subject to taxation on dividends. It is probable that bonus shares will become something of the past and that co-operatives would prefer to convert existing bonus shares into membership funds. In fact there are already such indications.⁷ Likewise it may happen that instead of accumulating reserve funds from retention of profit, co-operatives might prefer to transform this money into membership funds which is not taxable at the co-operative. Such a step should however be taken with great care as these funds are recoverable when a member suspends his farming or dies (even though the statutes may stipulate recovery subject to the availability of funds) and this could negatively affect the future capital position of the co-operative. With co-operatives now liable to taxation, one may logically deduce that co-operative leaders will press for a wider freedom of movement so as to enable them to partake in other activities in the economic field. However, the viewpoint held in regard to the spheres of activity in which co-operatives should partake still remains valid and in the event of concessions being made, co-operatives should treat this matter with great discretion.

In actual fact, the amendments in respect of

taxability have wide repercussions and necessarily implies that the Co-operative Act has been affected in its very nature. In the event of not falling back again to *ad hoc* measures as was often so characteristic for agriculture, the opportunity has now arisen where a final "modern" settlement could be arrived at for a specific type of enterprise which has come a long way - a settlement which will make it a part of the private sector as a necessary type of enterprise - a settlement that will earn respect instead of criticism, because it considers not only the interest of a particular group, but that of the community as a whole.

By way of scientific investigation and thinking, flexibility and vitality can be brought into the co-operative field, thus making thereof something elegant to both the farmer and the rest of the community and it not merely being a matter of growth of the co-operative for the sake of co-operation. Co-operatives have come "of age" in South Africa and the opportunity

has now arrived to prove their becoming of age.

REFERENCES

- 1 Report of the Commission of Inquiry into Co-operative Affairs, RP78/1967, Government Printer, Pretoria, p. 73.
- 2 *Ibid.*, p. 69.
- 3 Personal communication by the Registrar of Co-operative Societies.
- 4 Calculated from data supplied by the Office of the Registrar of Co-operative Societies and the Report of Commission of Inquiry into Co-operative Affairs.
- 5 Office of the Registrar of Co-operative Societies.
- 6 Among others see Scholtemeyer, J.H. "Bemarking en verwerking van landbouprodukte." Paper delivered at *Farmer's Day, U.O.F.S. 1977*.
- 7 Personal communication by the Registrar of Co-operative Societies.