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## RESILIENCE OF COOPERATIVE ENTREPRENEURIAL MODEL IN TIME OF CRISIS

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### ABSTRACT

What began as a crisis in finance markets has rapidly grown and deepened irreversibly its negative consequences in various economic sectors and social life. Evidence for these can be found in the majority of enterprises, mainly in the form of decreased efficiency, increased shutdowns, weakened investment confidence and reduced resources. Ventures fail despite the presence of government interventions and varied actions to address current economic and social downturn. However, cooperatives around the world have shown relative stability and resilience: financial cooperatives remain sound, consumer cooperatives report increased turnover, worker cooperatives respond efficiently to the new circumstances and increased job instability. The present paper develops the understanding and promotion of the characteristics and factors that determine cooperative success and reveal cooperative model as an important tool for community development and stability in Bulgaria. One distinctive cooperative feature is that they already act in the way promoted by the strategy Europe 2020 for smart, inclusive and sustainable growth. The fact that cooperative enterprises emerge in various sectors – agriculture, health, financial services, etc., shows in a different way their flexibility and adaptability towards changing environment and especially in time of crisis.

**Key words:** cooperatives, business model, policy support

### INTRODUCTION

Cooperative structures provide, assist and maintain a wide spectrum of economic, social, ethical demands and necessities, and for that reason their significance and role have received broad interest both from public and private authorities. This interest has also been supported by several theories in the economic and social field, which aim at explanation of cooperative structural characteristics and membership incentives. None of them has managed to capture thoroughly cooperatives' nature for the most obvious reason that during the years they have revealed as quite dynamic structures, which evolve progressively over time. Different cooperative models, strategies and development patterns have mapped the cooperative concept and understanding, and in the recent years have prompted diverse solutions across the enlarged Europe. In many of the countries in the EU-15,

cooperative formula and collective action represent a successful model to keep pace with the new challenges, by allowing cooperative members to participate in the added value of their products, creating employment and contributing to sustainability of rural areas, securing competitive advantage and preserving regional identity. At the same time, in the new countries (Bulgaria, Romania) the misconception of cooperatives and the contradictory experience in the remote past is still envisaged as a significant obstacle for cooperative development. After transition period various structures emerged and partially filled the gap left by the structural reform, but with varying impact and sustainability.

The present paper aims to address cooperative enterprises as a successful way whereby business can be performed and maintained even in time of economic downturn and instability. The first part

focuses on theoretical interpretation of cooperative nature in light of their specific management processes, membership relationships and rules and decision-making. European legal framework related to cooperatives, their functioning and position as the key driver of civil society is investigated in the second part of the paper. In the last part are provided some empirical evidence that confirm the capability of cooperative to deal with unfavourable economic situations and financial restrictions in a way better than that of conventional enterprises.

### Cooperative phenomenon

Probably one of the most unique characteristics of cooperative development considers the balance achieved between the process of interaction and involvement in different economic, social and political scenarios, and preservation of the initial cooperative principles and values at the same time. Although it might be too ideological, the simple fact that could not be neglected is that the strength of the cooperatives is in their members. Cooperatives are the people and the people hold the cooperative idea. Cooperative members explore economic benefits and increase their social standard by doing what they do for living in the best possible way. This additionally includes more rational use of market gaps and creation of competitive advantage based on specific regional priorities. Cooperatives provide products and services in niches where corporate systems have failed or do not have appropriate resources and financial interest to deal with. Predominant part of cooperative initiatives has arisen from the spontaneous incentives of rural groups to fulfil particular social need through economic undertakings - *“(...) non-profits have turned to organizing social enterprises to fulfil social equity missions. Communities and governments have turned to them for economic development”* (1). In time, their expansion in terms of influence and functions has provoked interest of the broader society, which resulted in organization, coordination, and back up of cooperative activity by the government, the local authorities and the community.

Significance of the cooperative form relates to the incentives provided for collective competitive behaviour and action as

homogeneous group. Olson (1965) defines the so-called *“selective incentives”* to approach simultaneously the social status or social acceptance and the monetary incentives. As proven later these incentives could not automatically solve collective action dilemma. The problem arises from the fact that even the payment for these selective incentives is collective action and it would provide benefits only to those interested in collective well-being (2). The bottom line is that what defines cooperatives could not be just generalized as the typical functions of *“rational”* or *“natural”* systems. It is true that cooperatives emerge at local level and initially have limited strategic options, which could define them as rational systems. But the effect of their initiatives has a broader strategic impact and at this point characteristics of the natural systems are also recognized. Taylor's theory (1971) on scientific management and bureaucratic idea of Weber (1947) promote cooperatives as social instruments for gaining maximal efficiency and limiting uncertainty (3, 4). Later in the comparison provided by Bartlet (1958) the broader definition of cooperatives as *“entrepreneurs' adjustments”* of the *“rational”* systems tend to be left aside (5). The main reason for this is the increase in their functional spectrum, performed activity and social responsibilities.

Being part of the dynamic environment means also complying with government policy and regulations, consumers' demand, and environmental requirements. Cooperative adaptation towards environmental constraints, provided through: internal structural differentiation; strategic contracts and long-term arrangements for gaining market access; competitive possession of key production resources; and social oriented and environmental responsible policy, considerably changes the general perspective of cooperatives as organizations with limited strategies and capacity for their fulfilment. Following this, the most obvious characteristic of cooperatives is the change rate of their external environment, which calls for active participation and efficient adjustment to the ongoing changes. The balance among members' interests, general cooperative well-being and interests of outside players complicates cooperative functions and activities,

but also creates problems related to management and evasion of possible opportunistic behaviour. The opportunity to integrate variety of operations in production process within the framework of one production system has found practical implementations in the form of – contractual arrangement with suppliers and processing companies; incorporation of all production phases and retail trade.

### Cooperatives in the European policy

According to the position of the Economic and Social Committee on “The role and contribution of civil society organizations in the building of Europe” (1999/C329/10), civil society organizations include social market players, organizations that represent social and economic players, non-governmental organizations and community-based organizations set up within society at grass-roots level to pursue member-oriented objectives (6). The same document provides interpretation of dynamics in the civil society: “(...) *Civil society is a collective term for all types of social action by individuals or groups, that do not emanate from the state and are not run by it. What is particular to the concept of civil society is its dynamic nature, the fact that it denotes both situation and action. The participatory model of civil society also provides an opportunity to strengthen confidence in the democratic system so that a more favourable climate for reform and innovation can develop*”. A participatory model, in which civil society declares its will and raises voice in the policy-making process, is expected to create favourable environment for democratic and innovative development in all spheres of community development.

But what is the role of the cooperative enterprises in this interaction process according to the civil law system? A comprehensive solution is provided by the Euro – Mediterranean network of social economy, which states that: “ (...) *Cohesion in society is only possible if the citizens are actively involved. It is in this process of cohesion where the Social Economy, as a member of civil society, has an essential role to play because this type of enterprise is characterised by acting as a school of civil participation*” (7). As social economy is defined wide range of forms such as: cooperatives, mutual societies, associations, foundations;

which are led in their action by the common idea for sharing certain principles. Representatives of the social economy are presumed to be both economic and social agents, although their distinction from the capital-based enterprises is revealed in terms of:

- priority given to the social purpose;
- acquisition of democratic control and opened membership;
- sharing common interests based on members' necessities and priorities;
- independence from the authorities and self-governance;
- reinvestment or re-distribution of accumulated resources, which remain as a surplus after covering costs related to the main activity, to other activities, investments or bonuses in line with the decision of the members.

The essential role carried out by these organizations is a reflection of their unique way of establishment and management as a collective, democratic way, economically feasible and competitive business projects with a social purpose. Legislation is recognized only as part of the driving mechanism of community development in its social and economic aspects. The existence of “*non-binding tools such as recommendations, guidelines, or even self regulation within a commonly agreed framework*” give the right finish to the process of building solidarity and strengthening social and economic relationships. This organizational approach is revealed as the key to sustainability of activity performed as well as further development of the region and the local society.

An example of a comprehensive definition of cooperative enterprises at national level is the Italian Civil Code (8). In Article 2515 (The Italian Civil Code, p.117) it is accurately specified that: “*The word ‘cooperative’ cannot be used by societies which do not have mutual purposes*”. Incorporated along their mutual purposes members are able to choose between unlimited and limited liability of their organizations. In cases of unlimited liability, in Article 2513 the law envisages that: “(...) *the members are secondarily liable without limit and in solido (1292 ff.) as secondary obligators*”. The participation in a limited liability cooperative society is committed only to the

members' assets, and the organization itself is "(...) limited with its assets for its obligation" (9). In general the membership in cooperative enterprises is open and the admission of new members is bounded with payment of quota or share, as well as a sum defined by the directors. The law stipulates that in the meeting of members, as one of the society organs, each member has one vote regardless to his quota or the number of his shares. In special cases conferring more than one vote is related to the precondition of participation of legal persons. They could be conferred by more than one, but not exceeding five votes. Profit distribution is regulated by Article 2536: "At least one-fifth of the annual net profits shall be set aside for the legal reserve fund, regardless of the amount of such fund. The portion of the profits which is not set aside for the legal reserve fund or for reserve funds provided for in the articles of association and which is not distributed to the members shall be used for mutual purposes".

Legislation sets the background and defines the boundaries that simultaneously restrict and stimulate particular economic activity and market interventions. In 1999 the Commission Regulation (EC) 2790/1999 is adopted to define, restrict and qualify the vertical integrated relations, which are in compliance with the Article 81 (3) of the Treaty. Contract agreements found to be in correspondence to the undertakings which aim at improving production and distribution of goods and thereby promoting technical and economic progress are generalized in: "(...) vertical agreements for the purchase or sale of goods or services where these organizations are concluded between non-competing undertakings, between certain competitors or by certain associations of retailers of goods" (10). These vertical agreements are furthermore found to be advantageous mechanism for improving the economic efficiency indicators as well as for the balanced distribution and better accumulation of the market power along the value-chain. Theoretical interpretation of the vertical integration has received practical implementation and acknowledgment for its resources to decrease transaction costs and optimize distribution costs in a way that accounts for the interests of the participating parties. Furthermore a special attention is given to the

enhancement of investment initiative and proportional increase of sales. This regulation expired in 2010 and has been replaced by the new Commission Regulation (EU) 330/2010 on the application of Article 101 (3) of the Treaty on the functioning of the European Union to categories of vertical agreements and concerted parties. In Article 1 (a) has been specified that: "(...) an agreement or concerted practice entered into between two or more undertakings each of which operates, for the purposes of the agreement or the concerted practice, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services" (11).

Despite the positive support that integration process along the value chain receives through adopted legal framework, there have been additionally implemented restrictions towards adverse market concentration and possible negative effect on competition practices. This control mechanism has been formulated in Council Regulation (EC) 139/2004. The main concerns of the legal authorities that have initiated such legal act are related to the enlargement of the European Union, sectors' diversity of the new Member-States and the reduction of trade and investment barriers. These factors call for more comprehensive glance not only on the new approaches that follow and regulate relationships that emerge with different dimensions and characteristics, but that provide the balance among the Member-States considering their economic development level. Therefore the legal matter is expected to be in line with the new emerging considerations towards balanced market concentration and power distribution, as well as to provide for effective control mechanism and tools. For that reason the Council Regulation (EC) 139/2004 includes in its text the Article 308 of the Treaty of which gives the opportunity: "If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community, and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures" (12). In this course the Community may acquire additional power in the

cases when it necessary to achieve certain aims and results “and also powers of action with regard to concentration on the markets for agricultural products listed in Annex I to the Treaty” (13).

All these legal aspects are followed by the course of action of the Europe – 2020. Nevertheless the increased concentration tendency has not only been perceived as favorable condition for intensive farm practices, market-oriented supply and market balance, but also as a source for deepening the inequalities among the different member-states on the bases of their competitive level and development capacity in particular economic sectors, such as the agricultural one. These inequalities have been described as: “(...) marginalization and land abandonment. Such developments would result in increased environmental pressures and the deterioration of valuable habitats with serious economic and social consequences including an irreversible deterioration of the European agricultural production capacity” (14).

### **Cooperatives and the crisis**

Whatever the consequences of the revised Lisbon strategy in 2005 and the positive effects accumulated in terms of employment and growth (Open Method of Coordination, OMC), the economic crisis has offset to a large extent most of its main achievements.

Presently the main policy debate focuses on how the EU 2020 could ensure coherence across its two main strands – the social and economic dimensions of the post-Lisbon strategy. For the first quarter of 2011 the GDP growth in volume in Europe was 0,8%, while the public balance as a percentage of the GDP was registered with a negative sign – 5,3%. The government debt has raised up to 80,4% as percentage of the GDP, and the total unemployment rate was pointed to be 9,4% for the second quarter of 2011. As later on reported by the CECOP, the unemployment has mostly affected developed countries, and in 2012 the unemployment rate reached 10,1% or 24,3 million unemployed people. The Trade Union Advisory Council (TUAC) warned that: “In the summer of 2011, the global economy entered a dangerous new phase as growth slowed down in virtually all countries, the

*recovery stalled in advanced countries and new financial risks emerged, particularly in Europe.”*

According to the Annual Report on EU SMEs for 2010-2011, Greece, Ireland, Romania, Latvia, Portugal and Spain are classified as “crisis countries”, while a group of countries such as Austria, Germany, Luxemburg, Malta, Sweden and UK show positive recovery in 2010.

International Co-operative Alliance reports for 1 billion cooperative members in 96 countries. Even more, at least 650 million people in the world are members of one or more cooperatives. In Europe cooperatives employ 4,7 million people. In Italy 43000 cooperatives of all types employ 1,2 million workers and generate turnover of 127 billion euros (15). In France 21000 cooperatives secure employment for 1 million people or 3,5% of the active working population (16). In Spain cooperatives provide 335000 jobs as reported for the first quarter of 2012.

The international definition provided by ICA, defines that the cooperative 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”. In the time of crisis, cooperatives tend to be more resilient than the conventional enterprises, even “innovative” as qualified by the EC Employment. “While the creation of enterprises (micro-enterprises included) has dropped by 11,6% in 2011, according to INSEE, cooperatives display healthy, almost defiant state, with regard to the deterioration in the economic context observed since autumn 2008.

The general observations show that worker and social cooperatives are more resilient in countries with strong cooperative roots and traditions, such as Spain, France and Italy. Even for Bulgaria, while statistics indicate for job losses and instability, most of the cooperatives show stable employment rate and viability. Federlavoro (Italy) reports that 68,3% of cooperatives have managed to keep the same level of employment, 18% even experienced employment growth and 12,9% faced job contraction. For 2011, COCETA (Spain) indicates for 13336 new jobs in the service sector.

According to the CECOP, cooperative resilience rests on the following *key elements*:

- Participation of the members in the management of the cooperatives;
- Reserve funds;
- Close connection with regional and territorial characteristics and specific needs;
- Community involvement;

- Capacity to organize and follow-up business transfers to employees.

The specific cooperative features that have contributed to cooperative stability also have positive impact over their environment (**Figure 1**):

Level of impact	Specific effects
Micro level	<ul style="list-style-type: none"> <li>• Mobilization of members' participation;</li> <li>• Involvement of wider stakeholders and community.</li> </ul>
Meso level	<ul style="list-style-type: none"> <li>• Business support entities for training, consulting and financing owned by the national cooperative unions/ alliances;</li> <li>• Consortia organizations.</li> </ul>
Macro level	<ul style="list-style-type: none"> <li>• Indivisible reserve funds are compulsory;</li> <li>• Establishing non-banking financial instruments.</li> </ul>

**Figure 1.** Cooperative specific effects

Evidences of this impact at micro, meso and macro level are witnessed in several countries. Members of the Romanian cooperative Colin Daily Bucharest (food industry) agreed on a voluntarily reduction of wages in order to save money in a short-term period. Polish NAUWC indicates that a number of cooperatives cut their wages temporarily by 10-25%, and even reduced the number of the working days per week from five to four. Service cooperatives decided not to increase the prices of their services, when the conventional enterprises did so, just because they wanted to keep their customers. The financial reserves, built before the crisis allow cooperatives to go beyond these short-term stabilizing measures and even to make investments in technology and structural changes in their production processes. In the time of crisis, Czech SCMVD reports for utilization of new technologies, penetration of Asian markets; Slovak CPS reports for innovation in products and the sale of products on line; in 2009 the Romanian UCECOM registered approximately 180 products and services related to the utilization of new technologies. In Spain, the worker cooperative la Veloz has diversified its activities in order to overcome the economic crisis.

Bulgarian member NUWPC commissioned a research from the University of National and World Economy to develop a pilot project for

the development of a retail network for the cooperative system. The investigation, which started at the end of 2010, showed the need to develop the retail network in order to facilitate the sale of cooperative products. Following this project, the Professional Education Centre of NUWPC has launched a specific training programme in May 2012 addressed to sales managers of all cooperatives belonging to the Union system.

When comparing the present situation of cooperative enterprises in Bulgaria with the situation 20 years ago, one can hardly speak of an improvement. In Bulgaria, increase has been reported in sartorial sector (11%), in non-food industry (53%). Investment activity also registers increase of 31% for 2012. It's been acknowledged that the cooperative model is a very successful method for achieving financial inclusion and for responsible microfinance. The founders of the Central cooperative bank were Central Cooperative Union, the regional cooperative unions and more than 1100 cooperative organizations. In the beginning its mission was to contribute to the development of the cooperative system in Bulgaria. Passing through different development periods, the Bank established itself as a universal commercial bank nowadays. In terms of total assets Central Cooperative Bank is on the 10<sup>th</sup> place in the classification of BNB for 2011.

## CONCLUSION

Cooperatives and cooperative development urge for a unifying approach towards better resources' accumulation – both institutional and financial, and the capacity of the regional chains in terms of investment opportunities, integration of production process and cost optimization. The interaction components of bilateral process “*strategic partnerships-institutions*” have broader impact, besides improving and benefiting economic performance of the agricultural enterprises. Cooperatives are embedded within the sustainability in the region they are established. They influence various prospects of the agri-value chain through balanced and competitive relations; concentration of the primary agricultural production; higher economic efficiency; and rural areas development.

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