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**CO-OPERATIVE PRINCIPLES – AS A BASIS AND SAFEGUARDS OF
TRUST DEVELOPMENT IN AGRICULTURAL CO-OPERATIVE
MARKETING AND MANAGEMENT**

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Abstract

In theory and according to Western European (Dutch, Danish etc.) and US practical experiences, *one of the main important private institutions which can strengthen producers and help to co-ordinate (agricultural) chains is the co-operative form. According to many authors and writers, one of the sources of increasing the competitiveness of co-ops can be traced back to trust which are exist between the members and the co-operatives, as well as among the members. Furthermore, management literatures on collaborations emphasize the role of trust as a managerial tool. Thus, in our paper, we try to find the answer to one of our main research questions: Can co-operative principles be taken as formal-legal securities of trust (development) in co-operatives and thus able to be used as a managerial tool?*

Key words: co-operation, co-operative identity, principles, trust, marketing, management, vertical co-ordination, agriculture

JEL classification: Q13, L14, L22

CO-OPERATIVE PRINCIPLES – AS A BASIS AND SAFEGUARDS OF TRUST DEVELOPMENT IN AGRICULTURAL CO-OPERATIVE MARKETING AND MANAGEMENT

1. Introduction

1.1. Theoretical background and motivation

In theory and according to Western European (Dutch, Danish etc.) and US practical experiences, *one of the main important private institutions which can strengthen producers* and help to coordinate (agricultural) chains is the co-operative form. 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*.

The development of countervailing power (Galbraith, 1963) – even only regionally - through the disposal of the products collected by co-operatives and other producer-owned organisations can get results such as strengthening market competition (e.g. ‘radiation effect’ on prices). This impact could have a positive efficiency effect on the whole chain or sector and might raise the members’ income in a socially well accepted way. Therefore establishing countervailing power by cooperatives might get a positive welfare effect as well without any or significant state support financed by tax players. They can also play significant roles in rural development solving - at least partly - the very serious problem of unemployment in less developed rural areas. In addition to economic aims, there are *several non-economic advantages* (Hakelius, 1996), like strengthening trust and social capital, which can be also important for the successful development of co-operatives and for the society in general.

In Western Europe, for example in Holland and Denmark (agricultural) co-operatives are bottom up organisations and they have emerged through a *volunteer 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. 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)

In order to be able to fulfil 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.) *co-operative execute new marketing strategies and use new management techniques*. According to many authors and writers, one of the sources of *decreasing transaction costs can be traced back to trust* which are exist *between the members and the co-operatives*, as well as *among the members*. Furthermore, management literatures on collaborations emphasize the role of *trust as a managerial tool*.

1.2. Main research question and methods

In our paper, we try to find the answer to one of our main research questions:

Can co-operative principles be taken as formal-legal securities of trust (development) in co-operatives and thus able to reduce some kinds of transaction costs?

In this paper *marketing and management theories*, as well as *exchange theories*, featuring *New Institutional Economics* analyses (e.g. agency and TCE theories) and 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*) supply the theoretical framework.

The structure of the paper is organized as follows: after *introduction*, the *second section* briefly reviews the relevant current literature regarding trust in supply chains and co-operatives, as well as on trust as managerial tool. Section three presents the “*co-operative identity*” concept as well as a brief introduction to co-operative principles. Co-operative principles as formal-legal securities of trust in co-operatives are in the focus of *fourth section*. *Finally*, we draw conclusions with implications for managerial applicability and further theoretical researches.

2. Trust in agrifood-economy

2.1. Trust as the key concept in collaborations

Often cited definition of trust is "willingness to be vulnerable," proposed by Mayer, Davis, and Schoorman (1995). In other words define "trust" to mean that one believes in, and is willing to depend on, another party (McKnight et al., 1998). It is “a pre-eminently modern phenomenon, resting, ultimately on the self-regulating, autonomous individual” (Seligman, 1998). “Trust is the degree to which the trustor holds a positive attitude toward the trustee's goodwill and reliability in a risky exchange situation” (Nooteboom et al., 1997; Ring & Van de Ven, 1992). Trust requires a previous engagement on a person's part, recognizing and accepting that risk exists (Mayer et al., 1995). So, former risk must be recognized and assumed, meaning that trust develops over time. Trust by this definition is independent of contractual provisions or controls in an exchange; it is a personal trait that influences commitment decisions in the sense that it affects an individual's assessment of the benevolence of other actors (Lazzarini et al., 2008). The definition of trust is the willingness of a party to be vulnerable to the actions of another party, irrespective of the ability to monitor or control the other party (Mayer et al., 1995). “Control or confidence is what you have when you know what to expect in a situation; trust is what you need to maintain interaction if you do not” (Seligman, 1998). Therefore, trust is needed when there is no basis for confidence, like when behavior cannot be predicted or when strangers are part of the interaction. Trust is necessary when the other is unknown, or behavior cannot be imputed or predicted, because either there is no system within which sanctions can be imposed or there is no underlying sense of or terms of familiarity or sameness that would allow such prediction (Seligman, 1998).

There are number of classifications of trust but we consider the following five kinds, according to their origin: calculus-based, experience-based, cognition-based, goodwill, and affect-based trust. Calculus-based trust is based on both the fear of punishment for violating trust and rewards for preserving it (Lewicki & Bunker, 1996). Trust can also originate from experience that has developed into a routine behavior, thus, it is named experience-based trust (Woolthuis et al., 2002). Trust may also evolve from knowledge and inference of the partner's abilities, traits, goals, norms, values, which is referred to as cognition-based or economic trust (Gulati, 1995; McAllister, 1995). Before the actual relationship begins, goodwill trust forms out of an initial value which is based on inclination or willingness to trust (Mayer et al., 1995). This inclination may be determined by survival conditions, experience and socialization, traits of people and/or firm culture, or institutional environment. Furthermore, the cooperation attitude is heavily

influenced by this type of trust. At the moment of entering a trustful relationship, firms already possess the willingness to trust each other. Another kind of trust based on loyalty, care, warmth, friendship or empathy for the other partner, and is called affect-based trust (McAllister, 1995). This type of trust can also originate from kinship (Ouchi, 1980), similarity or mutual identification on the basis of shared cognitive frameworks (Hellriegel et al., 1992; Gulati, 1995). A company's good image and reputation could serve as an example of such type of trust.

There is no doubt that the existence trust plays a key role for social as well as business relations. Trust is said to be at the core of any exchange relationship and play an increasingly important role as a key factor for successful transactions (Handfield & Bechtel, 2004). It is known that particularly trust is the key concept in the network theory that motivate actors to work together (Uzzi, 1997), informal mechanisms which can be used to generate cooperation in a supply chain (Ballou et al., 2000) and are necessary components for achieving competitiveness within socioeconomic relations (Ireland and Webb, 2007). In this context, trust is regarded by a number of authors as a mechanism for reducing risk and achieving efficient coordination of interactions (Sydow 1998). Moreover, a great number of authors has dealt with trust as a mechanism for achieving cooperation among firms and effective management based on the argument that the presence of trust is central to successful relationship marketing (Morgan & Hunt, 1994). Trust is thought to be a more appropriate mechanism for controlling organizational life than hierarchical power or direct surveillance (Hosmer 1995). A high level of trust between partners is viewed necessary to cooperative behaviour, whereas a low level of trust leads to competitive behaviour (Dabholkar et al., 1994). Moreover, trust has been identified as an important issue in interorganizational relationships (Gulati & Singh, 1998). Trust is said to lower transaction costs, enhance organizational efficiency and prevent opportunistic behaviour (Sodano, 2006), help to reduce the need for monitoring between partners and promote the sharing of information (Bakos and Brynjolfson, 1993). Partners are more willing to exchange knowledge and other resources in an accurate when engaged in a trustful relationship (Inkpen, 2001).

2.2. Role of trust in co-operatives

Trust in co-operatives usually considered as one of the main advantages which can help co-operative members to realise their economic and non-economic aims. One of the most inspiring paper on trust-generating mechanism in co-operatives is by Borgen (2001). The author explores the trust-making mechanism in co-operatives using a dynamic approach and finds empirical supports "...that stronger the members' identification to the collective organization, the more they trust the benevolence of the cooperative management". He especially points out "...the significance of identification-based trust in case of modern, large-scale cooperatives. (Borgen, 2001: 222). He also argues that, "another reason why trust is so important in cooperative organizations, is its potential capability to mitigate agency-problems (Borgen, 2001: 211). We can argue here that co-operative principles can play a key role to establish and develop the coherence in the organisation through loyalty and commitment. Naturally speaking shared norms and values help "...to build the required social capital and degree of trust." (Borgen, 2001: 214)

Hansen et al. (2002) analyse the role of trust on co-operative retention, performance and members' satisfaction examining trust along two dimensions: cognitive and affective. They also "argue that cognitive and affective trust refer to the process by which one determines that an individual, group or organization is trustworthy (Hansen et al., 2002: 43). Their empirical findings based on the evaluation and test of two marketing co-operatives and suggest that "...trust *among* members and trust *between* members and co-op management are important

predictors of group cohesion, which is a measure of the strength of the members' desires to remain in a group (co-op) and their commitment to it" (Hansen et al., 2002: 1).

James and Sykuta (2005) find that "Producer owned firms (POFs) have a potential advantage over investor-owned firms (IOFs) in that a higher degree of trust between POFs and producers may create contracting or operating efficiencies unavailable to IOFs." However, their empirical "...results also suggests that organizational trust and members' investment incentives can be competing interest; property rights that have been shown to promote investment incentives are counter to those associated with organizational trust." (James and Sykuta, 2005:574) They also find that higher the homogeneity of member interest as they are more "equal", higher the organizational trust in producer-owned firms (James and Sykuta (2005).

Ranging organisational form related to transaction costs Valentinov and Curtiss (2005) find that in cases of both agricultural producer and service co-operatives, "Trust is essential for creation and normal functioning of these organizations" (Valentinov and Curtiss, 2005:33).

Regarding transition economies, theoretically marketing co-operatives may solve many problems of transaction related problems via horizontal and/or vertical coordination. However, number of examples of co-operatives is still limited in countries like in Hungary, despite the fact that "...trust plays an important role for farmers to join a marketing cooperative in transition country" (Bakucs et al., 2007, 2008). One of possible explanation for this phenomenon is the lack of trust and willingness to co-operate among producers, as well as between farmers their business partners. (Bakucs et al., 2008). Analysing the most important causes to join to co-operative, Bakucs et al. find "...that the quantity, the existence of contract, flexibility and trust are the most important factor for farmers to selling their product via cooperative" (Bakucs et al., 2007: 15).

In a recent paper (Bakucs, L. Z., Fertő, I. and Szabó, G.G., 2008) *investigated the impacts of trust among the members, as well as between the members and the management* in the case of Hungarian Mórakert co-operative. According to the authors' knowledge, the above paper is the first to systematically investigate different type of trust among members of marketing co-operative and between members and management of a co-operative in a transition country. They focused on effect of trust on co-operative membership performance, satisfaction and their commitment to remain a part (member) of the co-operative according to the hypotheses and findings by Hansen et al. (2002) which analyse the role of trust in cooperative performance.

The results by Bakucs et al. (2008) suggest that trust among co-operative members and trust between member and management have positive effects on group cohesion. They also find, similar to Hansen et al. (2002) findings, that affective trust has a greater impact on group cohesion than cognitive trust on both levels. In addition, trust among members has a greater impact on group cohesion and members' satisfaction than trust between members and the management (Bakucs, L. Z. -Fertő, I. - Szabó, G.G., 2007). However, their result can not be generalised since it is only a case study with the number of observations of 136 (n=136) and it has got geographical and commodity limitations as well. Thus, further research is needed to clarify the role of trust in the success or failure of marketing co-operatives in Hungary and other transition countries.

3. The „Co-operative identity” concept¹

3.1. The elements of the “co-operative identity” concept

The concept of the “co-operative identity” (Szabó, 1995, 1997, 2006, 2008a) is proposed to serve as a general theoretical background for the economic evaluation of the role of co-operative principles in (agricultural) co-operation.

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 (marketing) 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..

3.2. 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

¹ The idea of examining co-operative aims, principles and the needs of 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 Gábor G. Szabó to develop a new concept of “co-operative identity” (Szabó, 1995, 1997, 2006, 2008a). Examination of each sector in agriculture is worthwhile, because the diversity existing in biological and technological processes, as well as in management techniques. These dissimilarities can influence the concrete realisation of the “co-operative identity”. Section 3 is based on Szabó (1997, 2006, 2008a) and repeated here for the sake of completeness.

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).

3.3. 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.

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.

3.4. 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 and 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 contains formal legal guarantees (e.g. principles) 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).

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

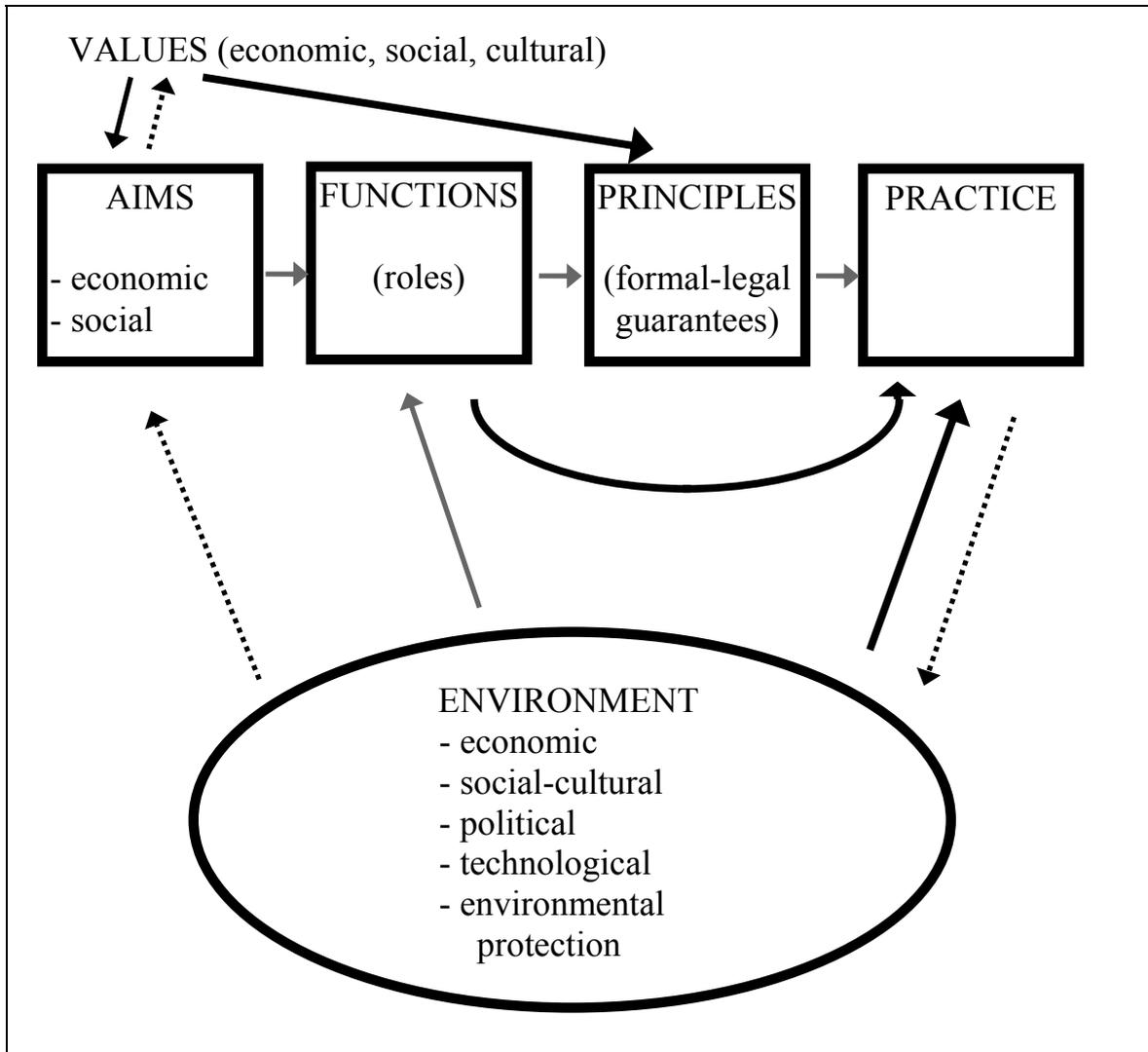
3.5. Relations of elements of the “co-operative identity”

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



Source: Szabó, 1997, 2006, 2008

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 Figure 1) 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 can form 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 Figure 1), 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.

4. Co-operative principles as formal-legal securities of trust in co-operatives

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 problem² (Hendrikse and Veerman, 2001b; Karantininis and Nielsen, 2004; Royer, 1999; Staatz, 1984) usually not as significant like in any other contractual relation between a farmer and Investment Oriented Firms (IOF). We further argue in

² The *hold-up problem*, probably the most known example for ex post problem/cost, relevant in agriculture, “... arises when one party in contractual relationship seeks to exploit the other party’s vulnerability due to relationship-specific assets” (Royer 1999, p. 49). The hold-up problem is significant in the dairy and fruit-vegetable sectors, explaining the existence high share of co-operatives in these industries (Staatz, 1984; van Bekkum and van Dijk, 1997; Kyriakopoulos, 2000). The *members of a marketing co-operative are not likely to fear* that after investing into relationship-specific assets, the other party (e.g. the processor or wholesaler) will change its mind and force them to accept lower prices for their products otherwise terminate their contractual relation.

our paper that *information and some parts of the enforcement costs are lower in co-operatives* due to the special relations and bonds among members.

Beyond the economic advantages of co-operatives there 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 is genuine or not, in case (e.g. in marketing type of co-operatives) is *not right from an 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 be able to keep members with higher patronage and also to be able to gain more capital from members*. It is understandable: if somebody delivers 10 or more times as much raw material (e.g. milk) to the co-operative than others then she or he would like to get higher influence on the governance of the co-operative.

All in all, as a very closely related issue to Transaction Cost Economics and the (democratic) decision-making process, there are a number of potential problems of the traditional (countervailing power) co-operative model (van Bekkum and van Dijk, 1997; Nilsson, 1998b) according to the agency theory (Nilsson, 1998a; Vitaliano, 1983). Regarding solving financial constraints, one of the new features of New Generation or Entrepreneurial type of co-ops is the up-front investments need to be made in proportion of the planned patronage of the members (Nilsson 1997, 1998b; van Bekkum and van Dijk, 1997).

Despite the disadvantages mentioned above, *main advantages* which can be *traced backed to trust in co-operatives* are the followings:

1. 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, authors) is a major co-operative advantage" (Spear, 1999).
2. 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.
3. Third, *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, despite the lack the necessary capital to invest. At least in smaller communities (e.g.

villages) a highly important issue is which *persons are to be responsible* (manage) for the organization of the co-operative.

Generally speaking, *if co-operative principles as safeguards have less power in practice* (e.g. members even do not know them) then probably *less trust will be generated in co-operative* and *it will lead to economic inefficiency* (occasionally to bankruptcy) or conversion to other, more secure and solid organisational forms, like ltd and public companies. The situation in transition countries the situation is even more complicated: co-operative principles (although in most of the cases stated in co-operative legislation) are still “top secrets” even for the members themselves.

The crucial issue for the future of agricultural co-operatives is the loyalty of farmers to their co-op and the leaders of the co-operative, especially under uncertainties dominating in the transition agriculture like in Hungarian fruit and vegetable sector (Szabó, 2008b). There are a number of reasons why members have still loyalty to their co-op and trust on different levels is one of the most important causes. The “organized trust” connected to relational connections in the co-op are crucial factors to solve the first hold-up problem, e.g. prevent post harvest hold-ups (Hendrikse and Veerman 2001b), at least at the relatively low level of product differentiation.

As shown trust is an essential mechanism to increase the loyalty of members to co-ops. In this context we want to stress the definition given by Barton. "A cooperative is a user-owned and user-controlled business that distributes benefits on the basis of use" (Barton, 1989a, p.1). Since in the case of marketing co-ops the user are business (people) themselves we argue that affective types of trust have to be transformed into cognitive types of trust so that the business rational of the members are aligned. In this context the clear understanding of the presented framework of co-operative principals can be regarded as essential. Overall, we assume that also trust is a social construct it should not be forgotten that still in most cases the members of co-operatives are business owner themselves and hence they expect of the co-op a contribution / benefit for their own businesses. Hence trust building has to be understood as trust building between two or more business entities.

5. Conclusions

Because of the new, more market-oriented environment (e.g. more liberal agricultural policies, opening European and world market, etc.) *co-operative execute new marketing strategies and use new management techniques. In order to be able to grasp recent developments, a new, interdisciplinary research* (including 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) *is proposed*. In this paper we have used exchange and management theories, as well as the “co-operative identity” concept to analyse the role of co-operative principles in trust development.

Conversion process taking place nowadays in Europe and US *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 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. Co-operative principles can obstacles (because of more complicated and slower decision making process in the organisation) or can be taken into consideration as formal-legal securities (guarantees) of trust between the members and co-operative, as well among the

members. Co-operatives with a strong and flexible identity can use principles and trust (generated and preserved by those principles) for their advantages thus increase their economic viability.

In the sense of the considerations proposed in this paper can be regarded as a *preliminary study* for further research. *More empirical analyses are needed* on the subject of trust-generating as well as on the development of trust in cases of (agricultural) co-operatives. Authors 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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