

Exploring the Opportunities and Challenges of Network Formation for Cooperatives in South Africa¹

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Abstract

Since inception, modern cooperatives have been instrumental in uplifting the social and economic conditions of people. As an economic model that seeks to advance the collective interest of its members, the cooperative movement has come to be viewed as an invaluable tool for human and economic development. Over the years, a number of challenges (such as the lack of knowledge about the purpose and functions of cooperatives, information, marketing skills and financial resources) have precluded cooperatives in developing countries, like South Africa, from actualizing these esteemed ideals. In some countries, there has been a growing emphasis on network formation by cooperatives as a strategy to overcome some of these challenges. Consequently, the past two decades have witnessed an emerging body of literature on cooperative networks. The bulk of studies on networks have largely focused on how resources and capabilities influence inter-organizational linkages that facilitate access to resources embedded in a network. Such resources include information, financial resources, new technologies and a variety of social capital. This article reviews the literature on network formation by cooperatives and identifies the attendant challenges and benefits. The article also reflects on the lessons that South African cooperatives could learn from these experiences to facilitate the development of a vibrant cooperative sector.

Key words: Cooperatives, networks, economic development, social capital

INTRODUCTION

The importance of the cooperative model in social and economic development has been emphasized over the years. After South Africa's transition to democracy in 1994, the new government adopted the cooperative model as one of the strategies for alleviating the triple challenges of poverty, unemployment and inequality. Despite government's commitments to the cooperative sector, recent studies have indicated a high mortality rate among newly established cooperatives. Recognizing the values of networking for the success of cooperatives from the international literature, this article seeks to explore how networks could be used as a success

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factor for cooperatives in South Africa. Given the appreciable dearth of studies on the networking activities of cooperatives in South Africa, we seek to provide insights into the challenges and benefits of networks for South African cooperatives. The article is divided into three sections. The first section presents an overview of the cooperative model and discusses some of the ideals of the model. In addition, the section explores some of the challenges faced by the South African cooperative sector. In the second part of the article, we review pertinent literature on network formation. The section also reviewed case studies of the networking activities of cooperatives. The third section examines the opportunities and challenges of networks for the South African cooperative sector.

Cooperative as a Model of Economic Development and Social Transformation

Historical evidence shows that human beings have attempted to resolve communal issues through cooperative endeavor (Braverman *et al.*, 1991; Ostrom *et al.*, 2002; Zeuli & Crop, 2004). These cooperative activities were quintessential to the success of primitive agricultural practices. In addition, cooperation at this early stage of civilization was critical for human survival as people struggled against various inclement forces of nature. From this humble beginning of human cooperation, cooperative forms of economic organization have grown into a global phenomenon. As an economic model that seeks to advance the collective interest of its members, the cooperative movement has come to be viewed as an invaluable tool for human and economic development (Njunwa, 2007).

Modern forms of cooperatives emerged in England in response to the harsh economic condition of the industrial revolution (Kokkinidis, 2010). Through the formation of cooperatives, vulnerable people were able to mitigate the high costs of living brought about by the socio-political imperatives of the industrial revolution (Antia, 2003). The Rochdale Society of Equitable Pioneers, formed in 1844, is often seen as the starting point of modern cooperatives. In Africa, the notion of cooperatives can be traced to the pre-colonial era when cooperatives existed in the form of community help. Cooperatives during this epoch took the form of communal work in preparing fields, planting and harvesting crops as well as communal management of grazing fields. Formal cooperatives in Africa are a vestige of colonialism (Brass *et al.*, 2004). During the colonial period, cooperatives aimed at advancing the interests of colonial powers. Consequently,

cooperatives during this era were the exclusive preserve of the colonial powers and were structured towards maximizing the production of cash crops for export.

Despite the advances in the study of cooperatives, various definitions of a cooperative have been used (see McBride, 1986; Nilsson, 1997; Porter & Lyon, 2006). The International Cooperative Alliance (ICA) defines a cooperative as “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 organized and operated on cooperative principles” (International Cooperative Alliance [ICA], 1995). In recent years however, there is growing trend towards accepting the definition of cooperatives by the ICA, an international expert institution on issues of cooperative. The strength of this definition lies in the fact that it synthesizes the disparate definitions of cooperatives. In addition, the definition focuses not only on the economic values of cooperatives, but also emphasizes the social and cultural values of the cooperative movement, aspects seldom recognized in other definitions.

Cooperatives can and do play invaluable roles in poverty alleviation, job creation, general economic development and social transformation (ICA, 1995; Ofuoku & Urang, 2009; Wanyama, Develtere, & Pollet, 2008). As a business model grounded in egalitarian and welfarist ideology, cooperatives are strategically placed to bring about greater benefits to society, unlike conventional capitalist enterprises, which are based on the philosophy of profit maximization. Through the values of self-help, self-responsibility, democracy, equality, equity and solidarity (ICA, 1995), cooperatives are able to impact on the lives of the poor and vulnerable. This is particularly true of developing regions, like sub-Saharan Africa, where almost 80 per cent of the population are involved in subsistence activities such as small-scale agriculture (Nyiraneza, 2007). According to Eade (1997), by pooling their resources to form cooperatives, vulnerable people are able to advance mutual benefits.

Cooperatives have, over the years, made significant contributions to the global economy. It is estimated that worldwide over 800 million people are members of cooperatives and another 100 million are employed by cooperative ventures (Mazzarol, 2009). In a profile of 300 largest global cooperatives and mutual organizations, ICA estimated their assets' worth in the range of US\$30-40 trillion with an annual turnover of US\$963 billion (Cronan, 2006). This underscores the significant role played by cooperatives in the global economy. The important role of cooperatives has attained international recognition as demonstrated by the recent declaration by

the Sixty-fourth Session of the United Nations' General Assembly that declared 2012 as "The Year of Cooperatives"³.

The South African Cooperative Sector

Against the backdrop of the avowed values and acclaimed advantages of the cooperative movement, the government of the Republic of South Africa (RSA) has in the past emphasized the importance of cooperatives as means to address some of its socio-economic problems⁴. To leverage this advantage, the government has actively supported establishment of cooperatives by setting up institutions and structures to nurture and service them. For example, the RSA government, through the Department of Trade and Industry (DTI), provides services such as education, training, linkages to financial institutions as well as assisting them in export marketing and investment (Department of Trade and Industry [DTI], 2012). Government's support of the development of cooperatives is informed by the conviction that they enhance integration of the poor and vulnerable members of society to the formal economy (DTI, 2009). Cooperatives are thus seen to be strategically placed to address some of the socio-economic problems facing the country. Moreover, the cooperative movement's values are well aligned to *Ubuntu* philosophy that is deeply entrenched in South Africa (Moodley, 2009). The *Ubuntu* philosophy is characterized by values of communal good and humanness (Venter, 2004).

The development of cooperatives in South Africa can be located in two streams. The first stream coincides with the years of white domination where the bulk of cooperatives – mainly agricultural cooperatives – were used to advance the economic interests of white South Africans (DTI, 2009; Dyer, 1997; Satgar, 2007). Consequently, various cooperative policies during this period directly advanced white-owned cooperatives (see van Niekerk, [1988], for a comprehensive list of the various South African cooperative policies). The second stream arose with the coming of a democratically elected majority government that sought to redress the prejudice of previous cooperative policies by focusing its support on emerging cooperatives, with particular emphasis on black-owned cooperatives (DTI, 2004a).

³ See <http://social.un.org/coopsyear/> for more details on the International Year of Cooperative.

⁴In a 1999 parliamentary address, Mr. Mbeki, the then president of South Africa stated that "The Government will place more emphasis on the development of a co-operative movement to combine the financial, labor and other resources among the masses of the people, rebuild our communities and engage the people in their own development through sustainable economic activity" (President T. Mbeki, Presidential address to South African Parliament, May 26, 1999).

Despite government's effort in supporting their development, it seems the cooperative movement has been unable to transform itself as expected. This has been ascribed to a myriad of challenges, including a lack of knowledge about the purpose and functions of cooperatives (Dlamini, 2010), absence of information about cooperatives (Gadzikwa, Lyne, & Hendriks, 2007; Ortman & King, 2007), no marketing skills (Koyenikan, 2008; DTI, 2009) and dearth of financial resources (Philip, 2003). This is further accentuated by the small size of a sizeable number of cooperatives making it increasingly difficult to surmount the challenges on their own.

Network Formation: An Overview

The small size of many emerging cooperatives has implications of higher transaction costs when transacting as individual entities. According to Nokovic (2008), the transaction costs approach is anchored on the view that organizations network to reduce cost. New Institutional Economics provides a framework to explore the implications of transaction costs for cooperatives (Dlamini, 2010). As a branch of New Institutional Economics, transaction cost theory seeks to address a weakness of "Neoclassical economics, which presumes perfect information, zero transaction costs, and full rationality, as some of its underlying assumptions" (Gadzikwa, Lyne, & Hendriks 2007:28). Dyer (1997) aggregates transaction costs into four categories: 1) search costs; 2) contracting costs; 3) monitoring costs; and 4) and enforcement costs. The management of these costs has implications for the efficient and effective functioning of cooperatives.

Network formation underscores the cooperative ability of human beings (Ostrom, *et al.*, 2002). Through cooperation, human beings create conditions that facilitate peace and development (Boulding, 2000). This view contradicts the thesis that emphasis the selfishness of the rational agent as epitomized in Hardin's (1968) *The Tragedy of the Commons*. Rather than act as isolated leviathans, organizations are increasingly turning to formation of strategic networks. Granovetter (2005:33) argues that networks impact on economic outcomes of organizations through the "flow and the quality of information" in the network, by ensuring compliance through rewards and punishment and by establishing norms by which members of a network can predict the behavior of participants in the network. Organizations form various types of linkages, which include but are not limited to, "strategic alliances, partnerships, coalitions, joint ventures, franchises, research consortia, and various forms of network organizations" (Ring & Van de Ven, 1994:90).

The past two decades have witnessed a burgeoning literature on business networks. The bulk of these studies have, largely, focused on how resources and capabilities influence inter-organizational linkages (Tang & Xi, 2006). Networks are often seen as self-governing systems (Van Raaija, 2006). The self-governance of network systems is realized through self-regulating structures that are established by actors within a network. Brass *et al* (2004:795), define a network “as a set of nodes and the set of ties representing some relationship, or lack of relationship, between the nodes”.⁵ Arguing from a positivist paradigm, Ring and Van de Ven (1994) see inter-organizational linkages as social constructs. The linkage is non-static, it is constantly evolving due to the actions as well as how individuals interprets the actions of other members of the network (Gulati & Gargiulo, 1999). This view implies that networks constantly adapt to changing internal and external imperatives. Through constant modification, networks adapt, thus becoming strategically placed to benefit its members. While cognizant of the above definitions, we characterize a network or a set of network as organizational linkages which consist of relationships between two or more organizations aimed at leveraging economics of scale and scope, facilitating access to various resources and lowering transaction costs. Such a linkage often cuts across public and private domains consisting of both horizontal and vertical linkages (Dredge, 2006).

Research on networks has majorly focused on the impact (whether positive or negative) of inter-organizational linkages on the behavior and functioning of an organization (Murray, Reynolds, & Taylor, 2006; Tang & Xi, 2006; Menzani & Zamagni, 2010), factors leading the formation of organizational linkage, the challenges and benefits of joining a network (Gulati & Gargiulo, 1999; Méndez, 2002) and issues of governance and legitimacy in networks (Human and Provan, 2000; Brass *et al.*, 2004). Understanding the factors that facilitate network formation – especially between competing firms – has been of interest to sociologists and organizational theorists. The formation of inter-organizational linkages facilitates access to resources embedded in a network. Such resources include information (Tang & Xi, 2006), knowledge and financial resources (Gulati & Gargiulo, 1999; Tang & Xi, 2006), new technologies (Ring & van de Ven, 1994) and a variety of social capital (Tang & Xi, 2006). Through network formation, organizations can counter negative externalities, “acquire resources, reduce uncertainty, enhance

⁵ Nodes refer to the actors (individuals, work units, or organisations) within the network (see Galaskiewicz, Greve, & Tsai, 2004)

legitimacy, and attain collective goals” (Galaskiewicz, 1985 cited in Brass *et al.*, 2004:802). Networks also allow organizations to benefit from economies of scale, economics of scope as well as attain strategic objectives, such as “outsourcing value-chain stages and organizational functions” (Gulati, Nohria, & Zaheer, 2000:2).

The development of inter-organizational theory in the 1960s and 1970s was a response to the awareness of resource dependency between organizations. This dependence has been evident in government reliance on network structures in delivering its services (Agranoff & McGuire, 1999). The complexity of modern society constrains the ability of organizations to act as isolated units (Klijn, 1997). This is accentuated by the fact that organizations often lack the in-house abilities and capabilities required for effective and efficient functioning. The work of Putnam (2001) demonstrates the relevance of networks (civic activities) to improved governance. Agranoff (2007:23) notes that factors necessitating the formation of cooperative networks include the “convergence of forces” in the complex web of modern society “life in an information society, the existence of multiple organizations that make and implement policy, and the need for a variety of resources to deal with the most difficult government problems”. The network approach to organizational linkages is opposed to a didactic view, which opines relationships between organizations from a hierarchical perspective. Similarly, it negates rational organization theory which sees an organization as having distinct goals and power with which it structures and dominates decision-making in a network (Klijn, 1997).

Establishing the legitimacy of a network is a prerequisite for building a successful network, because legitimacy is an essential precondition to eliciting the support of relevant stakeholders and increasing membership of a given network. Embedded resources in a network are invaluable to legitimacy building (Provan & Sydow, 2007). The development of trust between cooperating partners is also instrumental to nurturing legitimacy. Such relationships increase the likelihood of organizations committing more resources to building and sustaining the network (Gulati & Gargiulo, 1999). In addition, trust in a network lessens the fears that potential partners might have about joining a network. Prior contacts between cooperating partners, for example, where contracts were honored, is instrumental in furthering trust and legitimacy. This accounts for the use of informal legal arrangement in conflict resolution in many networks (Brass *et al.*, 2004). Consequently, resorting to external arbitrators can be regarded an indication of eroding trust in a network.

Within a given network, participating organizations occupy different positions. For instance, an organization may form a network with another organization or exist as the focal point of a network, which involves multiple organizations (Menzani & Zamagni 2010). In this sense, the matrix of organizational networks can take a number of forms. This points to the complexity of networks and underlies the dependencies between members of a given network.

Networking and the Cooperative Movement

Across the globe, cooperatives utilize networks to enhance their competitive advantage in the formal economy. Studies have shown that networks play instrumental roles in sustaining the cooperative movement in countries such as Canada, Mexico, Italy, Spain, and El Salvador. Consistent with these studies, Joshi and Smith (2002) argue that cooperating can reduce production costs through buying and negotiating power, sharing innovation, technology and quality upgrade costs, improvement of financial intermediation, attenuating risks through explicit and implicit pooled insurance, coordination of marketing strategies, and developing pertinent professional services.

Given the significance of network formation in determining the success of the cooperative movement, Menzani and Zamagni (2010:20) argue that network formation by cooperatives “is the normal way of operating as a result of their solidaristic dimension”. When cooperatives network, they are living out one of the principles of the cooperative movement: cooperation among cooperatives (ICA, 1995). Networks provide opportunities for cooperatives to develop innovative solutions to various challenges confronting them (Nokovic, 2008). By working together, cooperatives form a network of local, regional and national clusters that provide effective support mechanism to its members. Apart from facilitating access to market and reducing transaction costs, the existence of a strong network of cooperatives also enables them to lobby government on policy issues.

Case studies on network formation by cooperatives have shown that they emerge more easily when there is a high cluster of cooperatives within a given geographical region (see Smith, 2001; Méndez, 2002). For instance, the Mondragon and La Lega cooperative network all emerged in regions, which are characterized by high cooperative densities (Smith, 2001). Densification ensures that cooperatives have easy access to, and are able to interact with other cooperatives. Through interactions, they identify common challenges, which result in the

formation of both formal and informal networks. In addition, a dense network of cooperatives implies that knowledge about the working and functioning of cooperatives abounds – an essential element for governing cooperative networks (Smith, 2001).

The existence of strong networks (e.g. fair-trade networks) has created significant market opportunities for small-scale coffee growers (Méndez, 2002; Murray, Raynolds, & Taylor, 2006). Méndez (2002) studied the challenges and benefits of participating in organic and shade grown coffee fair trade networks by small-scale coffee cooperatives in El Salvador. The study found that for many cooperatives, participation in fair trade network provides alternative markets as it enabled small-scale coffee growers to sell their produce at better prices. Furthermore, coffee growers who took part in fair trade networks overcame challenges such as transportation and storage (Méndez, 2002). By contrast, cooperatives that were not part of the network were forced to sell their produce to available buyers, often at unattractive rates. Membership of networks also brought additional benefits such as sundry technical assistance and services.

Spain and Italy are two other countries where the existence of strong networks of cooperatives has been instrumental in supporting the growth of vibrant cooperatives. In their study of cooperative networks in Spain and Italy, Joshi and Smith (2002) found that the organization of cooperatives into networks makes it possible for cooperatives to reap the economy of scale and scope. In addition, networks provide invaluable services, such as finance, research and development training, organizational development, procurement, marketing, and development of new cooperatives. The services offered in the networks are essential to the survival of the cooperatives themselves.

Founded under the guidance of Don Jose Maria, the Mondragon Cooperative Cooperation (MCC) was central to the development of cooperatives in the Basque region of Spain (Kokkinidis, 2010). It is currently the largest industrial group in the region and the eight largest industrial group in Spain. It contributes about 15% to the GDP of the Basque region and also contributes indirectly to the region's economy. The MCC operates as a diverse entity in various sectors of the economy. This diversification is attributed to the goal of reducing the risks that members might be exposed to in the face of volatile market (Joshi & Smith, 2010).

La Lega, founded in 1886, is one of the oldest cooperative organizations in the world. It is a product of the Labor Movement in nineteenth century Italy. The network consists of about 5000

worker cooperatives, mainly agricultural cooperatives, housing cooperatives, as well as cooperatives that specialize in fields such as fishing and transportation (Joshi & Smith, 2010). Individual cooperatives that form La Lega operate as independent institutions while utilizing the services provided by the network. The organization exists primarily to promote cooperative development through education. Over the years, the Mondragon cooperatives and La Lega developed supporting structures for emerging cooperatives. Such support “has taken the form in both systems of risk mitigation, social insurance, innovation in financial intermediation and institutions, the encouragement of joint ventures and inter-firm alliances, and far-reaching technical innovation and technology transfer strategies” (Joshi & Smith, 2010:46). The networks formed by Italian cooperatives enabled them to reduce transaction costs, thus increasing their profit margins (Menzani & Zamagni, 2010). For efficiency and effectiveness, cooperatives form linkages with other cooperatives, government and private institutions. Networking by cooperatives thus enabled them to harness the advantage of economies of scale and scope.

Fox, Jeannette, and Gracie (2009) investigated whether Canadian agricultural cooperatives were attracted to establishing networks. They uncovered networks of agricultural cooperatives providing a range of services such as promotion, advisory services, research, information sharing, training and education, and advocacy. The study found that without these networks cooperatives would have difficulties accessing the services provided by the network. From these, Fox, Jeannette, and Gracie (2009) conclude that networking – both between cooperatives and with non-cooperative ventures – was instrumental to the development of cooperatives. Therefore, they advocated that Canadian agricultural cooperatives follow suit by organizing themselves into networks.

Cooperative Sector in South Africa: A Case for Network Formation

The experiences of cooperatives throughout the world, together with the knowledge gained from research conducted on them, yield important lessons that are highly pertinent to the South African context. Among the many advantages of networking and networks are the opportunities they afford cooperatives in addressing their challenges as a form of organized endeavor (Fox, Jeannette, and Gracie, 2009; Menzani and Zamagni, 2010). This is particularly important in South Africa where most cooperatives are nascent and struggling to become viable business enterprises (Department of Trade and Industry, 2009). Most of the newly established

cooperatives in South Africa “are mainly owned and operated by previously disadvantaged South Africans, mainly black and females who live in historically marginalized areas” (KwaZulu Natal Department of Economic Development and Tourism, 2009:9). Such socio-economic conditions make it more difficult for such cooperatives to gain access to services, which are critical to their survival.

In South Africa, studies have shown that the small-scale business sector is highly competitive (Hedley, 2012). Furthermore, emerging businesses must compete with businesses which are well established and have years of experience in their niche markets. Cooperatives, as a unique form of small business, find themselves in this highly competitive market condition and struggling to be successful. According to Smith (2001), the chances of cooperatives succeeding in a highly competitive market is compromised by absence of networks supporting the lower end cooperatives. These and other factors underscore the values of the activities, processes and structures of networks, if the cooperative movement is to develop and make valuable contributions to the country’s economy.

In order for cooperatives to give life to networks, an important step is educating members of cooperatives to come to understand and appreciate the values of networking. This would entail prompting them to look into exploring ways of building relationships with other cooperatives, government bodies and private institutions. Government departments and parastatals can play an instrumental role in this area of education. In doing so, care must be taken to ensure that the independence and natural evolution of networks is safeguarded. This will guard against emergent networks being controlled by the government. Over the years, the development and control of cooperative networks in developing countries have stifled the growth of the cooperative movement (Stanford, 2006). Among other things, an overly hierarchical approach misses a critical value for the existence of networks, namely servicing the needs of the members of the network (Smith, 2001). Consequently, a network that becomes subject to government control may fail to achieve meaningful success because the department or ministry that controls a network neither understands nor has capacity to address the fundamental needs that brought the cooperatives to form the network.

Evidence from the case studies reviewed in this article demonstrates that one of the factors that contributed to the success of networking is the existence of a high density of cooperatives

because densification increases interaction among cooperatives. Through interactions, a natural process of group formation is born. In addition, a high density of cooperatives reduces the costs of group formation (Nokovic, 2008). There is therefore a need to emphasize the necessity for supporting the formation of more cooperatives to reach critical mass, which will then stimulate the emergence of networks of cooperatives. Again, this should be a gradual process that builds on the success of existing cooperatives. This is to avoid a situation where the emphasis would be mainly on forming cooperatives without exploring the readiness and capacities of members of such cooperatives.

The success and sustainability of a network is determined by the extent to which it innovates and responds to changing internal and external imperatives. According to Smith (2001), the failure of the Beedi, a cooperative network in India, to adapt is one of the factors that prevented it from recording the kind of success enjoyed by Mondragon and the La Lega. Recognising this, the South African cooperative sector must work out practices, which will enable them to adapt to current socio-economic imperatives. This includes a movement away from the more traditional forms of cooperatives towards new types of cooperatives to obviate the weakness found in traditional forms. This could give rise to resilient cooperatives, helping them not merely to overcome the struggle to survive but also transform them into significant actors in the sectors in which they operate.

The record from Spain and Italy shows that the La Lega and Mondragon cooperative networks built on existing social networks. This is why Smith (2001) argues that network formation would have been more difficult if there was not enough social capital in the Basque region. From this experience, efforts must be geared towards building on the strong solidarity movement in South Africa, which was instrumental in the defeat of the apartheid regime. This includes incorporating the values of *ubuntu* which have been a defining feature of the South African cultural landscape into the cooperative movement.

CONCLUSION

The development of a vibrant cooperative sector is underpinned by the desire to draw on the values and strength of collective action. This article has explored the values of collective action and has shown that these values lie not only in interactions between individuals but between cooperative entities. By forming networks with other cooperatives, cooperatives promote cooperation among cooperatives. Through networking, cooperatives advance their interests as they access invaluable capital that resides in the cooperatives themselves. This is important for the South African cooperative sector in order to become a vibrant sector which could contribute to the lives of people who want to address their social, cultural and economic problems through collective action. The article has shown that in order to develop a vibrant cooperative sector, cooperatives must work towards collaborating with each other and non-cooperative institutions. A starting point in achieving this is to increase the densities of cooperatives in South Africa. Government institutions can be helpful in this respect in facilitating the development of cooperatives.

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