

Starting Co-operative Organisations for Medium and Small Scale Enterprises in Germany

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Background

The number of registered co-operatives in Germany is declining despite an increasing need for co-operation among small and medium sized enterprises (SME). Against this background the Institute for Co-operative Research at the Philipps University in Marburg, Germany, in co-operation with the Department for Small and Medium Enterprises of the Faculty for Business Administration of the University of Siegen, Germany, conducted from November 2000 to March 2002 an empirical research project on the start-up of co-operatives. This research was initially commissioned by the Department for Economic Development in the Ministry of Economics of the Land of Rheinland-Pfalz and the Regional Cooperative Federation of Hessen/Thüringen/Rheinland Pfalz. Subsequently, the Research Fund of the German Central Cooperative Bank (DZ Bank) also supported the project financially.

The purpose of the research project was to empirically test hypotheses about the reasons for the decline in registration of co-operatives. In order to do this, the motives in choosing specific legal forms for a business organisation, co-operative or not, were examined. Other issues looked at included the reasons for certain start-up projects not being concluded and the attitudes of business consultants and legal advisors towards the co-operative form. The research project resulted in a study which was recently published.¹ This article gives an overview on this study which, so far, has been published in German only. Co-operative movements in other countries also face declining numbers in the registration of co-operatives, hence this article examines reasons for this development and endeavours to make the research results in Germany also accessible to the English speaking reader.

Approach of the study

The study begins with a short introduction into co-operative
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theory and SME research. The need for SMEs to co-operate is analysed in the light of the specific business objectives of SMEs and the need for innovation owing to globalisation and the acceleration of technological change. Also examined, is the current discussion among specialists and representatives of co-operative associations on the amendment of the German Co-operative Law. This is followed by an explanation of the research methodology which included a survey on literature, discussions with experts (based on the 'delphi-inquiry', in empirical social research used to select the relevant hypotheses to be tested), the development of a questionnaire, pre-testing in the Land of Rheinland-Pfalz as well as a national survey and the analysis of the replies gathered.

The main part of the study contains the results of the survey on literature, plus the 'delphi-inquiry', and, above all, the survey of four target groups. The groups questioned included new co-operatives among SMEs (start-ups between 1992 and 2000), SMEs which showed interest in using the form of a registered co-operative (in German the registered co-operative is abbreviated to eG), but which finally did not lead to registration (hereafter called 'drop-outs'), associations and joint ventures not using any or another legal form (hereafter called 'non-co-operatives'), and experts which included various consulting professions such as tax advisors, chartered accountants, lawyers and consultants of chambers of commerce (hereafter called 'consultants'). Some results of the survey are examined below.

Design of co-operation

The first question examined was whether the choice of a certain legal form can be attributed to differences in the manner of co-operation. The survey shows that horizontal co-operation among SMEs prevails in Germany. The predominance of horizontal co-operation is especially strong among registered co-operatives (68 per cent) while vertical and complementary co-operation (32 per cent) does exist and deserves attention. Among the 'non-co-operatives' which were questioned, horizontal co-operation accounts for only 37 per cent whereas vertical and complementary co-operation accounts for 63 per cent.

The hypothesis that the registered co-operative is the legal form used mostly for geographically limited co-operation, is not supported by the actual data on newly created co-operatives, since nearly half of all SME-co-operatives operate nation-wide. Apart from this, it becomes clear that they are no longer located in the classical sectors of the German co-operatives such as agriculture but far more often in the service sector (68 per cent).

Formal aspects

Some advantages and disadvantages attributed to the legal form of a registered co-operative (eG) by specialists and federations were perceived differently by the SMEs and consultants who were questioned. Above all, it became apparent that new co-operatives do not express any need for voting rights in proportion to capital contributions. Also, a mere 60 per cent of consultants and only 55 per cent of the 'non-co-operatives' consider the right to vote according to share capital to be important, even though the answers were widely spread among such groups. By and large, the groups confirm the advantages of the German eG as regards easy entry and easy exit, limited liability, take-over protection, and the fact that no minimum capital is required. The fact that there is no participation in the gain in asset value for the departing member seems to be of little importance. Free tradeability of shares is considered only moderately important by non-co-operatives and consultants while new co-operatives and drop-outs argue strongly against free tradeability.

Under current German Co-operative law, both the board of directors and the supervisory committee must be elected from the circle of members. This rule is held by many to be a disadvantage of the co-operatives. Regarding this point, the research did not result a clear picture, since opinions within the four groups differed widely. Among the new co-operatives and the drop-outs who were questioned, slightly more than half were in favour of an administration by office-bearers elected from among the membership. The rest of these two groups were willing to also include non-members into their office-bearers. The willingness to include non-members was even higher as regards the composition of the supervisory

committee. Also, smaller co-operatives tended to be more willing to call non-members into the supervisory committee and some of them would even welcome the abandoning of a compulsory supervisory committee. Among groups of the 'non-co-operatives' and consultants who were questioned, slightly more than half found the rule to elect the office-bearers from among the members to be unattractive. The group of the consultants who were questioned, found that small co-operatives of ten to 15 members should be allowed the option not to have a supervisory committee and a board of directors and instead have only one person in charge. The option of one person in charge was, however, not supported by the majority of the new co-operatives (80 per cent) included in the survey.

Contrary to the widespread argument that the legal form of a registered co-operative is often rejected because of the current legal requirement of the minimum number of seven founder members, only seven per cent of the questioned new co-operatives and only eight per cent of the drop-outs found this minimum number too high. The majority of these groups (93 and 92 per cent respectively) was not of the opinion that this rule is an obstacle. The reality, however, shows that a quarter of these groups started off with only the required minimum number of members. However, among the 'non-co-operatives' and the consultants who were questioned, the answers to this question differed widely. In fact, more than half of the 'non-co-operatives' started with less than seven founders.

Pre-registration audit and compulsory audit

The formal pre-registration audit, which is compulsory for German eGs and which is frequently considered to be expensive and tedious, is often on hindsight recognised to be reasonable by most co-operatives. Slightly more than half of the new co-operatives admitted that the audit has been important for them in view of organisational and start-up problems. Among the questioned 'non-co-operatives', around 70 per cent considered an audit of the business concept prior to start-up as unimportant. Within the group of drop-outs, those who continued co-operating in another legal form generally had a more negative picture of the pre-registration

audit than drop-outs who ended their co-operation as a result of the audit.

The fact that registered co-operatives may not select their auditors themselves is seen as a great drawback by 'non-co-operatives' but not necessarily by registered co-operatives. The co-operative audit which also includes the evaluation of actual or potential member-promotion resulting from co-operation, is of little relevance to non-co-operatives. Co-operatives in the primary sector (agriculture, forestry and viticulture), however, deem this evaluation an important advantage for the co-operative form and cherish its embeddedness in the federative auditing structure.

Image and knowledge

The relevance of a positive image of a legal form has been explicitly confirmed in the 'delphi-inquiry'. The choice of the organisational form of co-operation depends particularly on whether or not a legal form is perceived to be up-to-date and more than 80 per cent of the questioned co-operatives consider their legal form to be the case while only 20 per cent consider the legal form of co-operatives out-of-date. However, nearly 70 per cent of the questioned 'non-co-operatives' see the co-operative legal form to be more or less out-of-date and only 30 per cent consider co-operatives up-to-date. Co-operatives are mainly associated with agriculture and credit, hence, many other business firms were not aware that the co-operative form might apply to their own business needs. In analogy, consultants feel less familiar with the co-operative form than with the limited liability company or other legal forms, about which, in their own assessment, they have more knowledge.

Promotional politics

The survey shows that the legal framework conditions neither fully determine the attractiveness of a specific legal form for SME-co-operation nor do such conditions create an exclusiveness for the use of the co-operative legal form for SMEs. Economic considerations and the advice received are just as important in the process of choosing a legal form.

From the author's point of view the first need is for federations, consultants and politicians to make the co-operative form better known again. This could be done for example, through co-operation between co-operative and other business federations/associations such as chambers of commerce, employers' and professional associations and social welfare organisations. Also, it would be necessary to positively advertise the benefits of a pre-registration audit.

Meanwhile the Confederation of German Co-operatives (DGRV) has started three working groups aimed at the promotion of co-operative enterprise within public services, trades and crafts and health care. This could be seen as an important step. These working groups should use all means at their disposal to raise levels of awareness and knowledge about the eG. Such means could include the development of a 'training module' for advisors, publications of 'best practices' as well as the placement of co-operative subject matter in the media. One could also encourage economic policy makers at national, regional and local levels to include co-operatives into their strategic planning, especially where the privatisation of public services is being considered or being implemented.

Interested groups could be provided with information on co-operative advantages, especially about the inherent protection from take-over which the co-operative form offers, the possibility of legal persons being members and about the role of democracy in the strategic management of co-operatives.

Co-operative research and teaching must be maintained if not extended. Many general business concepts might be applicable to co-operatives. Yet, tax advisors, business consultants, attorneys and accountants admit to having major knowledge deficits about this enterprise form, because text books and course work seem to neglect it. Research deficits exist in regard to the specifics of cost-benefit-ratios for co-operatives composed of SMEs engaged in personal services, in regard to governance structures and in regard to property rights. The objective must be to render the co-operative form more attractive in comparison with other enterprise forms. The demand for a typical co-operative organisational structure lies primarily with medium and small scale enterprises in the trades, among the professions as well

as among middle class consumers and the recipients of social services.

Also, regional and sectoral federations should co-operate more closely with each other, since many new co-operatives with SME members have a wider than regional scope, some being even international (eg Intersport). Such enterprises possess complex structures and sometimes show such rapid growth that they are forced to purchase external services and goods at a rate and of a kind that no federation is likely to provide by itself. It would thus make sense for federations to think about complementarities and synergies with each other and perhaps to specialise, otherwise federations should not attempt to offer services which go beyond those they are legally bound to offer.

Summary and outlook

In short the results of the study which are most relevant to promotional efforts can be summarised as follows:

- The German eG is seen to have some advantages for co-operation among SMEs: easy entry and easy exit for members, limited liability, take-over protection, and no minimum capital is required.
- Nearly half of all SME-co-operatives operate supra-regionally.
- New co-operatives do not express any need for voting rights in proportion to capital contributions.
- The fact that there is no participation in the gain in asset value for the departing member and no free tradeability of co-operative shares seems to be of little importance to co-operative founders.
- The issue of whether or not only members should be eligible for offices in the co-operatives, is seen differently depending on size. Small co-operatives want only one board, preferably small, while larger co-operatives prefer to have both board of directors and supervisory board.
- The minimum number of seven members to start a co-operative does not seem an obstacle to the choice of this form.
- Pre-registration audit by the federations can be made attractive to starting co-operatives.

- Too little is known about the inherent advantages of the co-operative form to legal and business consultants who influence the choice of legal form. Especially little is known about the inherent protection from take-over which the co-operative form offers.
- There is a great deal of scope for new co-operative endeavours among professionals, in trade and social services.

In order to achieve sustainable effects, meaning more co-operative start-ups, it is clearly not enough to change the co-operative law. Rather it is important to tackle the task of popularising this legal form effectively. This involves reaching as many consultants, business organisations, associations and federations in the economic and social fields as possible as well as interested politicians with clear, transparent and relevant information, material and advice.

Some smaller conferences, especially on perspectives for social service co-operatives as well as co-operatives in energy supply or distribution have been organised by the German Association for the Promotion of Co-operatives and individual persons such as one of the authors in her university environment. The interest of professional groups, NGOs and entrepreneurs has been positive. However, pre-planned co-operation between the various federations on promoting the idea over wider sectors has so far remained limited.

From the authors' point of view one possible first step towards this mainstreaming task would be a national strategic workshop among co-operative federations and co-operative specialists. The objective of such a conference would be to develop creative ideas and a common strategic action plan for co-operative start-up promotion. Such a workshop, if facilitated as a 'future workshop' (workshop methodology to transform visions into action), could result in a significant impetus.

In the end, however, a concerted effort is needed on all sides: the co-operative federations, the co-operative finance sector, business associations, welfare movements and politicians at all levels need to work together to bring to the fore the economic potentials inherent in this legal form. Such economic potentials are short in supply in these days of cuts in public spending, lack of entrepreneurial capacity and major

economic threats for SMEs.

Note

- 1 Göler von Ravensburg, Pinkwart and Schmidt, "Kriterien für die Gründung mittelständischer Kooperationen in genossenschaftlicher Rechtsform" (Criteria for the Establishment of Business Associations under Co-operative Legal Form), 104 pages, Volume 99 of the series of monographs on co-operative research of the Institute for Co-operative Research in Marburg (Marburger Schriften zum Genossenschaftswesen). The publication can be ordered at any specialised bookshop or from the Institut für Genossenschaftswesen an der Philipps-Universität Marburg (<http://www.wiwi.uni-marburg.de/lehrstuehle/einrinst/genossen>, email: genossen@wiwi.uni-marburg.de).