

## Cooperatives: Tools for Delivering Development Assistance

### Q. What are cooperatives and cooperative development organizations? How do they help foster sustainable development?

**A.** At the most basic level, a **cooperative** is a business owned by people who are also its customers. The members are suppliers or customers who benefit from the cooperative in a proportionate share of the profit or proceeds based on the business they do with the cooperative. A cooperative is owned by its members, and they exercise control over the business through a democratic system which gives all members a voice in governance decisions. In contrast, an investor-owned business is owned by shareholders who provide capital (invested capital) and receive proceeds (dividends) in proportion to the size of their investments in the business.

A **cooperative development organization (CDO)** is an organization dedicated to the creation and strengthening of cooperative businesses. In the United States, there are CDOs operating as nonprofits or as profit-making consulting firms that provide assistance to cooperatives in their formation, management and strategic-planning processes. Most CDOs are member organizations (associations or cooperatives) that have engaged in international development based on a commitment to social responsibility and a desire to spread the cooperative model. CDOs have a direct connection to cooperative businesses and are committed to helping form and strengthen cooperatives in developing countries. These organizations believe that the inclusive, member-owned cooperative business structure can help achieve equitable economic growth, as well as foster non-economic social and democratic benefits.

CDOs represent a 50-year legacy of stimulating economic growth, reducing poverty and fostering democratic governance systems in developing countries. CDOs help people organize cooperatives, so they can overcome the failure of investor-owned businesses to adequately provide goods and/or services at equitable prices or rates. Because the cooperative is their enterprise, the benefits realized from the business operations (profits or returns) are distributed to the members according to their participation in the entity's activities.

This *NGO Tips* paper discusses the distinct character of cooperatives and how CDOs employ this approach to help foster sustainable solutions for reducing poverty.

### CDO and Key Development Sectors

In the U.S., cooperatives have played a significant and constructive role in addressing market failure in sectors including infrastructure, health care, housing, insurance, agriculture, food systems and artisanal crafts. Relying on first-hand

knowledge and experience, CDOs have delivered programs and projects that have helped people in the developing world empower themselves and their communities. By fostering the creation of cooperatives, they have addressed the

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### Cooperative Development Organization (CDO) History

U.S. CDOs began their international development efforts just after World War II when they helped rebuild a devastated Europe. Two organizations were instrumental in galvanizing these efforts, the Cooperative for American Remittances to Europe (CARE) and the Cooperative League of the United States (CLUSA), which is now the National Cooperative Business Association.

In the following decades, other U.S. CDOs became engaged in building prosperity in poor countries by focusing on infrastructure (electrification and communications), financial services and agriculture. In 1961, the Foreign Assistance Act recognized the key role of cooperatives in international development, not only as an economic development tool, but also as an instrument for fostering democratic governance.

lack of reliable and affordable goods and services offered by investor-owned businesses.

For example, 75% to 80% of the world's poor people live in rural areas where agriculture is the primary livelihood. Farmer-owned cooperatives help small producers increase their leverage and stature in the marketplace 1) by bringing greater volumes of product to market or 2) by purchasing inputs in larger and more efficient bulk orders, thereby allowing them to sell these goods to their members at reduced prices.

Agriculture is part of an interconnected web of economic interactions. Rural development needs are met by improving agricultural productivity, but also by:

- Strengthening farmers' connection to markets;
- Providing information systems that enable farmers to make more informed production and marketing decisions;
- Increasing farmers' shares of the value of their production;
- Improving the infrastructure that allows trade to take place (roads, electricity and communications); and
- Facilitating the availability of production inputs, including financial services.

In each of these areas, cooperatives play a significant role.

In urban areas, cooperatives also provide solutions to problems faced by poor people, including inadequate or sub-standard access to housing, finance and health care. Because cooperatives are not sector specific, they can be used in a wide array of sectors to help overcome development challenges.

Market failure is one of those challenges. It occurs when goods and services are inefficiently provided or returns to capital and management are above competitive market rates. Some common explanations given for market failure are a lack of competition, high levels of perceived risk and a concern that moral hazard (cheating) may be difficult to control. Market failure is thought to occur frequently in rural areas and among poor people in low-income countries. Not only can a cooperative provide needed products and services, its membership structure can be a means of improving information, reducing moral hazard and encouraging loyalty, which in turn increases the competitiveness of the cooperative.

### What Makes an Organization a Cooperative?

Whether in the U.S. or abroad, people organize cooperatives to:

- Make services available to people who may not be able to obtain them elsewhere;
- Provide a market aggregation function, so that producers can leverage

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their market power by jointly accumulating their outputs and marketing them in bulk;

- Add value to raw commodities, which enables cooperative members to engage in more sophisticated and usually more profitable elements of the value chain;
- Allow members to realize economies of scale in purchasing needed inputs and supplies; and
- Combat exorbitant interest rates on financing or monopolistic price setting when producers represent a captive market for the limited services available.

There have been various sets of principles defining cooperative organizations; however, all agree that to be a cooperative, an organization must:

- Meet an economic need of the members. In most cases, a new entity is needed to overcome market failure, such as insufficient market power on the part of producers or the inability to obtain goods or services from investor-owned businesses.
- Be owned by its members. Members are the primary sources of capital and owners of the benefits (profits) generated by the organization.
- Be controlled by the members through a democratic decision-making process. Members exert control by voting for leaders, such as directors, and voting for resolutions which guide the direction of the organization in regularly held annual meetings.
- Distribute profits realized by the cooperative business to members according to their proportion of use of the cooperative's services or production.

### What Cooperatives Are Not

While it is important to know what cooperatives are, it is equally important to recognize what cooperatives are not. Over

the past century, many organizational structures have been called cooperatives that fit neither the true definition nor the spirit of the principles of cooperatives. In some cases, the deficiencies of these pseudo-cooperative organizations have created a bad image for cooperatives.

Governments may play a positive role in supporting cooperative formation by establishing an enabling legal environment, and in some cases, providing initial capital to support the creation of cooperative businesses and systems. However, the proper role for government does not extend to control over cooperative management beyond regulatory control. This regulatory control should be essentially the same as that imposed on all businesses (not just cooperatives) in order to assure that sound business practices are applied. For example, regulations may set capital standards for financial institutions or prompt payment requirements on business transactions.

### The Role of Cooperatives in Fostering Sustainable Development

As owners of the business, a cooperative's members have a stake in its effective operation. Typically, as cooperatives gain size and scale, larger numbers of previously poor and disenfranchised people become stakeholders in the economy and receive economic benefits directly through improved services and financial distributions from the cooperative.

In contrast, the profits of investor-owned businesses go to their shareholders in proportion to the size of their investments. In many instances, investment holdings are concentrated among people who already are financially secure. So, while investor-owned businesses do contribute to economic growth, unlike cooperatives, their benefits are rarely shared equitably and they do not necessarily provide a sustainable means for large numbers of people to benefit from their growth.

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**Cooperatives are not government-created business entities or public utilities.**

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### Non-Economic Benefits of Cooperative Development

In addition to providing a solution to members' business and economic needs, cooperatives also promote desirable social and democratic practices. In many cases, participation in a cooperative's governance system is an individual's first experience in joint decision-making or participatory democracy. Cooperatives provide a mechanism for community involvement in setting priorities for health care, education, investment and social services. Cooperatives also create a channel for building social capital and trust, and have been effective at bridging ethnic divides, particularly in post-conflict situations.

### Challenges to Making Effective Cooperatives

When working to form and organize successful cooperatives, CDOs must effectively address challenges at three levels: macro-economic, business strategy and organizational governance.

Any form of business faces organizational and operational challenges. Even in the developed world, at least half of start-up businesses fail within their first year. The challenges are multiplied when starting a business in a developing or transitional economy, where there is a high degree of risk due to economic instability, poorly structured markets and little or no regulation.

In addition to these typical challenges, cooperatives face several additional hurdles that are unique to them. The primary challenges include inappropriate policy schemes, market distortions and improper intervention by government. But while these pose obstacles to success, they are not insurmountable. CDOs that have experience with such situations can help guide nascent and developing cooperatives through the difficulties in their particular markets or countries.

Over and above the prevailing macro-economic issues that can pose challenges to successful operation of a new cooperative, there also are business issues that require sound analysis and appropriate planning. A cooperative, like any other start-up business, must analyze the market opportunities and consider questions including:

- Is the business strategy sound?
- Is the product or service well suited to the market?
- Is there competition that may be more efficient?
- Can the cooperative raise the required capital?
- Is there good management available?
- Are the external economic factors (inflation, regulation, etc.) favorable?

Finally, because cooperatives are group-owned and controlled, they also must successfully navigate a process of establishing sound organizational structures and practices. Among the fundamentals critical to the success of the cooperative are:

- Is the purpose of the cooperative well articulated, commonly accepted and shared by the membership?
- Is there good leadership by the elected board?
- Is the governance structure inclusive?
- Do members have knowledge, judgment and information to make sound business decisions?
- Is there an appropriate segregation of responsibilities between management and leadership?
- Is the prevailing legal and regulatory environment conducive to proper functioning of sound cooperatives, or do the legal requirements prevent co-ops from operating in accordance with recognized cooperative principles?

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### CDO successes include:

- More than 28 million people in Bangladesh being served by electrical cooperatives.
- More than 2 million people in Colombia being served by insurance cooperatives.
- Over 53,000 credit unions in a multitude of countries helping to provide financial services to 185 million people worldwide.
- 100,000 dairy cooperatives in India serving more than 12 million members.

### Benefits of Successful Cooperative Development

Despite the challenges, Cooperatives have proven themselves to be a successful means of lifting people out of poverty and helping to meet their demands for goods and services. Cooperatives provide a vehicle through which people can engage directly in business operations by: delivering products to the cooperative; engaging in the production process; buying goods and services from the cooperative; and by participating in the organization in a leadership capacity.

Cooperatives have allowed people to engage in economic expansion where they might previously have been disregarded, underserved or taken advantage of by

market forces. While the challenges to getting cooperative development done well are significant, the benefits that can be realized through effective organization of cooperatives in developing countries are significant in terms of size, scale and equitable development.

CDOs have many years of experience working to build cooperatives and cooperative systems throughout the world. Each CDO has its own set of guidelines, manuals and processes for establishing and supporting cooperatives to grow and thrive. Considerable background information is available at the Web site of the U.S. Overseas Cooperative Development Council ([www.ocdc.coop](http://www.ocdc.coop)).

#### For more information:

This NGO Tips brief is available online at [www.NGOConnect.NET](http://www.NGOConnect.NET). This dynamic and interactive site is dedicated to connecting and strengthening non-governmental organizations (NGOs), networks, and support organizations worldwide.

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