VORTRÄGE UND AUFSÄTZE

DES FORSCHUNGSVEREINS FÜR GENOSSENSCHAFTSWESEN

HEFT 29

AGRICULTURAL CO-OPERATIVES ARE FACING A CHALLENGE

Eigenverlag des FOG

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Wien 2004

Eigentümer und Herausgeber: Für den Forschungsverein für Genossenschaftswesen:
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Perspectives of Agricultural Co-operatives in Austria*

By Johann Brazda

Austrian agriculture is at present facing enormous challenges. The Common Agricultural Policy (CAP) of the European Union is to be changed, the enlargement of the Union and the coming WTO-negotiations will have to be faced. The question arises: is Austrian agriculture ripe for these challenges. One thing can already be said with considerable certainty: Austria's agricultural structure will be hardly recognizable after all these changes. Our agrarian structures are going to be faced with a major upheaval. This upheaval will entail a change in the structure of agricultural co-operation as well, i.e. co-operatives will be influenced by the changed agricultural structure in their respective fields of activity. They will have to become more integrated in horizontal and vertical value chains based on their proximity to food production and marketing. If the co-operatives want to continue to play a leading role in their fields of activity, then an analysis about their repositioning and new orientation has to be done. The agricultural co-operative in its traditional sense will probably cease to exist in Austria within a few years. According to regional situations there will be differently shaped co-operative units. Changing environments influence the chances and risks of co-operative development. They entail new needs of co-operative members and at the same time challenge the co-operative enterprises to adapt to structural change.[1] Especially important are changes which regard the number, size, orientation and organizational form of co-operative enterprises. The present article is to analyze the question whether the coming structural changes necessarily entail concrete visions of new co-operative structural models.[2]

1. Austria's agricultural structure

According to Austria's agricultural structure statistics of 1999 farms and forestry enterprises are active on approximately 7.5 mio.

* Translation by *Robert Schwdiwy.*

1 cf. *Engelhardt, W.W.:* Die Genossenschaft als Gestaltungsprinzip, in: *Laurinkari, J.* (ed.): Genossenschaftswesen - Hand- und Lehrbuch, Munich/Vienna 1990, p. 12.

2 cf. *Engelhardt, W.W.:* Allgemeine Ideengeschichte des Genossenschaftswesens, Darmstadt 1985, p. 31.

hectares of land.[3] 43 per cent of this area is used for forestry purposes (50 per cent of it being situated in the Austrian regions of Styria and Carinthia). 45 per cent serve non-forestry purposes (they are mostly situated in the eastern parts of Austria). 26 per cent of Austria's total agricultural area are permanent meadows, only 19 per cent consist of fields. The rest are permanent cultures like vineyards and orchards. The structure of agricultural production in Austria differs widely according to the climatic, topographic and economic situations of certain regions. The differences in agricultural production are responsible for regional divergences in the development of agricultural production and value-added over the years.

217.500 enterprises cultivate Austria's agriculturally used area. Only 37 per cent of these enterprises are run by full-time farmers. 60 per cent on the contrary hold another job, that often serves as the main source of family income and 3.6 per cent of farms are owned by corporations.[4] The number of agricultural enterprises fell by 9 percent between 1995 and 1999. This is part of a continuing process: Austrian farmers are becoming fewer and fewer. At the same time farming as a full-time occupation is gaining ground. Austria's region with the highest number of agricultural enterprises (25 per cent) and the largest agriculturally used surface is Lower Austria. It is followed by Styria (22 per cent) and Upper Austria (19 per cent). Austria's agriculture is still dominated by smallholders - two of three farmers work on less then twenty hectares - there is, however, a trend towards larger units. A comparison of 1995 and 1999 shows that the number of the smaller holdings decreased (especially those below 5 hectares). On the other hand, the number of enterprises with more than 50 hectares of land is increasing. 7.000 agricultural enterprises (3 per cent) already farm an area of more than 100 hectares. Enterprises with more than 200 hectares cultivate 41 per cent of Austria's agricultural area.

Compared to its size Austria is the most mountainous area in Europe. Three quarters of its surface consist of alpine area. 52 per cent of agricultural enterprises are situated in the mountains. 85.400 (37 per cent) of the existing units are classified as mountain farms. The share of agriculture in Austria's gross national product of 2002 amounted to 1.7 per cent (1.4 per cent of gross domestic product at

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[3] cf. Statistik Austria (ed.): Statistisches Jahrbuch 2004, Vienna 2003, p. 37.

[4] ibid. p. 286 (Agrarstrukturerhebung 1999).

market prices). This share has remained unchanged during the last three years.

During the first half of the 1990s Austria's agricultural and forestry lost on the average 5.5 to 6 per cent of employees per year - more than during the years before. Between the beginning of 1996 and the end of 2001 the process of labour outflux from agriculture was reduced by about half. In 2002 182.500 workers were employed in the agricultural sector (statistically corrected for seasonal fluctuations). This was 1.3 per cent less than the year before. 154.754 of these jobs were performed by people from the farmers' families. In total the agricultural quota of employment has decreased during the last years at an equal pace with the reduction of farmers. In 2002 only 5.1.per cent of all employees were working in agriculture and forestry. At the same time investment by agricultural enterprises showed a marked tendency to rise since the beginning of 1996. However, investment decreased by 1998 and was diminishing until the end of 2000.[5] At the same time more agricultural enterprises are dissolved than before. This development seems to indicate that the agricultural enterprises differentiate in their expectations and strategy for the future. One part of them is betting on rapid growth and hopes thus to secure its economic future. Another part, however, seems ready to resign in view of increasing competition in the EU unified market. A third part is looking towards more extensive management of its enterprises and other than agricultural income strategies.

As far as agricultural incomes are concerned the years 1994 (the last year before Austria became part of the EU) and the year 1995 were good years.[6] After this period agricultural incomes got under pressure. In 1996 to 1999 agricultural income decreased. In the years 2000 and 2001 there were increases of income but in 2002 incomes fell by almost 7 per cent and in 2003 by 5.5 per cent. Average percentage growth of agricultural income since 1994 amounted to 2.4 percent. This means that the income disparities compared with respect to the other groups of society are increasing. The basic factor of this development are the transition measures connected to Austria's EU entry in 1995. During four years decreasing compensation payments were an essential element of these measures. For the first EU year,

[5] cf. Grüner Bericht 2001, Vienna 2002, p. 128.

[6] cf. LBG (ed.): Buchführungsergebnisse 2002, Vienna 2003, p. 3.

i.e. 1995, these compensation payments were relatively generous, they amounted to almost one fifth of all income from agricultural and forestry. For the following years the decrease to 60 per cent, 40 per cent, 15 per cent und than 0 per cent showed, however, a rather steep character. This amounted to a yearly curtailment of about 5 per cent of total agricultural income.[7] Almost one fifth of the income of agricultural enterprises can, however, still be attributed to the public sector: there are area, animal and product premiums according to EU's Common Agricultural Policy (CAP), there are environmental subsidies, compensation subsidies and other subsidies.[8]

A further factor generating income reduction in the field of agricultural and forestry was the opening of the price gap. The terms of trade between agricultural products and the goods and services bought by agricultural and forestry have developed to the disadvantage of agriculture production. Austria's agriculture is at present characterized by a strong heterogeneity of its production conditions because of regional differentiation and climatic differences. On the other hand it is characterized by strongly varying farm sizes and different entrepreneurial goals.

2. Austria's agricultural policy

Austria's agricultural policy is called eco-social. (The eco in this term standing for ecologically oriented, not so much for economic). It rests on three pillars: sustainability, full area cultivation and multifunctionality. Multifunctionality is a basic reason for the idea of cultivating the full manageable area: this means agriculture is supposed to offer a variety of services based on professional and part-time farming.[9] The idea of utilizing all useable land cannot be linked to production efficiency in the strict sense. In times of massive overproduction it is especially difficult to justify subsidies for sub-optimal enterprises. The problem is that Austria's agricultural production is

[7] cf. *Schneider, M.:* Agrarsektor 1999: Produktion steigt, Einkommensdruck hält an, in: Der Förderungsdienst 7/2000, p. 221.

[8] cf. LBG (ed.): Buchführungsergebnisse 2002, Vienna 2003, p. 4.

[9] cf. *Pevetz, W.:* Die Multifunktionalität der österreichischen Landwirtschaft, in: Der Förderungsdienst 6/1998, p. 194.

to a very large extent situated in marginal areas.[10] Only a very small part of our agricultural area is situated in those top regions which are competitive in a globalized market. This means from a purely technical point of view agricultural production in Austria should be given up completely in many places because it is not viable under competitive circumstances. On the other hand agriculture contains a multifunctional element and this element is an undisputed fact in Austria's and even in European agriculture. On the basis of this commitment a political need for protection can be derived. The question is how this is to be done.

Basically the manyfold forms in which agriculture contributes to the wellbeing of society are to be regarded as equally valuable, even if up to now only the market services were subsidized. These different functions can be linked to each other or they may appear separate from each other. Each function gives a right to income, because without income-effect the fulfilling of the farmer's function is in danger. In today's society the farmer's role in the productive function of food and animal feed is only one function of many and not always his most important one. However, it plays a special role because without it all the other functions would be without a base. Cultivating the land means much more than agricultural production but without agricultural production e.g. landscaping would be only done on golf courses and skiing slopes.[11]

Accepting the multifunctionality of agriculture implies two aspects. Firstly agricultural production has to be regarded as the basis of pluri-functional service production. This means e.g. that the farmer's role as a landscape gardener cannot be continued without his production of primary goods (food and animal feeds). The conservation and creation of a cultivated landscape, an aspect desirable from a general economic point of view can only be done via the detour of the production of primary agricultural goods. Together with this production, however, the demand for the services of a superior servicing unit is generated. If we want cultivated alpine landscape in its pre-

[10] The EU's CAP-reform 2003 forces a total severance of the ties between direct subsidies and production, the individual EU nations, however will enjoy a large leeway with regard to their national adaptation of CAP. (cf. *Miller, J.*: EU-Agrarpolitik im Lichte der GAP-Reform, in: Ländlicher Raum 2/2004, p. 2).

[11] cf. *Pevetz, W.:* Die Multifunktionalität der österreichischen Landwirtschaft, in: Der Förderungsdienst 6/1998, p. 195.

sent form, we need the financing of this good which is e.g. sold by the tourism-sector as well.

Based on the heterogeneity of production of Austria's agricultural production and of its regional differentiation and different sizes we will look next at the possible further developments that can result.

3. Scenarios of Austria's agricultural structure

We will look at multifunctionality according to the main eight production areas as defined by Austria's agricultural statistics[12] (1.High Alps, 2. Lower Alps, 3 Eastern end of the Alps, 4. Wald- and Mühlviertel, 5. Carinthian basin, 6. Pre-alpine area, 7. Southeastern plains and hills, 8. North eastern plains and hills). To simplify our analysis we will reduce these eight main production areas to three structural areas, which are characterized by a dominant form of agricultural enterprise:[13]

- The area of the "High alps" is maintained as the largest single area and will be characterized by the term "Subsidy". In this field the aspect of maintenance of culturally formed landscape and agricultural production is dominant The dominant form of agricultural enterprise is the feed-farmer.
- In the areas "Southeastern plains and hills" and "North eastern plains and hills" the highest number of cash crop farms is concentrated. These areas are taken together to define our structural region "Global".
- The production areas "Lower Alps", "Eastern end of the Alps", "Wald- and Mühlviertel", "Carinthian basn" and "Pre-alpine area" are taken together under the structural term "Part-time". Here there is a concentration of live stock farms.[14]

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[12] cf. Statistik Austria (ed.): Agrarstrukturerhebung 1999 Gesamtergebnisse, Vienna 2001, p. 30.

[13] The Statistik Austria differentiates cash crop farms, feed-farms, live stock farms, permanent crop farms, mixed farms, vegetable units, forestry enterprises, combined units and non-classified farms. (See. Statistik Austria (ed.): Agrarstrukturerhebung 1999 Gesamtergebnisse, Vienna 2001, p. 21.)

[14] cf. *Draxler, G.:* Der Agrarstrukturwandel und seine Auswirkungen auf die Warengenossenschaften im System Raiffeisen, Dissertation, University Vienna 1999, p. 20ff.

3.1. Structural area "Subsidy"[15]

The area of "Subsidy" covers the largest part of the cultivaled areas of Austria used by tourism. There is a massive interest of society and of the tourist sector to maintain this landscape. However, as during the whole second half of the last century when many agricultural areas were turned into forests, during the next years will be not be every square meter of agriculturally used area maintainable. From a global economic point of view it is not understandable why a reduction of the alpine agricultural area by about 15 per cent should have a dramatic impact of the whole of the Austrian economy. It should not be the aim of a rational agricultural policy to call for the maintenance of all agriculturally used areas. The smallholder structure in this area will basically be continued. There will be few rationalization possibilities as far as economies of scale are concerned (except some favored areas in larger alpine valleys). However, smallholders will be able to survive only via direct subsidies. All of those who benefit from this aspect of the farmer as a landscape gardener will have to pay for the costs of it. Sometimes the tourism sector will have to pay more, sometimes the public.

Basically one can say about this structural area ("Subsidy")

- The basic farming structure is going to be maintained. Production conditions will not allow any radical rationalizations.
- There will be a reduction of agriculturally used area by about 15 per cent in those regions where the maintenance of these areas is not justifiable by general economic ends.
- Subsidization has to be direct subsidization and thus subsidization of the existing of farming not of the quantity of its produce (product prices).
- In the area "Subsidy" feed producers are dominant.

3.2. Structural area "Global"[16]

The most decisive changes in agricultural structure will happen in this area. An indication for this is the fact that only in these

15 ibid. p. 26.

16 ibid. p. 30.

regions a type of production is possible that can become competitive inside the unified European market. 65 per cent of cash crop farms are situated in this area.

Here agricultural enterprises have to create large units. At present the enterprises show an average size of 25 hectares. If this is pushed up to 70 hectares a drastic reduction of enterprises would follow.

Basic theses for this structural area "Global"

- These enterprises have to participate (relatively fast) in global or at least in European competition.
- There is a structural adaptation for cash crop farmers via mergers. This offers the problem of the property rights of the factor land.
- There will be a sizeable reduction in the number of agricultural enterprises in this area.
- There are no general economic incentives to impede this structural adaptation.
- In the structural area "Global" cash crop farms are dominant.

3.3 Structural area "Part-time"[17]

Structural area "Part-time" is the largest one as far as total area and the number of farmers is concerned. Therefore in this area less well defined developments are to be expected. These areas are going to be put under a higher pressure to adapt than the producers from inner alpine regions. The reduction of farms and the reduction of agricultural activity in the direction of part-time job are possible avenues for development. Since many farmers and to cling to their land they will mostly tend towards the second reaction.

Basic theses regarding the structural area "Part-time":

- high pressure towards structural adaptation
- reduction of cultivated areas by around 10 per cent to be expected

[17] ibid. p. 33.

- massive tendency towards part-time agricultural activity
- problem of the transfer of property rights
- in the structural area "Part-time" live stock farms are dominant.

The changes in Austria's agricultural structure especially in the areas "Global" and "Part-time" will be dramatic. Of the present 215.224 agricultural enterprises probably only 190.000 will continue and in some areas this reduction might be percentagewise much more important. Percentage reduction, however, will not reflect in an accurate way income reduction. This means many enterprises will be continued (because of the emotional ties of the farmer towards his land) in spite of the fact that they will be able to contribute to a much lower extent to the income of the farmers.

This scenario in itself does not address the co-operative aspect. It forms, however, the basis of our following analysis with regard to the future servicing aspects of agricultural co-operatives.

4. Raiffeisen co-operatives

Since their foundation more than a hundred years[18] ago Raiffeisen co-operatives in Austria have become important mainly in three sectors of the country's economy:

- Originating from the rural regions a strong network of co-operative Raiffeisen Banks was created. Today Raiffeisen is offering financial services all over the country.
- An equally dense network of warehousing co-operatives was created. 60 per cent of farmers are members in these warehouses. The market share of these co-operatives amounts up to 50 per cent. The co-operatives dispose of large scale storage facilities for grain and other storable products and are able to regulate farm markets by choosing the most appropriate time for selling.
- Austria's dairy sector is about 90 per cent co-operatively organized. Co-operative dairies in 2001 took in 95 per cent of Austria's

[18] cf. *Werner, W.:* Die Anfänge der Raiffeisen-Genossenschaftsbewegung im Gebiet des heutigen Österreich bis zum Ende der k.u.k. Donaumonarchie, in: Die Anfänge der modernen Genossenschaftsbewegung in Bayern, Österreich und Südtirol, Munich 1998, p. 204.

raw milk and have the following market shares: fresh milk 99 per cent, butter 95 per cent, fruit yogurt 80 per cent, mellow cheese 85 per cent and hard cheese 66 per cent.

The three traditional aspects of agricultural co-operative activity in Austria are summarized as money, warehousing and milk. They are still forming the three pillars of Raiffeisen Austria.[19]

A dense network of warehousing co-operatives and their subsidiaries was formed in Austria during a time when farmers had a mobility problem and had to move via horses or slow tractors. The independent warehousing co-operatives of each federal region (Bundesland) formed a regional association. These regional associations were grouped on a second level of federal association. This densely organized network was very convenient for members and customers. However, it created considerable costs and that became a problem already before Austria's entry into the European Union. The governing board of Austria's top level association "Raiffeisenverband" already created working groups in 1987, which had to analyze the question of a possible Austrian entry into the European Union. The result was quickly found.[20] Entry was indispensable for the future but there would be enormous problems in the warehousing and dairy sector.[21] The only branch of the co-operative Raiffeisen network which would not be touched by serious problems was to be the money sector. The prediction have become verified in the meantime, especially with regard to the top level institution, the „Raiffeisen Zentralbank Österreich AG". Within few years the Eastern European holding „Raiffeisen International Beteiligungs-AG" became very active in the reform countries of central and eastern Europe. For the warehousing sector and the dairies, however, the expected structural problems have also surfaced.

[19] See *Brazda, J./Schediwy, R.:* Überlegungen zum Thema „économie sociale" in Österreich, Wissenschaftliche Berichte, May 2000, Nr. 8, Wirtschaftskammer Österreich, Abteilung Bildungspolitik und Wissenschaft, p. 14.

[20] An interesting survey is given by the two brochures: Genossenschaftsfragen Folge 27 and Folge 29, a publication of the Austrian Raiffeisen Union.

[21] See *Brazda, J./Schediwy, R./Lehner, U.:* Èvolution récentes des principaux groups coopératifs et mutualistes en Autriche. Le cas du secteur laitier, in: Annales de l'economie publique sociale et cooperative Vol. 73 No. 1 March 2002, p. 135.

4.1. The dairy sector

The structural problem of co-operative dairies in Austria had become virulent because of the changing situation of retail markets already since the end of the 1960's. A relevant fact was the ever larger role of retail chains and hypermarkets, which built up an ever increasing market power. In May 1970 the „Molkerei- und Käsereiverband of Salzburg" and the „Sennereiverband of Tyrol" proclaimed their merger forming „Alpenländischen Milchindustrie" (Alpine milk industry). The most important co-operative merger, the creation of „Agrarverwertungsverband Agrosserta" was put through in October 1970 in the regions of Burgenland, Styria and Carinthia. In this merger the co-operative milk and cattle sectors of these areas were grouped together. However, these and other structural mergers were not sufficient to make Austria's dairies fit for the EU. This purpose was to be served by creating a central co-operative that was to encompass all dairy co-operatives. „Agrosserta", Alpi" „Burgenländische Molkerei- und Milchwirtschaftsverband", „Molkereiverband für Niederösterreich" und „Schärdinger Molkereiverband" founded in July of 1990 „AMF Austria Milch und Fleischvermarktung" (Austrian Milk and Meat marketing).[22]

The goal aimed at was to become the most important Austrian force (and with European status[23]) in the field of processing and marketing. To serve this purpose parallelisms in the field of production, logistics and assortment had to be removed and the administration had to be reorganized and reduced. According to this goal „AMF" envisaged a rationalization program, that aimed for a reduction of costs and the creation of fresh milk delivery and of brands[24] that would be marketable in the whole of Europe. The management of „AMF" was aware of the aspect that the necessary rationalizations would not be easy to carry through, because in its context competitors and even better opponents had to form a new playing team. Also „AMF" could only consult with its member associations; it had no

[22] cf. *Werner W.:* 100 Jahre Österreichischer Raiffeisenverband 1898-1998. Eine Chronik, in: *Bruckmüller E./Werner W. (ed.)*: Raiffeisen in Österreich - Siegeszug einer Idee, St. Pölten 1998, p. 232.

[23] cf. *AMF Austria Milch und Fleisch (ed.)*: Jahresbericht 1991, Salzburg o.J., p. 2.

[24] cf. *AMF Austria Milch und Fleisch (ed.)*: Blickpunkt Dezember 1990, p. 6.

power to enforce and the necessary structural mergers on the primary level were left to the regional associations.[25]

In „AMF“ there was a double structure: Production and marketing were not in one hand. In order to remedy this situation in 1995 mainly Upper Austrian dairy co-operatives created „Bergland-Milch“[26]. The new co-operative was serving farmer members in the region of Upper Autstria, Lower Austria, Styria an Carinthia.[27] At the end of 1995 ongoing losses led to a restructuring of “AMF”[28]. The dairy part of “AMF” was sold to „Bergland“ on the one side and to „Niederösterreichische Milchholding“ (Lower Austrian Milk Holding), later to be called „NÖM AG“ (after 1996) on the other side. During the middle of 1997 this restructuring was put through and the shares of the founding association at the “AMF” co-operative shares were about to be paid back to the founding associations. The disaggregation of “AMF” created two main dairy groups, one situated mainly in Upper Austria, the other one in Lower Austria, i.e. „Bergland“ and „NÖM AG“. Together they have a market share of about 60 per cent. Up to now they are still competitors in the market even though an “Austrian solution” of a super-merger was envisaged several times. Aside of „Bergland“ and „NÖM AG“ there exist a number of medium size dairy enterprises and some specialized smaller enterprises.[29] Continuing losses which led to an increase of the share of the Raiffeisen regional banks in the dairy sector were the main reason for several initiatives to coordinate co-operation between the two main Austrian dairy groups. So far this goal has not been achieved, but “NÖM AG” seems to have recovered quite well[30] (in spite of a rather unfortunate participation of Parmalat).

In spite of limited willingness to co-operate in Austria’s co-operative dairy sector Austria’s raw milk and milk products could estab-

[25] cf. AGRO intern Informationsdienst der Agrosserta Juli 1990, p. 4.

[26] cf. PUBLICO-Presseunterlage 26. April 1995 “BERGLAND” Die neue Chance am heimischen Milchmarkt, p. 6.

[27] cf. *Zittmayr, H.:* Die Entwicklung der Molkereiwirtschaft in Oberösterreich seit 1960 bis 1996, o.O., o.J., p. 10.

[28] cf. *C(eipek) K(urt)*: Nach Ausstieg aus der Milchsparte steht AMF vor Neubeginn, in: Raiffeisenzeitung v. 4. Jänner 1996, p. 1.

[29] cf. Vereinigung Österreichischer Milchverarbeiter, Presseunterlage vom 25. März 1997, p. 3.

[30] cf. Der Standard v. 13. Jänner 2004, p. 15: Keine Ruhe für Österreichs Molkereien und Parmalat-Skandal löst Zwist im Raiffeisen-Reich aus.

lish themselves very well inside the EU. Compared to the development of the dairy sector of Switzerland (so far not belonging to the EU) it has become evident that Austria's decision to enter gave a positive impulse to this highly sensitive market. Austria was able to continuously develop its export to the rest of the EU, whereas Switzerland had to suffer serious set backs.[31]

4.1. The warehousing sector

At the end of the 1980s the difficult income situation of farmers and the resulting turnover stagnation of the Raiffeisen warehouses started to create ever increasing problems. The reform of the EU's CAP in 1991/92 resulted in sizeable reductions of grain prizes and in moves to reduce cultivated area. It also became evident that Austria's agriculture and warehouses would have to face serious decreases in volumes and prices. Therefore „Österreichischer Raiffeisenverband", the top association of the sector, spoke out in favor of structural changes.[32] Independently the „Verband ländlicher Genossenschaften in Niederösterreich" of Lower Austria engaged in contacts with other warehousing associations of other regions and invited them to merger talks.

Both initiatives were successful. In 1993 it became evident, that at least three large regions, Lower Austria, Upper Austria and Styria, would create a new common association and thus reduce costs in the warehousing sector by establishing the two tier-system. Thus „Verband ländlicher Genossenschaften in Niederösterreich", „Oberösterreichische Warenvermittlung" and „Steirische Landwirteverband" formed „Raiffeisen Ware Austria". This company started its activities in October 1993.[33]

After a quick start the necessary structural adaptation, however, was performed relatively slowly. The reason for this has to be seen in the difficult deliberation processes inside the governing board and the supervisory board of the new company. Additional matter for

[31] cf. *Wenger, U.:* Milchwirtschaft auf dem Wachstumspfad, in: Schweizer Bauer v. 21. Januar 2004, p. 11.

[32] cf. *Böhm, G.*: Strukturwandel der Raiffeisen-Lagerhausgruppe im Hinblick auf die veränderten Rahmenbedingungen, in: Genossenschaftsfragen, Schriftenreihe des Österreichischen Raiffeisenverbandes, Folge 29, Wien 1992, p. 22ff.

[33] cf. *Werner, W.:* 100 Jahre Österreichischer Raiffeisenverband,. op. cit., p. 255.

discussion was created by the initiative of Generalanwalt Dr. Konrad of summer of 1994 to establish contacts with „BayWa AG“ for possible co-operation (this was a initiative coordinated with the supervisory board of “RWA”).[34] In the October of 1994 the presidium of the supervisory board was reelected.[35] Via these changes the problems with Upper Austria could, however, be only solved in part. Five warehousing co-operatives formed in April 1995 the „Lagerhaus Koordinierungs Gesellschaft“.[36]

Starting from 1994 „BayWa AG“ (originating from the Bavarian, i.e. German Raiffeisen sector) took over controlling interests in the warehousing associations of the Austrian regions of Tyrol, Carinthia and Vorarlberg.[37] In January of 1995 the „BayWa AG“ made it clear, that they would be interested in taking a share in “RWA” and that they were establishing contact with other Austrian regions to. “RWA” had initial started co-operation talks with „BayWa AG“ in the summer of 1993. Now, however, it wanted to continue them only after the positive outcome of structural measures would be evident and the positive effect of “RWAs” growth strategy had become evident. Since the financial results of “RWA” improved indeed “RWA” was able in 1997 to engage in more concrete talks with „BayWa AG“. Exchanging capital with „BayWa AG“ necessitated a change in the juridical form of “RWA” to a “RWA-AG”. Already for some time this changeover to the juridical form of joint stock company had been discussed. The mutual exchange of shares between „BayWa AG“ and “RWA-AG” was envisaged for 1998.[38] Operative business and administration of “RWA” were transformed into a newly founded joint stock company and December 1998 the decision making units of „BayWa AG“ and “RWA-AG” gave their assent to the formation of a strategic alliance of the two commercial houses.[39] The assent of the European Commission with regard to the cartel aspect was given in June 1999. „BayWa AG“ had, however, to except sizable restructu-

[34] cf. *Barazon, R.*, Die gelungene Überraschung, in: Salzburger Nachrichten v. 4. August 1994, p. 9.

[35] cf. *Werner, W.:* 100 Jahre Österreichischer Raiffeisenverband,. op. cit., p. 260.

[36] cf. *Affenzeller, P.*: Lagerhaus-Dissidenten gründen Schattenkonzern, in: OÖ Nachrichten v. 19. April 1995, p. 7.

[37] cf. Neues Volksblatt v. 25. Jänner 1995, p. 25: BayWa auf Expansionstrip. Raiffeisen winkt vorerst ab.

[38] cf. Kurier v. 27. Jänner 1998, p. 20: Handelskonzern BayWa expandiert nach Osten.

[39] cf. Geschäftsbericht 1998 RWA Raiffeisen Ware Austria, Wien o.J., p. 18.

ring costs only for 2002. Nevertheless the joint venture „BayWa AG-RWA-AG" was promising a positive development.[40]

By taking its interest in "RWA-AG" „BayWa AG" was focusing on the aim to increase its market position.[41] A main factor of the interest of „BayWa AG" in "RWA-AG" was the hope for synergies with regard to the reform countries in eastern Europe. "RWA-AG" was already active in Hungary, Slovakia, Czechia, Croatia and Slovenia.[42] After the exchange of shares the eastern activities of „BayWa AG" and "RWA-AG" in Hungary were put together into one enterprise.[43] In this way „BayWa AG" came closer to its aim to become an enterprise of European dimension.[44] The same aim was pursued in the merger with „WLZ Raiffeisen Aktiengesellschaft", of „Württembergischen Landwirtschaftlichen Zentralgenosssenschaft-Raiffeisen" in the summer of 2002 (A raiffeisen company serving the German region of Würthemberg).[45]

In 2002[46] Austria's Raiffeisen organization consisted of 1.665 co-operatives. 609 of these were credit co-operatives with 1.655 subsidiaries and 1,694.411 members. There were 100 warehousing co-operatives with 689 subsidiaries and 137.805 members and 170 dairy co-operatives with 90.968 members. The consolidated balance sheet of the money group made up the sum of 114.222 mio. €. The market shares of the money sector in Austria were 25,5 per cent of deposits, 22,1 per cent of the direct credits and 25,9 per cent funds. Turnover of warehousing co-operatives was 2,4 billion € and turnover of diary co-operatives 1,8 billion €. Especially successful was Austria's export development.[47] Thus Austria's export of cheese overtook Swiss chee-

[40] cf. *Haas, K.*: Heuer bereiten Österreicher den Bayern Freude, in: OÖ Nachrichten v. 23. Mai 2002, p. 10.

[41] cf. *C(eipek) K(urt)*: BayWa will durch Akquisitionen und Allianzen weiter wachsen, in: Raiffeisenzeitung v. 3. Februar 2000, p. 1.

[42] cf. *G(aubitzer) F(ranz)*: Die RWA steigt mit Betriebsübernahme in Ungarn kräftig aufs Gas, in: Raiffeisenzeitung v. 12. August 1999, p. 1.

[43] cf. *C(eipek) K(urt)*: RWA erreichte unter sehr schwierigen Rahmenbedingungen positives Ergebnis, in: Raiffeisenzeitung v. 10. Februar 2000, p. 1.

[44] cf. Raiffeisenzeitung v. 7. Mai 1998, p. 4: Der BayWa-Konzern.

[45] cf. WLZ Raiffeisen AG-Aktuelles v. 26. 11. 2002: Bundeskartellamt gibt WLZ und BayWa grünes Licht.

[46] cf. Österreichischer Raiffeisenverband (ed.): Raiffeisen in Zahlen, o.O. u. o.J.

[47] cf. *Wenger, U.*: Milchwirtschaft auf dem Wachstumspfad, in: Schweizer Bauer v. 21. Januar 2004, p. 11.

se exports already in the year of 2000 internationally. Austria's Raiffeisen group employed in 2002 47.933 persons. If more than 1.200 participations are taken account of the employees of Austria's Raiffeisen sector numbered around 100.000. Raiffeisen Austria is by large the most important private employer in Austria.

5. Perspectives of agricultural warehousing co-operatives according to regional types

We start our discussion of the development of efficient structures in the co-operative wholesaling sector by basing our propositions on the defined structural areas. A decisive point for the further analyses will be that the co-operative structure for the warehousing sector in Austria will have to be diversified.

5.1 Structural area "Subsidy"[48]

In the structural area "Subsidy" the multifunctionality of agriculture is especially evident. In this case the primary production is not the most relevant aspect. General economic benefits such as the creation and maintenance of a cultivated landscape contribute central aspects. Agricultural production solely measured by its productivity would not have any right to exist any more in these areas. Nevertheless there are good reasons why at least part of the production and with it its positive side effects should be maintained. This, however, necessitates a consensus concerning the cost bearing. If there is to be production in spite of lower productivity then these structural disadvantages have to be compensated financially. If production is to be continued then all those benefiting from farm activity in this area, even those who so far have been "free riders" will have to pay.[49] We do not have to state explicitly that the possibility for structural adaptation in this area is quite limited. There will be, however, some structural adaptation. Comparable to the development in the 1950's when there was a massive reduction in farming units there will be a similar process now too. This loss will amount

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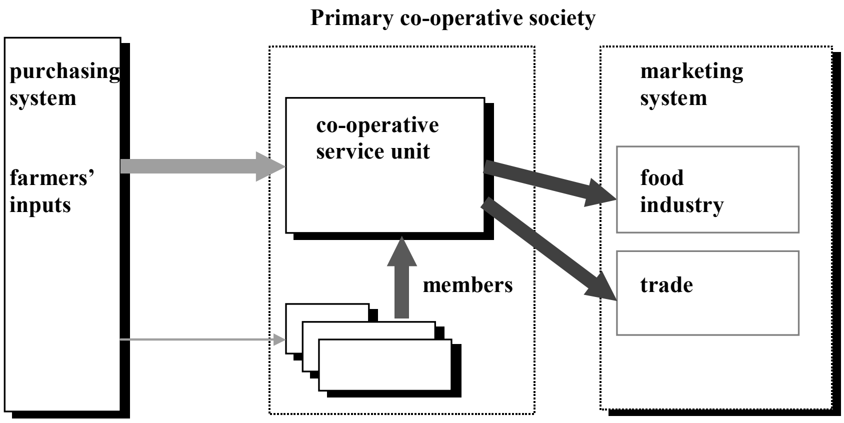
[48] cf. *Draxler, G.:* Der Agrarstrukturwandel, op. cit., p. 174.

[49] The trend towards direct subsidies in the EU makes it clear that inside the European union this necessity is increasingly seen. It has been, by the way pushed by the Austrian agricultural commissionaire Fischler.

15 or 20 per cent of all agricultural cultivated areas.[50] Agricultural enterprises in strong tourist regions will have better chances to continue their activity than those in areas without important tourism.

Fig. 1: Co-operative structure in area „Subsidy“ scheme 1



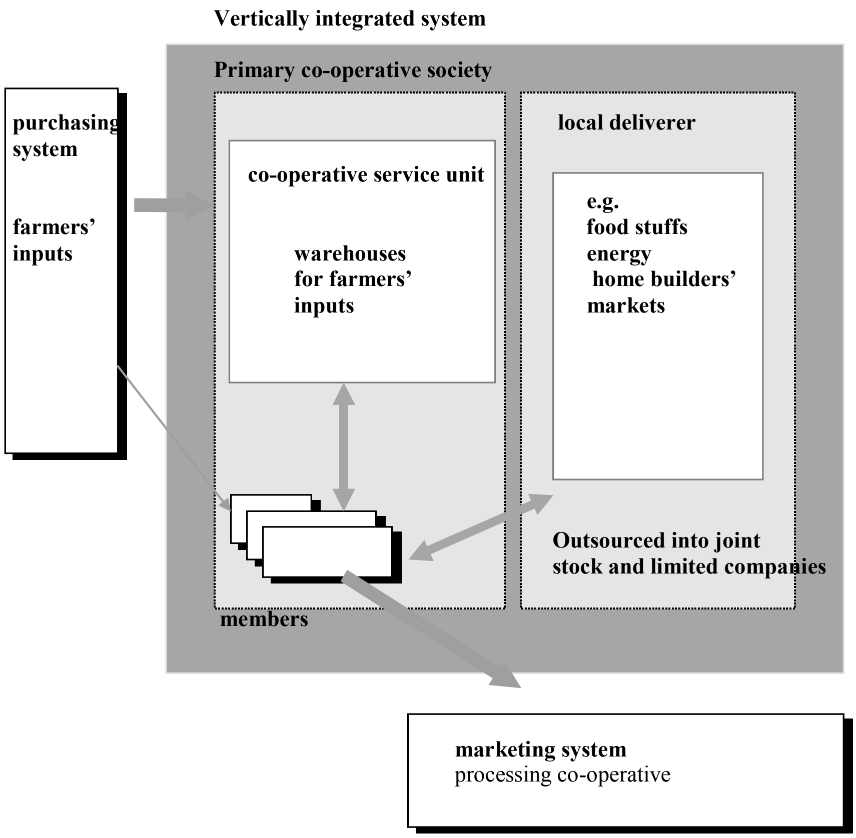
Source: *Draxler, G.:* Der Agrarstrukturwandel und seine Auswirkungen auf die Warengenossenschaften im System Raiffeisen, Dissertation, University Vienna 1999, p. 177.

As to be seen in fig. 1 co-operatives will continue to exhibit important functions in the structural area "Subsidy". Because of the relatively small farm size there it is not lucrative for the farmers to enter directly into contact with industry for their inputs. On the side of industry there are also few incentives to make deliveries to these small buyers. Thus the circulation of merchandize in its two senses via the co-operative will be continued.

The co-operative outlet as a local deliverer will remain there as a factor for success. Of course these structures have to be competitive. However, it is foreseeable that in the core activity for these co-operatives there will not be all out competition as in the area "Global". Co-operatives will increasingly engage in services for individual farmers. Direct marketing could open new areas of activity. There is a necessity for this because at present privately organized marketing

[50] The reduction of cultivated land can be set equal with an increase of forest surface.

Fig. 2: Co-operative structure in area „Subsidy“ scheme 2



Source: *Draxler, G.:* Der Agrarstrukturwandel und seine Auswirkungen auf die Warengenossenschaften im System Raiffeisen, Dissertation, University Vienna 1999, p. 180.

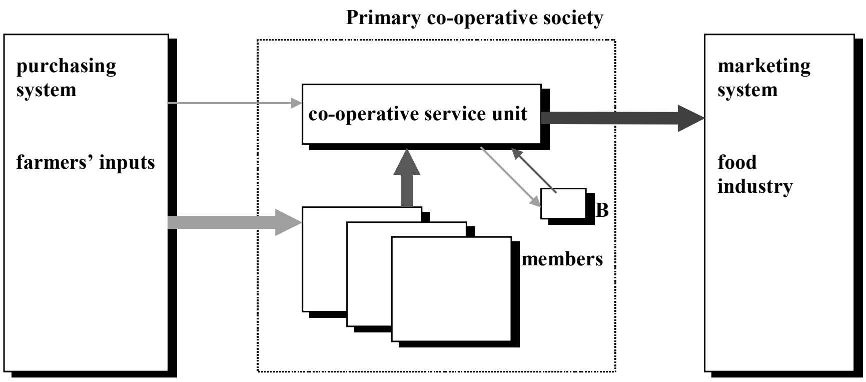
associations are formed. So far, the co-operatives have not been too active in this field.

More difficulties are to be expected on the functional level of the second tier. It is difficult to conceive of a two-tier system in this context.

5.2 Structural area "Global"[51]

This area is the smallest one with regard to its surface. However, with regard to Austria's agricultural production it is the most important structural area. Here the most decisive changes will take place. The dominant type of farm is the cash crop farmer. The strategic aim has to be cost leadership with regard to servicing of farmers and thus reorganization of the present structures. This strategic aim necessitates personnel reduction, the sale of not necessary assets and the creation of more efficient structures.

Fig. 3: Co-operative structure in area „Global"



Source: *Draxler, G.:* Der Agrarstrukturwandel und seine Auswirkungen auf die Warengenossenschaften im System Raiffeisen, Dissertation, University Vienna 1999, p. 165.

In the figure 3 the decisive effects of the circulation of inputs and outputs of farms are made evident. The most visible change will be that in the future a sizeable part of the input business will be dealt with directly between the (large) farming units and industry itself. If we used „Deutsche Raiffeisenwarenzentrale" as an umbrella organization in our operative business we would turn from a two-tier system into a three-tier system. However this kind of business does not

[51] cf. *Draxler, G.:* Der Agrarstrukturwandel, op. cit., p. 165.

even work with a two-tier system.[52] This means the co-operatives are losing functions in this area. Of course and this is shown in the figure by member B not all farmers will go for a structural improvement. For some enterprises there will be in the future sometimes no possibilities to enter directly in business contact with the industry. Agricultural co-operatives may have to cater to this demand. However, the additional costs will have to be strictly calculated and demanded. There can be no "solidaristic" dividing up of these costs. If certain farmers want to have this service they will have to pay the price for it.

Further characteristics for the economic environment of warehousing co-operatives in the structural area "Global" are the following:

- The inverse circulation of the merchandize business (that is sale of agricultural inputs, purchase of agricultural outputs) is getting lost successively. Very large farmers will buy less and less from the co-operatives (and they are - at present - the most important clients of co-operatives). These large farmers will deal directly with industry, not in the least because of improved communication technologies. Thus the sale of agricultural inputs is loosing its strategic importance.
- This loss of weakening of the present double circulation of inputs and outputs circulation will do away with the possibility to subsidize internal losses by internal profits. At present profits created by the sale of agricultural inputs can be used for covering the losses that are engaged by buying the agricultural output of farmers. In the changed scenario it is evident that co-operatives have to structure their marketing more efficiently and costs have to be covered in every respect. Therefore only cost-minimized service units will survive.
- Co-operatives services will be reduced to an absolute minimum. Services which can be performed by the large farming units will and should be performed by them in the future.

The structural area "Global" is thus characterized by the highest pressure of competition regarding the farming units but also with regard to the co-operative units servicing them.

[52] cf. *Trager, R.:* Oswald Hahn im Gespräch mit Ralf Trager, BayWa AG, in: ZfgG Bd. 48 (1998), p.232.

3.3 Structural area "Part-time"[53]

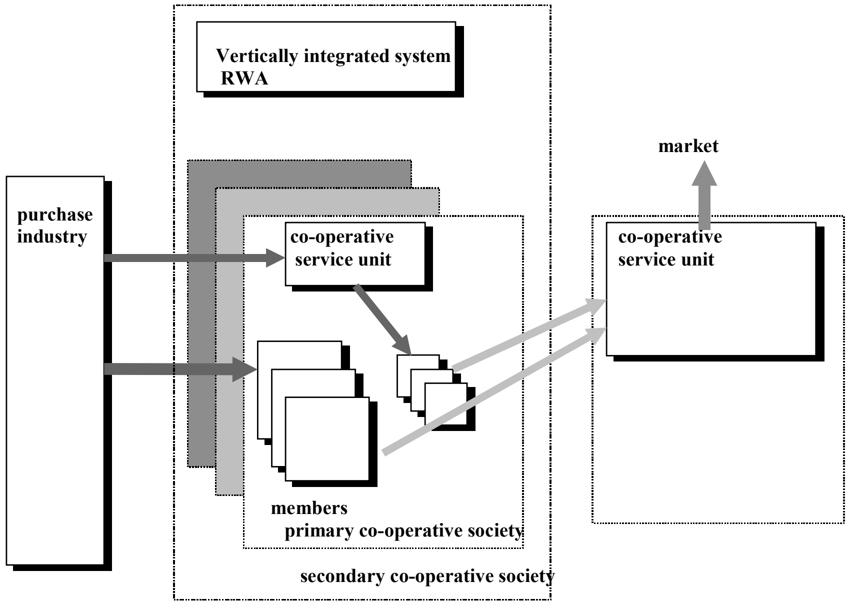
The structural area "part-time" is geographically situated between the two above mentioned more extreme cases. It is an intermediary case also in its characteristics. An important aspect is that these regions are dominated by live stock farms - and feed producers. Conditions are, however, not as tough as in the area "Subsidy". Farmers in the area "Part-time" are going to face increased competition and have to develop counter-strategies. Direct subsidies will not be available to the same extent as in former years. Marginal farms will have to close down (as in the area of "Subsidy"). The answer will be reforestation, here as well. However, this scenario will be less frequent in these intermediate areas. To continue full time farming much larger units will have to be formed. If this is not the feasible many farmers (with their well known tendency to "cling to the land") will seek additional income – this being made easier by the proximity of large urban agglomerations.

What are the tasks agricultural co-operation has to face in such a situation? There are few new tasks. Marketing activities will be extremely important given the mentioned structure of farming enterprises. A more heterogeneous membership structure has to be envisaged. The newly formed large farming units will enter in direct contact with industry, as in the case of "global". The smaller, highly automatized part-time farms, however, still need co-operative services in that respect. Co-operatives will be under enormous cost pressure in that field of business, total transparency with regard to costs will be necessary.

Co-operatives in these regions will lose their "Neighbourhood store aspect" (an aspect that will remain in the more alpine regions) . This will have to do with the proximity of urban areas as well as with the more intense focus on the purely agricultural side of their business.

[53] cf. *Draxler, G.:* Der Agrarstrukturwandel, op. cit., p. 182.

Fig. 4: Co-operative structure in area „Part-time“



Source: *Draxler, G.:* Der Agrarstrukturwandel und seine Auswirkungen auf die Warengenossenschaften im System Raiffeisen, Dissertation, University Vienna 1999, p. 185.

The higher level of co-operative activity will be reduced to co-ordination and back office functions.

6. Summary

Agricultural co-operatives in Austria will be able to master the future. However, important restructuring activities will be inevitable. The changed and changing environmental conditions will make for necessary adaptations. Three ideal types of possible changes have been summarized.

Structural area „Subsidy“

These co-operatives will be the most similar to their now existing counterparts. They will cater to the farmers' needs with regard to the acquisition of inputs as well as the marketing of outputs. Subsidies taking away some competitive pressure from the farmers will have similar effects also on their co-operatives. However, there will be at least some pressure to adapt. Costs will have to be minimized within the realm of the possible.

Structural area "Global“

In this area, the richest one with regard to agricultural output, the most important changes are to be expected. Co-operatives will be reduced to servicing units operating at optimal cost level. According to farm size farmers will market their produce at primary or at secondary co-operative level. Agricultural inputs will often be bought directly from industry.

Structural area "Part time"

The characteristics of this area make for a dominance of specialized types of co-operatives (milk, meat). Agriculture in these areas moves towards highly automatized small part-time farming units with differentiated needs varying according to size. Co-operatives will have to service these highly diversified needs.

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Corporate Governance in German Rural Co-operatives from a Property Rights Point of View

By Jost W. Kramer and Johann Brazda

1. Introduction

For some time now, the corporate governance system of German co-operatives has been under discussion. Depending on the principal focus of the author, the current corporate governance system has either been considered inadequate or overburdening. This paper aims to add some additional facts on this topic by applying the property rights theory towards German rural co-operatives.

While other parts of the new institutional economics (e. g. principal agent theory, transaction cost theory) have already been applied to co-operative research with some success, property rights theory has as yet been only rarely used in this regard. At the same time, the traditional structure of co-operatives, namely of co-operatives in Germany, has found itself to be in the middle of a somewhat controversial discussion. Especially subscribers to the shareholder value philosophy have criticised the co-operative structure as lacking in incentives and being outmoded. Maybe property rights theory has some input to offer for the proposed reforms.

Property rights theory is a concept which focuses on a person's or an institution's rights to act. As a rule, it may be said that no one has either the permission or the ability to enforce all rights that exist regarding a specific property. Awarding the rights of one specific property to different persons is called "attenuation".[1] As a rule of thumb it may be said that the higher the degree of attenuation, the lower the interest of a person to enforce his or her rights.

The existing limitations to an individual's property rights are to a large extent due to the requirements and barriers imposed on the

[1] *Furubotn, Eirik G./Pejovich, Svetozar*: Property Rights and Economic Theory: A Survey of Recent Literature, in: Journal of Economic Literature, 10/1972, p. 1146.

individual by its socio-economic environment. Therefore, regard property rights as "socially recognized rights of action".[2]

Property rights exist not only regarding material goods, but also regarding services. Currently, even intellectual property rights are being discussed.[3] Still a matter of dispute is whether property rights require a good to be in existence or not. While Dunn et al.[4] are in favour of the first view, when defining goods as everything that creates a benefit, Castle emphasises a different aspect. From his standpoint, "property rights are defined in the law and serve as rules governing the utilization and transfer of rights to wealth".[5] The second concept even includes rights against people, e. g. the rights as well as the obligations of employees in their relationship towards their employer, their colleagues, the labour union, the government etc.[6] From this point of view not the good itself is being owned, but a collection of property rights that may vary depending on socio-economic conditions.

The form in which property rights exist depends to a large extent on societal institutions, like traditions, conventions, ethics, and written or unwritten law: Different institutional frameworks lead to different sets of property rights. According to Tietzel[7], a complete formulation of property rights allows the exclusive but not unlimited use of a resource and contains four major categories of (sub-)rights:

1. The right to use a resource (usus),
2. the right to retain its profits (usus fructus),

[2] *Alchian, Armen A./Demsetz, Harold*: The Property Rights Paradigm, in: The Journal of Economic History, 33/1973, p. 17.

[3] *Albach, Horst/Rosenkranz, Stephanie* (eds.): Intellectual Property Rights and Global Competition. Towards a New Synthesis, edition sigma, Berlin 1997.

[4] *Dunn, Malcolm/Röpke, Jochen/Sälter, Peter*: Der Property Rights-Ansatz: Zur politischen Ökonomie von Handlungsrechten, unpublished manuscript, Marburg n. n., p. 2.

[5] *Castle, Emery N.*: Property Rights and the Political Economy of Resource Scarcity, in: American Journal of Agricultural Economics, February 1978, p. 2.

[6] *Kramer, Jost W.*: Der Beitrag des Property Rights-Ansatzes zur Erklärung wirtschaftlicher Entwicklung. Hinweise für die Politikgestaltung im Transformationsprozeß, Institut für Genossenschaftswesen an der Humboldt-Universität zu Berlin, Berlin 1996, p. 10..

[7] *Tietzel, Manfred*: Die Ökonomie der Property Rights: Ein Überblick, in: Zeitschrift für Wirtschaftspolitik – Wirtschaftspolitische Chronik, 30/1981, p. 210.

3. the right to vary its form and substance (abusus), and
4. the right to leave it to somebody else under mutually agreed conditions.

2. Attenuation of Property Rights

It has already been mentioned that in the real world a complete allocation of all property rights to a single individual or institution is extremely unlikely. Instead, the property rights regarding a specific good are divided into different sets and allocated to various individuals and institutions, based on law, power, force, or other ways of gaining ownership. The reasons for this attenuation may be due to legal, moral, similar restrictions, or transaction costs. The term "transaction costs" in this context covers all costs that evolve in the process of definition, exchange, surveillance, and enforcement of property rights.[8] Increasing these costs for exercising and enforcing the property rights of an individual or an institution decreases the range of possible actions[9] while simultaneously reducing the incentives for economic activity and the enforcement of property rights.[10] Similar reactions may be caused by restrictions based on the socio-economic environment, which are opposed to or even prohibit certain activities. Examples for such behaviour are drug-pushing, driving while intoxicated, or allowing stores to conduct business on Sundays or holidays. The higher the transaction costs and the fewer the allowed activities, the higher is the degree of attenuation, thereby increasing the development of positive or negative externalities.[11]

Incomplete specification of property rights and the evolution of external effects will happen whenever the enforcement costs do not enter into the calculation of the acting individual or institution. Such external effects may be advantageous as well as disadvantageous for third parties, as shown in the example of a supermarket parking lot. If parking is free of charge, not only will the customers benefit from it, but also other car owners who are more than likely to use the parking lot without making any purchases in the supermarket. The

[8] *Leipold, Helmut*: Eigentum und wirtschaftlich-technischer Fortschritt, Otto A. Friedrich-Kuratorium, Köln 1983, p.57.

[9] ibid.

[10] *Kramer, Jost W.*: Der Beitrag des Property Rights-Ansatzes, op. cit., p. 16.

[11] *Tietzel, Manfred*: Die Ökonomie der Property Rights, op. cit., p. 210.

costs for the parking of non-customers are included in the prices of the goods bought by the customers, no matter if they use the parking lot or not. Such "free rider effects" are more likely to occur in cases of common property when it is impossible to exclude someone from its use. To a certain degree, it can also be observed in the case of co-operative property.[12]

3. Rural Co-operatives in Germany

In Germany as well as in Austria, there exists a broad variety of so-called rural co-operatives. A closer look reveals the existence of a multi-tier and multi-level network of rural co-operatives.[13] On the primary level there exist three tiers which are mostly made up of local merchandise and service co-operatives. However, in the Eastern part of Germany there are several farming co-operatives which have established a tier of their own:[14] All local co-operatives form the basis for the regional co-operative business centres. These regional organisations form the second level of the system. The apex level consists of several national companies operating on behalf of the various co-operatives on the other levels and tiers. This system of operating co-operatives is supported by regional and national co-operative associations (Table 1).

3.1. Rural Merchandise and Service Co-operatives

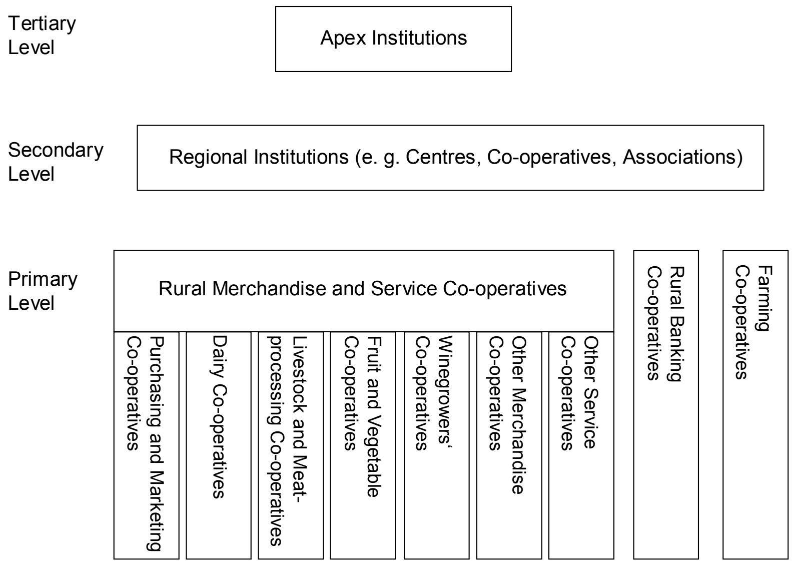
The first tier on the primary level are rural merchandise and service co-operatives, most of which are essentially multi-purpose co-operatives as they offer there members supply-side services as well as demand-side services. This tier consists of seven sub-tiers, ranging from specialised purchasing and marketing co-operatives to a

[12] *Kramer, Jost W.*: Der Beitrag des Property Rights-Ansatzes, op. cit., p. 17.

[13] The information in this chapter is for the most part based on Aschhoff, Gunther/Henningsen, Eckart: The German Cooperative System. Its History, Structure and Strength, 2. ed., Fritz Knapp, Frankfurt am Main 1996, p. 86-104.

[14] Metz, Egon: in: Metz, Egon/Schaffland, Hans-Jürgen (eds.): Lang/Weidmüller/Metz/Schaffland: Genossenschaftsgesetz (Gesetz, betreffend die Erwerbs- und Wirtschaftsgenossenschaften). Kommentar, Walter de Gruyter, Berlin-New York 2004, p. 12.

Table 1: System of Rural Co-operatives in Germany



Source: By authors.

broad variety of other service co-operatives. All in all, in 2002 there existed 2,324 of these co-operatives.[15]

3.1.1. Purchasing and Marketing Co-operatives

Purchasing and marketing co-operatives are specialised co-operatives, designed to support their member enterprises through improved access to purchasing and marketing facilities. Purchasing accounts for approximately 80 percent and marketing for the remaining 20 percent of the overall turnover of marketing and purchasing co-operatives.[16]

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[15] cf. *Stappel, Michael/Henningsen, Eckart*: Die deutschen Genossenschaften 2003. Entwicklungen – Meinungen – Zahlen, Deutscher Genossenschafts-Verlag, Neuwied 2003, p. 244.

[16] cf. *Aschhoff, Gunther/Henningsen, Eckart*: The German Cooperative System, op. cit. p. 89.

"The purchasing business includes the purchase of all products and supplies which are needed for agricultural production. The purchasing and marketing cooperatives mainly supply their members with feed, fertilizers, pesticides, seeds and fuel as well as machinery and construction material.

Marketing operations focus on the collection and selling of grain, rape and potatoes, i. e. agricultural products for which there are no special cooperative processing facilities".[17]

In the beginning, purchasing and marketing co-operatives were concerned only with the joint purchasing of agricultural supplies. Over time, however, their activities spread out. In consequence, they offer not only services for their members' needs, but serve broader rural needs by expanding their merchandise range. This has lead to the establishing of home and garden centres, gas stations, and similar enterprises.

If necessary, purchasing and marketing co-operatives have even become producers of agricultural goods. This is likely to happen if such activities offer either a better access to these goods for their members or if their members receive a higher income to processed goods than for raw goods.

On both the regional and the national level, purchasing and marketing co-operatives are members of regional purchasing and marketing centres. Theoretically, these regional centres are supposed to offer support on a wholesale level; in reality, however, there is a certain tendency to act as retail competitors as well. The regional centres in the purchasing and marketing sector have an apex organisation of their own, the Deutsche Raiffeisen-Warenzentrale (DRWZ) in Frankfurt am Main. "The corporate purpose of the DRWZ is trading in agricultural supplies and products of all kinds, especially the import and export of such products. Today, its activities focus on the negotiation of contracts with industrial companies and the handling of feed fertilizer imports as well as grain exports".[18]

[17] ibid.

[18] ibid. p. 91.

3.1.2. Dairy Co-operatives

Dairy co-operatives offer a mixture of services to their members: On the one side, they buy the milk from their members, thereby offering a marketing service, on the other hand, they offer a production service by processing the milk. "The dairy cooperatives collect the milk of the farms affiliated to them and process it to drinking milk, butter, cheese, and other dairy products. Then they sell the products to the retail trade and large-scale purchasers".[19]

In most cases, however, the production side of the dairy business is not operated by the dairy co-operatives themselves, but by regional dairy centres. While the dairy co-operatives work on a local level, the dairy centres operate on a regional level. Due to their greater size, they are better enabled to operate as wholesalers of dairy products.

In turn, these dairy centres are not only producing dairy products but supplying the dairy co-operatives with dairy supplies and machinery. The main distinction between dairy co-operatives and purchasing and marketing co-operatives is the fact that the raw milk necessitates a special co-operative processing facility while the goods handled by purchasing and marketing co-operatives do not.[20]

For the dairy co-operatives on the primary level and the dairy centres on the secondary level there exists an apex organisation as well, the Deutsches Milch-Kontor in Hamburg.[21] Its main responsibility is the export of dairy products both inside and outside the European Union. "Further activities include market intervention transactions for milk products, the development and promotion of joint brands, and the central purchasing of equipment and supplies for the dairy industry".[22]

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[19] ibid. p. 92.

[20] ibid. p. 89.

[21] ibid. p. 93.

[22] ibid.

3.1.3. Livestock and Meat-processing Co-operatives

Livestock and meat-processing co-operatives work in a similar way as dairy co-operatives: they collect the product (i. e. livestock) from the farms, transport the livestock to livestock markets and slaughterhouses. Simultaneously, they provide their members with supplies like breeding stock.

The processing is carried out by livestock and meat-processing centres – another similarity to the dairy structure. For price reasons, the centres on the secondary level focus on meat marketing instead of livestock marketing. Their activities have changed over time: “The livestock centers no longer confine themselves to slaughtering the livestock and selling the carcasses but also carve the carcasses up into cuts and further processing. Livestock marketing, meat marketing and further processing are effected by the same enterprise”.[23] A national apex institution is not in existence; the regional centres themselves are of impressing sizes and take on the respective duties.

3.1.4. Fruit and Vegetable Co-operatives

Fruit and vegetable co-operatives operate in similar ways as the co-operatives in the two branches discussed before: Collecting the produce from the member farms and making arrangements for further transport. Instead of slaughterhouses and dairy plants, however, the pool the produce in market halls and sell batches of individual products on a wholesale level. If necessary, they carry out sorting and packaging of produce as well. Some of these co-operatives own processing plants for the production of jams, fruit juices, and preserves. If necessary, they sell supplies to their members as well.

As either the sales of the products or the processing is carried out by the co-operatives, the secondary level is not required to fulfil such services. Instead, secondary level institutions have been established as associations which act as co-ordination centres for quality control, marketing, market stabilization, and similar services.[24] Its apex organisation, the Bundesvereinigung der Erzeugerorganisatio-

[23] ibid. p. 94.

[24] ibid. p. 95.

nen Obst und Gemüse in Bonn coordinates the activities of the secondary level organisations.

3.1.5. Winegrowers' Co-operatives

Another combination of collecting products from its members and processing them are winegrowers' co-operatives: They collect the grape harvest, process it into wine and market the wine. "Processing and selling begins with the collection and pooling of the grapes supplied by the members. Most of the wine obtained from the grapes is then sold by the winegrowers' cooperatives mainly to food wholesalers and retailers, wine wholesalers, private households and restaurants, primarily in the form of bottled wine".[25]

Due to imbalances between the demand for and the supply of wine, most winegrowers' co-operatives have established large storage facilities of their own. Winegrowers' co-operatives offer marketing services for their members', including brand names, but offer purchasing and other service functions as well. These include e. g. combating vine pests and offering equipment for collective use.[26]

An alternative to the storage in wine cellars owned by the local co-operatives are central storage facilities operated in various regions. They collect the wine from the local co-operatives, store it, market it and export it. Their marketing competence differs from that of the local co-operatives because it is aimed at customers outside the winegrowing areas. These central wine cellars are second level co-operatives. Its national apex organisation is the Deutsche Genossenschafts-Wein eG in Bonn. It used to be responsible for selling the wine to wholesalers. However, as these activities are increasingly taken over by the central wine cellars, the apex organisation focuses on co-ordination of common measures and the maintenance of contacts.[27]

[25] ibid. p. 96.

[26] ibid.

[27] ibid. p. 97.

3.1.6. Other Merchandise Co-operatives

The German as well as the Austrian Raiffeisen organisation to which most if not all rural co-operatives belong includes several other merchandise co-operatives as well. They offer similar services as the co-operatives described above, however, they are not as common and therefore not as widely spread. According to Aschhoff/Henningsen, the "most important ones among them are the garden landscaping cooperatives, some of which are called florists' cooperatives, and the fishery cooperatives".[28]

3.1.7. Other Service Co-operatives

In addition to this broad variety of merchandise, purchasing and marketing co-operatives there are several service co-operatives. Like the specialised merchandise co-operatives discussed above, they are very heterogeneous and due to this diversity, they are not as widely spread as the more common co-operatives.

3.2. Rural Banking Co-operatives

From a historical point of view, one of the oldest types of rural co-operatives are rural banking co-operatives. In Germany, they used to be labelled as "Raiffeisen Banken", which is still true for Austria. However, due to better infrastructure, increasing industrialisation, and stronger competition, the traditional distinction between rural banks and city banks is no longer valid in Germany. As early as 1972, this has lead to the establishment of a joint umbrella organisation for all banking co-operatives. Since then, several mergers between Raiffeisen Banken and Volksbanken have taken place, either as a strengthening of the co-operative market position or as a decrease of inter-co-operative competition.

Nevertheless, the co-operative banks[29] with branch offices in rural areas still serve the needs of both rural enterprises and rural

[28] ibid. p. 98.

[29] Similar co-operatives exist elsewhere, mostly labelled as credit unions. In Germany and Austria, however, these co-operatives offer full-service banking facilities and compete in the same market with commercial and savings banks. Therefore, the term co-operative banks is a better fit to there characteristics.

population. Some of the rural co-operative banks still offer their customers not only banking services, but offer agricultural merchandise as well. They act as multi-purpose co-operatives, linking banking services and purchasing and marketing services for their customers. During the last couple of years, the number of such multipurpose co-operatives has declined, because they were unable to benefit from economies of scale and size. The non-banking part of their activities was too small, while at the same time binding a lot of capital that could be more profitably employed for banking activities.

Nevertheless, in 2002 there were still 301 co-operative banks with an agricultural merchandise sideline in existence.[30]

3.3. Farming Co-operatives

In recent years and as a consequence of German unification, another type of co-operatives has become part of the Raiffeisen movement in Germany. These co-operative are called farming co-operatives, are successors of former socialists agricultural workers' co-operatives and in spite of outspoken opposition and negative expectations have been able to find a place of their own in a market environment. They are a special type of producers' co-operative in the agricultural sector whose members tend to be both shareholders as well as employees and/or landowners of a co-operative farm at the same time.[31]

"The purpose of these cooperatives is to promote the common production of agricultural products as well as the processing and sale of these products. Their members operate on common premises and a common area under cultivation. As successors to the former LPGs,[32] they usually farm comparatively large areas of land (changes

[30] cf. *Stappel, Michael/Henningsen, Eckart*: Die deutschen Genossenschaften 2003, op. cit., p. 44.

[31] *Kramer, Jost W.*: Entwicklung und Perspektiven der produktivgenossenschaftlichen Unternehmensform, Hochschule Wismar, Fachbereich Wirtschaft, Wismar 2003, p.16; *Mesecke, Hannes*: Rechtsformwechsel von Agrargenossenschaften aus Sicht der Neuen Institutionenökonomik, Diplomarbeit, Wirtschaftswissenschaftliche Fakultät der Humboldt-Universität zu Berlin, Berlin 2004, p. 13.

[32] LPG: Landwirtschaftliche Produktionsgenossenschaft. This type of compulsory collective farms was common in the former GDR, formed by the socialist administration.

since reunification notwithstanding); this large-scale farming has a favorable effect on the efficient use of machinery and materials".[33]

In 2002, there were 1.148 farming co-operatives in existence.[34]

4. Structural Economic Types of the Co-operative According to Dülfer

During the past decades, co-operatives have become increasingly aware of market forces.[35] Correspondingly, the need to adapt to the market forces rose, leading to the evolution of new organizational types and structures.[36] Due to these developments, the term "co-operative" currently covers a considerably broader range of co-operative structures than it used to do. It is necessary to distinguish the main types before entering into a discussion of conceptual co-operative problems.

Dülfer[37] offered an approach that has proven very helpful in this context and is therefore widely accepted.[38] He distinguishes between three main structural types of modern co-operative societies: "Executively Operating Co-operatives" (traditional co-operatives), "Market-Linkage Co-operatives" (market co-operatives) and "Integrated Co-operatives".

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[33] *Aschhoff, Gunther/Henningsen, Eckart*: The German Cooperative System, op. cit., p. 99.

[34] cf. *Stappel, Michael/Henningsen, Eckart*: Die deutschen Genossenschaften 2003, op. cit., p. 44.

[35] e. g. Bundesverband der Deutschen Volksbanken und Raiffeisenbanken – BVR: Bündelung der Kräfte: Ein Verbund – eine Strategie, vol. 1, Bundesverband der Deutschen Volksbanken und Raiffeisenbanken, Bonn 1999, p. 13.

[36] *Dülfer, Eberhard*: Typencharakter und Größenentwicklung der gewerblichen Kreditgenossenschaften (in Westdeutschland), Institut für Genossenschaftswesen an der Philipps-Universität Marburg, Marburg 1957, p. 62.

[37] *Dülfer, Eberhard*: Die Betriebswirtschaftslehre der Genossenschaften und vergleichbarer Kooperative, 2nd ed., Vandenhoeck & Ruprecht, Göttingen 1995, p. 93.

[38] *Zerche, Jürgen/Schmale, Ingrid/Blome-Drees, Johannes*: Einführung in die Genossenschaftslehre. Genossenschaftstheorie und Genossenschaftsmanagement, R. Oldenbourg, München and Wien 1998, p. 79.

4.1. Executively Operating Co-operative (traditional co-operative)

The executively operating co-operative has developed from collective ordering. Two types of this co-operative may be distinguished: a primitive version and a higher developed one. Dülfer characterizes the primitive type as follows: "In this type, ... the group specially elects an executive board that only has to collect the members' wishes and later on distribute the acquired goods among the recipients. This board is not permitted to make own decisions. It only transforms the received information into collective information which is passed on as an order to the supplier."[39] The types of goods as well as their quantities are well defined; there is no need for additional control through a promotional obligation, as this kind of co-operative only allows for promotional activity.

The higher developed type of the executively operating co-operative developed with the necessity of stock-keeping. Co-operative warehousing evolved as a way to reduce costs through quantity discounts and decreased risks of deferred shipment. In this way, the co-operative shows the first signs of a real business enterprise, e. g. leasing warehouse capacities. As opposed to the primitive type, the stock-keeping aspect of the higher developed executively operating co-operative disables the members from influencing the co-operative's services in the short run. However, the co-operative still bears the significant features of an executive instrument for the members' interests.[40]

Due to the co-operative's independence which goes hand in hand with stock-keeping, a divergence of the co-operative's activities and the members' wishes is possible. However, defining the goals is comparatively simple if the principles of efficiency and profitability are obeyed. It needs to be mentioned, though, that such an implementation causes a certain change of meaning as far the promotional obligation is concerned. With regard to market relations of the co-opera-

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[39] *Dülfer, Eberhard*: Strukturprobleme der Genossenschaft in der Gegenwart. In: Forschungsinstitut für Genossenschaftswesen an der Universität Wien (ed.): Neuere Tendenzen im Genossenschaftswesen, Vandenhoeck & Ruprecht, Göttingen 1960, p. 12; translation by *J. Kramer*.

[40] *Dülfer, Eberhard*: Die Betriebswirtschaftslehre der Genossenschaften, op. cit., p. 94.

tive, it may be stated that no market relations exist between the members and their co-operative. These exist only between the co-operative and the opposite side of the market, regardless of whether that is the demand side or the supply side.

4.2. Market-Linkage Co-operative (market co-operative)

Market-linkage co-operatives and executively operating co-operatives differ mainly in the weaker ties between the co-operative and its members. The market-linkage co-operative has developed typical features of an enterprise, e. g. hired staff, management structures, an internal hierarchical structure. This formalization of the enterprise, which is quite typical for all higher developed organizations, leads to a certain distance between members and hired managers. In the special case of a market-linkage co-operative, this distance is increased due to the considerable amount of business that is done with non-members.[41]

A result of these transactions with non-members is the reduced economic importance of the members. The members identify themselves with their co-operative less strongly than in the case of a traditional co-operative. The ties that bind co-operative enterprise and co-operative member have weakened. Due to this slack, the relations between the co-operative and its members have changed into relations similar to those between a capitalist enterprise and its customers.[42]

In comparison to the executively operating co-operative, the market-linkage co-operative is influenced to a greater degree by the "disturbing influences of competition"[43] that require a more pronounced management and control system. Therefore, professionals from outside the co-operative are hired for the co-operative's top management positions and even for the executive board. Their know-how is necessary for the market success of the co-operative. Such integrati-

[41] *Zerche, Jürgen/Schmale, Ingrid/Blome-Drees, Johannes*: Einführung in die Genossenschaftslehre, op. cit., p. 93.

[42] *Dülfer, Eberhard*: Strukturprobleme der Genossenschaft in der Gegenwart, op. cit., p. 18.

[43] Ibid. p. 18; translation by the *J. Kramer*.

on of outsiders, however, may create conflicts because the goals and preferences of hired experts are different from those of members.[44]

The co-operative society gains more independence from its members and becomes more of an enterprise than before. With the hiring of management professionals, members lose an important part of their control and their influence in the co-operative. Due to these developments, the relationship between the co-operative and its members shows even more similarities to the relationship between a customer on the market and an enterprise. Therefore, the promotion task gains additional importance in order to avoid the transformation of the co-operative society into a commercial enterprise. In spite of the increased importance of the promotion duty, it becomes harder to define for organizational as well as informational reasons.

4.3. Integrated Co-operative

While the market-linkage co-operative (e. g. a credit co-operative) is characterized by a weaker relationship between co-operative and members, the features of the integrated co-operative (e. g. a taxi co-operative) are to the contrary: the strength of the relationship has increased. The closer co-operation between the co-operative and its members is a result of the higher degree of concentration on the market. This can be observed on the retail market for food products, where co-operatives compete with retail outlets that belong to big chains or wholesalers. A loose relationship, such as the one between a member and a market linkage co-operative, would be highly disadvantageous (e. g. no corporate identity; no common public relation concept; a high degree of non-uniformity among the co-operatives, even though they belong to the same federation and act on similar markets).

The management of the co-operative enterprise therefore has to accept new responsibilities which have evolved from the co-operative's duties with regard to information.[45] One responsibility of the existing relationship is market research. This is absolutely necessary in

[44] *Kramer, Jost W.*: Interessendivergenzen, Informationsgefälle und Mitgliederdemokratie bei Genossenschaften, Beiträge zur Diskussion, Schriftenreihe des Genossenschaftsverbandes Sachsen, 1/1997, p. 20.

[45] *Dülfer, Eberhard*: Strukturprobleme der Genossenschaft in der Gegenwart, op. cit., p. 22.

order to stabilize and increase the members' competitive abilities, however, for cost reasons it cannot be carried out by the members themselves. Therefore, the co-operative has to offer this service. The co-operative's duty to keep its members informed, in this case, is closely connected with an increased integration of the members into the co-operative society. At the same time, a "reversal of the steering system" happens. Due to these development trends, the co-operative's management does not only influence the production process of the co-operative with regard to goods and services; but, at least partially, it also governs the activities of their members' own enterprises (e. g. retail stores with a joint marketing strategy).

The formal structures of power and influence are reversed: The members are no longer able and competent enough to give orders to the co-operative's management regarding the promotion task. Even defining their individual interests proves to be very difficult. Consequently, the members engage professionals for the co-operative's board of executives which in turn provides them with recommendations on how to improve their own, individual situation. The management staff does not only act in an advisory capacity but is permitted to enforce orders.[46]

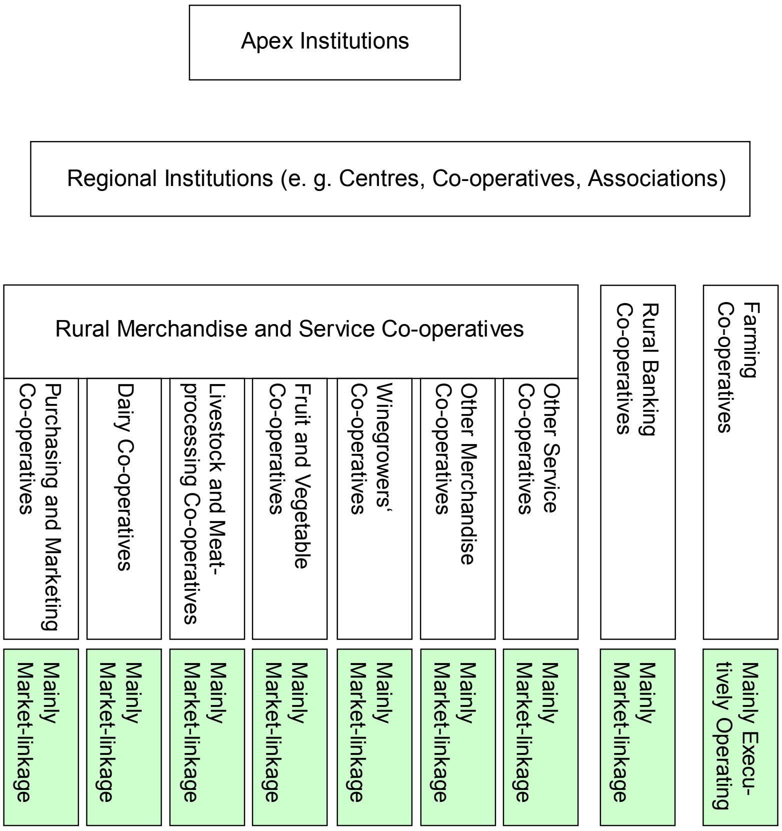
This reversal of roles makes it fairly difficult for members of the co-operative to decide whether certain business ventures were necessary and part of the promotion duty or whether they happened due to particular managerial interests.

4.4. Overview of structural economic types of rural co-operatives

This chapter aims at linking the structural economic types with the existing rural co-operatives in Germany. As a result of co-operative behaviour towards members, customers and markets it becomes obvious that most co-operatives have developed into either market-linkage co-operatives or integrated co-operatives.

[46] *Münkner, Hans-H.*: The Formation of Integrated Systems of Co-operative Societies, in: Review of International Co-operation, 71, 2/1978, p. 108.

Table 2: Structural Economic Types of Rural Co-operatives in Germany



Source: By authors.

5. Structural Influences of the Legal Form, the Registered Co-operative

Based on the legal form of a registered co-operative in Germany, two important aspects of its structure may be distinguished. The first of these is a general structure which is mandatory for all registered co-operatives.[47] Secondly, a large number of structural details of the co-operative are influenced by or originate from its activities, its branch, its size, and/or similar factors.

5.1. General Structure

All registered co-operatives in Germany consist of an executive board, a supervisory board, and a general assembly or a representative assembly, depending on the size of the co-operative.

Since 1974, the executive board is directly responsible for all business activities of the co-operative (§ 27 (1) GenG (co-operative law)). Only extraordinary decisions with a great impact on the future development of the co-operative (e. g. mergers) require the assent of the supervisory board or even of the general or representative assembly. In all other aspects, decisions of the executive board can not be vetoed before they are realized. In general, the executive board is responsible for all decisions concerning the day-to-day-business of the co-operative enterprise.

The supervisory board in most regards acts, as the name implies, as a supervisory institution and therefore is no real counterpart for the executive board. With the exception of those very few transactions where its consent is required for its realization, the supervisory board may be informed before the act, but without the rights to prevent activities or transactions. Only after the fact the supervisory board may evaluate the effect and the usefulness of a given activity. If it is dissatisfied, it may act accordingly. In severe cases, the board may even suspend members of the executive board. In general, the supervisory board is responsible for the supervision of the executive

[47] Co-operatives that are organised as joint stock companies, limited liability companies, or in any form other than a registered co-operative are not taken into consideration within this paper.

board and those decisions concerning the business of the co-operative enterprise that are not part of the day-to-day-business.

In principle, the most important body is the general assembly. Theoretically, it not only elects the members of the board, but also carries out the annual closing of the accounts, and evaluates whether the co-operative's members have been sufficiently promoted. A closer look at the typical proceedings, however, reveals a somewhat different situation in which the assembly accepts the suggestions of both the executive and the supervisory board without much discussion.[48] The general meeting is responsible for the supervision of both the executive and the supervisory board, for decisions of an extraordinary nature with regard to the co-operative enterprise, and for decisions concerning the co-operative as a society.[49]

In addition to these inner-co-operative bodies there is a fourth body in existence which is not a part of the co-operative itself, but mandatory for all registered co-operatives: The annual audit by a co-operative auditing association.[50]

5.2. Structural Details

While the above mentioned requirements are imposed on all registered co-operatives in Germany, co-operatives are nevertheless required to find an organizational structure within the legal framework that fits their individual needs. Even though this organizational structure is greatly dependent on the co-operative in question it nevertheless is possible to discern those tendencies that are caused by the discrepancy between member's expectations and market requirements.

[48] In this respect, the situation within the co-operative is quite similar to that in corporations, as analysed by *Berle, Adolf A./Means, Gardiner C.*: The Modern Corporation and Private Property, 5th printing, (1932; reissued 2003) Transaction, New Brunswick/London. 2003.

[49] *Münkner, Hans-H.*: Ten lectures on co-operative law, Friedrich-Ebert-Stiftung, Bonn 1982, p. 70.

[50] ibid., p. 76.

These strains within a co-operative are most obvious in worker's co-operatives[51] and farming co-operatives but they exist in other co-operatives as well. The main cause of these strains is the dual nature of a co-operative: On the one hand, the co-operative is an enterprise that has to compete in a market; on the other hand, it is a society that has to promote its members. These opposing interests have to be balanced within every co-operative and the way they are balanced depends very much on the stage of co-operative development, the business branch, and the size of the enterprise.

As a rule, it may be said that the larger the enterprise is, the stronger the market pressure will be and the lesser the influence of the members. This is especially true for co-operatives with a very large number of members, e. g. consumer co-operatives and credit co-operatives. In these cases, the boards will not only gain influence at the members' expense, but at the same time there will be a tendency to award market influences a higher significance than member's interests.

The more members there are within a co-operative, the smaller is the influence of an individual member. The less influence a member has the lower tends to be his or her interest in the co-operative, his "feeling of belonging". Therefore, the members of the boards, namely of the executive board, will gain influence, while the general assembly will lose importance.

For similar reasons, the market influence will be of lower importance in the case of an executively operating co-operative[52] than in either a market-linkage co-operative or an integrated co-operative. Not only does the executively operating co-operative tend to be smaller in size, but also closer to its members. The duty to promote the co-operative's members has a stronger impact.

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[51] *Kramer, Jost W.*: Prinzipielle und aktuelle Aspekte der Produktivgenossenschaften, in: *Kramer, Jost W./Eisen, Andreas* (eds.): Genossenschaften und Umweltveränderungen. Prof. Dr. Rolf Steding zum 60. Geburtstag, LIT, Münster 1997, p. 119; *Kramer, Jost W.*: Entwicklung und Perspektiven der produktivgenossenschaftlichen Unternehmensform, Hochschule Wismar, Fachbereich Wirtschaft: Wismar 2003, p. 17.

[52] *Dülfer, Eberhard*: Die Betriebswirtschaftslehre der Genossenschaften, op. cit., p. 93.

This becomes obvious by examining more closely the typical market-linkage co-operatives (e. g. credit co-operatives, consumer co-operatives, housing co-operatives) or integrated co-operatives (e. g. taxi co-operatives, retail co-operatives). Either the co-operative tends to do business with non-members as well as with members, or the market pressure causes a centralization of decision power within the co-operative.

6. The Allocation of Property Rights within a Co-operative

For an evaluation of the allocation of property rights within a co-operative, it is necessary to reconsider the four major areas of rights: The right to use a resource (usus), the right to retain its profits (usus fructus), the right to vary its form and substance (abusus), and the right to leave it to somebody else under mutually agreed conditions.

Looking at these major areas of property rights, it becomes obvious that the rights regarding the use of the resource are awarded to the executive board. In this regard, the co-operative is quite similar to other enterprises. The management is supposed to use the resources in the best possible way in order to promote the members.

The right to retain the profits is, at least formally, awarded to the general or representative assembly. In German co-operatives, the general assembly formally passes the balance sheet and the win and loss statement (§ 48 (1) GenG (co-operative law)).[53] The executive board draws up the balance sheet and the win and loss statement; the general assembly, however, is permitted to change it.

The rights regarding the variation of the co-operative's form and substance are allocated to different bodies. According to German co-operative law, the co-operative has to focus on the promotion of its members. Neither the general assembly nor the boards can vary the core of the co-operative. If such far reaching changes are desired, the co-operative has to be transformed into a different kind of enterprise. At a lower level, the general assembly is permitted to vary the form and the substance of the co-operative, namely with regard to the "society" part of the co-operative. Regarding the "enterprise"

[53] *Metz, Egon*, op. cit., p. 771.

part, there is a threefold hierarchy within the co-operative: The executive board has the right to perform minor changes in the form and substance, while the supervisory board may permit moderate changes. The most important changes have to be decided upon by the general assembly or by the representative assembly.

The right to leave the co-operative enterprise to somebody else is exclusively within the power of the general assembly, as it would be of the utmost importance for the future development of the co-operative. Therefore it has to be decided on by the owners, the members of the co-operative.

7. Where are the Problems?

Even though the allocation of property rights is fairly specified, due to the German co-operative law, there exist several problems regarding this allocation and the attenuation caused by it. Some of these problems are based on the law itself, some of them have evolved due to lack of enforcement of the rights mentioned above. All of this tends to have some influence on the four characteristic features of a registered co-operative: Promotion principle, identity principle, democracy principle, and solidarity principle.[54] This influence simultaneously affects the corporate governance structure of the co-operative, as we will see.

7.1. The Promotion Principle

Every co-operative has to fulfill its promotional obligation towards its members. Promotional obligation or promotion principal in this context means: Who will benefit in which way from the co-operative's activities. The main difficulty, however, is defining the exact extent of this obligation. While the promotional obligation was fairly easy to define in the very first (traditional or executively operating) co-operatives, it has recently become much harder to specify how a co-operative is supposed to promote its members. The right to

[54] *Flieger, Burghard*: Produktivgenossenschaft als fortschrittsfähige Organisation. Theorie, Fallstudie, Handlungshilfen, Metropolis, Marburg 1996, p. 20; *Kramer, Jost W.*: Zur Organisation produktivgenossenschaftlicher Unternehmen, IGA Zeitschrift für Klein- und Mittelunternehmen - Internationales Gewerbearchiv, 47, 3/1999, p. 167.

use the resources has been awarded to the executive board, but the members are still required to designate the goals for which these resources should be used.

It is a moot point whether this setting of goals is part of the right to use the resources or part of the right to retain the profits. However, if the members do not define the goals, they are virtually unable to accurately ascertain whether they have been promoted or not.

Theoretically, the members define the goals for the co-operative, thereby simultaneously defining the promotional obligation for the co-operative's management. Instead, a closer look at the proceedings at general assemblies reveals that the members do not define the co-operative goals at all. Therefore, the promotional obligation is in danger of becoming hollow.

Engels[55] even considers the promotional obligation to be just an empty phrase. He states that all former attempts to fill the concept of a promotional obligation with life have failed. As a consequence, property rights regarding the definition of the promotional obligation have been acquired by the co-operative's management, namely the executive board.

Even though Engels' arguments are somewhat biased since there is not even a hint of differentiation between co-operatives that differ in size, branch, or development stage, it can not be denied that there is a tendency among executive boards to acquire the right to define their own goals. This tendency seems to increase in accordance with the size of the co-operative and the number of its members. It seems to be strongest among market linkage co-operatives, where the general assembly has been replaced by a representative assembly.

Property rights theory offers an explanation for this development: transaction costs for the individual member are higher than the gains he could expect from a definition of the promotional obligation. Therefore, the definition of the promotional obligation becomes similar to that of a communal property, which has been informally claimed by the group with a more favourable cost-gains-ratio. The groups with low transaction costs and a chance for higher profits are

[55] *Engels, Michael*: Verwässerung der Verfügungsrechte in Genossenschaften, Zeitschrift für betriebswirtschaftliche Forschung, 7/8/1997, p. 675.

the executive board and to a lesser degree the supervisory board. Their transaction costs were lower because they had fewer people to convince to act jointly, and they also had the benefit of superior information. At the same time, they could profit from a non-defined promotional obligation, as this increased the difficulties to control whether they fulfilled their obligation at all. The fact that the allocation of property rights provided by § 27 (1) in the amendment of the co-operative law in 1973 was demanded by the management professionals[56] is evidence for such a development. The paragraph in its current form states that the executive board is empowered to handle all day-to-day business activities, limited only by the by-laws.[57]

If the transaction costs for member's involvement were high before these legal changes, they are close to prohibitive now, at least in those co-operatives with a large number of members. In most of these co-operatives there is no general assembly but a representative assembly, where it is even more difficult (i. e. more costly transaction-cost-wise) for an ordinary member to convince the assembly, especially if he is not a member of the representative assembly.[58] Besides, in many co-operatives the election lists for the representative assembly and the supervisory board are drawn up under the close supervision of the executive board. This enables the executive board with the chief executive officer as its key member, to handpick the persons who are to supervise its activities. The corporate governance structure is kept formally intact, but is weakened in its core.

Another problematic area has been pointed out by Engels, who emphasizes that the increase of reserves tends to decrease the importance of the share capital that is directly owned by the co-operators. If a member decides to leave the co-operative he receives no share of the accumulated reserves.[59] Therefore, whenever members

[56] *Lenfers, Guido*: Die Genossenschaftsrechtsnovelle von 1973 - Entstehung und Bewertung, Regensberg, Münster 1994, p. 68.

[57] *Hettrich, Eduard/Pöhlmann, Peter*: Genossenschaftsgesetz. Kommentar zu dem Gesetz betreffend die Erwerbs- und Wirtschaftsgenossenschaften und zu umwandlungsrechtlichen Vorschriften für Genossenschaften, C. H. Beck, München 1995, p. 140.

[58] Sparda-Bank West eG in Düsseldorf is an example on how to minimize members' rights (cf. *Kramer, Jost W.*: Fortschrittsfähigkeit gefragt: Haben die Kreditgenossenschaften als Genossenschaften eine Zukunft?, Hochschule Wismar, Fachbereich Wirtschaft: Wismar 2003, p. 12).

[59] *Engels, Michael*: Verwässerung der Verfügungsrechte in Genossenschaften, op. cit., p. 676.

decide to increase the reserves they vote away a share of their profits without ever having a chance to share in this part of the capital stock, with the notable exception of a liquidation of the co-operative. Employing the terminology of property rights theory, it is obvious that the members decide to surrender a certain part of their set of property rights. It is, however, uncertain what they receive in return – if anything at all.

If the promotional obligation is well defined and obeyed by the management of the co-operative, the real impact of this property rights disclaimer is of comparatively low importance. In this case, members will benefit from the better performance of the co-operative which will become possible due to the higher capital stock. If the promotional obligation tends to be fuzzy, as has been argued above, the members receive no compensation at all. They waive their rights in deference to the executive board – which further weakens the corporate governance structure.

The rights to vary the form and substance of the co-operative seem to be of comparatively low importance. Therefore, hardly any problems can be observed regarding this set of rights and its allocation. A notable exception may be found in the banking sector, where numerous mergers have happened during the last couple of years. This development is, for the most part, likely to continue in the foreseeable future. An ad hoc evaluation regarding the impact of mergers on members' rights is very difficult. Therefore, further research is required.

The fourth set of property rights focuses on the right to leave the property to somebody else. In this case, two aspects have to be distinguished. On the one hand, there is the member's right to leave its share to somebody else, on the other hand there is the possibility of leaving the co-operative itself to somebody else.

Engels focuses exclusively on the first aspect and reaches the conclusion that the law creates a severe attenuation of the property rights of members. He states that the only way for a member to leave the co-operative is to terminate the membership, to return the shares and to receive the share in the capital stock. According to Engels[60], this attenuation of the member's property rights further increase the property rights of the executive board.[61] He points out the absence of a secondary market for co-operative shares and fails to recognize the low necessity for such a market: As a rule, current members of the co-operative can terminate the membership and receive the par value of their shares, while prospective members need only apply for membership, provided they meet the requirements (e. g. owning milk stock for the membership in a dairy co-operative).

Engels claims that the executive board is enabled by these regulations to follow a strategy of member selection, pushing unwanted members out of the co-operative while choosing desired applicants for membership. Theoretically, this could happen, but empirical evidence for Engels' statement seems to be missing.

It has to be admitted, however, that Engels is right insofar as a co-operative member's property rights differ from those of a shareholder in a joint stock company. Whether this is indeed a higher attenuation as Engels claims or only a difference in allocation, is still to be argued. Once again, the promotional obligation is of great importance. If the promotional obligation is fulfilled, disadvantages for the members due to this allocation of rights are hardly noticeable. If the promotional obligation is not fulfilled, however, the drawbacks for the member are severe.

7.2. The Identity Principle

The identity principle states that theoretically all members of the co-operative are identical with one well-specified group of clients. These co-operative clients may be customers, either on the supply side (e. g. retail co-operatives) or on the demand side (e. g. consumer co-operatives, housing co-operatives), or employees (e. g. workers co-operatives). Therefore the property rights of the members are supposed to represent an identical influence via their capital share and via their share of transactions with the co-operative.[62]

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[60] ibid.

[61] These arguments by *Engels* require some comments: not only does he neglect the chance to transfer the share to somebody else, as provided by § 76 (1) GenG (co-operative law). He also argues that as a rule members of co-operatives have only one share per capita. This is not only wrong for all those co-operatives where the number of shares per capita depends on the amount of business transacted with the co-operative (e. g. number of cattle in the case of a dairy co-operative), but also overlooks the fact that in many co-operatives the ratio of members versus number of shares indicates a much higher ratio (e. g. in credit co-operatives).

[62] In this context a possible proportional gap between the capital share and the transaction share will be neglected, even though such gaps exist.

Reality, however, proves that this theoretical model currently is valid only in very few cases, mainly in supply side co-operatives. For the majority of co-operatives, non-member transactions have become quite typical.

The property rights of the members have been influenced by this development quite drastically, as non-member transactions tend to decrease members' economic importance. While the property rights stay formally the same, they are devaluated economically. The more transactions are carried out with non-members the lower is the importance of the members. This does not only create a certain bias on the part of the co-operative management towards non-members; but, it may even lead to a transformation of the co-operative into a capitalist enterprise or cause an economic failure of the co-operative. The most notable examples for such developments have happened in consumer co-operatives. In both cases the promotional obligation suffered as well.

Farming co-operatives find themselves in a very special situation because they tend to have a very heterogenous membership structure: current landowners, former landowners, current employees, former employees, financial investors, are only five groups of members that can have very diverse interests. At the same time, not all landowners and/or all employees are members of the co-operative. This does not necessarily mean that the co-operative becomes impossible to manage, but it sure makes it difficult to balance members' interests.

7.3. The Democracy Principle

With regard to the democracy principle, it may be supposed that all members have an equal influence on co-operative matters, as is to be expected by the concept "one man, one vote". Instead, reality proves to be different.

The democracy principle in co-operatives has become somewhat meaningless for two different reasons. Firstly, the German co-operative law prescribes for registered co-operatives a mandatory hierarchy of at least three, but in many co-operatives of four levels: Executive board, supervisory board, general assembly or representative assembly, and ordinary members (in case of a representative assembly).

Even though all these levels are exclusively staffed with members of the co-operative, the influence and the access to information varies immensely. Therefore, a certain lack of control can be observed in many co-operatives.[63]

The democratic influence of the members is therefore predetermined by the co-operative law, depending on their role within the co-operative. A certain attenuation of property rights is evident.

Secondly, the legal cause for this fact finds a counterpart in kind in organizational theory. As Boettcher[64] points out, it is next to impossible to run any kind of organization that has more than a very small number of members in accordance with a veto right for individual members. Larger organizations require some kind of a hierarchy to enable at least minimum efficiency. For this reason, unequal distribution of democratic influence is unavoidable.

Such an unequal distribution, nevertheless, requires an adequate control mechanism in order to avoid unwanted and unwarranted influence of certain members and of certain levels within the co-operative. A suitable organizational solution is needed.

7.4. The Solidarity Principle

Whether or not any difficulties exist regarding the attribution or attenuation of property rights in the realm of the solidarity principle is very difficult to evaluate. This is mainly due to the fact that the solidarity principle itself continues to be somewhat fuzzy in its content. Who is supposed to be the recipient of the solidarity? How is the solidarity to be exercised? How is the solidarity to be measured?

For these reasons, it is very hard to evaluate whether the solidarity principle is put into practice in the first place, not to mention whether or not the individual's property rights are obeyed.

Nevertheless, there are some examples that throw some light on the difficulties of this principle. Typical examples are retail co-opera-

[63] *Kramer, Jost W.*: Interessendivergenzen, Informationsgefälle und Mitgliederdemokratie bei Genossenschaften, op. cit., p. 29.

[64] *Boettcher, Erik*: Kooperation und Demokratie in der Wirtschaft, J. C. B. Mohr (Paul Siebeck), Tübingen 1974, p. 59.

tives that usually offer discounts to customers with large volume orders. In such cases the question is raised as to whether or not such discounts are an infringement of the solidarity principle. The poorer customers that are in a greater need of promotion are denied these discounts due to their smaller orders, while the stronger and wealthier members receive an additional benefit. On the other hand, there is the peril that the stronger members might leave the co-operative (and establish a co-operative of their own) if they do not receive such discounts. In turn, this may lead to an even worse situation for the smaller members of the co-operative.

8. What could be done?

A closer look at the problems mentioned above reveals that the heart of the matter lies in the definition of the promotional obligation. If the current situation is to continue, the promotional obligation is well on its way to becoming an "empty phrase" as stated by Engels.[65] Consistent with such a development, several co-operatives in Germany are in danger of losing their special characteristics. In the end, this might even jeopardize their continued existence as a co-operative.

A possible solution for many problems that are linked to the promotional obligation has already been described by Boettcher[66] several years ago. His concept of a promotion plan and a promotion report would solve many of the problems that have mentioned above. For reasons of brevity, this concept shall not be described here as it has received sufficient attention in various publications.[67]

The main reason why the promotion plan, as well as the promotion report, is used only in a minority of co-operatives is the executive

[65] *Engels, Michael*: Verwässerung der Verfügungsrechte in Genossenschaften, op. cit., p. 683.

[66] *Boettcher, Erik*: Die Genossenschaft in der Marktwirtschaft, J. C. B. Mohr (Paul Siebeck), Tübingen 1980, p. 82, 99.

[67] *Boettcher, Erik*: Die Problematik der Operationalisierung des Förderungsauftrages in Genossenschaften: Förderplan und Förderbericht, in: Zeitschrift für das gesamte Genossenschaftswesen, 29, 3/1979; *Weber, Wilhelm/Brazda, Johann*: Promotion Balance Sheet, Promotion Report, Promotion System, in: Dülfer, Eberhard in cooperation with Laurinkari, Juhani (eds.): International Handbook of Cooperative Organizations, Vandenhoeck & Ruprecht, Göttingen 1994, p. 738.

boards' unwillingness to implement it. During the last couple of years, the management staffs of the co-operatives, namely the executive boards, have acquired numerous rights that used to belong to the general assembly and/or the supervisory board. To some extent, these rights have been allocated to the boards by the last amendment of the co-operative law. Most of these rights, however, have been obtained because the transaction cost situation was in favour of the managerial interests instead of the members' interests. Since the promotion plan and promotion report would reduce the property rights of the executive boards, the boards are quite unlikely to support such changes. Transaction costs that would result from the formulation and execution of a promotion plan and promotion report are an additional reason for the lack of implementation.

Nevertheless, the mandatory use of the promotion plan and the promotion report would strengthen the structure of the co-operative. As the transaction costs for its enforcement are quite high and next to prohibitive for an individual member, this is unlikely to happen without outside support. At the same time the corporate governance structure would be strengthened.

Such support might come from a number of sources. The most efficient would be a change of the co-operative law requiring a mandatory implementation of promotion plan and promotion report in all co-operatives, or at least in all larger co-operatives (e. g. with more than 300 members).[68] Other supporters could be the co-operative auditing unions, as these instruments would enable a better material audit which is required by co-operative law. A third source of support could be found in the co-operative research institutes, e. g. through an in-depth study on the implementation of these instruments.

In the long run, the implementation of a promotion plan and a promotion report may even have a positive cost-gains-ratio because it offers additional information for the co-operators and may therefore be an instrument to win over additional members, thereby increasing the capital stock of the enterprise. At this point in time, however, this is purely speculative as sufficient empirical research does not yet exist.

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[68] This would be similar to some provisions enforced by the KonTraG (law on control and transparency in enterprises) regarding controlling instruments and early warning systems within enterprises.

9. Summary

In Germany as well as in Austria exist a large number of rural co-operatives that are engaged in a broad variety of business activities. There organisational structure is determined by co-operative law and to a lesser degree by statutes or by-laws. As has been shown for German rural co-operatives by applying property rights theory the corporate governance structure as determined by law is formally still in existence, while it actually has been shifted in favour of the executive board. This has created an imbalance where on the one hand no longer any corporate governance is actually taking place while on the other hand members' interests may easily be neglected, because it is the executive board that determines the members' interests and also whether they have benefited from the co-operatives activities. Suitable instruments to improve the corporate governance structure within such co-operative are the promotion plan and the promotion report as developed by Boettcher. However, for transaction cost reasons and due to the current attenuation of property rights, it is unlikely that these instruments will be implemented without outside pressure, e. g. through a change in co-operative law.

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