



# CO-OPERATIVES IN THE FREE STATE PROVINCE (2):

## *An implosion of new firms*



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# 1. Background

In March 2014 the Department of Economic Development, Tourism and Environmental Affairs (DETEA) requested a study on all the co-operatives in the Free State Province. The International Labour Organisation (ILO) then requested the SME Observatory of South Africa based at the Centre for Development Support (CDS) of the University of the Free State (UFS) to develop a proposal responding to the DETEA request. Over several meetings the scope of the study was developed and a proposal was submitted that was endorsed by DETEA and that forms part of the agreement between the UFS and the ILO for the execution of the study.

The time available for the study was extremely tight. The first report<sup>1</sup> completed at the end June dealt with:

- The enterprise category of co-operatives as defined in the legislation
- A short overview of the literature on co-operative studies.
- The scope of the study and an overview of the data sets obtained for the analyses.
- An overview of the occurrence of co-operatives per economic sector.
- An overview of the occurrence of co-operatives at Provincial, Metro and District municipal level, and Local Municipal levels to indicate the geographic spread.
- A comparison of the Co-operative profiles of some Local Municipalities and towns with the Enterprise Architecture of those municipalities and towns
- A focus on the specific economic activities of co-operatives within some sectors, and
- Listing issues for reflection to be work-shopped with DETEA.

This second report is based on telephonic interviews with 215 co-operatives to determine what the situation is pertaining to the economic activities and employment creation by the co-operatives. It also deals with aspects relating to the membership of co-operatives, the dominance of women in co-operatives, the perceived importance of various business skills and a self-assessment of the co-operative members about their competency levels, as well as information about their markets.

A third report will deal with the outcome of *in-situ* interviews with at least 30 co-operatives as well as a report on a focus group discussion with officials in the Thabo Mofutsanyana District Municipal area.

Whilst this report should preferably be read together with the first report, the definition of co-operatives as well as the preliminary findings of the first report will be summarised before dealing with the essence of the second report.

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<sup>1</sup> Wessels J & Nel W 2014: **Co-operatives in the Free State Province: an Explosion of Firms.**

## 2. Definition of co-operatives

The Co-operatives Act (No 14 of 2005) defines a co-operative as “*an autonomous association of persons united voluntarily to meet their common economic and social needs and aspirations through a jointly owned and democratically controlled enterprise organised and operated on co-operative principles.*” The formulation of the “co-operative principles” in the Act is important. The key aspects of these are:

- Open membership: “*a co-operative is open to persons who can use the services of that co-operative and who are able to accept the responsibilities of membership*” [Section 3 (1) (a) of Act 14 of 2005].
- Democratic control: In the case of a primary co-operative that has to have at least 5 natural persons as members, each member will have only one vote. In the case of a secondary co-operative (formed by two or more primary co-operatives) no member can have more than 15% of the total vote.<sup>2</sup> [Section 3(1) (b) and Section 3(3) of Act 14 of 2005].
- Financial interest by members: “To the extent feasible...” members will provide the capital of the co-operative. [Section 3 (1) (c) of Act 14 of 2005].
- Limited returns: The return on equity is limited to the percentage determined by the constitution of the co-operative. [Section 3(1) (d) of Act 14 of 2005].
- Capitalising the enterprise: At least 5% of the annual surplus remains non-divisible to members and should be set aside as a reserve fund. [Section 3(1) (e) of Act 14 of 2005].

Section 10 of the Co-operatives Amendment Act (No 6 of 2013) also makes it unlawful for a person or an entity to utilise the term co-op or co-operative for any association or entity that is not registered in terms of Act 14 of 2005 as amended.

## 3. Summary of key findings from the first report

### 3.1 Key issues emanating from the literature survey<sup>3</sup>

There are clearly commendable objectives for supporting and establishing co-operatives. These include worker control and empowerment, better access to finance, informal learning, and collective marketing. Despite this, the literature consulted pointed to the following:

- Earnings can be low or negligible;
- Access to supermarkets or non-local markets is a challenge;
- Co-operative structures can lead to internal conflict;
- Grant dependency can undermine sustainability and delink reward from productivity and quality;
- Consideration of suitable support advisors and models that encourages SME to link into higher marketing opportunities would be advantageous;

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<sup>2</sup> Since the members of a secondary co-operative are the primary co-operatives, the 15% maximum vote by a member (a primary co-operative) in fact requires that a secondary co-operative should comprise of at least 7 primary co-operatives. This anomaly was only corrected by The Co-operatives Amendment Act (Act 6 of 2013).

<sup>3</sup> Sources consulted are listed in report 1

- User co-operatives should also be considered; and
- Alternative enterprise forms may be more suitable than co-operatives in some instances.

### 3.2 Findings based on analyses of the co-operative data base of the Free State

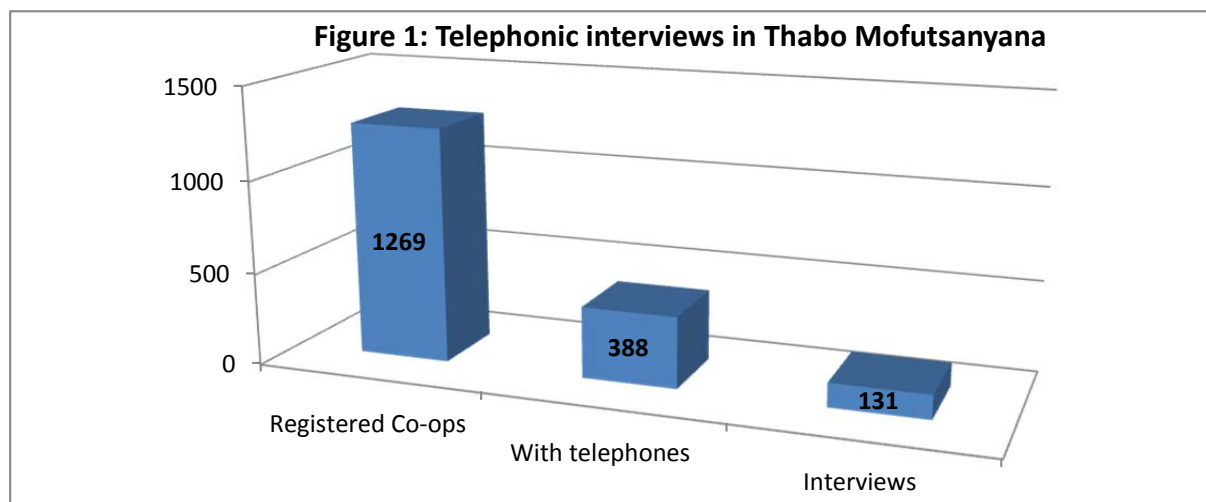
The following findings were documented in the first report:

- 3.2.1 It appears highly unlikely that the birth explosion of co-operatives is the result of members in communities freely and voluntarily and spontaneously deciding that they wanted to formalise their entrepreneurial efforts through forming co-operatives.
- 3.2.2 It appears far more likely that the explosion of firms was the result of a public sector driven campaign to create co-operatives. It could possibly have been driven by consultants who had received an incentive for each co-operative registered. As the literature argues there is a need to be sensitive to the very real financial, skills and marketing challenges co-operatives face and when establishing them, focussing on their potential markets and user needs is critical as supply does not necessarily create demand (Philips 2003; Borda Rodriguez and Vicari, 2014).
- 3.2.3 If the conclusions in (a) and (b) are correct, it can be predicted that successful enterprise growth is fairly low and that a high failure rate of co-operatives as formal enterprises, could, unfortunately be anticipated.
- 3.2.4 Philips (2003) notes that institutional support must be appropriate and consider key variables which impact on success. The State serving as an enterprise incubator could ignore the very basic dynamics of local economic drivers and value chains and further enhance the prospects of the enterprise failure of co-operatives.
- 3.2.5 The creation of the enterprises appears in many instances as an exercise in formal enterprise creation without real economic activity supporting it. These impacts cannot be assessed purely from a database and has to be pursued by research assessing outputs and impact on GVA and employment opportunities.
- 3.2.6 The Enterprise Architecture approach of the SME Observatory proves that **formal entrepreneurial space is in many sectors already fully occupied**. Enterprise formation through forming co-operatives in trade will therefore either set such co-operatives up for failure or push existing trading entities into oblivion.
- 3.2.7 A large percentage of enterprises are mainly aimed at local, community consumption expenditure, e.g. catering services and in some cases even to the expenditure of the members of the co-operative. Given the socio-economic conditions of such local communities, **these attempts boil largely down to a recycling of poverty since it fails to bring in money from outside the community**. Poverty cannot be addressed in this way. A broader vision for what co-operatives can undertake and the niche that they can fill is clearly needed (Philips, 2005; Hartley and Johnston, 2014).
- 3.2.8 A substantial number of co-operatives appear to be established to gain income from public sector expenditure. Apart from a number that were blunt enough to state that “tendering” is their activity, a large number are aimed at feeding schemes (schools) and cleaning services (public sector buildings). This can be considered as a redistributive approach rather than growing of the economy since it is tax income (derived from private sector surplus and, in the face of a budget deficit, from loans Government has to take on) that is used for the food parcels, feeding schemes and such cleaning and security services.

- 3.2.9 The overwhelming majority of co-operatives are aimed at production of commodities (vegetables / poultry / crops) or undifferentiated products (catering services for community gatherings). This large scale failure to grasp opportunities to embark on differentiated products will not provide the leverage that could be obtained by a targeted intervention to create conduits for products or services that will bring in money from outside the local communities (export-led enterprises). In addition, as the literature argues there is scope to also encourage the establishment of ‘user co-operatives’ which are regarded as poorly developed in the country (Philips, 2003).
- 3.2.10 It is unlikely that here has been a rapid change in the entrepreneurial climate in the Free State. This is due to the fact that many of the new co-operative enterprises probably do not have entrepreneurs with adequate business skills in them. Any intervention with the thousands of co-operatives will have to be carefully thought through and assessed. There clearly is a need to learn from succeeding and failing co-operatives what the key catalytic variables are.

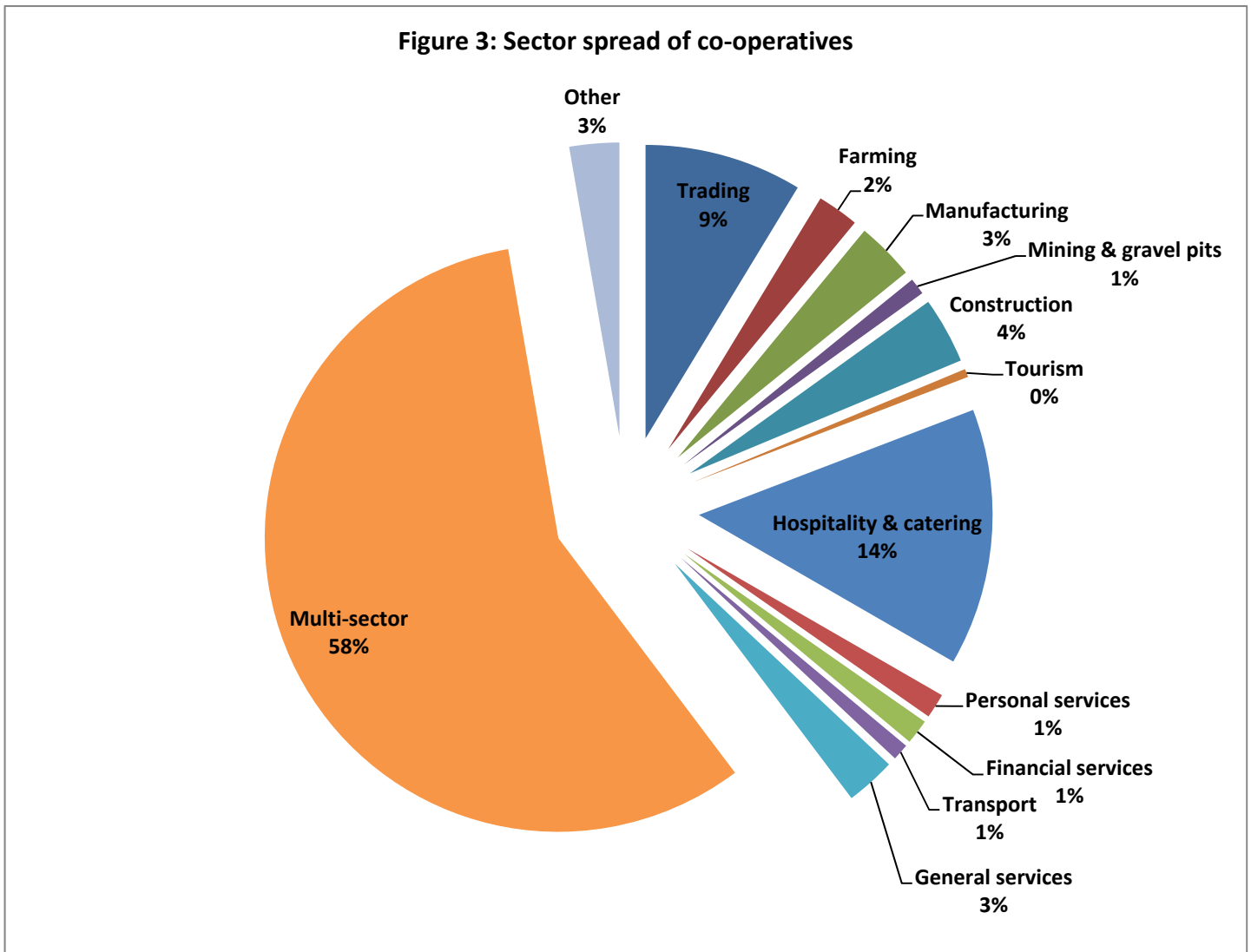
#### 4. The sample for the telephonic interviews

Whilst DETEA repeatedly expressed their desire that all co-operatives should be contacted, this is not possible due to constraints in resources. A research study should not be considered as an audit or a census but rather a representative snapshot of the environment. The Terms of Reference was amended to increase the sample for telephonic interviews to 215 with a request that it should concentrate on the co-operatives functioning in the Thabo Mofutsanyana District area. Figure 1 clearly indicates that of the **1 269** registered co-operatives in the Thabo Mofutsanyana District area, only **388** have telephone numbers. Of all these only **131** interviews could be conducted: In the remainder of the cases the telephone numbers were either no longer operational, or belonged to someone who had nothing to do with the co-operative, or to a person that indicated that the co-operative never got going and that he/she was not really in a position to give information about the co-operative.



Since the number of telephonic interviews could not be completed in the Thabo Mofutsanyana area (59%), the remainder were sought predominantly in the district areas of Lejweleputswa (25%) and the Mangaung Metropolitan area (11%). Eventually a total of 220 interviews were conducted. Numerous interviews had to be conducted in up to 5 or 6 calls,

since the interviewee did not have all the information and either had to consult someone else in the co-operative, or referred the interviewer to another person in the co-operative. The spread of the sample over the province is depicted in Figure 2.

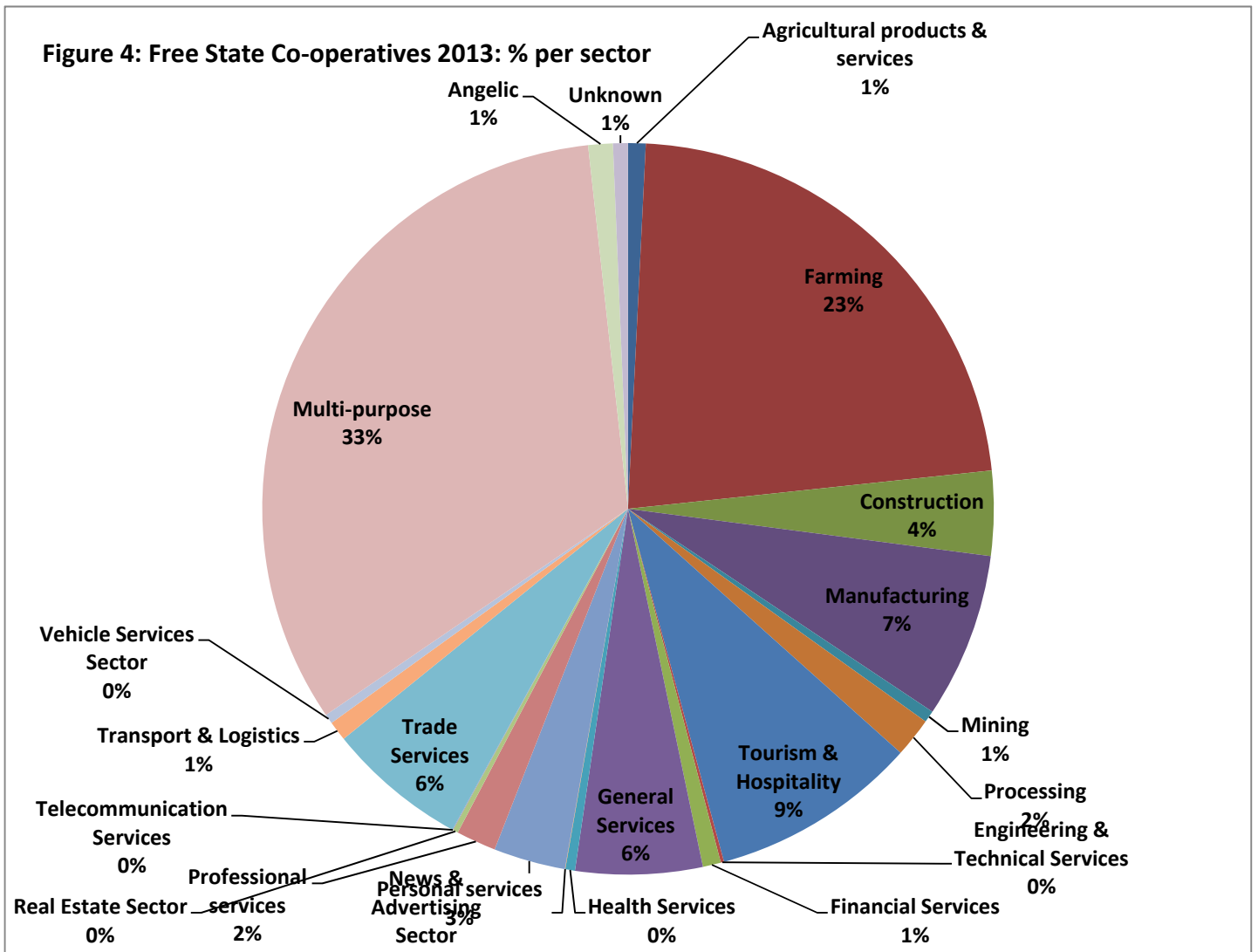


The interviewers were trained by Dr Deidre van Rooyen, Director of the Centre for Development Support, both in the technical aspects of the questions on the interview schedule, as well as in interview ethics. Interviewees were given the opportunity to freely voice their opinions since the information revealed would not be linked to a specific co-operative.

The interviews took place from 7 – 24 August and the interview schedule was also available in a Sesotho translation to overcome any potential language barriers. The vast majority of interviews were conducted in English.

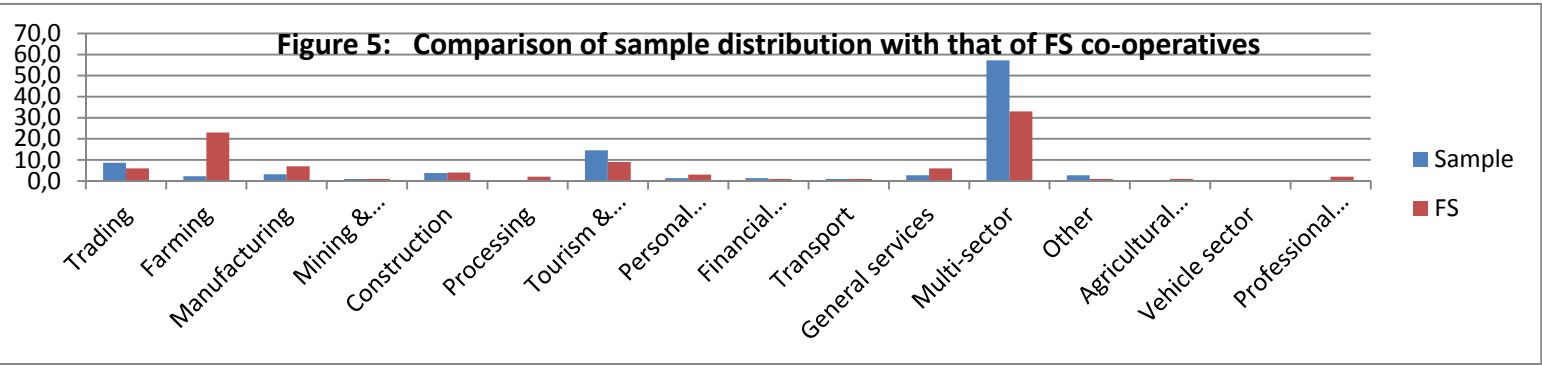
Data capturing and cleaning took place in the latter part of August and beginning of September. The sector distribution of the interviews is presented in Figure 3. This clearly gives an indication that there are far too many (58%) multi-sectoral co-operatives.





The undifferentiated nature of the enterprises with a dominance of multi-sector entities (as also emerged from the analyses of the data sets) is the first aspect to attract attention. Linked to that is the low occurrence of farming co-operatives. A comparison of the the interviews conducted and the data set based on the CIPC data, revealed that numerous co-operatives that were on the basis of the CIPC data classified as farming co-operatives, now indicated that they were multi-sectoral and apart from farming engaged in trading, catering and other activities.

Figure 5 compares the sample distribution per sector with that of the Free State as a whole as in Figure 4 above. The major difference is that several of those classified as “Farming” co-operatives are in fact multi-sector co-operatives. The sample is therefore representative enough to come to valid conclusions for the situation pertaining to the co-operative situation in the Free State Province.

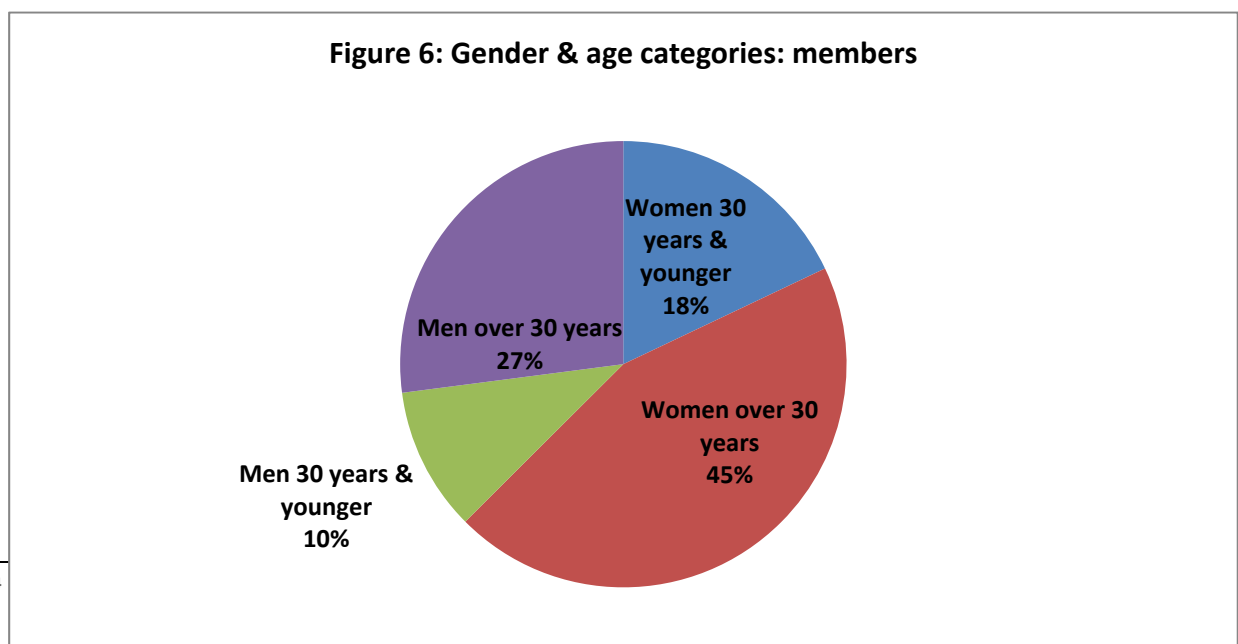


This also explains why the trading co-operatives form only 9% of the sample. A large percentage of those classified as trading co-operatives according to the information on the CIPC data base now also responded by stating their multi-sector character. Apart from trading they are engaged in a range of activities from farming, personal care and catering and were now captured as multi-sector co-operatives.

The reality of the situation based on interaction with the co-operative members in the interviews, is therefore even less differentiated than what was observed in Report 1 based on the CIPC data analyses. It therefore is important to repeat a statement from Report 1: *“The wide range of activities from totally unrelated sectors that are under one enterprise umbrella creates the impression of low skills levels and lack of specialisation. It is a poor combination for survival in a globalising economic context.”*<sup>4</sup> This will be further assessed later in the report in Section 9.

## 5. Membership of co-operatives

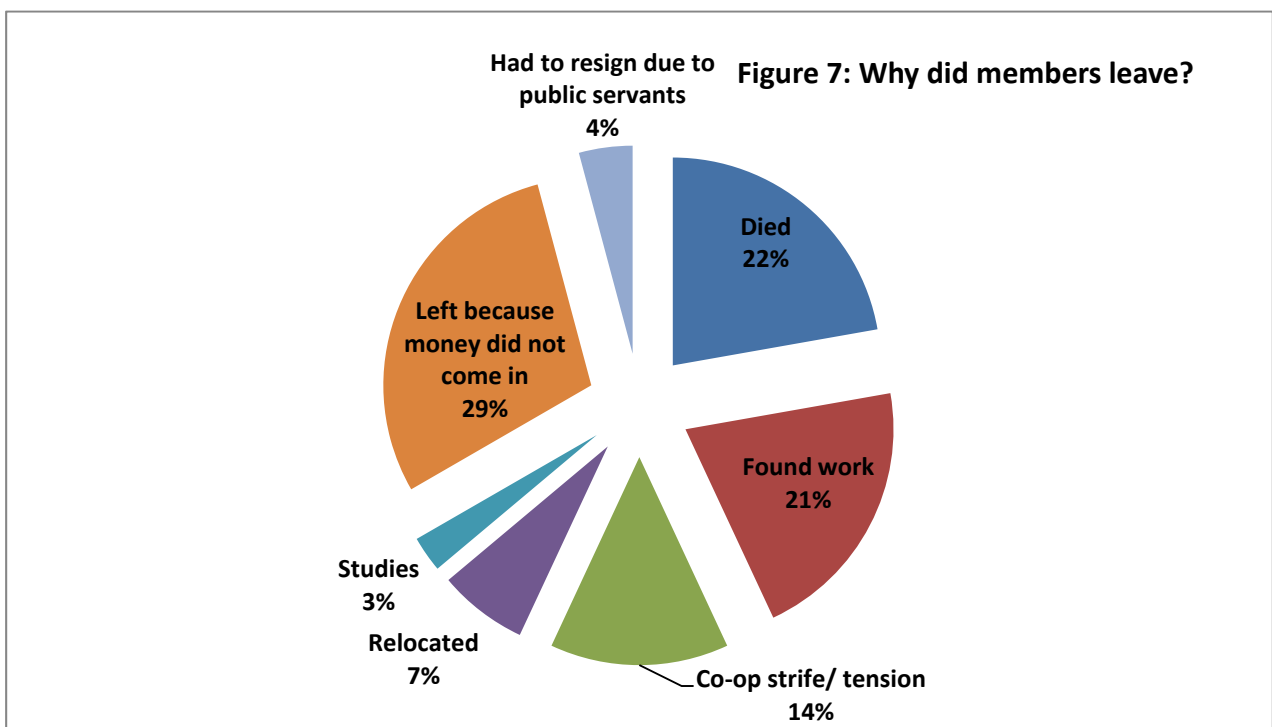
The gender distribution of the respondents (considering that in several cases more than one respondent had to be interviewed) was 49% male and 51% female. The gender and age categories of members of co-operatives at the stage of the interviews are depicted in Figure 6. Women dominate the membership with a share of 63% in total.



The variance for the distribution of women in co-operatives is largely found in the tourism and hospitality sector with its dominance of catering enterprises, as well as in personal care where hair and beauty services are dominated by women, whilst the majority of clothing manufacturing co-operatives also have a dominance of women.

The 220 co-operatives jointly had 1 987 members when they were established. That gives an average membership of 9.03 members per co-operative. Since a few co-operatives boasted very large numbers (more than 100), it is important to look at the mean as well. The mean co-operative had 5.1 members at founding. By the time of the interviews, the total membership had declined by 21.4% to a total of 1 562 members. That implies an average membership of 7.1 per co-operative and a mean of 4.9 members. The membership per co-operative will be revisited later when employment (Section 10) is discussed.

It is important to consider why the membership has declined. Given the fact that the overwhelming majority of co-operatives are young enterprises that were recently established, the disappearance of 1 in 5 founding members deserves attention. Four reasons explain 86% of the membership decline (Figure 7). It is appropriate to convey some messages from the co-operative respondents themselves:



- *“One member passed on. Three left because of co-operative politics.”*
- *“Three members left because they didn’t see any progress and support from the municipality.”*
- *“Five members got jobs.”*
- *“Two members relocated to another town.”*
- *“Three members died and eight just left.”*
- *“Four members just gave up because they didn’t see any progress.”*

- *“Four members became tired waiting for funds.”*
- *“Seven members left because there was nothing that the co-operative was doing.”*
- *“The co-op failed and everyone left.”*
- *“She didn’t want to do hard labour. She only wanted to be a driver.”*
- *“People didn’t want to work.”*
- *“They didn’t want to work and relied on others to do the work, but then they want their share.”*
- *“We all lost hope and we are no longer interested in a co-operative.”*

The high incidence of members who became disheartened because of enterprise failure (29%) is important to note. Considering that a large percentage of co-operatives with telephone numbers could not be contacted at all, could reflect the fact that those co-operatives are also non-functioning and that their members therefore also “left” the co-operatives. This could imply that people that are becoming disillusioned are substantially higher than the 29% of those co-operatives that could be contacted.

## 6. Procurement & Markets

In this section the focus will be on the extent to which co-operatives in the Free State are locality bound in terms of their markets, but also their supply chains. Furthermore, the clients and suppliers within the localities where the Co-operatives operate will also be considered.

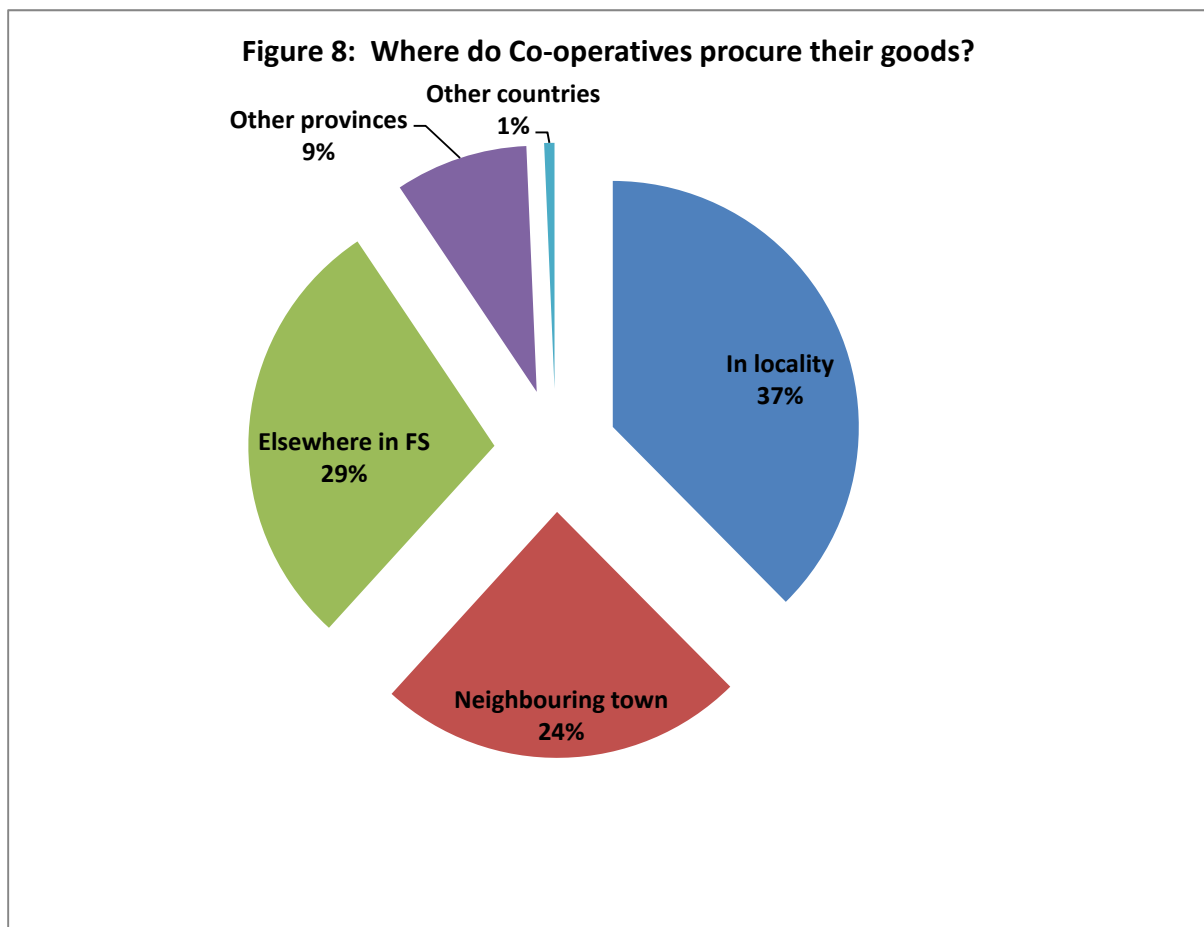
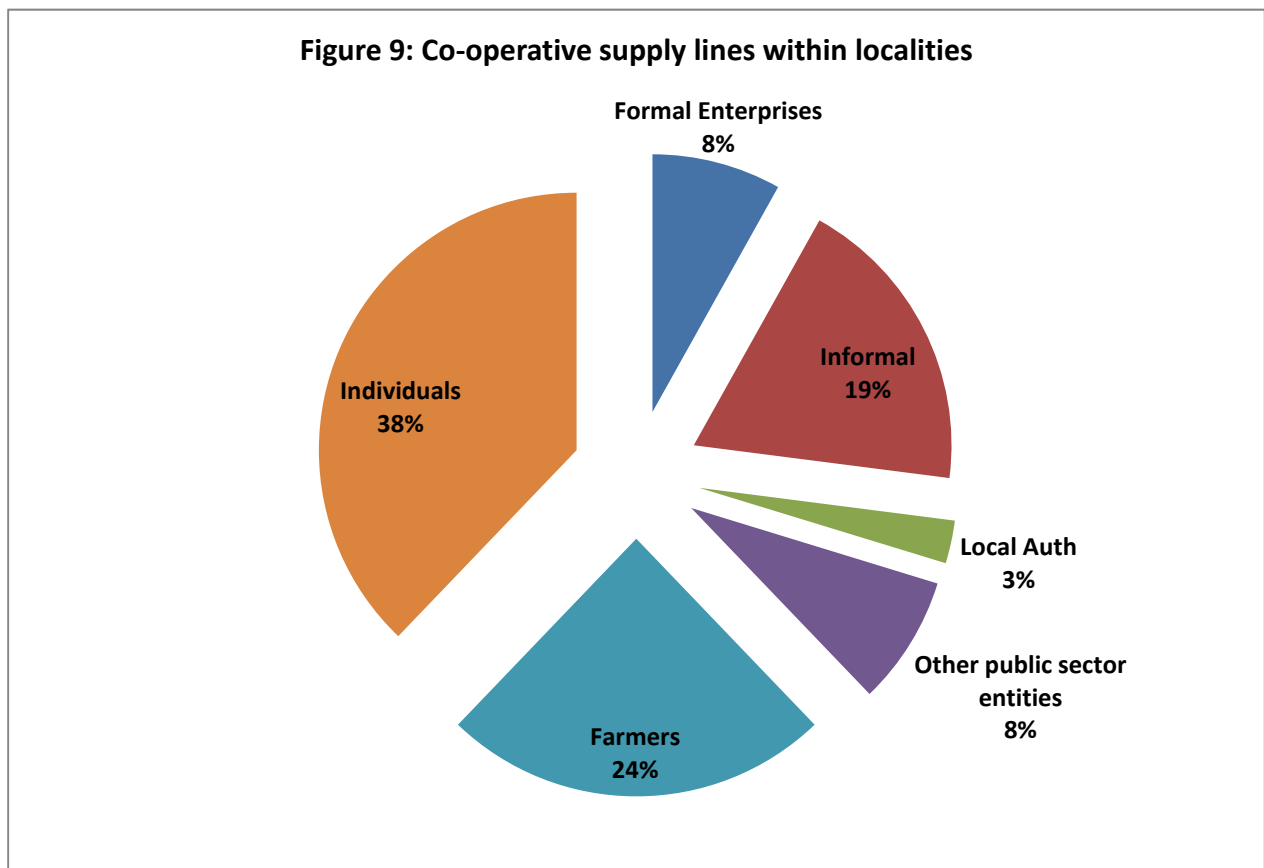


Figure 8 indicates where co-operatives are sourcing their inputs (supplies). It is important to stress that the percentages here do not indicate value, but reflects the origin or position of the suppliers. Furthermore, this does not imply a “Made in China” or a “Made in Bangladesh” assessment but rather refers to where the transaction is taking place for supplies. Sixty one percent (61%) of the suppliers are in the locality or the neighbouring towns with a further 29% elsewhere in the Free State Province. This indicates that 90% of the suppliers of co-operative inputs are in the Free State with 9% in other provinces and 1% in another country (Lesotho). The reasons for this could be:

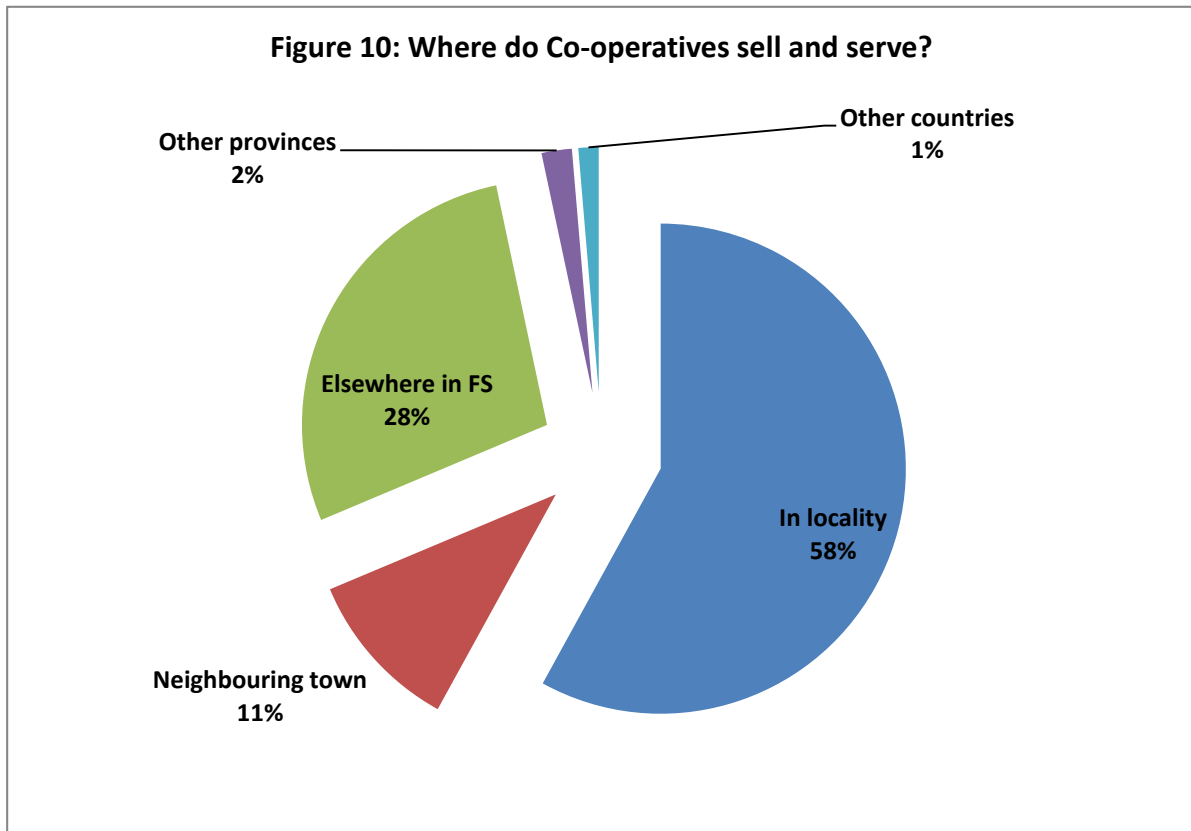
- A dependency on public transport and therefore operating with suppliers close-by;
- Knowledge about potential supply chains is limited to the known environment; and
- Cost considerations since procuring over a longer distance would in most cases imply larger orders to make it cost efficient.



In Figure 9 information about the procurement of goods and services within the locality is unpacked. It needs to be stressed again that this is not a chart indicating the value of the various supply chains, but rather a portrayal of supplier links. The interesting aspects emerging from this figure are the following:

- Thirty eight percent (38%) of the suppliers indicated are individuals;
- Farmers in the locality form the next largest sector of suppliers with 24%;
- In almost 1 out of every 5 cases the co-operatives are sourcing supplies from the informal sector; and
- Other formal enterprises (8%) and Public Sector entities (apart from the local authority) also stands at 8% of the the suppliers.

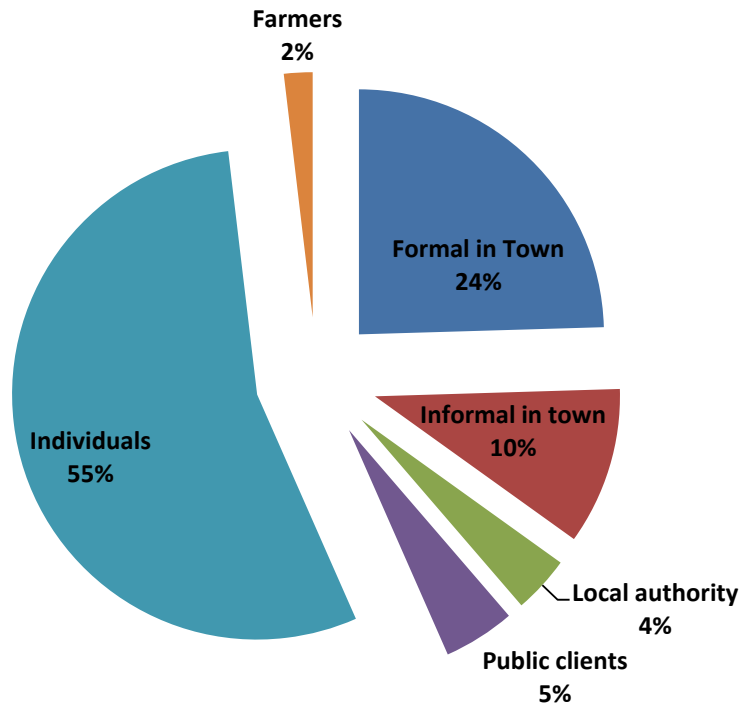
In terms of value added, the few formal enterprises that are suppliers as well as the farmers could easily outweigh the value of goods and services sourced from individuals. Figures 8 & 9 show that less than 40% of the co-operative suppliers are in the locality where the co-operatives operate.



In terms of the markets, Figure 10 gives an indication where co-operatives sell their products and services. Again, this gives an indication of how the clients are spread rather than size of the markets. It is clear that more than half of the clients (58%) of co-operatives are in the locality, with 11% in neighbouring towns and 28% elsewhere in the province.

Figure 11 portrays the distribution of clients within the locality.

**Figure 11: Co-operative Clients in locality**

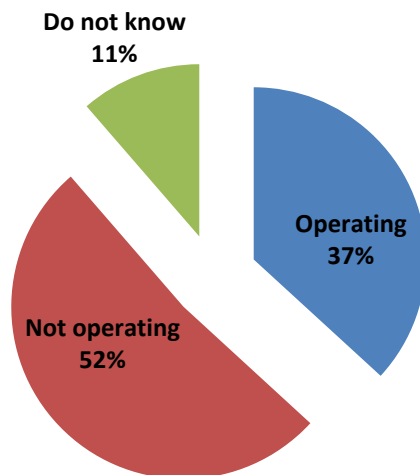


From the above percentages on the supply chain and the market, it can be confirmed that co-operatives are procuring goods from outside (the locality as well as the province) and selling primarily in the locality and the province.

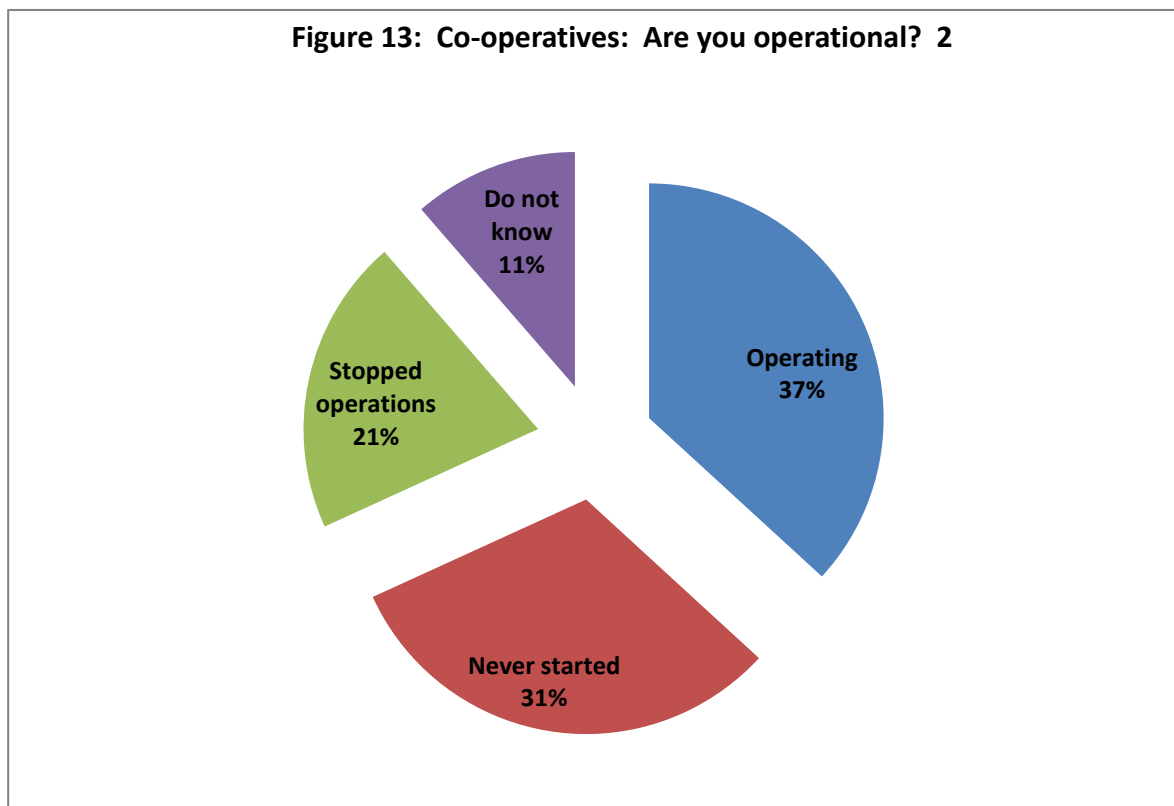
## 7. Non-functioning co-operatives

The key question to the 220 co-operatives interviewed was whether they were operational or not. The results are captured in Figure 12. The strangest response was that 11% of the co-operatives interviewed were not certain whether they were operational or not. The non-functioning co-operatives in the sample can therefore be stated as 63% (including 52% and 11%).

**Figure 12: Co-operatives: Are you operational? (1)**



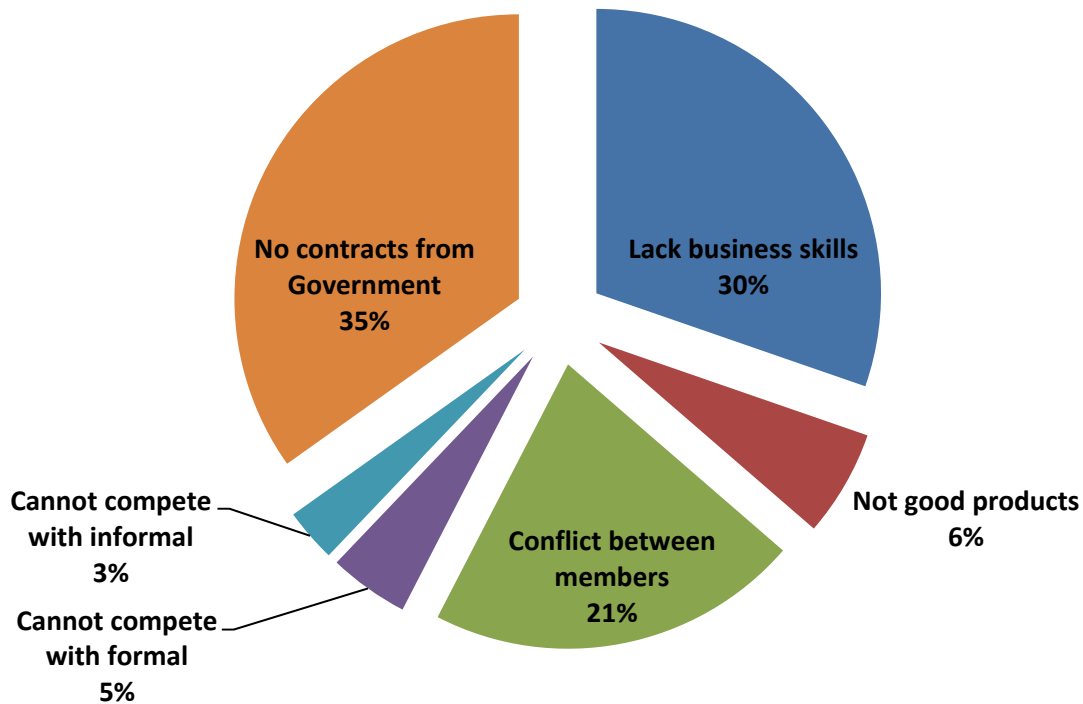
By unpacking the not-operating component, it becomes evident that a significant percentage of the formal co-operatives have never conducted business (Figure 13).



In fact, for every two co-operatives that stopped operations three never commenced with operations. Therefore co-operatives that have been registered were not pre-existing entities by entrepreneurs that were eager and ready to commence trading, manufacturing, or delivering a service. The responses in Figure 14 furthermore confirm the preliminary conclusions formulated in the first report why co-operatives fail.



**Figure 14: Why non-functioning?**



Several of the issues raised in the first report as possibilities, are hereby confirmed.

- An over-reliance on the Government as client (35%). This dependency is indicative of enterprises that are not viable without such support or contracts and therefore businesses that are not competition fit in the open market.
- Co-operatives is a very problematic entity to manage (apart from the purely business aspects) because of the different personalities within the business (21%).
- The lack of business skills (30%) should be a warning signal.
- The other three reasons listed share a commonality - poor products or services (6%) are fundamental reasons for an inability to compete with formal businesses (5%) or informal businesses (3%).

Each of the reasons on its own would have potential to scuttle an enterprise in a competitive world, but in the case of co-operatives, these reasons can often be multiplied.

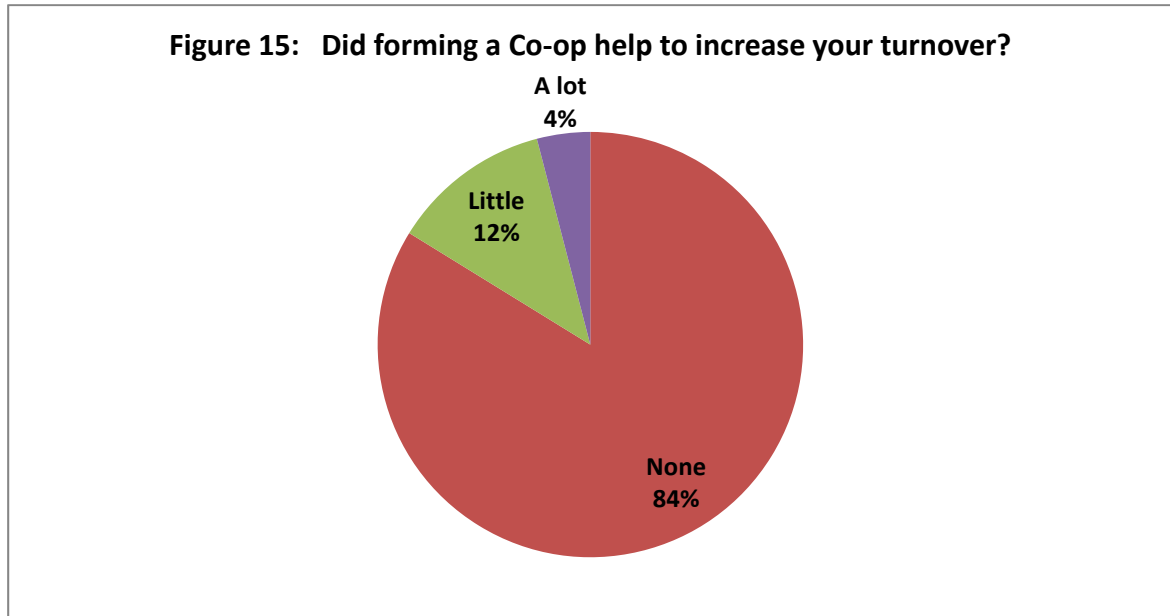
## **8. Functioning Co-operatives**

In the sample of 220 co-operatives 81 (37%) were functioning. The impact of forming a co-operative was assessed by asking two questions:

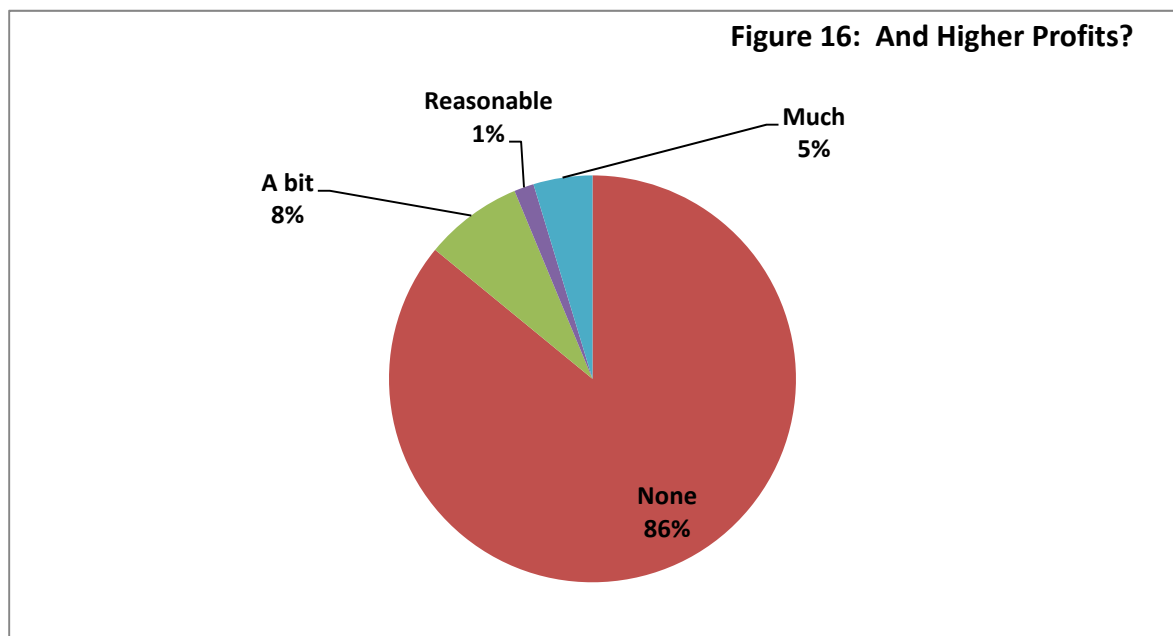
- Did forming the co-operative in any way assist you in increasing your turnover?
- Did forming the co-operative in any way assist you in improving your profit margin?

The rationale for the two questions was to assess on the one hand expansion of the enterprise activities (turnover) and secondly to assess whether the formation of the co-

operative was making the enterprise more viable or sustainable (i.e. a better profit margin). Figure 15 conveys a fairly bleak picture, with 84% of the respondents indicating that they had experienced **no increase in turnover** and a further 12% indicating that there was just a slight increase. A mere 4% of respondents indicated that turnover had increased a lot.



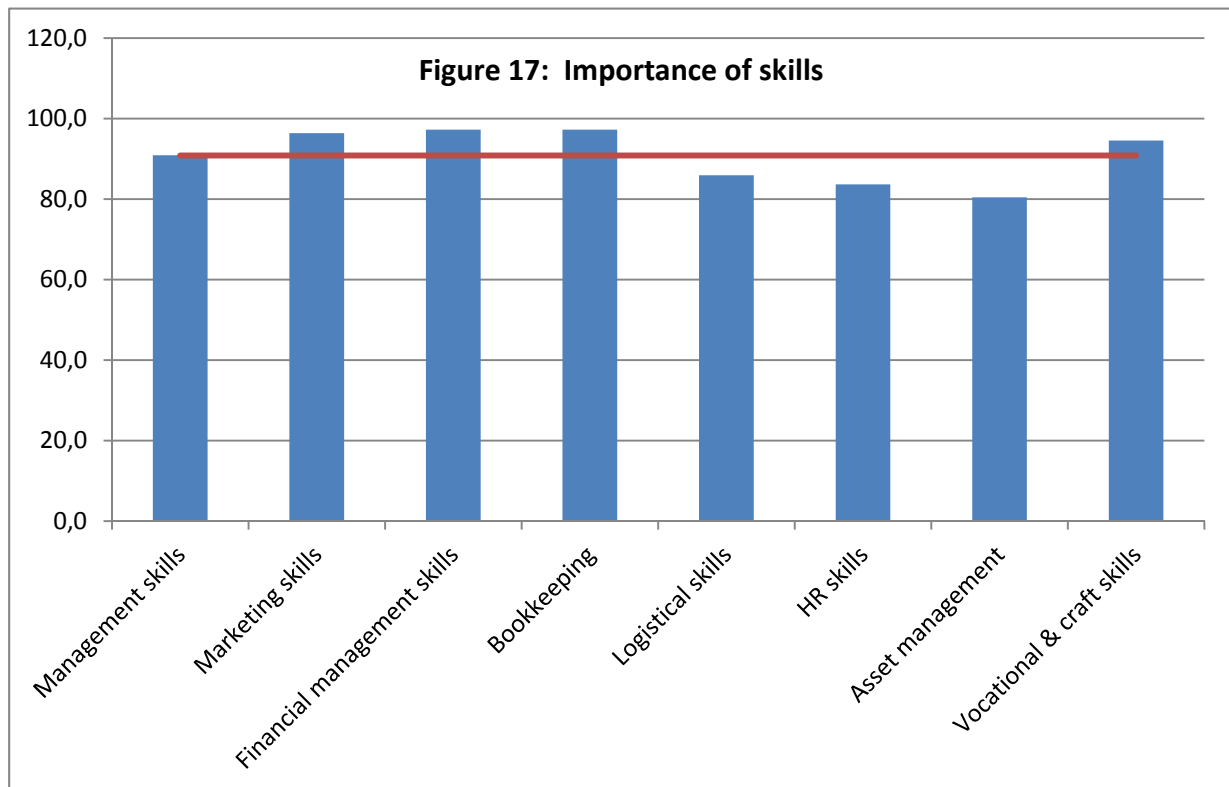
Just as sobering is the message from Figure 16 concerning profit margin. In this case, **86% of co-operatives indicated that there was no increase in financial sustainability** and only in 5% of the cases was the profit margin much better.



## 9. Skills, competencies, business plans and budgets:

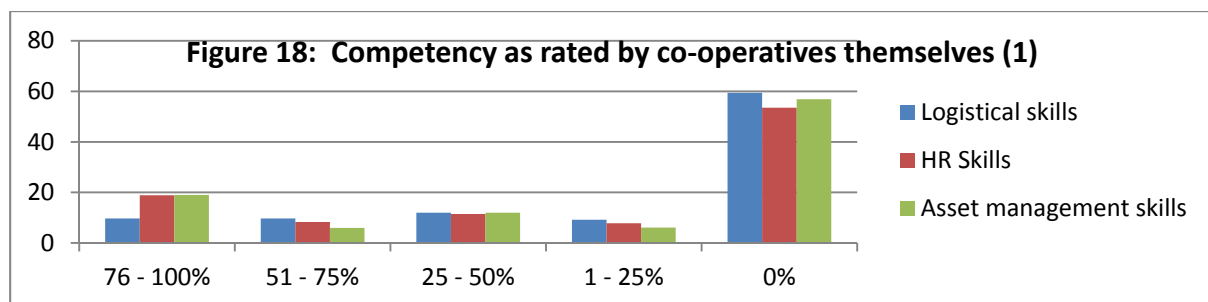
Co-operatives, despite their particular characteristics, need, just like other businesses, a range of management processes and competencies to grow and survive. Interviewees were

asked to rank a range of business management skills according to the importance they bestow on them. Figure 17 indicates how the 220 interviewees rated the respective business skills.

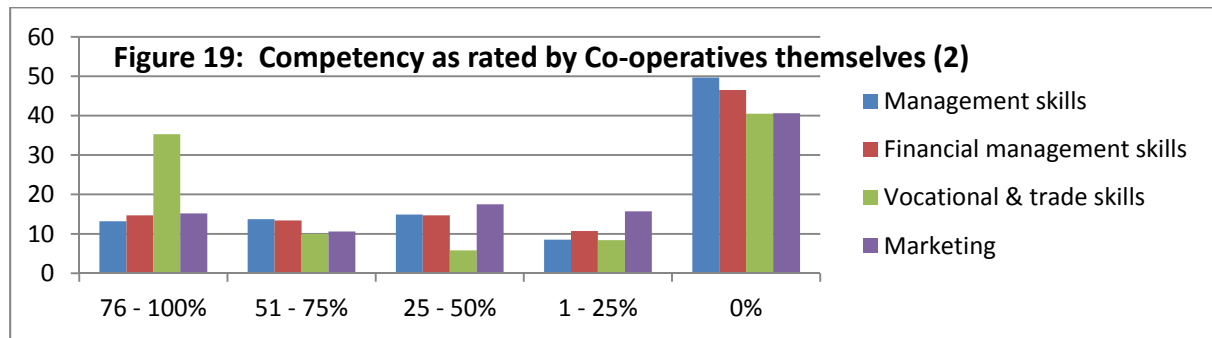


The average level of importance was 90.8%. Management skills (90.9%), marketing skills (96.3%), financial management skills and ordinary bookkeeping skills both at 97.3% and vocational & trade skills at 94.5% were rated higher than the average. Logistical skills (effective arrangements and time co-ordination as well as physical movement of inputs and products), human resource management skills (83.6%) and asset management skills (80.5%) were considered as less important, but not one of these was rated lower than 80.5%.

The interviewees were then asked to rate the competency of their co-operative in these skill requirement categories. An interesting aspect that emerged, is evident when comparing Figures 18 and 19.



The perception of competencies in the skills categories that are higher than the average importance consideration as indicated in Figure 17 is expressed in Figure 19. The perception of competencies in the skills categories below of the skills importance average line in Figure 17 is expressed in Figure 18. The lack of competencies is higher in the categories where the skills were not deemed as important as the other skills (60% plus rated the skills level in these categories as non-existent or below 25%) whilst in the skills categories considered as more important the self-grading is slightly better (between 48 and 58% rated the skills level in these categories as non-existent or lower than 25%).

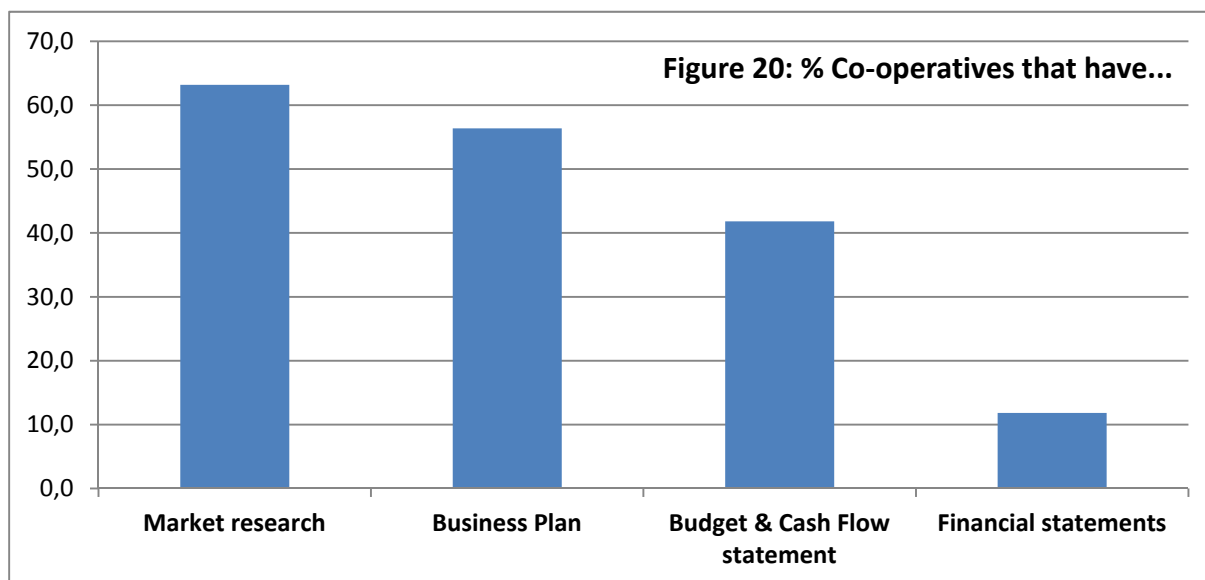


To express this differently.

- For every 100 co-operatives that consider their competency in **Management Skills** as 51% and higher, there are 216 who consider their skills in this field as below 25% or non-existing.
- For every 100 co-operatives that consider their competency in **Financial Management Skills** as 51% and higher, there are 204 who consider their skills in this field as below 25% or non-existing.
- For every 100 co-operatives that consider their competency in **Vocational & Trade Skills** as 51% and higher, there are 108 who consider their skills in this field as below 25% or non-existing.
- For every 100 co-operatives that consider their competency in **Marketing Skills** as 51% and higher, there are 218 who consider their skills in this field as below 25% or non-existing.
- For every 100 co-operatives that consider their competency in **HR Skills** as 51% and higher, there are 225 who consider their skills in this field as below 25% or non-existing.
- For every 100 co-operatives that consider their competency in **Logistical Skills** as 51% and higher, there are 354 who consider their skills in this field as below 25% or non-existing.
- For every 100 co-operatives that consider their competency in **Asset Management Skills** as 51% and higher, there are 252 who consider their skills in this field as below 25% or non-existing.

It paints indeed a desolate picture of competency level and assisting co-operatives with such skills levels to establish businesses will already add positive outcomes to job creation and growth in the economy. This confirms the preliminary conclusion based on the Database Analyses in Report 1 that there appears to be a low skills base that would hamper the survival of the newly formed co-operatives.

It is interesting to note (Figure 20) that several of the co-operatives that had conducted market research and developed a business plan, did not start with business activities at all and remained non-operational. What is striking is that only 56 out of 100 co-operatives have a business plan. That implies that in 44% of the cases co-operatives were formed without having a business plan. The percentage of those with financial statements is very low.



A textbook example of the lack of market research emerged from two co-operatives that were established to produce gel blocks as an alternative for paraffin. One of them stated: *“Paraffin was no longer (to) be manufactured and we came up with the idea of using gel. But paraffin is still manufactured. We stopped because gel is more expensive than paraffin.”*

## 10. Employment capacity of Co-operatives:

The 220 co-operatives jointly had 1 987 members when they were established but declined to 1 562 members at the time of the interviews. In some cases membership is considered by officials as employment potential and even employment created. That is an error of reasoning: membership in co-operatives is the equivalent to shareholders in companies because they have an interest in the enterprise. The employment creation capacity of the co-operatives in the Free State is far below the membership totals.

As captured in Figure 21, of the 1 562 members a mere 226 were employed (and it is from the comments clear that they do not necessarily earn monthly salaries) with an additional 23 non-member employees<sup>5</sup>.

<sup>5</sup> Whilst the question was about employment within the co-operative, in 4 out of 10 cases where quality assessment of the interviews were done by subsequent calls, the employment opportunities mentioned were employment outside the co-operative. This figure can therefore not be used as if the employment opportunities were created by the co-operative formation.

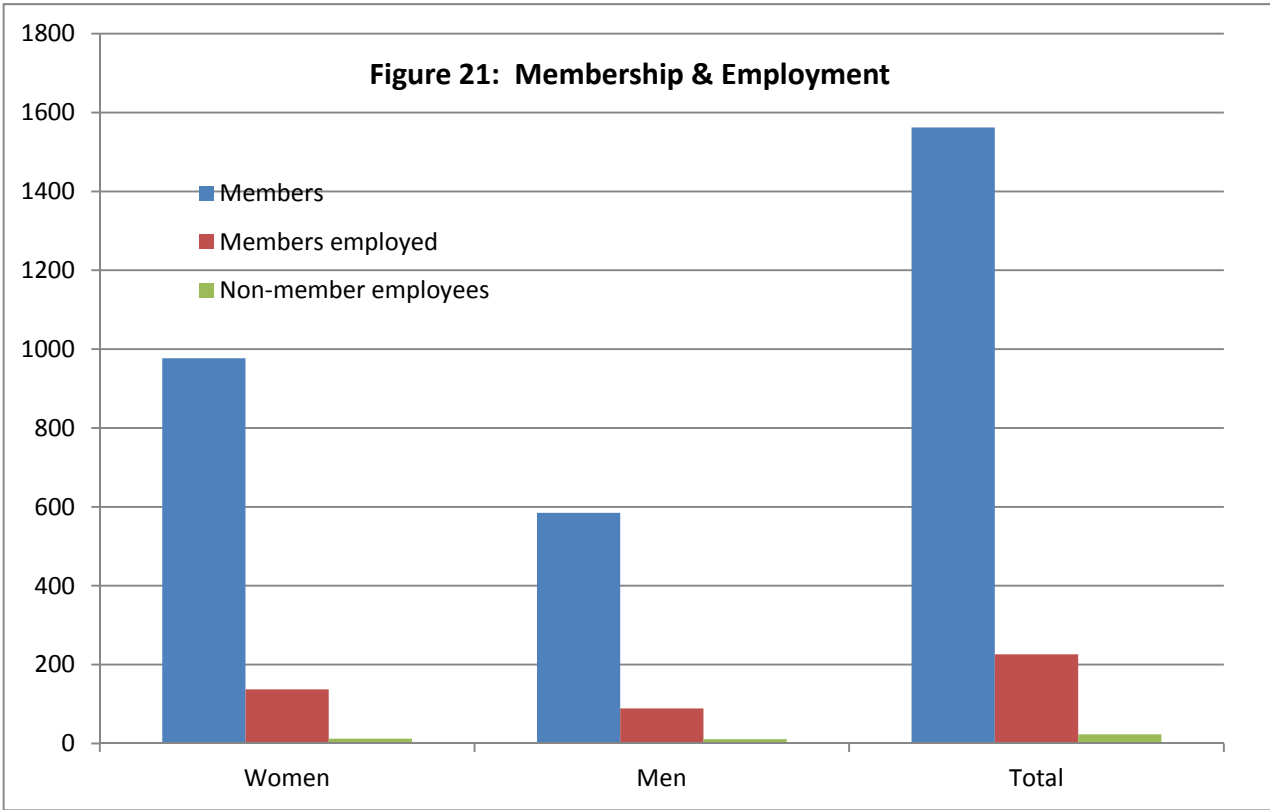


Figure 22 expresses the employment opportunities as a percentage of membership in terms of gender. The total indicates that the participation rate for men is slightly higher than that for women. Although in total, the employment opportunities are less than 16% of the membership total.

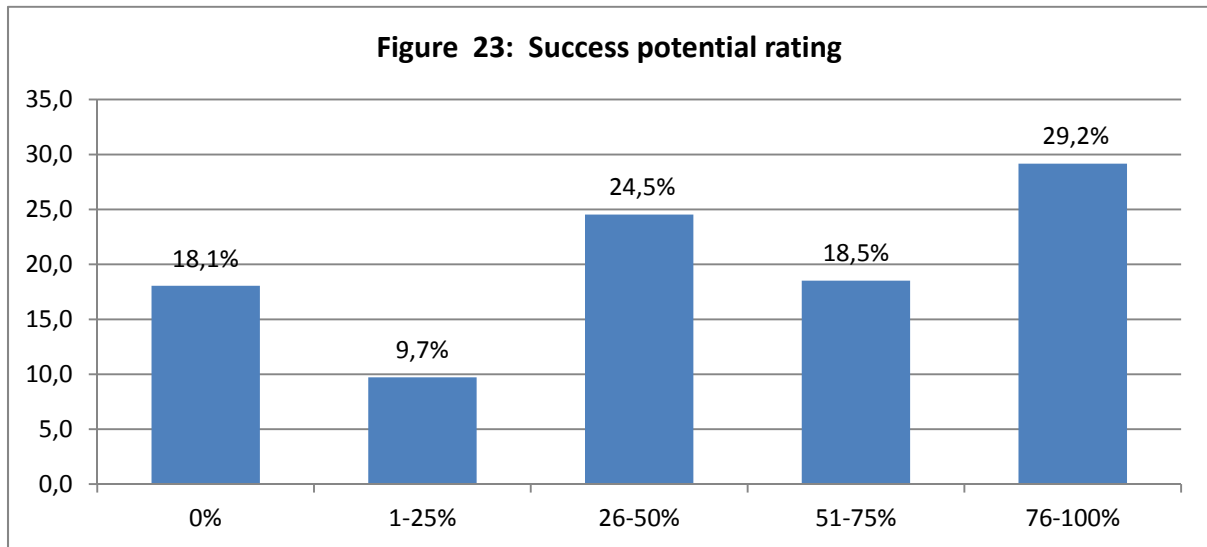


Even when considering the part-time employment opportunities, the percentage only increases to 16.3% of total membership. Whilst this at first glance appears to be just over

one job opportunity per co-operative, the real employment impact has to be considered against the backdrop of the co-operative creation effort.

## 11. Perceptions about the future by co-operative members

The respondents were also asked to rate their expectations about the future of their co-operative. They could rate it at 0%, 1 – 25% success potential, 26 – 50% success potential, 51 – 75% success potential, or 76% and more potential for success. Figure 23 states the success potential rating.



It is however interesting to note that there are clear geographical differences in the success potential assessment.

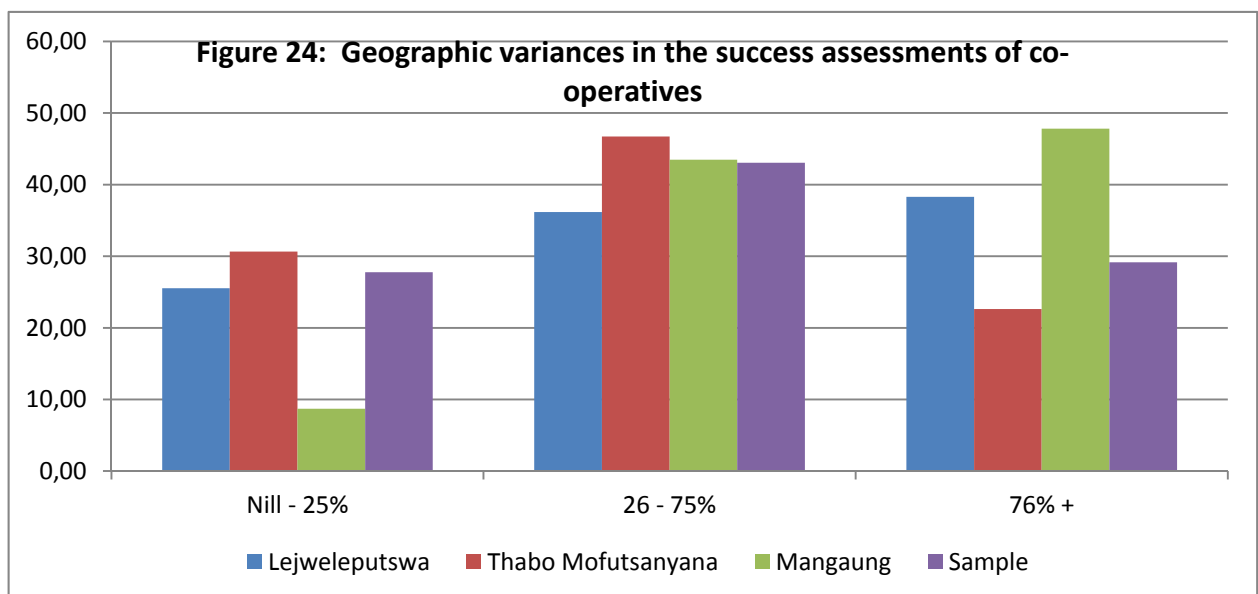


Figure 24 shows the average situation based on the full interview sample and how that compares with the assessments in the district areas of Lejweleputswa, Thabo Mofutsanyana

and Mangaung. It is quite clear that Thabo Mofutsanyana's co-operatives have a bleaker view of the future than those in Lejweleputswa or Mangaung, with the Mangaung co-operatives having the rosier perspective about their future. This is an aspect that requires further research.

In addition they were asked to give a reason for their rating.

Since it is a very subjective assessment, a rating of more than 75% as well as 1 – 25% is often motivated by the same reason, for example. “a *lack of funding*”. This indicates that the co-operatives are optimistic and believe that the lack of (government) funding is the only barrier preventing success. While those co-operatives that indicates a low rate of successful potential are no longer optimistic that the (government) funding will materialise.

Of those that are **very optimistic** (More than 76% prospects of success), the reasons given were the following:

- 18% indicated the dedication and hard work of the members (although several of the co-operatives who had indicated this have not been operational as yet)
- 21% indicated that there was a large demand for their products and services (although the vast majority of these co-operatives did not report an increase in turnover or a better profit margin as dealt with in Section 8 above).
  - *“High demand for feeding schemes in rural areas”*
  - *“Big demand for feed pellets and we just need funding”*
  - *“The local schools always need feeding schemes”*
  - *“There’s a big demand for cleaning services in schools and hospitals”*
  - 9% indicated that they already have everything in place like *“making sure our product is quality before we sell”* (but this co-operative is not trading as yet) and that they *“have the knowledge and skills”*
  - 15% indicated that they are optimistic, but *“still need to attain skills to do well”*
- 27% are very optimistic and just waiting for funding or contracts (schools and feeding schemes were specifically mentioned).
- 9% believed that they *“can overcome all challenges together”* and *“are determined to succeed”*.
- 

It is when considering the comments of those with **high hopes** (51 - 75% chance of success) that it is evident that the positive outlook is often more of a wish than a considered assessment.

- 17.5% of the reasons in this segment centred around a last outstanding barrier before success:
  - *“We still need to market ourselves more and we need financial training”*
  - *“We still need skills mentoring and we also need funds”*
  - *“We only need training in business management. And then we also need tools, electricity and water...”*
  - *“The demand for our product is very high. We need more training on how to cook”*.
- 15% of these reckon the co-operative will succeed if there was just a more reliable market for its products and services:



- *"The success depends on the Government and how there is a greater demand for our services"*
- *"We only work when we are needed and struggle for full-time jobs. If the Government can help with the contracts, we will succeed"*
- *"The demand for a car wash fluctuates too much"* (but despite this, the success assessment is between 51 – 75%)
- *"Some of us get impatient when the funds are low"*
- *"The production does not make enough profit".*
- 17.5% estimate that more funding or support or grants will ensure their success:
  - *"We just need a bit of funding for tools"*
  - *"We are just waiting for machines and also for training"*
  - *"We have machines. The only thing we now need is a big contract"*
  - *"If we can have training and funding we will succeed"*
- The remaining reasons for these co-operatives to be hopeful are wide-ranging, but some are quite significant:
  - *"We are going to produce a product that will be much in need"* (yet again another co-operative that has not started activities as yet).

Of those who have **lost all hope** (0% chance of success) the co-operatives mentioned the following reasons:

- 38.5% blamed a lack of funds (*"promised contracts did not materialise / funding not forthcoming"*).
- 25.6% mentioned internal conflict and members who just lost hope and left
  - *"Members are fighting and we lost all hope"*
  - *"We could not work well and went separate ways"*
  - *"We lost all hope because no funding and split up"*
- 23.1% noted the lack of support and poor advice
  - *"The contracts never materialised"*
  - *"The Municipality doesn't support us. We send a proposal and they never answered"*
  - *"Seda gave us advice that we should demolish our old place and they would give us funds for a new place"*
  - *"The Municipality is slow with paperwork and our members lost hope"*
- 10.3% of the cases blamed poor business skills
  - *"We haven't a clue where to begin and we weren't given advice how to start and market the business to get contracts"*
  - *"We don't know how to start a business"*
  - *"We needed training on everything how to run a business"*

Those with **little hope** (1 - 25% chance of success) mentioned:

- *"We have no experience in business"*
- *"Our members spend the money on themselves, so there was no financial management"*
- *"We lack skills"*
- *"We will succeed if we get what we need, like funds, or contracts from schools"*
- *"We don't have skills, a business plan, equipment or funds"*

- *“We lack knowledge of business”*
- *“We need business space, equipment and profit”*
- *“We still need training and the knowledge on how to make things”*
- *“We need more skills. We lack the most important”*
- *“We took the initiative to start something and we ended up struggling”*

Those with **some hope** (26 – 50% hope of success) raised important reasons for their views:

- *“There is a lack of projects and sometimes people who haven’t bid for it get the contracts”*
- *“The chance on success and failure are equal because of the behaviour of the members”*
- *“Finding clients is difficult”*
- *“I just need dedicated members in the co-operative”*
- *“We have made little progress but I am still confident”*
- *“Our co-operative was going to create employment for 80 people, but now it struggles”*
- *“We had overspending on our product and lack supplies”*
- *“We are in the transport business and need a bus or a taxi to transport our passengers”*
- *“We have hope since most of the work will be done by the machines”*
- *“We are depending on feeding schemes”*
- *“We are not sure where we are heading because of the lack of funds”*
- *“We still have hope that if we get the grant funding we can start”*

The latter reasons convey a gloomy impression rather than the optimistic ratings given. The reliance on public sector contracts (feeding schemes) and start-up grants seem to develop a dependency mind-set.

## **12. Conclusions based on the 220 interviews**

In this section an assessment based on both the statistical and the qualitative information emanating from the interviews will be given.

These findings will then be compared firstly to earlier studies<sup>6</sup> on co-operatives in South Africa and then to the key issues observed in the literature survey on co-operatives.

The findings based on the data base (Report 1) are further reflected upon in Table 1 by focussing on the quantitative and qualitative information from the 220 interviews.

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<sup>6</sup> Eising W. and Shenxane T., 2010: An Assessment of Co-operatives in Rural and Peri-Urban South Africa. EU. Pretoria

<sup>6</sup> Ntuli M, Deputy Minister of Trade & industry, 2010: Briefing on the Development and Support Programmes for Co-operatives: Presentation to the Select Committee on Trade and International Relations.

**Table 1: Comparison between findings in Report 1 (categorising co-operatives) and Data from 220 interviews with co-operatives**

<b>Findings from Report 1</b>	<b>Findings based on data from 220 interviews</b>
The birth explosion of registered co-operatives is unlikely the result of spontaneous action by co-operative members and suggests a public sector campaign.	The role of the Premier's Office, DETEA, Local Municipalities, the Departments of Education, Agriculture, SEDA, as well as consultants to motivate the formation of co-operatives has been established. The Co-operative Incentive Scheme with a grant of up to R350 000 was used.
The likelihood of successful enterprise growth is fairly low and a high failure rate could be anticipated.	A high failure rate has been confirmed.
Government structures as an incubator for co-operatives ignored the very basic dynamics of local economic drivers and value chains.	In the case of operating co-operatives the low level of linkages to formal enterprises in the value chains is evident.
A substantial number of co-operatives appear to depend on Government contracts (feeding schemes, cleaning contracts, etc.) and that reinforces dependency rather than sustainability.	The lack of contracts (and the non-arrival of grants) cited by a very large percentage of failed and operating co-operatives, indicate that dependency on Government is a major issue.
Enterprise growth through public sector expenditure has more a redistributive impact than a growth impact.	Was not assessed in the interviews
Co-operatives have been created by not taking note of the entrepreneurial space available in communities – often creating several similar co-operatives in the same locality.	This crucial issue was never considered. The many co-operatives all contending for feeding scheme contracts indicate that there was little or no consideration about viability thresholds or alternative opportunities.
Many co-operatives appear to be focusing on generating income from the very local communities where they reside with no or little potential to tap into a wider consumer market.	This is confirmed by both quantitative and qualitative data.
The production of commodities and very basic services dominate and there is little to suggest differentiated products or services.	No evidence of differentiated products emerged in the interviews. Lack of market intelligence became clear in several cases
Basic skills (cook, look after animals, plumbing and other construction skills) dominated the formation process rather than assessing the markets for services and products produced with such skills.	The low rating for key business skills is evident and proves that a certain entry level of vocational or trade skills was considered as sufficient for the formation of the enterprises. The motivators for co-operative creation in the public sector should take note that a bricklayer is not necessarily a construction entrepreneur or that a woman who bakes delicious cakes is not automatically a successful catering entrepreneur.
It is unlikely that the wave of new enterprises in the form of thousands of new co-operatives was carried by entrepreneurs with sufficient business skills.	
	The inherent management requirements of co-operatives manifests clearly in the often mentioned conflict between members.
	The co-operatives procure largely outside the locality and find their market

	<p>within the locality. (Figures 8 &amp; 10). This suggests that they find their niche to a large degree in the lack of mobility of the local market. Co-operatives therefore, to a certain degree, pump money out of the locality by selling local and procuring elsewhere.</p>
	<p>Forming co-operatives has had a very low impact on increased turnover and profitability. The vast majority of co-operatives indicated that it made no change in their financial situation.</p>
	<p>Employment creation is very low in the sample. The moment one considers that the sample already excludes co-operatives that could not be located; the employment impact of the co-operative effort is even lower.</p>
	<p>The co-operatives were launched without an assessment of the skills capacity and without considering the entrepreneurship factor. T</p>

In short the business case for the formalisation of co-operatives does not appear to have had any meaningful impact on combatting poverty, unemployment or inequality. One could argue that decision-makers and administrators are not aware of this situation and that this study is therefore important. Two other major studies have also highlighted similar issues:

In 2010 the EU commissioned a study on co-operatives in South Africa<sup>7</sup>. The study was submitted to both the National Treasury and CoGTA and concluded the following findings.

- 88% of co-operatives that were formed were either lifeless or dormant.
- In CoGTA as well as the municipalities no dedicated skills and resources were available to support the concept of ward co-operatives.
- The interdepartmental working group on co-operatives was not functioning well.
- The concept of ward co-operatives is basically flawed since it tries to create enterprises without consideration of markets.
- *“It is common practice in the field, that **Government officials encourage communities to establish co-operatives**, and are often directly involved in the process of establishing these co-operatives, which on its own is against the definition of a co-operatives of “autonomous association of individuals that voluntarily come together to meet their needs”. Lessons from the field and from other countries show that co-operatives should not be imposed by government to communities.”*
- *“The **incentive scheme and money-driven/supply-driven interventions for co-operatives** is one of the main reasons behind the emergence of co-operatives”.*
- *“**The current practice of buying equipment and material for co-operatives by municipalities does not seem to work**, instead it creates a dependency syndrome”.*
- *“The co-operative form of enterprise seems to be the only form being supported by government to get people out of poverty. However, **a concerted effort to educate people about other forms of enterprises is missing.**”*
- *“International success stories of co-operatives rather point to **user/service co-operatives than worker co-operatives, especially as part of poverty reduction**. Worker co-operatives are more difficult to manage and sustain and unfortunately they form the majority of registered but non-functional co-operatives in South Africa.”*

Furthermore in 2010, the then Deputy Minister of Trade & Industry, Maria Ntuli<sup>8</sup> concluded:

- From 2006 to 2009 R62 million was spent on co-operative development by the Co-operative Incentive Scheme (CIS) and an estimated 1 550 jobs were created.
- In addition, just under R1 billion was spent by a few National Departments and Provincial Governments from 2006 – 2009 on co-operative development.
- Out of 22 080 registered co-operatives only 132 complied with the Cipro requirements of submitting financial statements.
- Only 12% of the registered co-operatives were surviving at that stage.

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<sup>7</sup> Eising W. and Shenxane T., 2010: An Assessment of Co-operatives in Rural and Peri-Urban South Africa. EU. Pretoria

<sup>8</sup> Ntuli M, Deputy Minister of Trade & industry, 2010: Briefing on the Development and Support Programmes for Co-operatives: Presentation to the Select Committee on Trade and International Relations.

She then argued that training of co-operatives should receive priority to prevent the ongoing demise of co-operatives that are created.

Therefore, the question can still be considered whether the ongoing creation of co-operatives is healthy even though the mortality rate of these enterprises is extremely high? Would this still action still be a meaningful strategy to pursue economic development and the combatting of poverty, unemployment and inequality?

These are some of the issues to consider further in the final report after raising these as well during the focus group discussions.

### **13. Issues to be dealt with in the third report:**

The last report will deal with:

- The findings of 42 *in situ* interviews with Co-operatives (fieldwork already completed and data being analysed)
- A focus group session in Thabo Mofutsanyana with district based officials from DETEA, the Dept. of Agriculture and LED officials to discuss and reflect on the findings of Report 1 and Report 2.
- A focus group session with DETEA (and other) in Bloemfontein to discuss and reflect on the findings of Report 1 and Report 2.
- Recommendations based on the findings.

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