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Legislative limits of cooperatives: a new institutional economics review of the cooperatives' legislations in Eswatini

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ABSTRACT

Cooperatives in Eswatini have largely been intermediaries for government and donors in their rural development agenda. They are also out-growers for agri-commodity value chains. This has made cooperatives drivers of rural economic growth and development. However they usually collapse without the external support because they fail to access finance, efficient management systems and qualified personnel. The new institutional economics (NIE) theory argues that traditional cooperatives (TCs) suffer from ill-defined property rights which diminishes the incentives to invest risk capital into a TC. This has given rise to new generation cooperatives (NGCs), as seen in developed countries. This desktop study analyses the cooperatives' legislation in Eswatini to identify the extent to which it allows cooperatives into NGCs. It was found that cooperatives built under the current legislations could satisfactory alleviate the decision making efficiency problem while the capital investment efficiency problem could remain a problem. Therefore, cooperatives in Eswatini are more likely to be underinvested and under poor management. It is recommended that a review of the legislation could also study and evaluate the impact of allowing cooperatives to evolve into NGCs alleviates the capital efficiency problems by allowing cooperatives to introduce a tradable (non-redeemable) and appreciable B-class share.

Key Words: B-class share, Eswatini, ill-defined property rights, institutions, New Generation Cooperatives (NGCs), Traditional cooperatives (TCs)

RÉSUMÉ

Les coopératives d'Eswatini ont largement servi d'intermédiaires pour le gouvernement et les donateurs dans leur programme de développement rural. Ils sont également des petits producteurs pour les chaînes de valeur des produits agricoles. Cela a fait des coopératives des moteurs de la croissance et du développement économiques ruraux. Cependant, ils s'effondrent généralement sans le soutien extérieur parce qu'ils n'ont pas accès au financement, à des systèmes de gestion efficaces et à un personnel qualifié. La théorie de la nouvelle économie institutionnelle (NEI) soutient que les coopératives traditionnelles (CT) souffrent de droits de propriété mal définis, ce qui diminue les incitations à investir du capital-risque dans une CT. Cela a donné naissance aux coopératives de nouvelle génération (CNG), comme on le voit dans les pays développés. Cette étude documentaire analyse la législation des coopératives en Eswatini pour déterminer dans quelle mesure elle permet aux coopératives de participer aux CNG. Il a été constaté que les coopératives construites sous les législations actuelles pourraient

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atténuer de manière satisfaisante le problème de l'efficacité de la prise de décision tandis que le problème de l'efficacité de l'investissement en capital pourrait rester un problème. Par conséquent, les coopératives d'Eswatini sont plus susceptibles d'être sous-investies et mal gérées. Il est recommandé qu'un examen de la législation puisse également étudier et évaluer l'impact de la transformation des coopératives en CNG atténue les problèmes d'efficacité du capital en permettant aux coopératives d'introduire une action de classe B négociable (non remboursable) et appréciable.

Mots clés: Part de classe B, Eswatini, droits de propriété mal définis, institutions, coopératives de nouvelle génération (CNG), coopératives traditionnelles (CT)

INTRODUCTION

A cooperative is "an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise" (International Cooperative Alliance [ICA], 2005). These organizations are built on internationally recognized seven principles: (1) voluntary and open membership; (2) democratic member control; (3) member economic participation; (4) autonomy and independence; (5) provision of education, training and information; (6) cooperation among cooperatives; and (7) concern for the community (ICA, 2005). These principles influence cooperatives legislations and subsequently the individual cooperatives' by-laws. These principles radiate certain values which include self-help, democracy, equality, equity and solidarity in the structures and operations of cooperatives. These values resonates with the principles of "Ubuntu" which sits well with African ethos. Cooperatives are "user owned and user controlled" entities that benefits patronage and not capital investment, which protects poor people from being exploited by capitalist. Since the beginning of the cooperatives' movement in 1844 when the Rochdale Society of Equitable Pioneers was formed, cooperatives have been identified as a pro-poor form of business that can alleviate inequalities, poverty, hunger and other socio-environmental challenges in communities.

Proponents of cooperatives who view them as business entities argue that cooperatives are a vehicle to coordinate smallholder farmers to inputs, finance, produce and services markets (Hu *et al*., 2000; Stockbridge *et al*., 2003; Louw *et al*., 2007; Ortmann and King, 2007; Markelova *et al*., 2008; Devaux *et al*., 2009; Hellin *et al*., 2009; Reardon *et al*., 2010; Simelane *et al*., 2019). This is because cooperatives are able to reduce unit transport costs, processing costs, storage costs, compliance costs and transaction costs by pooling produce; facilitate financing of value adding investments by pooling capital; improve farmers bargaining power; promote their access to government and NGOs support; have more returns to members since they are a offered soft tax regime; pool produce to meet market-scale requirement from processors; and could facilitate the enforcement of grades and standards.

Levin (1987) and Ortmann and King (2007) reported that cooperatives are usually driven by donor and government funding to support rural development projects. However, some are developed by agribusiness companies as their out-growers/producers. Usually when the external funding runs dry these cooperatives collapsed and some remain dormant. This poses a huge setback to rural development and also reverses the gains of the rural development which is mainly foreign direct investment (FDI) through NGOs and government. Some of the factors that may contribute to the failure

of cooperatives include the fact that (1) in most cases their existence is externally driven – lack communal ownership; (2) farmers do not lay down capital to run the organization hence there they might not see the loss in their failure; (3) the initiators (donor, government and companies) usually do all the technical and administrative stuff without building much capacity on the owners (members); and (4) it is the general poverty in rural areas. However, these factors can be alleviated by the adoption of institutional arrangements that allows cooperatives to adopt by-laws which are aligned with the new generation cooperatives (NGCs). These NGCs were found to better alleviate the challenges of accessing risk capital and management in traditional cooperatives (TCs)

Cook (1995), Cook and Iliopoulos (1999) and Lyne and Collins (2008) argued that the poor institutional arrangement may be the central threat to the sustainability of cooperatives. One of the theories they use to argue this point is the new institutional economics (NIE) theory of ill-defined property rights which results to six problems in TCs. The ill-defined property rights stems from the cooperatives founding principles. To a high extent these problems cripple the self-sustainability prospects of TCs. Therefore it is important to allow cooperatives to evolve into the NGC structures.

METHODOLOGY

This was a desktop study with extensive literature review on cooperatives legislation's evolution and the ill-defined property rights theory. The main objective was to find out if the failure of cooperatives in Eswatini could be attributed to the ill-defined property rights theory. This line of argument was then supported by the desktop review of the Eswatini legislation for cooperatives. The framework of analysis was developed using the problems associated with the ill-defined property rights theory on TCs. This framework was then overlaid on the Swaziland Cooperative Societies Act (SCSA), 2003 and Swaziland Cooperative Societies Regulations (SCSR), 2005 to evaluate the extent to which these legislations allow cooperatives to develop institutions (by-laws) that helps them alleviate the problems of ill-defined property rights. This enabled the researchers to pick up clauses that limits or allows cooperatives to adopt efficient institutions similar to those of NGC structures. The critic and analysis was developed and presented with some recommendations for Eswatini legislators.

COOPERATIVES' LAW AND THEIR EVOLUTION IN ESWATINI

The cooperative movement in Eswatini dates back in 1931 when the Tobacco Cooperative Society Pty. Ltd. came into operation. Eswatini cooperatives by then were registered in South Africa under the South African Cooperatives Societies Acts, 1922 and 1939. In Eswatini the Registrar of Cooperatives was appointed in 1962, with the primary duty of drafting a local legislation for cooperatives. This resulted to the Cooperative Societies Proclamation No.28 of 1964 as the legislation for cooperatives in Eswatini. This legislation saw the registration of 14 cooperatives by 1968 when the country got independence (Mnisi, 2014). These cooperatives assisted members to easily access of inputs at low cost, enabling contract farming (out-growers) and market access (agents of marketing boards/parastatals).

Before 1986 most of the cooperatives were farmer-cooperatives or multipurpose cooperatives with savings and credit elements. Mnisi (2014) reported that a pure savings and credit cooperative (SACCO) was registered in 1986 and since then they have grown in number. The formation of cooperatives federations in the late 1980s was the peak of the cooperative movement in Eswatini. The major ones were the Central Cooperative Union (CCU) which is a federation for farmers/multipurpose cooperative and Swaziland Association of Savings and

Credit Cooperatives (SASCCO) which is a federation SACCOs. The CCU was more of an intermediary bank for its members (individual farmer-cooperatives) where development agencies and government entrusted funds which were then loaned to member-cooperatives. Both the SASCCO and CCU collapsed and the CCU was further liquidated. Hlatjwako (2010) reported that the CCU was liquidated because of poor management and poor loans repayment by member-cooperatives. In the case of SASCCO, poor management was found as major reason for its failure to complete a multi-million Emalangeni (SZL) building to provide rental spaces in the Eswatini capital town (Hlatjwako, 2010). The failure of the two federations lowered the trust in cooperatives which let down the cooperatives' movement in the country. The theory of ill-defined property rights in TCs may also explain these federations' failure. For instance if the SASCCO's by-laws offered incentives for additional (risk) capital to its members and strategic partners (non-members), the federation may have averted the failure to complete the building. The poor performance in farmer-cooperatives was also reported by Sachs and Roach (1983), Magagula and Faki (1999), Masuku *et al*. (2016), and Simelane *et al*. (2019). They found that farmer-cooperatives face unpredictable patronage, fluctuating membership and poor management because their membership is predominantly rural poor and aged people (mostly women) with low levels of education.

The ICA in 1995 reviewed the cooperatives principles after a serious lobbying by cooperatives to transform the principles such that they balance the benefits between labour and investment (Hoyt, 1996). This resulted to the 1995 cooperatives principle which allowed cooperatives to reward capital fairly as patronage/labour. Therefore the Eswatini government reviewed the 1964 legislation to come up with the Swaziland Cooperatives Societies Act (SCSA) of 2003. This Act allowed cooperatives to give 5% capped annual dividends on capital to members and it reinforced participation of federated cooperatives as secondary cooperatives. Thereafter, the Swaziland Cooperatives Societies Regulations (SCSR), 2005 was enacted to support the SCSA, 2003. The SCSR, 2005 seems to clarify more on the governance issues that were lacking in the SCSA, 2003, and most of those issues were critical in the management of SACCOs.

In Eswatini there are rural agricultural schemes/ associations and cooperatives which were driven by government (e.g. Mayiwane Maize Scheme), donor agencies (e.g. Commonwealth Development Corporation, IFAD, European Union, Taiwanese government), NGOs (e.g. Canadian Unitarian Schemes, Usuthu Mission Young Farmers' Cooperative) and private companies (e.g. Casalee/ tobacco outgrowers and cotton growers) (Levin, 1987). These associations and cooperatives were involved in food production (maize, rice, tomatoes, poultry e.t.c.), cash crops production (tobacco, cotton, sugarcane) and some were sharing irrigation water without coordinating in production or marketing. These "cooperatives" contributed to rural growth and development significantly. When the external support diminished, these cooperatives collapsed and some became dormant. Levin (1987) identified a number of challenges that resulted to the failure of these "cooperatives" ranging from land tenure, poor management, lack of trust, farmer withdrawal (absentees), poor access to capital and corruption. Recent reports like that of Manyatsi (2006), Hlatjwako (2010), Mavimbela *et al.* (2010) and Masuku *et al.* (2016) on farmer- cooperatives, show that they faced challenges in attracting additional capital; had poor management; members lacked trust on directors and poorly participated in the cooperative activities.

Recently, a government parastatal named the

Eswatini Water and Agricultural Development Enterprise (ESWADE) has been tasked with the development of rural communities in Eswatini mainly by establishing irrigated sugarcane farms for rural communities as a climate change impact and poverty alleviation strategy. Their projects are mainly funded by donors and international banks which is co-financed through loans taken by farmer-groups. ESWADE organised the communities as "companies" registered under the Companies Act, 2009. However, these companies institutional arrangement resembles those of cooperatives i.e. shares are not tradable, shares do not have a known value and voting rights are egalitarian. The main disadvantage of these companies being registered under the Companies Act, 2009 is that they are subjected to a high tax regime than if they were organised as cooperatives. Under the Eswatini Income Tax Act 2013, companies are taxed at a maximum rate of 30%, and if members receive dividends on shares, the shareholders are also taxed at a rate of 10% in excess of SZL20 000. On the other hand, cooperatives are not taxed on their surplus that accrue from just tractions within members (core business); they are only taxed on individual members' dividends at a maximum rate of 10% on the amount in excess of SZL20 000. These companies can save a 30% tax on their profits if they are registered under the as cooperatives act. Rafique and Ntshalintshali (2015) reported that the decision them as companies was because the Commissioner of cooperatives could not register new cooperatives unless they show viability and they must be spaced more than 30km apart. These reasons cannot supersede the value of rural development. The SCSA, 2003 allows for companies to convert to cooperatives, therefore these companies could be converted to cooperatives. This transfer is even important because the sugar industry is facing a "cost-price squeeze phenomenon", where inputs are increasing during declining sugar prices on the global markets. Therefore the savings on tax would ensure that the shareholders still get income for their livelihoods.

The share structure of these farmer-companies is similar to that of cooperatives and it seems to be attached to the land. Farmers contributed their land to acquire the membership shares, however ownership (in-common), votes (decision making) and benefits (dividends) are equal regardless of the size of land contributed. This share structure is fixed and cannot be used to attract investment or used as collateral for loans. Therefore, the innovation in cooperatives share-structure could assist these farmer-companies.

In South Africa many large cooperatives demutualized to form investor-owned firms (IOFs[1]) because the Cooperatives Act, 1995 was then aligned with the pure cooperatives principles of 1996, which emphasize farmer-owned, egalitarian control and benefits accrue more to labour than capital (Ortmann and King, 2007). The arguments in favour of IOFs included their easier access to various sources of capital; their ability to attract top-quality management; the alignment of shareholders' interests with those of customers; and the entrepreneurial flair often missing in cooperatives (Ortmann and King, 2007). These attributes from IOFs supports their sustainability and viability in the current turbulent markets climate. Whilst the IOF structures may ensure business viability and sustainability, they subject poor rural farmers as captives of capitalists with low benefits accruing to the farmers. However, the hybrid cooperatives (NGCs) balances the accrual of benefits between producers and investors.

Between companies (IOF) and traditional cooperatives there are several innovative structures (see Chaddad and Cook, 2004) of cooperatives that seeks to alleviate the challenges of traditional cooperatives without the need to demutualize. These include the proportional-investor cooperative (PIC) and member-investor cooperative (MIC). These types of cooperatives tie patronage to investment (i.e. big investors

[1]A vertical integration of cooperatives into a processing or marketing firm.

are large patrons) and the MIC works well for multipurpose cooperatives where some members are free to invest in a range of products some of which they are not patrons of and they will receive dividends in proportion to their investment. These strategies bring capital into the cooperative and creates demand for shares as members are obliged to keep their patronage at par with their investment (i.e. in the PIC) and keep their investment higher to get more dividends (i.e. in the MIC). The new generation cooperatives (NGCs) have the characteristics of MIC and PIC, however in a NGC new members are required to buy membership shares and a second level share (B-Class) in proportion to their expected or allocated patronage volumes. Moreover the B-class shares offer capital gains since they are tradable and hence it has capital gains at market price as the cooperative continues to do well (Harris *et al*. 1996; Cook and Iliopoulos, 1999; Lyne and Collins, 2008). There are also investor shared cooperatives (ISC) who attract strategic partners (non-patron members) to put their capital into a cooperative to gain dividends and capital gains (van Bekum and Bijman, 2009). The NGCs structure enable the development of an ISC structure as the investor (non-patron member) has significant benefits as member-patron. Investors (strategic partners) are usually business minded people and entrepreneurs who may not only bring risk capital, but would also contribute to the innovative management and credibility of the cooperative.

Most developed countries fairly evolved their cooperative legislation to allow their cooperatives to evolve into efficient structures after deregulating markets e.g. Europe (see van Bekum and Bijman, 2006), USA (see Cook and Burress, 2009), Canada (see Hensley and Swanson, 2003), New Zealand (see Woodford, 2008). Eswatini's agricultural markets are semi-regulated – they still have marketing boards but farmers are not obliged to sell through them. The role of the boards in assisting farmers has been questionable for some time in Eswatini. For instance the SNAU (2010) and World Bank (2011) reports criticized the National Agricultural Marketing Board's behaviour of playing as a regulator for horticultural products yet they are active in the horticultural mainstream value chains. Therefore, there is a need to relax the cooperatives' institutions to allow cooperatives to bring strategic partners who will assist them in efficient business decision making and raise capital for themselves.

Arguably, cooperatives can seek finance from financial organizations like banks, but they are viewed as high risk business to finance, because there are usually poor management systems (lack of records and credit history), high crop failure risk, lack of farm infrastructure (irrigation), and lack collateral and dynamic market requirements. Moreover, loans have fixed rates of payments and attract interest if extended yet farm produce and prices are highly inconsistent and unpredictable. Therefore equity investment is better than loan investment for farmers, because equity is rewarded based on profits gained (dividends is in proportion of profits), yet loan repayment is just a fixed cost which is difficult even to negotiate.

The New Institutional Economics (NIE) theory for cooperatives postulates and argue that traditional cooperatives constrain the efficiency and sustainability of cooperatives in the recent economic climate. Evolving markets and dynamic consumer demands has placed huge requirements on farmers to frequently upgrade their products to meet certain grades and standards (Louw *et al.*, 2007; Henson, 2008; Lee *et al.*, 2010). These requirements demands farmers to frequently seek risk/additional capital to meet them. To attract capital, TCs have to be credible and reward capital fairly as labour (e.g. better dividend cap, tradable

and appreciable shares). Cook (1995), Cook and Iliopoulos (1999) and Sykuta and Cook (2001) argued that traditional cooperatives suffer from ill-defined property rights that rewards labour and disregard investment. Investing huge or extra capital in TC does not equate to higher decision making rights or high residual claims for that member, and the capital is tied-up (not tradable and not appreciating). These are generally disincentives to invest in a TC. Cook (1995) argued that these ill-defined property right structure in cooperatives results to five 5 main problems: the free-rider problem (internal and external); influence problem; control problem; horizon problem; and portfolio problem. This ill-defined property rights stem from cooperatives founding principles and results to members' reluctance to invest into the cooperative once they realise these challenges.

The subsequent parts of the paper discusses the ill-defined property rights problems on cooperatives as a theoretical framework to overlay on the SCSA, 2003 and SCSR, 2005 for analysis to determine their flexibility to allow cooperatives to evolve from traditional cooperatives to efficient structures of cooperatives like the NGC or ISC. Lastly, conclusion and recommendations will follow.

THEORETICAL FRAMEWORK

Kherallah and Kirsten (2002) argued that the NIE theory provide an economics with both theory (neo-classical economics) and institutions (classical economics) to explain the determinants and evolution of institutions over time and evaluate their impact on economic performance, efficiency and distribution. They also argued that amongst the several applications of the NIE theory, it can inform the design of organizations like cooperatives to prevent their market failure and provide a theoretical focus for analyzing the structure of transactions and their governing institutions. Recent studies on cooperatives (Cook, 1995; Harris *et al*., 1996; Cook and Iliopoulos, 1999; Sykuta and Cook, 2001; Chaddad and Cook, 2004; Woodford, 2008; Chibanda *et al*., 2009; Cook and Burres, 2009; Rosairo *et al*., 2012) have been dominated by the NIE theory, in their analysis of cooperatives institutional arrangement and the resultant behavior of farmers. Cook (1995) argued that TCs suffer from ill-defined property rights that cause conflicts over residual claims and decision control. These ill-defined property rights results into five (5) major problems which are the free-rider problem (external and internal), influence problem, control problem, horizon problem and the portfolio problem. These problems limit the efficiency of TCs to attract investment for value adding assets and their ability to develop and sustain a business strategy. The analytic framework (see Table 1) for this paper will be based on the problems of the ill-defined property rights in TCs.

Free-Rider Problem

The free-rider problem is two folds;

External free-rider. External free-riding happens when members of a cooperative cannot exclude non-members from reaping the benefits of the cooperative equally as members (Gadzikwa *et al*., 2007). It stems from the "concern for the communty" principle. This is more common when open-access resource or public goods are managed by cooperative, because public goods have non-excludability and low rivalry characteristics (Young and Hobbs, 2002; Gadzikwa *et al*., 2007). Therefore, members will tend to limit investment and participation in the cooperative, because non-members (who may have even refused to join the cooperative) will benefit from the investment. However, Gadzikwa *et al*. (2007) also argued that if members see more benefits accruing to them, this disincentive has limited significance.

Internal free-rider. Cook (1995) and Sykuta and Cook (2001) described free-riders as members of a cooperative who access gains they did not fully invest towards. It stems from the "voluntary and open membership" principle.

New members of a TC gain benefits from assets they found in the cooperatives yet they are expected to contribute the par value of shares as the old members. This is because shares are not appreciable in a TC.

Gadzikwa *et al.* (2007) described internal free-riding as when members of a cooperative shrink their membership obligations in the cooperative, but still access full membership benefits. Therefore, risk averse members will benefit equally from assets that were financed by entrepreneurial members. In Chaddad and Cook (2004) typology of cooperatives, the proportional investment cooperatives (PICs) structure alleviate this problem by strengthening proportionality between investment and patronage. Moreover, introducing a B-class share that is appreciable and non-redeemable may alleviate this problem as seen in NGCs. In the NGC cooperative structure the B-Class share is usually positioned a delivery right which is proportional to patronage (Nilsson and Ohlsson, 2007), this alleviates the free-rider problem because members who have more produce to supply will have to invest more (buying more shares).

Influence problem. The TCs are built on the principle of "democratic control" with the value of equality. This principle is commonly referred to as egalitarian voting rights or one-member-one-vote, where the majority vote rules regardless of capital contribution or volume of patronage (Hoyt, 1996). It enables member patrons to equally control decision making in the cooperative. Hendrikse and Veerman (2001) argued that the influence problem worsen as cooperatives seeks to finance specific assets for downstream value-adding functions because large investors cannot influence decision making. Moreover, Sykuta and Cook (2001) also argued that this problem increases as the cooperative diversity increases (bigger in size) like multi-purpose cooperative. In a multipurpose cooperative, it is highly likely that decisions are Pareto-optimal because of the diversity of interests and operations in the cooperative. In most cases risk averse members are usually the majority, and therefore, capital endowed patrons and non-patron may be reluctant to invest if the decision-making power rests in a majority of risk averse members. This argument resonates well with Chibanda *et al.* (2009), who argued that the influence problem discourages entrepreneurial members who may wish to invest additional risk capital for value adding assets in TCs.

Some cooperatives' legislation allows cooperatives, by-laws to tie voting rights with investment (and patronage) which gives big investors and patrons more voting power. Some cooperatives who have non-patron members don't give voting rights to those shareholder, while others give capped voting rights. For instance, in New Zealand voting rights were capped at 40% for non-patron members (Woodford, 2008), while in Minnesota investors would hold up to 85% of the voting rights (Hensley and Swanson, 2003). Lyne and Collins (2008) described these non-patron members as "strategic partners". Chaddad and Cook (2004) described cooperative structures with non-patron investors as investor-shared cooperatives (ISC). They argued that this innovation breaks cooperative solidarity as it divides the cooperative members into transacting-members and non-transacting members. The interests of the two groups become Pareto-optimal as member-patrons are looking for high returns on patronage, while investors are looking for maximum returns and capital. This conflict of interests may also compromise the efficiency of decision making and increase transactions costs of decision making (Sykuta and Cook, 2001; van Bekkum and Bijman, 2006). In the case where non-patron members are admitted and given voting rights it is important to keep member-patron with majority voting rights to

keep cooperatives' ownership and control on the hands of poor famers.

Rosairo *et al*. (2012) and Esnard *et al.* (2016) argued that if there is separation between control and ownership the influence problem is not a big issue even when farmers have heterogeneous interest and egalitarian voting rights. Moreover, they also argued the influence problem is perpetuated by government appointees, and thus recommended that if there are government appointees in a cooperative they should not participate in voting. Therefore, if power is given to the democratically elected (using secret ballot) board of directors (who are member-patron) and also give qualified managers authority to make strategic and operational decisions the influence problem may be greatly alleviated (Rosairo *et al.,* 2012; Esnard *et al*., 2016). However, they must provide a platform to constantly discuss issues with members so that there is symmetry in information and decision making between the directors and members (Rosairo *et al*., 2012).

Control problem. The non-tradable (redeemable) and non-appreciating equity share-structure of TCs makes it difficult to monitor management by using share-market signals (Cook, 1995). Therefore, cooperatives are forced to put more internal control systems in the absence of a market yardstick to monitor business performance. Moreover, TCs cannot incentivize managers by offering those shares because shares in TCs have nominal value and only benefits patronizing members.

Cooperatives alleviate this problem by offering managers performance bonuses if they meet the cooperative's targets assigned to them by the directors or general assembly. This aligns managers' interests with membership's interests and hence reduce the severity of the control problem. Esnard *et al*. (2016) argued that if the power to hire and fire managers solely rest on democratically elected directors, the control problem is sufficiently alleviated. This is because the managers become fully accountable to the directors, and it makes monitoring the cooperative's mangers performance much easier. Moreover, if the TC is large the cost of taking decision is high since all (2-thirds) members have to vote, therefore giving democratically elected directors and their management more autonomy reduces such costs.

Portfolio Problem. Cook (1995) argue that the lack of transferability, liquidity, and appreciation mechanisms for flexible transfer of capital prevents members from adjusting their cooperative asset portfolios to match their personal risk preferences or opportunities. In TCs members can only withdraw or transfer their capital upon membership termination and it is redeemed at par value. The other challenge is that there are usually no gains in holding more shares than the minimum required shares which makes the market for TCs shares to be thin. This will deter capital endowed members and other potential investors (strategic partners) from investing their capital into the cooperative because it is difficult to transfer it in case of any risk or opportunities.

Harris *et al*. (1996), Sykuta and Cook (2001) and Lyne and Collins (2008) argued that cooperatives may alleviate this problem by offering a tradable and appreciable share B-class share to its patron-members and or non-patron members. This share can be tied to patronage as a "delivery right", or tied to capital as preferred share offered member-investors, or can be a publicly listed share which is offered to non-patron members. The incentives around the B-class share makes it lucrative if the cooperative is doing well.

Horizon problem. The horizon problem occurs when a member's residual claim on the net income generated by an asset is shorter than the productive life of the asset (Cook, 1995). In a TC, shares are redeemable at par value upon membership withdrawal – the shares do not

have capital gains. Therefore these shares are only valuable while the member is still actively patronizing the cooperative. This suggest that members are more likely to invest in value adding assets that carries benefits within their active time horizon than beyond (Beverland, 2007). It creates a disincentive for member to invest towards growth opportunities and assets like brands, research and development because more benefits accrue beyond their active time horizon in the cooperative.

Some cooperatives allow their directors to revalue shares annually in line with the cooperative's performance or offer bonus shares. Esnard *et al*. (2016) found that cooperatives in Saint Lucia re-value their shares to offer members capital gains. Similarly, Fonterra (a dairy cooperative) in New Zealand was doing that and they referred to these shares as "fair value shares" (Nilsson and Ohlsson, 2007). However, mechanically valued share and bonus shares may not be efficient strategies, as directors may undervalue the shares or give few bonus shares in fear of redemption risk in a TC because shares are redeemable. The most efficient solution to this problem is allowing cooperatives to issue tradable (non-redeemable) and appreciable B-Class share (Harris *et al*., 1996; Lyne and Collins, 2008; Rosairo *et al*., 2012; Esnard *et al*., 2016). This share will capture capital gains as the cooperative continues to do well. This will therefore benefit patron-investors even beyond their active time horizon. It will also benefit retiring patron-investors as they will trade the shares at a better price in future.

ANALYSIS OF THE SCSA, 2003 AND THE SCSR, 2005

The analysis of the SCSA, 2003 and SCSR, 2005 seeks to identify the extent which the legislative framework subject or alleviates the free-rider, influence, control, horizon and portfolio problems on cooperatives. This will determine the flexibility of the Eswatini cooperatives to adopt innovative cooperative institutional structure to formulate efficient institutions in their cooperatives like the NGC. The analysis are summarized in Table 2.

External free-rider problem. Section 36 (1), SCSA, 2003 forbids persons who have not pay the minimum share price stipulated in the by-laws of cooperatives to get the benefits of the cooperative. This allows the cooperatives to exclude non-members from benefiting from cooperative work if possible. However, in common pool resources or public goods (eg. managing a communal dam), it is difficult to exclude non-members (Gadzikwa *et al*., 2007; Ostrom and Hess, 2007; Lyne and Collins, 2008). This makes the external free-rider problem to be resilient on assets that have the open-access property rights structure but alleviated in non-public goods.

Internal free-rider problem. Section 33 (3c), SCSA, 2003 encourages new members to pay the minimum required capital shares at par value and gain the right to fully use and benefit from the cooperative. This encourages the internal free-rider problem as new members' investment into the cooperative does not reflect (reward) the benefits created by old member's investments through appreciated shares. The lack of capital gains and tradability of shares reflected in Section 21 (3b), SCSR (2005) also encourages this problem because the member's capital will be fixed in the cooperative with little gains. Moreover, Section 23, SCSR, 2005 prohibits cooperatives to limit the number of people who can join a cooperative, without seeking the commissioner's authority. This results in the cooperative becoming very big which encourages free-riding and high transactions cost of monitoring free-riders.

Influence problem. Section 4(b), SCSA, 2003 and Section 25, SCSR, 2005 states that in primary cooperatives (individual cooperative), every member has one vote irrespective of

Table 1. Framework of analysis (ill-defined property rights)

Problem	Causes	Effect	Alleviation
External free-rider	• Non-excludability of opportunistic non-members to benefits	• Discourages investment in public goods e.g. research, environmental protection	• Whenever possible do not allow beneficiation of non-members
Internal free-rider	• Membership benefits equal regardless of investment or shares	• Discourages member-patron investment • Unpredictable supply –affect strategy	• Tie patronage to investment: B-Class share (appreciable and tradable)
Control	• Absence of market signals for coops' performance • Government's interference	• Delayed signals for poor management • Managers do as please • Managers please politicians not coops	• Performance bonuses; • Autonomy to democratically elected directors over managers
Influence	• Egalitarian voting rights • High diversity in the coop. • Bureaucratic appointees given more power.	• Risk averse members influence decisions • Difficult to reach consensus – factions in large groups • Coops decisions turn political	• Voting rights investment • Strategic decision making be fully given to patron-directors and managers
Horizon	• Benefits accrue in the future when member has left • No capital gains to investment (shares are redeemable @ par value)	• Members invest only in assets within their active time horizon.	• Appreciable and tradable B-class shares • Fair value shares
Portfolio	• Fixed capital • Shares are not tradable.	• Members cannot avert risks and capture opportunities for their capital.	• Tradable and appreciable B-Class shares

Sources: (Cook, 1995; Cook and Illopulos, 1995; Harris *et al.,* 1996; Hoyt, 1996; Sykuta and Cook, 2001; Chaddad and Cook, 2004; Beverland, 2007; Gadzikwa *et al.,* 2007; Lyne and Collins, 2008; Chibanda *et al*., 2009; Rosairo *et al,* 2012; Esnard *et al*., 2016)

Table 2. Summary of clauses in the SCSA, 2003 and SCSR, 2005 that affect the efficiency of cooperatives in Swaziland

Problem	Responsible clause		Conclusion	Recommendation
	Alleviates	Perpetuates		
External free-rider	Section 36 (1), SCSA, 2003	None	Partly alleviated, but not in public goods.	Satisfactory, but can still try to attach copy rights if possible.
Internal free-rider	None	*Section 33 (3c) SCSA, 2003 *Section 83 (b), SCSA, 2003	Not addressed at all	Align investment with patronage using B-class share.
Influence	*Section 53(1), SCSA, 2003 *Section 48(1), SCSA, 2003	*Section 4(b), SCSA, 2003 *Section 25, SCSR, 2005	Satisfactory alleviated	Satisfactory, but consider voting rights structure of non-patron members (strategic partners)
Control	*Section 94(1c), 2003 *Section 48(3), SCSA, 2003 *Section 61(2), SCSA, 2003 *Section 40(4), SCSA, 2003	None	Satisfactory alleviated	Satisfactory, but may also introduce a B-class listed share
Horizon	Section 84 (1), SCSA 2003	Section 21 (3a), SCSR, 2005	Not alleviated	Introduce a B-Class share that is tradable and appreciable.
Portfolio	Section 14, SCSR, 2005	None	Conservatively alleviated	Increase market for shares (tie investment to patronage or increase dividend

the number of shares held by that member. However, Section 40(5), SCSA, 2003 states that in an "apex" (federation of cooperatives) cooperative, voting must be capped at 3 votes per member (cooperative). If members directly take part in strategic decisions, the arrangement in the primary cooperative perpetuates the influence problem.

Section 48(1), SCSA, 2003 gives power to democratically elected directors and managers to make strategic decisions. Moreover, in the Eswatini legislation, all the directors are member-patrons and are democratically elected through a secret ballot [Section 53(1), SCSA, 2003]. This makes decision making to be in the best interest of the members, hence the influence problem is sufficiently alleviated.

Control problem. Section 94(1c), 2003 allows cooperatives to give incentive bonuses to employees. This create an incentive to management and staff to commit themselves in achieving annual targets assigned to them by the directors. Section 48(3), 61(2) and 40(4), SCSA, 2003 give full authority to the directors to hire, appraise and even fire managers. The control problem is alleviated. However an appreciable and tradable share can better alleviate this problem, by giving market signals of mediocre performance of the cooperative's management immediately. This tradable and appreciable share can be listed and offered to top managers to align their interest to patrons' interest. However, it can be safely concluded that the control problem is sufficiently alleviated since directors (who are member-patrons) have full authority over managers.

Portfolio problem. Section 83 (b) and 87(2a&b) SCSA, 2003; Section 14 (1&2) and 21(3b), SCSR, 2005 allow cooperatives members to withdraw and transfer amongst themselves any extra shares, while maintaining the minimum required shares. These shares may only be transferred to a new member or an underinvested member of the cooperative [Section, 87 (2a and b), SCSA, 2003; Section 14, SCSR, 2005] or any other member who may want them. This creates a platform for members who own bonus shares to trade them, because they are extra shares. However, the market for share is only to new members and the incentive to increase shareholding under this legislation is the 5% caped dividend [Section 50(1), SCSA, 2003]. This is a low incentive, because even the market for shares is thin in a TC.

If investment was tied to patronage, new entrepreneurial members would buy more shares to match their expected high supply. Likewise, if shares were appreciable, capital endowed members would also be attracted to buy more shares, so that they can lease or sell it in the future at a higher price. This would increase the market and incentives to invest additional shares, because it would be easily traded in future in line with the members risk and opportunities at that time. Therefore, Eswatini cooperatives may alleviate the portfolio problem, but at a very conservative level. This can be improved by allowing cooperative to offer members a tradable and appreciable B-Class share.

Horizon problem. Section 21 (3b), SCSR (2005) states if a member withdraws he/she will be given money equivalent to the nominal value of the shares without interest, which implies that shares are redeemable by the cooperative at par value (not appreciable) only upon membership withdrawal. This perpetuates the horizon problem.

Section 94(1g), SCSA, 2003 allow cooperatives to issue bonus shares to members if they made a surplus. It is not clear whether the bonus share is proportional to patronage or investment. However, if we consider Section 4(e), SCSA, 2003 which states that all surplus distribution to members activities are proportional to

patronage, then the bonus share is proportional to patronage. An exception to that clause is the dividend, where it is clearly stated that it is proportional to investment [Section 94(1b), SCSA, 2003] and is capped at 5%. The bonus share would alleviate the horizon problem if patronage was tied to investment. This would make high patrons to be high investors too, so any benefit accruing to patronage is the same as it's accruing to investment.

The provision for cooperatives to stipulate the nominal value of each share in their by-laws [Section 84 (1&2), SCSA, 2003] can be used to increase the share-value in relation to the performance of the cooperative. However, the bonus shares and revaluation of shares expose the cooperative to redemption risk since shares are redeemable in a TC, and directors may be conservative is giving a fair value of shares or more bonus shares. The B-class share is better.

Can cooperatives work with private companies (strategic partners)?

Section 18(2), SCSR, 2005 states that, "except with a written permission of the Commissioner, no company or association whether or not incorporated shall become a member of a registered society". This means that private companies (registered under the Swaziland's Companies Act, 2009) can be members of cooperatives, if the Commissioner perceive the joining as valuable to the survival of the cooperative. The admission of private companies into cooperatives would bring investment, management skills, and can also enhance the credibility of the cooperative to access debt capital and coordination with markets. Section 47(2), SCSR, 2005 creates room for cooperatives to also invest in private companies. This may allow cooperatives to have subsidiary companies or invest in upstream (input supplies) and downstream (produce) markets to influence decision making in the value chain. This can reduce transactions costs and improve governance along the chain, through reducing information asymmetries between cooperatives and markets (inputs and produce).

In the case where a non-patron member (private companies) joins the cooperative in Swaziland, the only benefit is the 5% caped dividend, and their investment does not carry voting rights and does not appreciate. This may create a disincentive for strategic partners to buy cooperative shares. Moreover, Section 86, SCSA, 2003 limits the share capital a member can hold to a fifth (1/5) or 20% of the total share capital of a cooperative. This may compel cooperatives to seek for several sources of risk capital which may complicate their capital structure and increase the costs of management. However, if this limit can be increased to at least 50%, cooperatives may be able to admit just one non-patron investor.

Strategic role of secondary cooperatives

Part VII of the SCSA, 2003 allow cooperatives to federate or establish secondary cooperatives. The aim was not just establishing a lobby structure but to facilitate joint activities like coordinating with inputs, finance and produce markets for members (primary cooperatives). The challenges of ill-defined property rights mostly came from studies on marketing cooperatives. Therefore, it would be advisable that the legislation allows secondary cooperatives (marketing cooperatives) to adopt these institutional innovation. Section 40 (5) SCSA, 2003 allows members of secondary cooperatives a maximum of 3 votes per member which is in proportion of the cooperative membership, and this gives big cooperatives a bigger voice in decision making. This is a right step towards the evolution of cooperatives if the membership is made proportional to investment, which means big primary cooperatives will invest more in the secondary cooperative. However, the current

arrangements of secondary cooperatives does not carry incentives for attracting risk capital into the cooperative either by member-patrons or strategic partners.

CONCLUSION AND RECOMMENDATION

The fact remains that cooperatives are central to rural agribusiness development and market (product, finance and extension) access. However, cooperatives' legislation hinders them in accessing risk capital which is key to their sustainability. This has resulted in the demutualization and or collapse of cooperatives which has detrimental repercussions on rural economic growth and development. Institutional innovations around addressing capital issues in cooperatives have been developed in other countries and they are fruitful. The analysis of the SCSA, 2003 and SCSR, 2005 using the NIE (ill-defined property rights) theory for cooperatives suggest that cooperatives formed under this legislation will satisfactory alleviate the control and influence problems. However, they would still be vulnerable to the internal free-rider problem, portfolio problem and horizon problem. These three problems are more attached to the individual benefits on capital. In general smallholder farmers are poor, with low levels of education and the fact that farming is a risky business. These challenges makes it difficult for TCs to access capital from financial markets. Therefore, there is a need to incentivize members to invest additional (risk) capital, and further attract strategic partners to invest in cooperatives. As shown in developed countries, the introduction of a non-redeemable and appreciating B-class share on top of membership shares better alleviates these problems of ill-defined property rights. This B-class share can be tied to patronage to incentives active patrons to invest more capital and rent-out or sell when they lose interest or retire. In a multipurpose cooperative it can be tied to investment as a preferred share so that other non-patron members can buy shares for a commodity they are not supplying and get dividends on capital. This share is also flexible to be offered to capital bestowed non-members in the community and managers to invest risk capital and get dividends on profits. This B-class share can have capped or no voting rights as long as cooperatives management decision are separated from strategic decisions. In the ESWADE farmer-companies, the current membership shares can be tied to the land so that farmers will not sell their land and the B-class share would be tied to the business so that it can be traded (leased)

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STATEMENT OF NO-CONFLICT OF INTEREST

The authors declare that there is no conflict of interest in this paper.

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