

# Co-operative and Mutual Enterprises as a Business Model Innovation

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This article examines the nature of co-operative and mutual enterprises (CMEs) as an example of business model innovation. It overviews the historical evolution of the CME business model and its adoption of both economic and social innovation practices to achieve its strategic purpose. Historically, the resilience and sustainability of the CME business model has been shaped by its ability to respond to member needs through the application of economic and social innovation.

## What are CMEs?

CMEs comprise a group of related organisations (e.g., co-operatives, mutuals, friendly societies, credit unions, and building societies) that while having numerous distinctive differences, share sufficient common attributes to justify being considered as representing a unique business model (Mazzarol et al., 2018). Although there is no universal definition of a CME, it is an acronym and concept that traces its origins the 1990s when the term was first used publicly (Co-operative Futures, 2000).

The principal characteristics of CMEs are member-ownership, a strategic focus on members' economic and social purposes, plus democratic governance based on sharing, democracy, and delegation for the benefit of all its members (Mazzarol et al., 2018). CMEs also possess a commitment to enhancing trade through the application of innovative organisational systems that are democratic and inclusive in nature (Ridley-Duff, 2015).

## What is business model innovation?

Business model innovation (BMI) remains a work in progress within academic circles (Wirtz et al., 2016). Definitions for BMI are many and varied, with little consensus (Foss & Saebi, 2017). However, it can be broadly viewed as a process of re-engineering the business model through reconfiguring at least three key areas. The first, is a focus on "*content*" through investment in forward or backward integration across the supply chain. In IOFs this typically takes the form of vertical integration designed to capture the full value available within the industry or market. In CMEs, the value chain is often comprised of member suppliers and/or buyers, which creates enhanced control over the supply chain through mutual ownership and collaboration (Mazzarol, et al., 2013)..

The second, is a focus on "*structure*", whereby the organisation reconfigures its existing resources, assets, and capabilities to generate new value. IOFs have traditionally undertaken BMI through the creation of strategic business units, subsidiaries, and joint ventures (Miller, 1986). However, CMEs (particularly those whose members are small firms) are by nature strategic networks, coalitions (Staatz, 1983; 1987), or a "nexus of contracts" (Sexton, 1983; 1986). CMEs are hybrid structures that are not hierarchical (vertical), but a network of interdependent actors, which imply strengths and weaknesses (Menard, 2007).

They have a better potential to create n-form business models, based on heterarchy rather than hierarchy in their organisational design, and which can deliver enhanced knowledge management, innovation, and resilience (Hedlund, 1994). CMEs comprise a variety of organisational forms and the extent of their hybrid versus hierarchical configuration varies from one type to another, with implications on governance (Chaddad, 2012).

The third, is a focus on “*governance*”, which involves changing the role and responsibilities of one or more actors within the firm’s business activity system to generate new value. This can involve organisational restructuring as well as changes to strategic alliances (Amit & Zott, 2012). Here the difference between IOF and CME governance is important, with the former based on shareholders with a ‘one-share-one-vote’ allocation of power, while the CME follows a democratic membership model of ‘one-member-one-vote’.

BMI is therefore a process of business re-engineering with the aim of enhancing value creation (Wirtz & Daiser, 2018). In the design and redesign of a business model, it is important to recognise that success “depends as much on art and intuition as it does on science and analysis” (Teece, 2018). Further, it needs to be linked to strategy, guided by a deep understanding of the needs of customers, or members (in the case of CMEs), and the resources and organisational structures that can best sustainably satisfy those needs. In addition, the success of good business model design is contingent on an understanding of the strengths and weaknesses of existing business models (Teece, 2018).

### **What are the main characteristics of the CME business model?**

A business model is the strategic blueprint of how an organisation will create and distribute value (Morris et al., 2005). The business model concept emerged slowly within academic literature from the 1950s, but gained momentum during the 2010s, as its application shifted from an operational to a strategic focus (Teece, 2010).

The principal attributes that distinguish CME business models from those found within investor-owned firms (IOFs) are the purpose, value proposition, approach to market segmentation and value chain configuration, pricing and competitive positioning strategies, and performance metrics (Mazzarol et al., 2018). Where the IOF business model is primarily designed around a purpose (mission), and a value proposition to maximise shareholder returns, the CME business model is focused on addressing the economic and social needs of members by creating value through the maximisation of member benefits.

While an IOF business model typically focuses on targeting customer and market segments that can generate the most profit and returns to shareholders, the CME business model is usually targeting areas of greatest need for members. Further, in general CMEs are focused more on creating both economic and social value for its members than are IOFs.

In relation to pricing and competitive positioning strategies, IOF business models usually seek to reduce supplier costs while securing price premiums from customers. Further, to maximise profits and shareholder returns, IOF business models focus their competitive positioning on securing control over strategic assets that can be leveraged to enhance their bargaining power in relation to buyers and

suppliers. This contrasts to CMEs, which have supplier-buyer value chains comprising their members. As a result, they usually focus on delivering better prices for those suppliers and buyers within the supply chain who are active members. Here the strategic focus is on value creation for the CME membership.

### **The historical evolution of CME business model innovation**

The origins of CMEs can be traced back to the medieval guilds that served as a foundation business model for the Friendly Societies, one of the oldest CME types, which emerged in Scotland and Wales in the 12<sup>th</sup> and 13<sup>th</sup> Centuries. Two of the earliest recorded Friendly Societies were established in Scotland in 1598, and 1634 (Electric Scotland, 2022; Patmore & Balnave, 2018). These societies represented a BMI in the form of a mutually owned and governed financial benefit fund for seafarers and their families in the event of sickness or death (Fraser, 1934).

Within an economic and social system that offered little or no government assistance, and only charity from the Church, the business model offered by the Friendly Societies quickly gained public support. The BMI addressed *content* by using collective action and ownership to create the funds needed to address the economic and social problems it was responding to. In turn the creation of a mutually owned pool of funds created a new *structure*, and the democratic ownership that the members of the society enjoyed represented a new *governance* model.

With their business models building on the foundations laid by the guilds, these societies involved members swearing oaths of fealty, committing to the observance of laws and codes of conduct, and paying fees. However, in return they secured access to financial benefits to assist with unemployment, sickness and funerals thereby alleviating economic and social pressures on their families (Weinbren & James, 2005).

By 1800 these societies were the dominant form of mutual assistance for working people within England and Wales and had largely replaced the older guilds (Cordery, 2003). Government legislation (e.g., *Rose Act, 1793 and Friendly Societies Act, 1875*), granted these firms legal recognition, protection, and regulation, plus exemption from taxes and charges (Cowherd, 1960). The success of this business model saw their growth in UK, with England and Wales having 32,000 societies serving more than 4.7 million members by the 1870s (Davis, 1876). They were a key element in Britain's social welfare system (Cordery, 2003).

The business model developed by the Friendly Societies provided the foundations for the creation in 1844 of Rochdale Society of Equitable Pioneers, which is recognised as the start of the contemporary co-operative (Drury, 1937). The co-operatives operated under the Friendly Societies legislation as no co-operatives' law existed in the UK at the time (Patmore & Balnave, 2018).

Rochdale contributed to CME BMI via the creation of the co-operatives principles that have endured to the present with only modest changes. These enshrined the need for voluntary and open membership that was not exclusive to a member's gender, age, religion, race, or political affiliation. Also, active democracy via one-member-one-vote governance. In addition, it laid down rules for how members could

trade with the co-operative, receive benefits, including share capital and profit distributions, in a manner that preserved mutuality (Fairbairn, 1994). The founding constitution of Rochdale contained clear statements of strategic purpose that focused on both economic and social goals (Rochdale Society, 1877).

### **CME expansion in the Asia-Pacific**

During the 19<sup>th</sup> and 20<sup>th</sup> centuries, Friendly Societies and Rochdale co-operatives were established throughout the Asia-Pacific. These included producer and consumer co-operatives, plus credit societies and unions, and insurance mutuals (Gide, 1922). The BMI they brought with them helped to transform the economic and social well-being of their members, in agriculture, fishing, forestry, health care, housing, retailing and financial services.

They enabled farmers in Quebec to transition from subsistence to commercial farming during the 19<sup>th</sup> Century (Doyon, 2002). With similar patterns found in the United States which saw CMEs increase in numbers from 1810 to the 1850s (Patmore & Balnave, 2018). The Rochdale model was the dominant form within consumer co-operatives found across North America and Australasia from the 1850s (Patmore & Balnave, 2018).

The first Friendly Society in Australia was established in 1828 (Exley, 1936), and their numbers grew throughout the 1830s (Wetternhall, 2018), supported from the 1850s with legislation derived from Britain (Marshall, 1950). They provided affordable health, medical and pharmacy services to their members (Green & Cromwell, 1984). From 1859, Rochdale model consumer co-operatives began to spread across Australia, offering better prices and protecting their members from the trap of store credit offered by IOF retailers (Balnave & Patmore, 2012).

During the 20<sup>th</sup> Century agricultural producer co-operatives helped transform the social and political economy of rural America (Mooney, 2004). During the 1930s Great Depression, electricity co-operatives provided power supplies to rural America, which continues today for 48 of 50 states in the USA (Heriot & Campbell, 2006). Faced with competitive market challenges in the 1970s and 1980s, the emergence of New Generation Co-operatives (NGC), as a BMI response to the need for greater clarity surrounding ownership rights demonstrated the adaptiveness of the CME business model (Nilsson, 2001).

Although NGCs were pioneered in the United States, they have spread throughout the Asia-Pacific with examples in Australia (Plunkett & Kingwell, 2001), and China (Ma, Hu & Guo, 2011). These adaptations of the original Rochdale model have provided farmers, particularly smallholder producers the ability to add value and strengthen their bargaining power within the supply chain through network alliances, enhanced information flow from the market, and collective pursuit of opportunities and threats (Manalili et al., 2008).

CME business models were introduced to many Asia-Pacific nations during the colonial era. For example, in 1904 the British administration in India established co-operative banks, modelled on the

Germany Raiffeisen banking system, to provide affordable credit to smallholder farmers and shopkeepers. This model was replicated in Sri Lanka, Malaya, and Singapore (Birchall, 2013).

Following independence, these former colonies saw their CME sectors expand and become a significant focal point for their governments' economic and social development policies (Mitchie & Rowley, 2014). This has included communist states such as China (Bernardi & Miani, 2014), Vietnam (Nghiem, 2008), and non-communist states such as Malaysia (Othman et al., 2014). The CME business model offers an alternative to government ownership, or IOF investor control, which often sees ownership concentrated into the hands of a minority, or to foreign-ownership (Cox & Le, 2014).

### **CME BMI in the Asia-Pacific**

By 2021 the Asia-Pacific was home to 20% of the world's top 300 largest co-operatives, which included Japan's agricultural co-operative federation Zen-Noh, and Japanese Consumers' Co-operative Union (JCCU), as well as the Indian Farmers' Fertiliser Co-operative Ltd., Australia's bulk grain wholesaler and exporter, Co-operative Bulk Handling (CBH) Group Ltd., and New Zealand's Fonterra Co-operative Group Ltd. dairy co-operative (ICA-Euricse, 2021).

The CME business model continues to provide social and economic innovation for the benefit of its members throughout the Asia-Pacific region (Rowley & Michie, 2014). For example, China's agricultural co-operatives have shown high levels of innovation through adoption of new technologies, as well as developing social innovations such as hybrid business models (e.g., capitalistic but mutually owned), guided by modified versions of the co-operative principles (Lou et al, 2017). Longitudinal analysis of the role membership of co-operatives has on productivity within China's rice production found that while there are some differences found across regions, co-operatives help improve rice productivity where farms are small or medium sized and less-mechanised, due in part to the support and training the co-operatives provide to members (Lin, et al., 2022).

In India, dairy co-operatives have enabled small and marginal dairy farmers to turn their country into the world's largest milk producer. This has included innovations in the conversion of animal manure into biogas and fertiliser on a large scale, with concurrent benefits to the environment and the economic and social well being of the rural community (Rath & Joshi, 2020). Co-operatives in India's dairy industry have played an important role in the diffusion of innovations such as artificial insemination for dairy herds, due to the social connectivity and knowledge exchange that exist amongst the members (Gosh et al., 2005).

The co-operative business model has been demonstrated to be important to assisting small holder farmers as the national economies of South Asia transition from state ownership dominance to free market private ownership. For example, in Sri Lanka agricultural co-operatives have played a vitally important role in helping economic reconstruction following the Civil War in that country (Kadirgamar, Rashid & Shah, 2021).

In addition, female membership and participation in India's co-operatives has significantly enhanced the economic and social empowerment of women (Dohmworth & Liu, 2020). Also in India, the existence

of workers' co-operatives has enhanced the overall rate of employment growth within the coir industry in Kerala State. However, poor management and a lack of innovation within the coir producer firms, has impacted profitability, suggesting the need for local firms and co-operatives to collaborate in BMI to turn the industry around (Naseef & Jyothi, 2019).

Malaysia's rubber industry is important to the national economy, but it is dependent on smallholder farmers, many of whom are now leaving the industry. To address this, the formation of producer co-operatives, and greater investment in government incentives and R&D have been proposed (Ali et al., 2021). Malaysia has also used housing co-operatives to help address housing shortages for low to middle income households. Such co-operatives have a long and successful track record in Malaysia (Abu Bakar et al., 2017). The creation of an Islamic public-private housing co-operative model (IPHCM) has created an innovative business model to provide affordable public housing (Abdul et al., 2021).

Agricultural co-operatives in Vietnam provide a valuable mechanism for the dissemination of information about crop and crop management innovations as well as market pricing, particularly to small holder farmers. Where large scale producers have more ability to source information via their own channels, their smaller counterparts were more reliant on co-operatives (Hoang, et al., 2022).

In Thailand, co-operatives have a strong compliance with the co-operative principles, which helps to support their sustainability and ability to support their members through education, knowledge dissemination and personal development (Singsee & Suttawet, 2021). Thai agricultural co-operatives have enhanced the market share of local durian producers through innovative approaches to the integration of value adding within the supply chain, with a BMI involving product development, marketing strategies, network building and management efficiencies (Grodgangunt et al., 2021).

South Korea has a strong CME sector including both producer and consumer co-operatives that distribute share capital (equity) to members (Seo & Choi, 2021). Financial services CMEs such as credit societies and unions have demonstrated their ability to enhance the economic and social well-being of low-income communities (Birkenmaier & Tyuse, 2005). Korean credit unions played a key role during the 1960s in protecting the financial welfare of industrial workers who were victims of excessive usury by private sector credit providers (Yoo, 2017). A similar pattern took place in Japan where that nation's co-operative banks and consumer co-operatives championed the interests of their members (Birchall, 2013).

In Australia, the credit unions and building societies provided a strong alternative to the major IOF banks. However, competitive market pressure and the deregulation of the banking and finance sector during the 1980s and 1990s, led to the demutualisation of many mutual institutions. In response the sector engaged in a process of BMI comprising marketing, external capital raising, and mergers (Davis, 2016).

This process was facilitated by changes to Australian company law, which recognised the mutual enterprise within the legislation and provide eligible firms to raise external capital via mutual capital instruments (MCI). These are not issued as ordinary shares and provide the holder with no membership rights, or the power to influence the demutualisation of the entity that issues them. In 2020, Australian

Unity, a large Friendly Society, used MCIs to raise \$120 million from its members (ASX, 2021a), and a further \$230 million from the public the following year (ASX, 2021b). This innovation in the capital raising of Australian mutual enterprises, builds on the earlier introduction of co-operative capital units (CCU), that emerged from 2012 through the development of the Co-operative National Law framework that modernised Australia's co-operative's legislation (Apps, 2016; Mamouni Limnios et al., 2016).

## Conclusions

The history and current practice of the CME sector within the Asia-Pacific suggests that the unique nature of the business model offered by this type of enterprise has provided and continues to provide economic and social innovation to the benefit of its members. The unique characteristics of its content, structure and governance enables the CME to address social and economic problems that IOF and government businesses are unwilling or unable to.

CMEs are not a perfect business model, and their success and sustainability depends on the quality, commitment, and adaptability of their boards, managers, and members. However, the CME business model in its myriad different permutations has been recognised by governments throughout the world as an important mechanism for enhancing the economic and social well-being of communities (Roelants et al., 2020). It does this through the application of a unique business model that offers a *content* solution that embraces collaboration and cooperation throughout the supply chain, a *structure* that leverages the collective resources and capabilities of the combined membership, and a *governance* model that is founded on the principles of democracy, equity, mutually beneficial, and collaborative

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