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## Accounting for Co-operation

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*Abstract*

*What should managers and boards account for when reporting to members of a co-operative? If co-operatives are different from investor driven firms in terms of their purpose, values and principles what impact should that have on accounting and reporting? The purpose of a co-operative is to meet member and community need. In contrast, the purpose of investor shareholders in setting up or buying shares in a corporation is to get the maximum return. The difference is fundamental. The standard internationally accepted accounting system and standards are appropriate for investor owned business but inadequate and even distorting for co-operatives given their fundamentally different purpose. This paper explores how the approach to accounting and reporting in a co-operative should reflect this fundamental difference. It suggests the broad brush strokes of what a framework for co-operative accounting might look like and how accounting systems appropriate for differing types of co-operatives might be developed.*

**Key Words**

Co-operative, Accounting, Co-operative Difference

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## ACCOUNTING FOR CO-OPERATION

Created in 2002, the Master of Management – Co-operatives and Credit Unions program<sup>1</sup> at Saint Mary's University in Canada faced a daunting challenge.

How could it create a management curriculum that was designed for co-operative businesses whose purpose was not to maximize the return to investors but to meet member and community need - businesses for whom meeting need was not something done to enrich investors but to serve humanity?

A fundamental part of that challenge was how to begin developing an approach to accounting that would be rooted in and consistent with co-operative purpose, values and principles. Standard approaches to accounting measure how a company uses its resources efficiently and effectively to maximize the return to the investors who own the company. The challenge was - how could co-operatives begin to use accounting tools to measure how their resources were used effectively and efficiently to achieve co-operative purpose, values and principles? Standard accounting also has as its task ensuring reporting is transparent for investors. This transparency is also vital for co-operatives but should extend to members, workers and communities impacted by the co-operative as well.

An early conclusion was the realization that you best manage what you measure and that using the wrong accounting tools would have a dual impact on the quality of co-operative management: it would send a subtle message to management and directors that they should be maximizing returns to capital and that their performance would be enhanced by behaving more like an investor-owned business; and, the tools would fail to serve managers and boards by ignoring whether performance was efficiently and effectively meeting co-operative purpose, values and principles.

In 2006, to create a new approach to accounting we held an international Symposium on Co-operative Accounting which attracted participants from five countries.<sup>2</sup> The participants and the papers presented suggested that the direction in which we were heading was sound but a nagging question remained. How would the Canadian

### The Co-operative Context

#### Co-operative Purpose

- Meeting member and community need

#### Organizational values

- Equality
- Equity
- Mutual self-help
- Self-responsibility
- Democracy
- Solidarity

#### Co-operative Ethical Values

- Honesty
- Openness
- Social responsibility
- Caring for others

#### Co-operative Principles

- Voluntary and Open Membership
- Democratic Governance
- Member Economic Participation
- Autonomy and Independence
- Education, Training and Information
- Co-operation Among Co-operatives
- Concern for Community
- *Ecological Perspective?*

accounting standards body, the Canadian Institute of Chartered Accountants<sup>3</sup> (CICA) regard the idea of 'co-operative accounting'? To test the water we sent the Symposium papers to CICA with a modest request for \$5,000 funding to do further research. The response was an inquiry from CICA indicating that, while they did not have a small grant program, they would welcome an application for considerably more funding under their Centre of Excellence program.

The application was made and CICA awarded funding for three years which they subsequently extended and which has continued under their successor organization, CPA Canada. The new research organization was the Centre of Excellence in Accounting and Reporting for Co-operatives, CEARC. Since that time CEARC has established an iSORP (International Standards of Recommended Practice) research initiative, published a series of papers, appointed a Research Fellow, made presentations at conferences and funded research grants. A lot of progress has been made toward a credible but different approach to co-operative accounting. A number of useful tools have been explored and developed. The question now is – what vision do we have for where co-operative accounting needs to go?

Co-operatives stimulate equality of opportunity and economic activity consistent with participatory democracy. A co-operative society disperses decision making widely through a society, maintains social responsibility and encourages people to contribute to creating a better world based on their individual strengths and personality. It combines individual liberty with social responsibility. In our world it offers an important alternative business model which, while not perfect, promises to be less destructive of nature and human society. Improving its accounting will improve its performance.

### **Future Directions**

There are four key elements that have to shape accounting for co-operation. The first is that the accounting system must be demanding. Co-operative accounting must account with precision for how resources are used by co-operatives to achieve their goals. Members and communities have to have full confidence that co-operatives are meeting their goals and that the impacts of their activities are understood and positive. Members, boards and managers need to be confident that the co-operative is financially sound and healthy.

The second element is that accounting needs to take into consideration the history of co-operative development in different countries to reflect historical realities and particular strengths and weaknesses of the co-operative experience.

As co-operatives grow and mature in an economy, the third key element that must emerge in accounting for co-operation is the innovative measurement of the purpose, values and principles of co-operation. It is not enough to measure financial performance as if a co-operative is a capital driven organization whose purpose is to maximize the return to investors. The ideas of co-operation are of enormous value. They flow from hundreds of years of accumulating human wisdom about what ideas and beliefs make co-operative, reciprocal and socially responsible

behaviour successful. The values and principles do not stand alone but interact with each other. Together they make co-operation in society function smoothly.

Finally, accounting for meeting human need, operational impact and social and economic transformation cannot be seen as unrelated to accounting and reporting on financial health. The engagement of workers, satisfaction of member or customer need and operational impacts all play vital roles in ensuring financial health.

### **Developing an Accounting Framework**

**Co-operative Purpose.** Co-operative business purpose changes everything. The purpose of capitalist business is to maximize the return to the owners of capital. The purpose of co-operatives is to meet member and community need and to accomplish that while respecting co-operative values and principles. Observing co-operative values and principles is what makes working relationships within the co-operative and between the co-operative, society and the natural world function smoothly. The core question for co-operative accounting is how effectively and efficiently does the organization use its resources to achieve its purpose and goals while respecting co-operative values?

The ultimate importance of Co-operative Purpose, Values and Principles is that, taken together, they:

- Shape visions and goals
- Steer and flavour operations
- Shape expectations for workers, members, the public and governments

Some measurements of co-operative performance may be similar to what is measured in an investor driven firm but they need to measure them from a different perspective. Investor-owned firms may adopt measures that are similar to those that are related to co-operative purpose, values and principles but they are optional to their purpose and can be sincere or simply public relations. For a co-operative they flow from the heart of the business purpose, values and principles. For example, marketing for a co-operative transcends simple selling and should be rooted in education. It should inform rather than manipulate. It should be open and honest in providing information about products and, in an increasingly confusing world, assist people to access the information about products that is important to them. It should point out the advantage of purchasing a product from, or working for, a co-operative in terms of trust. It should honestly portray how the co-operative affects the community and makes it better. It should be significantly more than a sales pitch to boost profits.

**Accounting Process.** The foundation steps for every co-operative accounting process are:

1. Develop a vision and mission – What kind of society does the co-operative wish to contribute to creating and what is its role in building that society?

2. Set clear goals – State clearly what member and community needs do the members want the co-operative to meet. A co-operative may wish to limit income inequality by setting a target for the gap between the highest and lowest paid person working for it or it may wish to ensure workers all receive a living wage.
3. Measure creatively – For example a financial co-operative with the goal of limiting waste might measure the cost per cubic feet of waste disposal per account.
4. Manage what you measure and use the results. Measurements should be used to encourage members, boards and management to identify short-comings, make future progress and help to refine and improve goals.

**Accounting for What?** What do co-operatives need to account for? The rationale becomes very different than that of an investor owned firm. It differs as well depending on what type of business operations a co-operative is carrying out, whether it is reporting to workers, consumers, farmers, the community, government or to some combination of them. For example, a farm co-operative or consortium of them might enter into an agreement with the Government to supply food to hospitals. At a minimum, it must report to members and government. Below are some preliminary thoughts on what types of measures would be appropriate. These are focused on consumer co-operatives and would have to be adapted for agricultural, worker or solidarity co-operatives.<sup>4</sup>

- Efficient use of resources to meet member need – Should include some measurement of what goods and services are desired by members and what portion are met.
- Efficient use of resources to meet community need. There will be numerous ways in which the activity of the co-operative will impact the community, either negatively or positively. This component should include an assessment of what impacts members and the community wish to see the co-operative address, set out objectives and measure how effectively they are being met.
- Measuring the presence of co-operative values as perceived by members and workers.
- Measuring the presence of co-operative principles as perceived by members and workers.
- Measuring worker engagement and workplace satisfaction. Reflection on co-operative values and principles cannot but lead to an expectation that workers will not be exploited or regarded as less human than consumers or producers. Farmers, fishers, workers and consumers are interdependent. Workplaces that are safe, engaging and satisfying serve everyone better.
- Measuring the sources and impacts of capital. Are the sources of capital consistent with co-operative purpose, values and principles?
- Measuring financial health. This requires a set of measures to include such things as the real value of member shares, capital adequacy for future needs, technological change and contingencies.
- Measuring democratic governance. This should go beyond the numbers of members attending meetings and voting. It should measure the ability of members to influence decisions and participate in various ways.
- Reporting on the positive transformation of society, on how a co-operative helps make a better world for generations to come.
- Reporting on the contribution to increasing individual and social human freedom.

*Assumptions.* In adapting the ideas and principles of accounting, and developing a co-operative approach to accounting, a number of realities should be assumed to remain:

- The shift must respect social objectives of the society.
- Government will continue to regulate behaviour to ensure the public good and that co-operatives serve their members and society.
- The accounting framework should support the efforts of co-operatives to create an improved quality of living and a more efficient meeting of human needs.
- The accounting system should nurture freedom and contribute to the transformation of society to make it more caring and sharing and reflective of co-operative purpose values and principles.

**Preliminary thoughts.** One might visualize a set of Indexes that together would compose a framework for Co-operative Accounting. They could include: An Index of Meeting Human Need; An Operational Impacts Index; A Socio Economic Transformation Index; and A Financial Health Index. Each index would be calculated from a set of weighted measurements based on a formula. Together they might look as shown in Figures 1 below.

Figure 1 suggests a preliminary visualization of what an ecological co-operative accounting framework might look like. As the arrows suggest, a fully developed framework would account for the linkages between various indexes. These indices are not independent of each other but interdependent.

For example, improvements in meeting human need impact financial health and improved financial health impacts operations. Some of these linkages will be obvious



but others may not be immediately evident at the beginning. Pieces of the framework exist for all co-operatives in their existing accounting. Some may need to be modified. For other pieces of the framework the data exists but it needs to be utilized, and for still other pieces new data collection is required.

A co-operative may have measures of worker satisfaction which can be used as is or with slight improvements, and links between worker satisfaction and productivity and financial health can be explored. Improvements in meeting member need can be related to improvements in product quality and sales revenue. Leadership in improving income equality in the community may lead to measurable changes in membership growth and growth in revenues and the co-operative's surplus.

Clearly the development of a mature co-operative accounting framework is not a short term project and should always be a work in progress in terms of its sophistication and detail. That said, it is a process that can be moved forward more quickly with co-operation among co-operatives and by larger co-operatives sharing with smaller ones. As the framework is built it will give increasing understanding of the dynamics of the organization and increasingly useful insights as to how effective various departments and programs are and their impacts on the organization. The key is an ongoing commitment to improved performance.

Each co-operative needs an 'accounting and reporting development plan' so that it can continuously improve its accounting function and do it in a manner that delivers value for cost. The reporting that flows from the accounting system needs to be an efficient use of resources and provide information that meets the co-operative's purpose. It demands the creative use of formulas and information without creating burdens that will lead to abandonment of the system.

**Meeting Human Need Index.** If we accept that meeting member and community need is the core purpose of a co-operative, then their success or failure is clearly linked to whether they meet the needs for which the members established them. For example, a retail food co-operative should know: what proportion of an average members food needs the co-operative was successful in supplying;<sup>5</sup> how members rated the quality of the food; whether the prices were fair; if the service was timely and respectful; and, to what extent the co-operative met the community need goals that mandated by the members and board, such as ensuring low income families had access or that the cooperative provided useful information on healthy or local food.

Figure 2



The challenge is to create the measures required. This is not an easy task since measures cannot be copied from investor owned firms. However, it is very possible to develop measures. As an

example, during the early 1990s Co-op Atlantic was able to determine from government statistics what an average family of two or four, would spend on food. It also knew the size of each member family and could determine how much each family of four purchased. It could then determine what percentage of the food consumed by an average family was supplied by the co-operative. This was an excellent measure of how effective the co-operative was at providing member families with the food they needed and wanted.

With careful computer programming such measures could be made more sophisticated each year, an index of needs met could be created that members could better understand. By developing links to existing data bases and sophisticated formulas the cost of the index could be minimal. The index could be a measure increasingly valuable to the board and management as well. It also allowed the co-operative to assess what needs were not being met and explore strategies for bridging the gap.

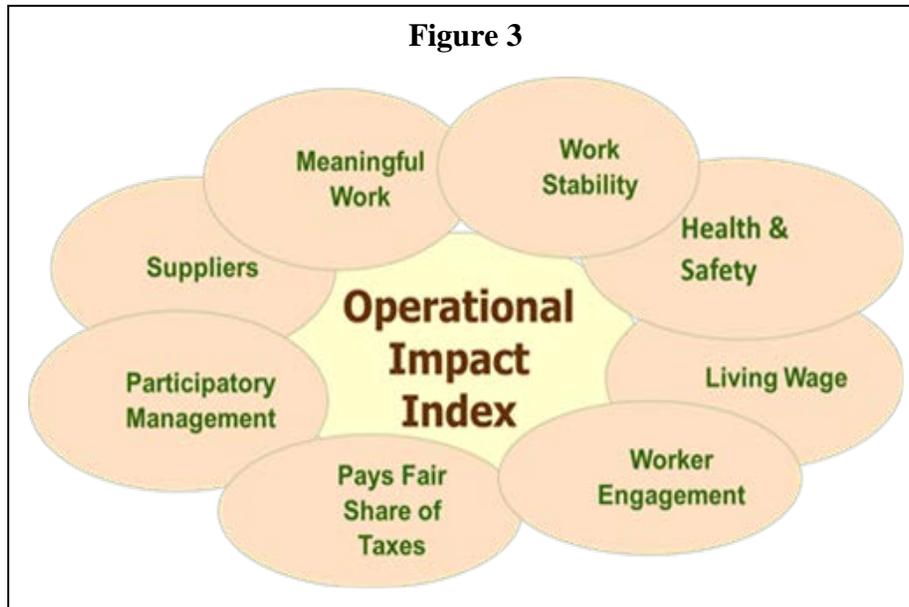
The Co-op Atlantic experience did, however, show that not only do we need to measure but that our perception of what we measure and why is important. Some managers at Co-op Atlantic interpreted the measurement of the percent of needs met as a measure of member loyalty. They turned the idea of the measure on its head and when sales fell and members began to increase the portion of food purchased elsewhere, managers blamed poor member loyalty instead of seeing the failure as a failure of management to meet member need. It was not uncommon for managers to say things like, ‘The problem here is that members do not care and do not bother supporting their co-operative. They do not really want one.’ The real problem was the failure to provide an effective one.

As a co-operative adds additional measurements related to prices, quality of service delivery, member input and product quality, it can develop an index that reflects its performance. If the index improves over time, members, boards and managers and the community can tell at a glance how well their co-operative is functioning. Operational performance improvement can be enhanced.

Operational effectiveness is essential if a co-operative is to achieve excellence in meeting human need. It is also very important that co-operative values and principles are evident in its operations. A worker owned co-operative that treats suppliers as if they were less human than co-operative members, will do itself damage. The same is true if remuneration to workers is not sufficient to allow them to live healthy and dignified lives or to have a reasonable expectation of stable work. The elements suggested below can and should be improved upon. Again the measures can be developed over a number of years and their development can be hastened by similar co-operatives sharing with each other.

**Operational Impact Index** . The Universal Declaration of Human Rights begins with the statement, ‘‘Whereas recognition of the inherent dignity and of the equal and inalienable rights of all members of the human family is the foundation of freedom, justice and peace in the world,...’’<sup>6</sup> It can also be argued that co-operative purpose, values and principles rest on respect for the inherent dignity of the human person. Co-operative values such as democracy, self-help, self-

responsibility, solidarity, caring for others, equality, equity, openness, honesty and social responsibility have their base in this and similar strains of thought.



Co-operative values and principles have certain logical outcomes and consequences for how a co-operative operates or else they are not sincerely held by managers, boards and members. But one might argue that it is impossible to perfectly implement co-operative values, and besides, co-operatives will find it difficult to compete with investor owned firms not hobbled by such fine ideals. Both these thoughts are true but so is the old saying, *'the perfect is the enemy of the very good.'* It can also be argued that co-operative values and principles are rooted in human nature, are attractive to people, and facilitate smooth functioning of an organization.<sup>7</sup> Co-operatives cannot be reasonably expected to achieve perfection but they can be reasonably expected to seek constant improvement.

The challenge of a commitment to constant improvement while operating in the context of an economy dominated by investor-owned business is a topic worthy of a separate essay. That said the raw power of huge accumulations of capital allow predatory market behaviour, exploitation of workers, degraded products, intimidation of suppliers, confusion marketing and many other practices repugnant to co-operative business practice. It is seldom that there are no improvements possible and improvements delayed need not mean improvements denied. There is a difference between saying 'this is something we cannot do yet' and, 'this is right because it is what the market allows.'

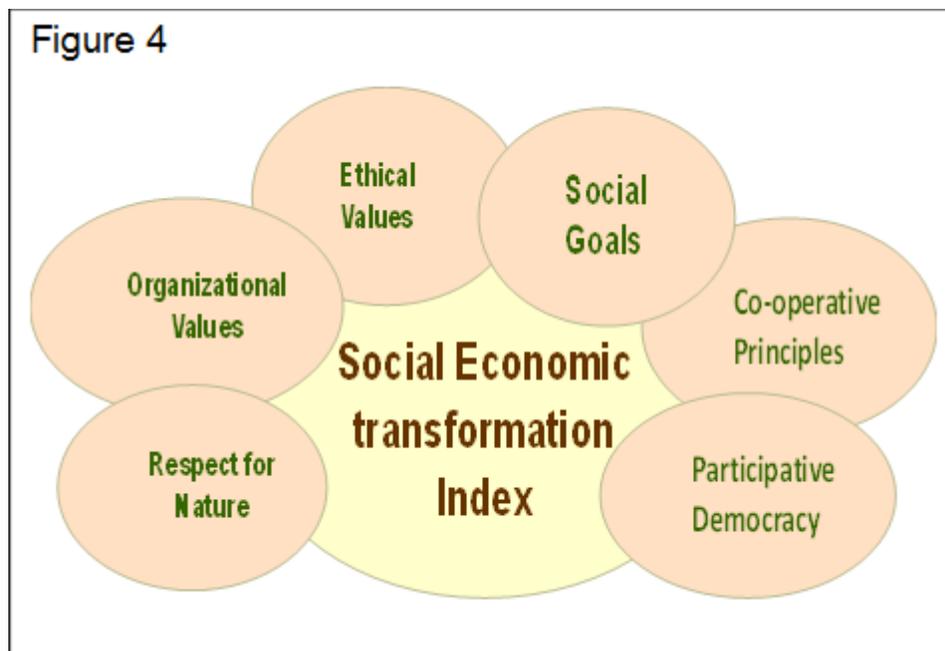
What the Operational Impact Index (Figure 3) attempts to capture is the logical implications of a co-operative's operations being rooted in a respect for human dignity and the co-operative values and principles. Workers in co-operatives should be able to expect the co-operative to strive to

provide them with a living income, a healthy and safe workplace, stable work, as much workplace autonomy as possible and engagement and participatory management. These are all consistent with co-operative values and principles. One might also expect that concern for community would lead a co-operative to pay its fair share of taxes and that suppliers would be treated fairly as well. The index can be seen as a tool for identifying opportunities.

It is not intended to suggest measuring each and every one of these attributes is the perfect solution for every co-operative. They are suggested as a good starting point. They can be part of the accounting plan.

**Social Economic Transformation Index.** Dr. Sidney Pobihushchy, the highly regarded Canadian co-operative theorist and scholar, described the responsibility of co-operatives to the world around them in the following terms:

“The Co-operative Values and principles convey a very important central message: Respect for the dignity of life, all life, not only human life but the life of nature as well.”<sup>8</sup> His presentation laid out a logical rationale for why co-operative values and principles extend beyond the day-to-day activities of the organization to encompass a responsibility to respect nature and all life on the planet. It is a responsibility that extends beyond members to their families, communities and local and global society. Additionally, one can make a case that if a co-operative has a responsibility to serve its members it is surely in their interest to improve the world they live in. Figure 4 attempts to suggest some measurable elements of that responsibility.



Some of the suggested areas of measurement, co-operative principles, ethical and organizational values, and participative democracy are vital to effectiveness of the co-operative as a co-operative. Participative democracy, while included in both values and principles, has been singled out simply

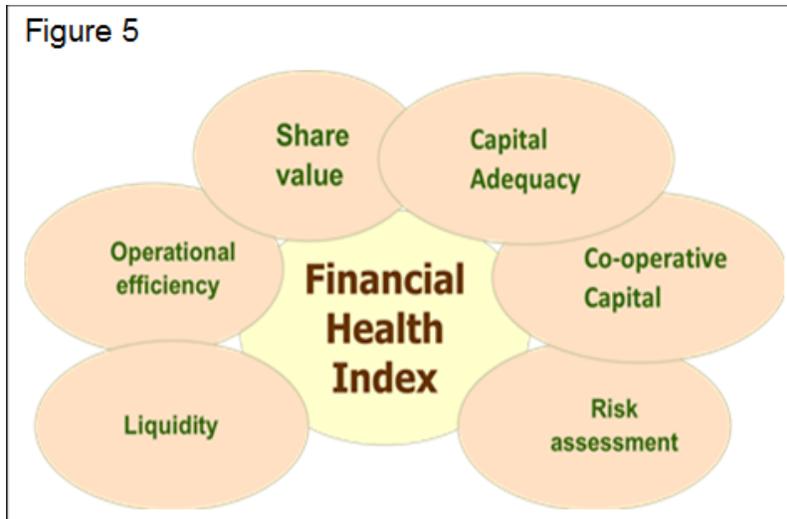
to underscore the need to extend democracy beyond the simple one member one vote involvement to wider issues of participation. Democracy in large complex co-operatives must extend beyond voting for the board of directors and include increasingly effective ways for members to influence directional decisions on an ongoing basis.<sup>9</sup> What needs to be measured is how effectively members and the community can influence decision making. In consumer, producer and co-operatives of small businesses the engagement of workers and their ability to influence decision making is beneficial to them and the co-operative.<sup>10</sup> One member one vote is the foundation, but a host of member, worker and community engagement tools can be chosen to make democracy robust, and measured for their effectiveness.

Participatory democracy is included in social transformation because members of co-operatives, particularly if they are members of multiple co-operatives, are more likely to insist on and participate in democratic processes in the larger society. Co-operatives enhance the functioning of a democratic society. The ability of co-operatives to function democratically will be severely limited if the larger society is not democratic.<sup>11</sup>

Respect for nature and social goals are solely focused on issues exterior to each co-operative but vital to their members and embodied in the principle of concern for community. Social and environmental issues are important to member regardless of the type of co-operative. Co-operative members all have a need for clean water and air or a safe community and should expect their co-operative, at an absolute minimum, not to undermine obtaining these needs and hopefully to enhance their availability. Clearly it is not within the resources of co-operatives to cure all the ills of the communities and societies in which they are located, much less the world. But every co-operative can add what it determines is its reasonable contribution. Concern for community demands that every co-operative consider its social and environmental roles and engage in reasonable action. What this approach suggests is that, as with every other action taken by a co-operative, a reasonable effort ought to be made to measure its effectiveness.

**Financial Health Index.** This index is much closer to the traditional type of accounting than the previous three indexes that make up the robust co-operative accounting framework. It must be noted that the Financial Health Index reflects co-operative purpose, values and principles. Its focus is significantly different from accounting for how resources are used to maximize the return on invested capital.

In general it needs to be credible to accounting standards bodies at the same time as it reflects the reality of the co-operative difference as indicated in Figure 5.



Some suggested elements need explanation. For publically traded investor-owned firms, it is often claimed that social responsibility is reflected in stock prices in the marketplace. In theory, their share values decline if they disregard their social responsibilities. We all know that this is often not true. In contrast co-operative shares are not publically traded. Co-operative members capitalize their co-operatives, in part, through share purchases. These shares are cannot be traded and can only be sold back to the co-operative at their purchase price. For example, the required shares for membership in a credit union or co-operative grocery store may be only a few or several hundred dollars. In a worker owned co-operative required shares are often in excess of ten thousand dollars. But what is their real value 25 years after the formation of the co-operative? If the co-operative were wound up, assets sold and debts paid the remaining funds might be worth more or less than the sum of the original purchase price, depending on how well the co-operative was run.

In many food co-operatives in Atlantic Canada in the 1990s, shares nominally worth \$600 to \$800 dollars were actually valueless. Many local co-operatives, had they been wound up, would have had negative share value. The co-operatives lost money for years and their ballooning accounts payable to Co-op Atlantic (the service co-operative they owned) were ignored by local managers and Co-op Atlantic itself. Poor maintenance meant buildings and aging equipment were often worth less than book value. Their gradual decline in value, had it been reported clearly to members, would have been a powerful wake up call. Members need to have a clear sense of the real current value of their shares. Any valuation of shares reported to members must be approximate but it can be close enough to be of value to members.

The 'co-operative capital' part of the index would measure whether the capital of the co-operative was aligned with co-operative purpose, values and principles. Investor driven capital in a co-operative will deflect it or even completely undermine its purpose.<sup>12</sup> Co-operatives need tools to rate various forms of capital in order to understand the level of risk to the co-operative business model, if any, posed by its capital structure. Co-operatives, if they are to make a major contribution to the economy need to develop a "breed" or type of capital with characteristics and behaviour fitted to purpose, values and principles.

‘Capital adequacy’ should take into account not only the state of assets and the need for contingency funds, but the assessed need for technological adaptation, expansion or diversification, if planned.

**Realistic Planning for Co-operative Accounting.** These indices will not spring into being fully developed. In smaller co-operatives it may be possible to develop a basic framework quickly especially if they share information with similar co-operatives. For more sophisticated, complex measures a high initial cost may be difficult for even a group of small co-operatives. They need to be grown gradually. Large co-operatives can develop complex, sophisticated measures, indices and accounting frameworks faster and hopefully when appropriate will share them with smaller co-operatives. Small co-operatives can proceed more slowly, adding and adapting the ideas of others on a scale consistent with their size. Different types of co-operatives will develop systems suited to the needs they are meeting. The measures of farm co-operatives will differ from consumer and worker co-operatives. What makes sense for an energy co-operative will be different from accounting and reporting that makes sense for a garment manufacturing co-operative. The specific measures can change but the focus on the four indices can remain consistent.

This suggested framework categories and indices are preliminary but hopefully suggest directions that would apply to co-operatives around the world but still be adaptable to the unique history, culture and aspirations of diverse countries such as Cuba, Kenya, New Zealand, Korea or Canada. The work of developing a systematic co-operative accounting framework which all co-operatives can draw upon is a work in progress. The more co-operatives share and engage in mutual self-help with each other, the more quickly a comprehensive, consistent approach will develop. Co-operatives around the world can play a significant role in accelerating that progress. National and international co-operative organizations can play a decisive role in the evolution and development of the framework.

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<sup>1</sup> Now renamed the Co-operative Management Education Program

<sup>2</sup> Chamard, J. and Webb, J. Tom, Editors, Symposium on Accounting for Co-operatives, Proceedings, 2006, <http://www.smu.ca/webfiles/Symposium2.pdf>

<sup>3</sup> Now the Chartered Professional Accountants Canada, CPA Canada.

<sup>4</sup> A solidarity co-operative is one in which there are different classes of membership, for example, workers and consumers in a retail co-operative, or in a day care co-operative, parents and teachers.

<sup>5</sup> For example if an average family spent \$10,000 on food how well did the co-operative do in meeting that need? Did the family obtain \$2,000 or \$8,000 worth of food from the co-operative?

<sup>6</sup> United Nations, <http://www.un.org/en/universal-declaration-human-rights/> accessed March 3 2017.

<sup>7</sup> See Webb, J Tom (2016) From Corporate Globalization to Global co-operation: We owe it to our grandchildren, Fernwood Publishing, Nova Scotia, Canada, especially Chapters four and five.

<sup>8</sup> Pobihushchy, Sidney (2003) Establishing a Co-operative Economy, Keynote Speech, Co-op Life Conference, Montpelier, Vermont, November 13-14, 2003 (Available from author on request)

<sup>9</sup> For example, if Wikipedia can engage 250,000 people in building what is arguably the most accurate on line encyclopedia, surely a co-operative with 50,000 or even a million members can devise ways for members to engage in planning.

<sup>10</sup> While there are various ways to categorise co-operatives I am using the description 'producer' co-operative in this instance to refer to co-operatives in which the members are farmers or fishers. They could also be included in a category that included other small and medium businesses where the members hire workers such as retail stores or hotels, etc.

<sup>11</sup> The history of co-operatives under Mussolini in Italy is instructive, as is the functioning of co-operatives in Stalinist Russia, but there are many examples from all over the world. Dictatorships do not tolerate co-operatives and unless they pay strict obedience, co-operative leaders are persecuted.

<sup>12</sup> For a deeper discussion of co-operative capital see: Robb, Alan J; Smith, James H; Webb, J Tom (2010) Co-operative Capital: What it is and Why Our World Needs It, For the conference on: Financial Co-operative Approaches to Local Development Through Sustainable Innovation, 10-11 June 2010, Euricse, University of Trento, Trento Italy.