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ECONOMIC COOPERATION IN KENYAN CREDIT COOPERATIVES: EXPLORING THE ROLE OF SOCIAL CAPITAL AND INSTITUTIONS

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A thesis submitted to the Faculty of Commerce, Law and Management at the University of the Witwatersrand, Johannesburg in fulfilment of the requirements for the degree of Doctor of Philosophy.

September 2011

DECLARATION

I declare that this thesis is my own, unaided work. It is submitted in partial fulfilment of the requirements of the degree of Doctor of Philosophy in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in any other University.

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Elizabeth Wangui Muthuma

ABSTRACT

Credit cooperatives make a significant economic and social contribution to development in Kenya. They are unique financial institutions that are jointly owned and democratically controlled by their members. This study explores how members of Kenyan credit cooperatives achieve economic cooperation. A sociological basis of cooperation exists because cooperatives are voluntary associations. Economic cooperation was thus conceptualised as collective economic action that enables individual actors to secure economic benefits through associational membership. An economic sociology perspective provided the theoretical basis for combining the analysis of economic interests and social relations.

The study employed a qualitative case study research design involving a rural and an urban credit cooperative. Social capital was used to explore the role of associational features in facilitating collective action while the concept of institutions was used to examine how institutions organize and shape collective action. Each cooperative was conceptualised as a microstructure to enable an analysis of group relations. An analysis of the economic and socio-political context provided the contextual basis for economic cooperation.

The findings suggest that shared values and solidarity bonds are important in creating collective economic resources while maintenance of the collective resources depends on regular reciprocity exchanges, effective enforcement and transparent representation. A new regulatory framework that emphasizes prudential standards and economic efficiency has redefined the incentive structure for Kenyan credit cooperatives. It is likely to favour a business rather than a social welfare mentality in the cooperatives. The socio-political context reveals persistent vertical linkages that have resulted in low political and economic power for rural smallholder farmers compared to urban public sector employees.

The study concludes that although credit cooperatives have acted as financial catalysts by enabling the participation of disadvantaged groups in the economic sphere, they are also societal mirrors that reflect the broader income and gender inequalities existing in society. The recognition of cooperatives as economic and social organizations therefore contributes to a better understanding of how cooperatives work.

Keywords: credit cooperative, economic cooperation, social capital, institutions, collective action, microstructure, associational feature.

ACKNOWLEDGEMENTS

I am very grateful to my supervisor, Dr. Gillian Godsell, for her guidance and support throughout my research journey. I also gratefully acknowledge the research grant provided by the board of the Oppenheimer Memorial Trust. Their faith in me was greatly appreciated. This research project would not have been possible without the participants of the two Kenyan credit cooperatives who generously gave me their time and shared their experiences. Beth Mwangi and Erick Sile facilitated my introduction to the credit cooperatives. Their assistance during the fieldwork was invaluable. Wamuyu Wamunyu provided excellent research assistance including transcriptions. I could not have asked for a more competent and supportive colleague. The Kenya Tea Development Agency (KTDA) Corporate Affairs Department kindly made some data available to me.

My family demonstrated unwavering belief in me. Their love and support saw me through the difficult phases. Ephraim Dhlembeu, Grace Lubaale and Wanjiku Kiambo provided constructive feedback. Judy Backhouse was a mentor and provided helpful advice and tips regarding the research process. Cecile Badenhorst provided excellent resources in the form of her books and writing workshops. I also benefited from the writing workshops organized by the Postgraduate Project Office, Faculty of Humanities. Staff and students at the Graduate School of Public and Development Management helped in various ways.

TABLE OF CONTENTS

Declaration ……..... ii
Abstract …….. iii
Acknowledgements…….. iv
Table of Contents……..... v
List of Abbreviations……... ix
List of Tables…….. xi
List of Figures…… xii

Chapter 1: Introduction…… 1

1.1 Background to the research……..... 1
1.2 Research problem…….. 2
1.3 Purpose statement …… 5
1.4 Research questions ……..... 5
1.5 Justification for the research ……. 6
1.6 Definition of the Cooperative Identity……... 9
1.7 Structure of the thesis……. 11
1.8 Delimitations and Limitations of the study……. 12

Conclusion……... 12

Chapter 2: A Conceptual Framework of Economic Cooperation ……..... 13

2.1 A review of economic cooperation in the literature…… 14
2.2 The conceptual components of economic cooperation…….. 18
2.2.1 Concept of the actor…….. 19
2.2.2 Concept of economic action…….. 20
2.2.3 Concept of social structure……. 21

2.3 The concept of social capital…….. 27
2.3.1 Definitions and features……. 27
2.3.2 Associational features of social capital and their theoretical roots……... 30
2.3.3 Factors influencing the effectiveness of social capital……. 35
2.3.4 Measuring social capital…….. 40

2.4 The concept of institutions……..... 43
2.4.1 Institutions and economic development…… 43
2.4.2 The need for effective state institutions…….. 46
2.4.3 Institutions and their socio-political context……... 47

2.5 A conceptual model of economic cooperation …….. 50

Conclusion…….. 53

Chapter 3: Notes on Methodology…… 55

3.1 An epistemological journey……..... 55
3.2 A constructivist perspective…….. 57
3.2.1 Implications for the study……. 59

3.3 The research design…….. 60
3.3.1 Qualitative case studies……. 60
3.3.2 An embedded multiple case design…… 62

3.3.3 The choice of cases (study population) ……... 63

3.4 Data collection…… 65
3.4.1 Ethical considerations……... 65
3.4.2 Sources of data…….. 66
3.4.3 Limitations of data collection……. 71
3.4.4 Case study database…… 71

3.5 Analysis of the data…… 72
3.5.1 The use of CAQDAS……. 73
3.5.2 Notes on terminology and citation……. 74

Conclusion…….. 75

Chapter 4: Cooperatives in Kenya…… 76

4.1 Phases of cooperative development……... 76
4.1.1 Colonial era, 1908-1962……. 76
4.1.2 Harambee era, 1963-1979…….. 79
4.1.3 Liberalization era, 1980-1999……. 82
4.1.4 Economic recovery era, 2000-2008…… 93

4.2 Policy direction and state regulation……... 100
4.2.1 Paternalistic-Interventionist Phase……. 100
4.2.2 Laissez faire-Minimalist Phase…… 106
4.2.3 Facilitative-Regulatory Phase…….. 109

4.3 Trends in cooperative development……... 112
4.4 New regulatory developments in the financial sector…… 114

Conclusion…….. 115

Chapter 5: Social capital in Credit Cooperatives…… 118

5.1 Harambee: a national self-help ideology……. 118
5.1.1 'Cooperation helps people develop together'…….. 122
5.1.2 Member motivations: the element of self-interest……... 125
5.1.3 Member benefits…… 127

5.2 Bounded solidarity……. 128
5.2.1 The creation of collective capital…… 130
5.2.2 Loyalty arising from solidarity bonds……... 130
5.2.3 Opening the common bond: Implications for solidarity……. 134

5.3 Reciprocity exchanges: risks and rewards……..... 136
5.3.1 The importance of regular member interaction……... 138
5.3.2 The risks of reciprocity……... 140

5.4 Enforcement of agreements……... 141
5.4.1 Dealing with loan defaulters……... 142
5.4.2 Voluntary vs. compulsory member contributions……... 144
5.4.3 The problem of low financial literacy…… 146
5.4.4 Member-employee relations……... 148
5.4.5 Management-board relations…….. 149
5.4.6 The case for member education……. 152

5.5 Representation and trust……. 155

5.5.1 Mode of representation…….. 155
5.5.2 The role of elections in engendering trust……... 157
5.5.3 Voting considerations for member representatives……. 159
5.5.4 Governance responsibilities of board members…….. 161
5.5.5 Board considerations in decision-making…… 163
5.5.6 Negotiations in decision-making at the AGMs……... 165

Conclusion…….. 167

Chapter 6: Credit cooperatives as Social and Economic Organizations……. 169

6.1 Wakulima Rural Credit Cooperative……... 170
6.1.1 Physical description of the FOSA Branches……... 172
6.1.2 Financial products and services at Wakulima credit cooperative……. 174

6.2 The tea sector…… 177
6.2.1 The Pre-liberalization Phase, 1964-1992……. 178
6.2.2 The Liberalization Phase, 1993-2000…….. 182
6.2.3 The Post-liberalization Phase, 2001-2008……... 185

6.3 Uwezo Urban Credit Cooperative…….. 190
6.3.1 Physical description of the FOSA Branch…….. 192
6.3.2 Financial products and services at Uwezo credit cooperative…… 194

6.4 The public enterprises sector…….. 195
6.4.1 A state-driven economy…….. 195
6.4.2 Structural adjustment…….. 197
6.4.3 Public sector reforms and privatization of public enterprises…….. 199
6.4.4 A legal framework for privatization…… 202

6.5 Wakulima and Uwezo cooperatives as social organizations……. 204
6.5.1 The influence of the political context……. 205
6.5.2 The influence of an organization context……... 208
6.5.3 The issue of gender inequality…… 210

6.6 Wakulima and Uwezo cooperatives as economic organizations…….. 214
6.6.1 The effect of variable tea prices…….. 214
6.6.2 The effect of stable salaries……. 216

6.7 Wakulima and Uwezo cooperatives as financial institutions…… 217
6.7.1 The role of technology……... 220
6.7.2 The effects of increased competition…….. 221
6.7.3 The 'net borrower' effect…… 222

Conclusion…….. 224

Chapter 7: Economic Cooperation in Credit Cooperatives…….. 227

7.1 The cooperative microstructure…….. 227
7.1.1 The source of power relations…… 230
7.1.2 The social vs. business nature of cooperatives……..... 232
7.1.3 Cooperative-society linkages. ……. 234

7.2 The role of social capital in economic cooperation……. 242
7.2.1 Social capital and the influence of the social structure……. 244

7.3 Relations between credit cooperatives and institutions. ……..... 245

7.3.1 Cooperative-state linkages ……. 245
7.3.2 The incentive structure for credit cooperatives……... 250

7.4 A revised conceptual model of economic cooperation……... 253
7.5 Lessons in cooperative development …… 256
7.5.1 An underlying values foundation…… 257
7.5.2 Compatibility of the cooperative model with member needs…….. 258
7.5.3 The effect of economic rationalization on the social purpose of cooperatives…… 259

Conclusion……... 261

Chapter 8: Conclusions and Implications. …… 263

8.1 The focus of this research. …… 263
8.2 Contributions of the study……. 265
8.2.1 The conceptualisation of social capital…… 265
8.2.2 How social capital facilitates collective economic action……. 268
8.2.3 The influence of institutions……... 269

8.3 Implications for theory…….. 270
8.3.1 Measuring social capital……. 270

8.4 Implications for policy and practice…… 271
8.4.1 Some practical implications…… 274

8.5 Directions for future research…… 274

Bibliography

Appendices
I - Participant consent form
II - Interview schedules
III - Cooperative examples

LIST OF TABLES

Table 1.1: Cooperative values and principles…….. 9
Table 2.1: Associational features of social capital…… 35
Table 2.2: Social capital indicators for a Kenyan credit cooperative……... 42
Table 3.1: Number of research participants who were interviewed……. 68
Table 3.2: Key to interview transcript citations……... 75
Table 4.1: Cooperative societies statistics…… 79
Table 4.2: Number of cooperatives by type, 1997-2007……. 95
Table 4.3: Trends in cooperative development……... 113
Table 5.1: Member-defined qualities of a good representative…… 161
Table 6.1: FOSA Branch statistics for Wakulima credit cooperative, 2008……. 174
Table 6.2: Comparative statistics for Wakulima and Uwezo credit cooperatives……. 218
Table 7.1: Gini index for Kenya and selected African countries……. 237
Table 7.2: Gender disparities in income and employment opportunities……. 239
Table 8.1: Practical implications for members and cooperatives…….. 274

LIST OF FIGURES

Figure 2.1: The cooperative microstructure……..... 26
Figure 2.2: A conceptual model of economic cooperation in Kenyan credit cooperatives…… 52
Figure 4.1: Growth in annual turnover by cooperative type……..... 96
Figure 6.1: FOSA clients at Wakulima credit cooperative……. 173
Figure 6.2: Smallholder tea farm in Central Kenya……... 173
Figure 6.3: Performance of Wakulima BOSA and FOSA products, 2005-2007…… 176
Figure 6.4: Average tea yield by grower, 1990-1998…….. 185
Figure 6.5: FOSA banking hall of Uwezo credit cooperative…… 193
Figure 6.6: KTDA tea payments from 1991-2007…… 215
Figure 6.7: Growth in Uwezo member shares and deposits, 1990-2008……... 216
Figure 7.1: Inverted pyramid of the cooperative microstructure……... 228
Figure 7.2: Normal pyramid of the cooperative microstructure…… 229
Figure 7.3: Emergent relationship between social capital and economic action……..... 243
Figure 7.4: A revised conceptual model of economic cooperation…… 256

LIST OF ABBREVIATIONS

ACOSCCA	African Confederation of Savings and Credit Cooperative Associations
AGM	Annual General Meeting
ATM	Automated Teller Machine
BOSA	Back office Savings Activity
CAQDAS	Computer-assisted Qualitative Data Analysis Software
CBK	Central Bank of Kenya
CDC	Commonwealth Development Corporation
CGD	Centre for Governance and Development
CIC	Cooperative Insurance Company
CIPEV	Commission of Inquiry into the Post-Election Violence (Kenya)
DFID	Department for International Development (United Kingdom)
DGIPE	Department of Government Investments and Public Enterprises
EAC	East African Community
ECA	Economic Commission for Africa
EFT	Electronic fund transfer
EPZA	Export Processing Zone Authority
ERS	Economic Recovery Strategy for Wealth and Employment Creation
ESAF	Enhanced structural adjustment facility
ESTU	Executive Secretariat and Technical unit
FGD	Focus group discussion
FOSA	Front Office Service Activity
FSD	Financial Sector Development (Kenya)
GDP	Gross Domestic Product
ICA	International Cooperative Alliance
ICU	International Credit Union
IFI	International financial institution
IGAD	Inter-Governmental Authority on Development
ILO	International Labour Organization
IMF	International Monetary Fund
IREC	Independent Review Commission
IT	Information technology
KACC	Kenya Anti-Corruption Commission
KACCU	Kenya Agricultural Commodities Cooperative Union
KERUSSU	Kenya Rural Savings and Credit Cooperative Union
KETEPA	Kenya Tea Packers Limited
KCC	Kenya Cooperative Creameries
KFA	Kenya Farmers Association
KNFC	Kenya National Federation of Cooperatives
KPCU	Kenya Planters Cooperative Union
KSTGA	Kenya Small Tea Growers Association
KTDA	Kenya Tea Development Agency
KTGA	Kenya Tea Growers Association
KUSCCO	Kenya Union of Savings and Credit Cooperatives
KUSSTO	Kenya Union of Small-Scale Tea Owners
MOCDM	Ministry of Cooperative Development and Marketing
NACHU	National Cooperative Housing Union
NACO	National cooperative organization
NARC	National Rainbow Coalition
PCA	Productivity Commission of Australia
PRGF	Poverty Reduction and Growth Facility
PRPC	Parastatal Reform Programme Committee
PRSP	Poverty Reduction Strategy Paper
ROSCA	Rotating savings and credit association

ROK	Republic of Kenya
SACCO	Savings and credit cooperative society
SAP	Structural adjustment programme
SCDA	Special Crops Development Authority
SID	Society for International Development
SLY	Savings-Liquidity-Yield
SMS	Short Message Service
UNDP	United Nations Development Programme
USA	United States of America
WOCCU	World Council of Credit Unions

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND TO THE RESEARCH

One of the classic questions in social theory is how social relationships affect behaviour (Durkheim, 1893/1933; Polanyi, 1944; Simmel, 1908/1955; Weber, 1922/1968). In recent years, the concept of social capital has generated much research focus because of its heuristic ability to explain cooperative behaviour between and within groups (Grootaert & Van Bastelaer, 2002; Portes & Sensenbrenner, 1993; Putnam, 1993, 2000; Schuller, 2007; Woolcock, 1998). Previous research on cooperation has tended to focus on informal structures such as rotating savings and credit associations (Ardener, 1964; Besley, Coate & Loury, 1993, 1994; Geertz, 1962; Gugerty, 2001); microcredit borrowing groups (Anthony, 2005); group-based microfinance programmes (Ito, 2003; Woolcock, 1999); and rural community groups (Narayan, 1999; Woolcock & Narayan, 2000). Consequently, there has been inadequate research attention on cooperation in formal structures such as cooperatives even though they are also member-based organizations.

This thesis aims to enhance our understanding about how members of cooperatives achieve economic cooperation. Economic cooperation is construed as the explicit or implicit objective that voluntarily brings people together to meet their economic interests. The International Cooperative Alliance (ICA) defines a cooperative as a voluntary association of people who share a common affiliation and are motivated to meet their social, economic and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise (ICA, 2007a). This definition means the cooperative is both a voluntary association and a joint enterprise. Thus, although cooperatives usually receive attention as economic organizations, they also merit consideration as social organizations. The economic and social foundation of cooperatives reflects the duality of the cooperative identity (McKillop, 2005; Valentinov, 2004).

Much of the published cooperative research has tended to focus on the economic aspects of cooperatives and only implicitly recognize the social dimension (Develtere, 1994). A dominant economic focus on cooperatives neglects the sociological basis of cooperation within cooperatives as voluntary associations. This study attempts to fill the knowledge gap by examining cooperatives as social organizations. The researcher argues that it is important to investigate the sociological basis of cooperation because it will contribute to a better understanding of how cooperatives work. In a similar vein, Woolcock (1999) has argued that an analysis of social relationships in group-based microfinance programmes can offer a better understanding of how these programmes work. A sociological appraisal is also likely to provide additional criteria by which group-based programmes or member-based cooperatives can be evaluated.

This study is concerned with credit cooperatives in Kenya. In many African countries, they are known as savings and credit cooperatives (SACCOs). In the United States, they are known as credit unions while in Quebec, Canada and other French-speaking countries, they are known as *caisse populaires*. The World Council of Credit Unions (WOCCU) reports that in 2008, there were 53,689 credit unions in 97 countries around the world. Collectively, they served an estimated 185 million members within those countries (WOCCU, 2008). Countries with the highest number of credit union members include the United States (89 million); India (20 million); Kenya (3.7 million); Australia (3.5 million); Brazil (3.3 million); and Ireland (2.9 million).

1.2 RESEARCH PROBLEM

The background to this research is Hyden's (1973) study of East African rural marketing cooperatives in which he found that economic cooperation was not necessarily an objective let alone an outcome. Hyden argued that the existing conditions in which the rural marketing cooperatives operated in (traditional communalism) were inconsistent with the expectations of modern economic cooperation. He attributed this inconsistency to Durkheim's classical distinction between "mechanical" and "organic" solidarity, based on the type of division of

labour prevailing in any particular society. In mechanical solidarity, individuals share a similar lineage in terms of the social and geographical environment in which they are born. They are also subordinated to a common conscience and loyalty to the primary group. In organic solidarity, individuals group themselves according to a particular social activity, usually their occupational milieu. Individual conscience is guided by self-interest and solidarity is achieved through mutual contractual agreements (Durkheim, 1893/1933).

According to Hyden (1973), modern economic cooperation presupposes a situation characterized by organic solidarity. Thus, cooperation involves individual efforts converging towards a unifying collective end. In contrast, he found that rural cooperatives in East Africa functioned in an environment bearing the features of mechanical solidarity. Thus, they may have had common ends but not a collection of individually defined objectives – cooperation in the rural cooperatives was incidental.

The notion of mechanical solidarity, in which individuals are subordinated to a common conscience and like-mindedness is maintained, has been criticized as an "over-socialized" account of behaviour, because it focuses on static internalized behavioural patterns that have marginal effects on behaviour (Granovetter, 1985; Wrong, 1961). The idea of traditional communalism has also been criticized as being idealistic and inconsistent with the reality. According to Migot-Adholla (1970), traditional communalism idealizes existing African peasants as "some exotic type characterized by a basic benevolence and relative un-differentiation." In reality, socio-economic differentiation and kinship-neighbourhood loyalties are some of the prominent factors that affect differential participation by individuals in the cooperative organizations (1970: 36).

Three and a half decades after Hyden, I revisit the problem of economic cooperation in Kenyan cooperatives. This time round, economic cooperation is examined from the member's perspective. Economic cooperation is presumed to be an objective of collective action rather

than an outcome of external constraints. Another difference is the type of cooperative based on the predominant type of cooperative at the time of research: Hyden's research focus was agricultural marketing cooperatives while the current study focuses on credit cooperatives. The different type of cooperative is not seen as a substantive point of departure because all cooperatives, regardless of their business, require cooperative behaviour from members.

The research question becomes: ***How do members of credit cooperatives achieve economic cooperation*?** Essentially, I argue that the concept of social capital which encompasses several features of association can help explain the attainment of economic cooperation among members of the cooperatives. The economic behaviour of members is first presumed to be embedded in networks of personal relations. This assumption is derived from the notion of 'embeddedness' in which Granovetter (1985) argues that a fruitful analysis of economic behaviour requires the consideration of its social context and an appreciation of the dynamic nature of the existing systems of social relations. However, the notion has a weak theoretical foundation that makes it unsuitable for examining the sociological context of economic organizations (Portes & Sensenbrenner, 1993; Uzzi, 1996; Flora, Sharp, Flora & Newlon, 1997). It is therefore complemented by the concept of social capital.

Economic cooperation in cooperatives occurs within a specific institutional context that is defined by government policies and legislation as well as informal norms and culture. The concept of institutions is useful in analyzing the influence of the external context on the collective action of members. The notion of embeddedness draws attention to the fact that economic organizations (such as cooperatives) function simultaneously as social structures with history and continuity that gives them an independent impact on the performance of the economy (Granovetter, 1985; Zafirovski, 1999). In this way, the notion of embeddedness supports the dual identity of cooperatives as economic and social organizations.

1.3 PURPOSE STATEMENT

The purpose of the study was to explore how members of two Kenyan credit cooperatives achieve economic cooperation. The nature of the credit cooperative as a jointly-owned and democratically-controlled organization presupposes the presence of associational features that may facilitate cooperation. Associational features such as particularistic values, norms of reciprocity, sanctions and closed networks have been associated with cooperative behaviour (Parsons, 1949; Gouldner, 1960; Blau, 1964; Coleman, 1990; Portes & Sensenbrenner, 1993; Putnam, 1993). The concept of social capital provides a theoretical approach to examine this proposition. This study therefore builds on and contributes to work in social capital. In particular, it explores how social capital facilitates collective action in credit cooperatives.

Collective action in the cooperatives is likely to be shaped by the unique historical, economic, social and political contexts found in a specific country (Woolcock, 1998; Szreter, 2002; Svendsen & Svendsen, 2004). The historical, economic and socio-political contexts were examined under the concept of institutions. The institutional environment that governs Kenyan credit cooperatives thus formed the context of the study. A critical analysis of the institutional context was incorporated into the study with a view to understanding how formal and informal institutions organize and shape collective action in the cooperatives.

1.4 RESEARCH QUESTIONS

The central research question was posed as: **What is the role of social capital and institutions in facilitating economic cooperation in credit cooperatives?**

Four research objectives were devised in order to answer the central research question. These were to: (i) develop a well-grounded concept of social capital in credit cooperatives; (ii) investigate and illustrate how social capital facilitates collective economic action; (iii) describe and analyze the influence of formal and informal institutions on credit cooperatives; and (iv) identify theoretical and policy implications of the research findings. These aims were translated into the following four questions:

1. How is social capital in credit cooperatives conceptualized?
2. How do the features of social capital facilitate collective economic action in credit cooperatives?
3. What is the nature of the interaction between credit cooperatives and their institutional environment?
4. What are the theoretical and policy implications of the research findings?

1.5 JUSTIFICATION FOR THE RESEARCH

Cooperatives have been touted as suitable vehicles for economic development and poverty reduction (Birchall, 2003; Prahalad, 2006; Simmons & Birchall, 2008; Wanyama, Develtere & Pollet, 2009). They remain a development focus for international agencies such as the UK Department for International Development (DFID) and the International Labour Organization (ILO)[1]. The focus on cooperatives is based on their significant contribution to economic and social development world-wide. According to the International Cooperative Alliance (ICA), cooperatives are estimated to provide 100 million jobs worldwide, a figure which is 20% more than those offered by multi-national enterprises. Over 800 million people around the world are members of a diverse group of cooperatives. These range from small-scale enterprises to large multi-billion dollar enterprises (ICA, 2007a).

The ICA country statistics reveal that cooperatives are significant economic actors in the national economies of both developed and developing countries. In 2006, Brazilian cooperatives were responsible for 40% of the agricultural gross domestic product (GDP) and for 6% of total agribusiness exports. In Cyprus, the cooperative movement held 30% of the market in banking services and handled 35% of all agricultural produce marketing. In France, cooperative banks handled 60% of total deposits. In New Zealand, 22% of the GDP was generated by cooperative enterprise while Kenyan cooperatives were responsible for 45% of the GDP and 31% of national savings and deposits (ICA, 2007b). Cooperatives also contribute to human and social

[1] See DFID, 2010; ILO, 2001

development through employment creation, education and training of their members, and solidarity networks with other cooperatives.

Kenya has had a relatively long history of cooperative development, having marked its centenary celebration of cooperatives in January 2009[2]. The Kenyan cooperative movement has over 7 million members (Co-op Bank, 2008; Wanyama, 2009). It has been characterized by strong growth in membership and a positive contribution to the country's economic and social development. The Ministry of Cooperative Development and Marketing (MoCDM) estimates that the movement directly employs over 300,000 people and indirectly contributes to the employment of 1.5 million people (MoCDM, 2009a; Wanyama, 2009).

Credit cooperatives comprise an important and vibrant segment of the Kenyan cooperative movement. According to the Central Bank of Kenya (CBK), they serve an estimated 6.3 million members with a shares and deposit base of Ksh. 177 billion (US$ 2.3 billion[3]) and an outstanding loan portfolio of Ksh. 105 billion (US$ 1.3 billion) (CBK, 2009). A national survey on access to financial services revealed that an estimated 8% of Kenyans were served by credit cooperatives and other microfinance institutions while 13% had used a loan product from a savings and credit cooperative (FSD, 2007). Credit cooperatives have therefore played a key role in broadening financial access to Kenyans.

Credit cooperatives have also contributed towards personal and family investment, including the provision of entrepreneurial capital. Development loans offered by most of these cooperatives have been used to buy land, build houses, invest in businesses or farming, buy household furniture and meet other family or social obligations. In addition, credit cooperatives have long been associated with the payment of school fees (ROK[4], 1987; Wanyama, 2009). Most cooperatives also provide some form of social protection through benevolent funds to which

[2] President's Speech available at http://www.statehousekenya.go.ke/speeches/kibaki/jan09/2009300101.htm
[3] Based on the Central Bank exchange rate of 1US$ = 78 Kenya Shillings (CBK, 2009).
[4] Republic of Kenya

members contribute regularly and draw from when they are bereaved. Their significant socio-economic contribution to development makes credit cooperatives a logical choice for a research study on Kenyan cooperatives.

Cooperatives are people-based organizations and rely on the active participation of members to develop their comparative advantage as well as to differentiate themselves from investor-owned firms. They are also economic entities and thus subject to the realities of the economic environment (Lele, 1981; Simmons & Birchall, 2008). The duality that exists between the social and economic roles of the cooperative has been described as one of democracy and efficiency where democracy refers to the organization of members as owners and users, and efficiency refers to the business operation of the cooperative (McKillop, 2005; Westergaard, 1970). The duality of roles in a cooperative implies that each role cannot be separated and treated independently of the other.

This study recognizes cooperatives as economic and social organizations. An economic sociology perspective provides the theoretical basis for the combined analysis of economic interests with the analysis of social relations (Smelser & Swedberg, 2005). This perspective is based on the premise that the economy is not autonomous: instead, it is part of the social system, embedded in society (Polanyi, 1944). An economic sociology perspective adopts the methodological principle of holism by recognizing the influence of institutions such as culture, economy and the polity on individual and organizational actors (Zafirovski, 1999). It therefore accommodates the analysis of micro-level actors in meso-level economic units (cooperatives) and their interaction with macro-level institutions (Nee, 2005).

The methodological implications of the economic sociology perspective include the primary use of qualitative methods in order to enhance understanding (*Verstehen*) and explanation (Weber, 1922/1968; Zafirovski, 1999). The study methodology therefore involved a qualitative case study design. The interpretive case study consisted of a rural and an urban credit cooperative as

the two cases in the study. Interpretive case studies are differentiated from basic descriptive case studies by their in-depth analysis and theoretical orientation (Merriam, 2001).

1.6 DEFINITION OF THE COOPERATIVE IDENTITY

The ICA definition of a cooperative is applied in this thesis. The ICA defines a cooperative as: *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* (ICA, 2007c, para. 1). The ICA Statement on the Cooperative Identity[5] lists a set of six primary values and seven cooperative principles that comprise the cooperative identity (see Table 1). A description of the cooperative principles is provided below the table.

Table 1.1: Cooperative values and principles

Cooperative Values	Cooperative Principles
• Self-help • Self-responsibility • Democracy • Equality • Equity • Solidarity *Ethical values: honesty, openness, social responsibility and caring for others.*	1. Voluntary and open membership 2. Democratic member control 3. Member economic participation 4. Autonomy and independence 5. Education, training and information 6. Cooperation among cooperatives 7. Concern for community

The first principle is ***Voluntary and Open Membership.*** Cooperatives are voluntary organizations that are open to all persons who are able to use their services and willing to accept the responsibilities of membership without discrimination on the basis of gender, race, religion, social or political affiliation. The second principle is ***Democratic Member Control***. Cooperatives are democratic organizations that are controlled by their members who actively participate in making decisions and setting policies. Elected representatives are accountable to

[5] http://www.ica.coop/coop/principles.html

the membership. In primary cooperatives, members have equal voting rights (one member, one vote). Cooperatives at other levels are also organized in a democratic manner.

The third principle is ***Member Economic Participation***. Members contribute equitably to, and democratically control, the capital of their cooperative. Part of that capital is usually the common property of the cooperative. In addition, members usually receive limited compensation on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: setting up reserves; proportionate compensation to members based on their transactions with the cooperative; supporting any other activities approved by the general membership.

The fourth principle is ***Autonomy and Independence***. Cooperatives are autonomous, self-help organizations. The terms of any agreements with other organizations, including governments, must ensure democratic control by their members to maintain their cooperative autonomy. The fifth principle is ***Education, Training and Information***. Cooperatives provide education and training for their members, elected representatives, managers and employees to enable effective contribution to the development of their cooperatives. They also inform the general public about the nature and benefits of cooperation.

The sixth principle is ***Cooperation among Cooperatives***. Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures. The seventh principle is ***Concern for Community***. Cooperatives work for the sustainable development of their communities through policies approved by their members. These values and principles comprise the cooperative identity and usually form part of cooperative legislation.

1.7 STRUCTURE OF THE THESIS

This thesis is composed of eight chapters that are broadly classified into three sections. The first section consists of three chapters and is the introductory section. Chapter One provides the background context which situates the study, the problem and purpose statements as well as key definitions and limitations of the study. Chapter Two presents the literature review and the conceptual framework by which economic cooperation is defined and theorized. The conceptual framework is summarized into a conceptual model of economic cooperation. Chapter Three presents a narrative account that provides the justification of the methodological approach and procedures employed in the study.

The second section presents the specific context and the findings of the study in three chapters. Chapter Four presents a contextual analysis of cooperative development in Kenya with specific focus on its historical development, policy direction and state regulation. Chapter Five provides a detailed description of the associational features of social capital in the two cases employed in the study. The aim of the description is to provide evidence of how social capital facilitates collective economic action in the credit cooperative cases. Chapter Six presents the findings of credit cooperatives as economic and social organizations based on an analysis of their interaction with the institutional environment.

The third section comprises the final two chapters. Chapter Seven presents a discussion and interpretation of the findings. One of the contributions of the chapter is a revised conceptual model of economic cooperation based on the findings. Chapter Eight presents the study's conclusions about the research problem and research questions. It also provides a summary of the main contributions of the study and implications for theory and policy. A bibliography concludes the study. The appendices include the consent form and interview schedules that were used in the research, and selected cooperative examples.

1.8 DELIMITATIONS AND LIMITATIONS OF THE STUDY

The specific combination of factors that constitute the Kenyan context render this study atypical and limited generalization is warranted. Furthermore, the study was conducted in Kenya in the second half of the year 2008. This period was particularly important to the study because it followed a devastating episode of post-election violence that was experienced in January and February of that year. By July, there were still large numbers of internally displaced people and a slow reconstruction of people's lives in areas that were worst affected by the violence. There was also the uneasy feeling of an ethnically polarized environment. These unique circumstances had a limiting effect on the fieldwork phase of the study.

This study was primarily an investigation about cooperation and not cooperatives. Cooperatives were simply the units of analysis for this sociological inquiry into collective action. The study was therefore not designed to be a general evaluative research of cooperative development. Furthermore, the choice of a qualitative research methodology meant that the cases selected for the study were uniquely particularistic: they were purposefully selected on the basis that they could offer insight and in-depth understanding about cooperation. For that reason, the qualitative case study design is not suited for empirical generalization (Patton, 2002; Stake, 1995).

Conclusion

This chapter lays the foundation for the thesis. It introduces the aim of the study which is to explore how members of Kenyan credit cooperatives achieve economic cooperation. It also provides the rationale for examining cooperatives as economic and social organizations. The next chapter provides a review of the literature on economic cooperation and presents the conceptual framework for the study.

CHAPTER 2

A CONCEPTUAL FRAMEWORK OF ECONOMIC COOPERATION

The aim of this chapter is to present a conceptual framework that theorizes the problem of economic cooperation and develops an analytical scheme for its empirical application in credit cooperatives. A logical place to begin a systematic study of economic cooperation is with its meaning. Economic cooperation is taken to mean the explicit or implicit objective that voluntarily brings people together to meet their economic interests. The ICA definition of a cooperative implies economic cooperation because it identifies the purpose of the cooperative to be the promotion of the economic interests of its members in line with cooperative principles (ICA, 2007c).

In the study, economic cooperation is conceived as a collective action problem situated within the formal organization setting of a credit cooperative. Economic cooperation is thus conceptualized as collective economic action that enables individual actors to secure economic benefits through associational membership. It involves the creation and maintenance of collective economic resources for use by members.

Economic cooperation may occur within formal or informal organizations. Formal organizations include cooperatives and collective investment vehicles such as mutual funds and unit trusts while informal organizations include savings clubs, rotating savings and credit associations (ROSCAs) and microcredit borrowing groups. Informal organizations are usually not registered with any formal authority and are therefore governed by rules and norms that are based on dense networks of social relations among participants. They rely mainly on the use of internally generated sanctions to enforce mutual agreements (Ardener, 1964; Geertz, 1962; Gugerty, 2001). Formal organizations are governed by rules and contracts which are officially recognized and enforceable. In addition, these organizations are usually subject to some form of financial

regulation. Most formal organizations also display some elements of a vertical or hierarchical structure (Ito, 2003).

This chapter consists of five main sections. The first section presents several theories drawn from the literature that relate to economic cooperation. The next section explains the conceptual framework in terms of the conceptual components of economic cooperation. A discussion of the two key conceptual components – social capital and institutions – is provided in two separate sections. The final section presents the conceptual scheme of economic cooperation that was developed for the study. The chapter concludes with a summary of the main points.

2.1 A REVIEW OF ECONOMIC COOPERATION IN THE LITERATURE

The literature provides several theories on how economic cooperation is achieved at various levels. At the societal level, Durkheim (1893/1933) posited that economic cooperation developed as a result of the division of labour. His concept of society was a system of interconnected functions that characterized the different individual personalities. Using the analogy of a living organism, he argued that economic cooperation was an expression of "organic solidarity". In other words, the cohesion that arose from differentiated individual functions was similar to the cohesive functions of the organs of a living animal. He also argued that the strength of the solidarity grew in direct proportion to the level of differentiation among individual personalities. This was because a high level of differentiation led to a greater sense of interdependence among individuals and resulted in a robust solidarity. Interdependent social relations arising from organic solidarity were governed by cooperative law that was accompanied by sanctions which allowed restitution (rather than penance). In his view, the formal contract was a perfect expression of cooperation.

Group formation on the basis of economic interests was theorized by Simmel (1908/1955). He posited that in the course of cultural development, group cohesion that was based on geographical and sociological factors tended to be replaced by purposive or individual interests.

He referred to the development of the English consumer cooperatives, pioneered by the Rochdale cotton weavers, whose original association was largely based on a similar locality. Over time, the occupation of the members became the governing principle of the worker's associations rather than geographical proximity.

Weber (1922/1968) also recognized the role of individual interests in the formation of voluntary associations. He referred to "associative" relationships in which actors mutually agreed to a "rationally motivated agreement of interests" (1922/1968: 41). Examples of associative relationships include rational economic exchange, and "pure" voluntary association based on either self-interest or the common adherence to a set of absolute values (such as a religious sect). Thus, cooperatives can be considered to exhibit associative relationships between individuals based on self-interest and the adherence to cooperative principles that are internationally recognized.

The analysis of individual interests has spawned several theories including rational choice theory (Coleman, 1990); social exchange theory (Blau, 1964); and the logic of collective action (Olson, 1965/1971). These schools of thought explain that cooperative behaviour is achieved when it is in the individual's interests to comply with collective goals. In order to facilitate cooperation, certain mechanisms such as incentives, sanctions and reciprocal exchange are applied. Thus, individuals cooperate depending on the system of rewards or penalties for cooperative or uncooperative behaviour, independent of the collective good produced by the group. Furthermore, cooperation may be regarded as a form of strategic interaction particularly when it involves reciprocity (Anthony, 2005).

In her article on cooperation in microcredit borrowing groups, Denise Anthony identifies three competing mechanisms for facilitating group cooperation: social identity, sanctions and reciprocity. She found that rather than competing mechanisms, group identity, reciprocity and sanctions tended to be inter-connected processes in group cooperation. In particular, she found

that reciprocity was a more important mechanism for producing collective goods and compliance because it enabled members to gather information, assess reliability and continually monitor one another as well as demonstrate their own willingness to cooperate. This led her to conclude that commitment to specific actors in the group through reciprocal relationships facilitated successful cooperation (Anthony, 2005).

In another study focussing on rotating savings and credit associations (ROSCAS) in Kenya, Gugerty (2001) found that social connectedness among the participants facilitated collective action by providing the necessary information to distinguish opportunistic from non-opportunistic behaviour. Her finding supported earlier network research by Uzzi (1996) who found that actors embedded in a dense network of social relationships were more likely to achieve cooperation. This helps explain why Gugerty found that internal sanctions in the Kenyan ROSCAS worked better than community-based social sanctions even though the former were not always effective in promoting timely repayment.

In recent years, the concept of social capital has been put forward to explain the voluntary cooperation of people in close-knit groups, communities and even entire countries[6]. The concept encompasses several features mentioned in the preceding paragraphs such as group identity, social sanctions, norms of reciprocity and participation in social networks. The ability of social capital to facilitate the voluntary cooperation of people has been explained by the presence of generalized trust based on social norms of reciprocity (Putnam, 2000); the presence of dense networks of civic engagement (Putnam, 1993); the establishment and adherence of norms by 'closed' networks among close-knit communities (Coleman, 1990); and the imposition of sanctions that discourage opportunistic behaviour (Portes & Sensenbrenner, 1993). These different aspects reflect the multifaceted nature of social capital.

[6] See Putnam, 1993, 2000; Knack & Keefer, 1997; Woolcock, 1998; Paxton, 1999; Woolcock & Narayan, 2000; Grootaert & Van Bastelaer, 2002.

However, the concept is burdened with an imprecise definition, multiple units of analysis and measurement indicators which have slowed its acceptance as a theoretical construct (Akcomak, 2009; Van Oorschot, Arts & Gelissen, 2006). In addition, there are lingering questions about the appropriateness of the term 'social capital' as a form of capital (Schuller, 2007; Sobel, 2002) despite some attempts to clarify its status as a form of capital (Bourdieu, 1986/1997; Lin, 2001). Then there are questions about its legitimate claim to causal linkages. Some scholars argue that research claims that link the presence of social capital with various positive outcomes such as better democracies and better economic performance are at best associational and at worst spurious (Durlauf, 2002; Portes & Landolt, 2000; Wong, 2004).

In spite of these shortcomings, the concept of social capital is particularly suitable for a study on cooperatives because their nature as member-based organizations implies the presence of associational features that can be examined under the concept. Furthermore, Valentinov (2004) has developed a social capital theory of cooperative organizations in which he argues that social capital is the major resource of organizations governed on the basis of cooperative principles. Thus, cooperatives depend on social capital in the same way that markets and hierarchies are based on price and authority relations respectively.

Valentinov (2004) refers to the notion of the 'dual nature' of cooperatives. According to this notion, the cooperative simultaneously exists as a social group (in the tradition of sociology and social psychology) as well as a joint enterprise, owned and managed by the members of the group. The sociological construct of a group means that the cooperative organizational structure exhibits a high degree of symmetric interdependencies among member-actors who participate fully in the production and decision-making functions of the enterprise. In contrast, capitalist firms exhibit asymmetric interdependencies where full participation of actors is limited to the production process and not to managerial decision-making.

Symmetric interdependencies in cooperatives imply that all members have an equal status and therefore the internal coordination and resource allocation in a cooperative will be primarily determined by the quality of interpersonal relations between its members. These interpersonal relations are also likely to exhibit features of social capital such as shared norms and values that promote trustworthiness (Valentinov, 2004). It is these features that provide a comparative advantage to cooperatives through lowered transaction costs (Guinnane, 2001; ILO, 2001) and more efficient social exchange (Fafchamps, 2006).

The concept of social capital therefore provides a suitable conceptual tool to explore the different associational features by which members of a cooperative achieve economic cooperation.

2.2 THE CONCEPTUAL COMPONENTS OF ECONOMIC COOPERATION

The premise of the conceptual framework is that economic action is embedded in social relations. This means that the sociological concept of the actor and economic action must first be considered. Second, economic cooperation takes place within a form of social organization: the concept of social structure is analyzed for this purpose. Third, economic action occurs within a relational context which presupposes a detailed analysis of the social interactions within the social structure. The concept of social capital is applied to this end. Finally, the concept of institutions deals with the assumption that economic cooperation takes place within a specific institutional context and economic and socio-political factors must be taken into account in the analysis of economic cooperation. These four concepts comprise the components of economic cooperation:

i. The concept of the actor and economic action.
ii. The concept of social structure (microstructure).
iii. The concept of social capital.
iv. The concept of institutions.

The concepts of the actor, economic action and microstructure are examined in this section while separate sections have been devoted to the concepts of social capital and institutions due to the large body of literature dealing with the two concepts.

2.2.1 Concept of the Actor

In this study, the actor is conceptualized as a person who is in interaction with others and the broader society. This study assumes that the actors are linked with and influence one another by virtue of the fact that they are all members of a particular credit cooperative. The sociological concept of actor is derived from Weber's treatise on social action. According to Weber, social action could only be so defined if it took into account the behaviour of others and was "thereby oriented in its course" (Weber, 1922/1968: 4). The concept of sociological actor has also been defined as "one who is immersed in and attentive to the social milieu" (Zafirovski, 1999: 616). The social milieu is not limited to the actor's immediate circle of interactions but can include the broader society as well. In this way, the sociological concept of the actor refers to the "actor-in-society" and is therefore a "socially constructed entity" (Smelser & Swedberg, 2005: 4).

A distinction is made between the actor in economic sociology, *homo sociologicus*, and the actor in economic theory, *homo economicus,* in terms of their motivations (Zafirovski, 1999: 600). The economic actor is assumed to be a "rational egoist" whose motivations are driven by pure self-interest (utility, money, profit). In contrast, the sociological actor is assumed to be a "complex and multidimensional social actor" whose motivations range from rational (self-interest) to non-rational (altruistic) in both economic and non-economic behaviour. Non-economic motives that may characterize the sociological actor are prestige, power, morality and justice. The study adopts the sociological concept of the actor which means a broad scope of motivations in both economic and non-economic behaviour.

The actor is also assumed to be a 'knowledgeable agent' capable of accounting for his action which arises from his deep understanding of the world in which he lives (Giddens, 1984). The

social actor draws upon this knowledge to produce and reproduce day-to-day social encounters. Drawing from the theory of structuration, the actor therefore engages in purposive action and can elaborate upon the reasons for his action. In this sense the actor should neither be regarded as a "cultural dope", whose actions can be explained only in terms of cultural dogmas nor as a mere prop of social relations (Thompson, 1989: 58).

2.2.2 Concept of Economic Action

The actor in the study engages in economic action as a form of purposive action. The focus of this section is to describe the sociological concept of economic action and outline the ways in which it was applied in the study. First, the concept of economic action in sociology may be explained in terms of both formal and substantive rationality (Smelser & Swedberg, 2005). This means that the rationality of economic action in sociology is not limited to the conventional maximization of utility under conditions of scarcity (formal rationality) but includes allocation that is guided by other principles such as communal loyalties or sacred values (substantive rationality) (Weber, 1922/1968). Thus, one of the study's assumptions was that economic action in the credit cooperatives was subject to formal and substantive rationality in keeping with the broad range of motivations of the sociological actor.

Second, the sociological concept of economic action involves the empirical investigation of the meaning that economic processes and objects have for human action (Smelser & Swedberg, 2005). Member participation in credit cooperatives was therefore not assumed to be the sole result of either individual preference or the outcome of financial market development. Instead, the researcher sought to actively interrogate the meaning of membership in the credit cooperative among its members. Furthermore, the analysis of constraints on economic action must take into account the active influence of other persons and groups on the individual actor as well as the influence of institutional structures (Smelser & Swedberg, 2005).

Third, the dimension of power is recognized in the sociological concept of economic action (Weber, 1922/1968). Weber explained that economic action involves the intentional exercise of power and so reflects the differential possession of power among individual actors. In this regard, the sociological concept of economic action differs from the traditional economic view which assumes actors have equal power and that perfect competition occurs under conditions of equality (Reinert, 2006). In addition, the sociological analysis of power is not limited to the market context but includes broader societal contexts such as the political and class contexts (Smelser & Swedberg, 2005). The implications of power were explored in the study through an analysis of power relations among members in the credit cooperative as well as an analysis of the institutional environment of credit cooperatives.

Finally, the sociological concept of economic action is based on the fact that the economy is considered to be an integral part of society (Polanyi, 1944). The interaction between the economy and the rest of society is therefore subject to sociological inquiry (Zafirovski, 1999). It also implies that the functioning of economic processes may be affected by changes in institutional and cultural parameters (Smelser & Swedberg, 2005). In the study, the institutional influences on economic action in the credit cooperatives were taken into account.

2.2.3 Concept of Social Structure

A social structure is conceptualised as the mode of organization through which economic cooperation is realized. In its most basic form, the sociological concept of social structure comprises "patterned social relations among individuals and groups" (Blau, 1964: 283). This concept has been developed to include the elements of social role and status. By status, Merton refers to "a position in a social system occupied by designated individuals" while role refers to "the behavioural enacting of patterned expectations attributed to that position" (1968: 423). According to Merton, the two concepts – social status and social role – are fundamental to the description and analysis of social structure.

Thus, social structure can be described as "the patterned and relatively stable arrangement of roles and statuses found within societies"[7]. The notion of social structure presumes a predictable pattern of organization, activity and social interaction between and within groups of people. The analysis of the social structure also tends to incorporate cultural norms and values which play an important role in defining and shaping social status and societal interaction (Parsons, 1949; Merton, 1968).

The sociological concept of social structure is derived from the functionalist paradigm which aims to provide explanations of the effective 'ordering' of social affairs exemplified by terms such as the status quo, social order, consensus, social integration and solidarity. The paradigm has generated a well-developed form of "regulative" sociology (Burrell & Morgan, 1979). Structural-functionalism regards the social structure as a relatively persistent and stable entity that exists independently of human action. The constraining qualities of structure over individual action are strongly emphasized (Blau, 1964; Merton, 1968; Giddens, 1984).

The concept of social structure was radically enhanced by Anthony Giddens' theory of structuration in which he diverged from the structural-functionalist image of structure as one with a fixed or mechanical character (likened to a skeleton or girders of a building). The aim of structuration theory was to bridge the paradigmatic dualism that existed between the role of the individual (actor) and structure in society. On the one hand, structural-functionalism regarded the structure as more important than the individual actor while on the other, interpretivism regarded the individual as more important than the structure.

Giddens (1984) chose to bridge this divide by suggesting that social structure was in fact a virtual "order" of transformative relations created by social actors who possessed knowledge in the production and reproduction of routine social encounters. He introduced the term "duality of structure" to explain that structure was both the medium and outcome of recursive action that

[7] This definition is from the Online Dictionary of the Social Sciences. http://bitbucket.icaap.org/dict.pl?alpha=S

was chronically implicated in the reproduction of social practices. The key contribution of the theory of structuration appears to be "the establishment of a kind of balance between structure and agency, micro and macro, environmental constraints and strategic choice" (Pozzebon, 2004: 268). Although the theory of structuration is often considered a meta-theory because of its high level of abstraction, it is often appropriated in social science research as a secondary theoretical foundation (Held & Thompson, 1989; Pozzebon, 2004).

The structural-functional concept of social structure still provides useful insights in the ordering of social association. For example, Blau's (1964) structural analysis identifies three aspects of social organization – integration, differentiation and organization. Integration arises from the notion that every functioning social structure represents a consensus of values among its members, originating from the work of Parsons (1949). Differentiation involves the different positioning of roles and statuses in the social system evidenced in distinct social strata (see also Blau, 1977). Organization involves the emergence of autonomy and centralized control including the use of coercive sanctions (Blau, 1964).

The sociological concept of social structure is often used in reference to large collectivities at the macro level. Blau (1964) provides an important distinction between micro and macrostructures. He uses the term "microstructure" to refer to the interrelations between individuals in a group and "macrostructure" to refer to the interrelations of these groups in a larger collectivity. The three aspects of social organization – integration, differentiation and organization – apply to both microstructures and macrostructures. This distinction is important to the study because credit cooperatives are conceptualized as microstructures that are operating within a larger macrostructure made up of diverse social groupings.

Social integration in microstructures is attributed to the existence of interpersonal relations while the integrative bonds of social solidarity in macrostructures arise from shared particularistic or cultural values (Blau, 1964). However, this is not to say that the bonds in a microstructure,

subsumed in the macrostructure, cannot reflect these values. The influence of cultural values must also be extended to microstructures. Differentiation in microstructures arises from intra-group status while differentiation in macrostructures arises from distinct social strata and intergroup mobility. Again, the same argument can be made that the status distinctions in a microstructure are likely to reflect the different social strata in a macrostructure. Thus, high status individuals in society are likely to occupy high status positions in microstructures. It is therefore likely that microstructures will demonstrate some of the features of macrostructures in the same manner that a community could be a microcosm of a society. Thus, integrative bonds, distinct social positions and a system of authority will be just as evident in a credit cooperative as they would in the broader society.

The notion of a microstructure is particularly useful to the study because it narrows the research focus to interpersonal relations within the group of members comprising a credit cooperative. However, the analysis of the microstructure is also extended to its association with external groups within society through an analysis of the institutional context. The next section focuses on the credit cooperative conceptualized as a microstructure in order to facilitate a sociological analysis of group relations.

- *The cooperative as a microstructure*

Lin (2001) categorizes social structures into organizations, associations and networks based on the presence of explicit rules that accord authority to certain positions. Thus, hierarchical formal organizations (firms, corporations, agencies) constitute formalized social structures. In the middle of the range are voluntary associations (Parent-Teacher Associations, clubs, cooperatives) which are formal organizations but less strictly hierarchical. Social networks represent an informal social structure because there is little or no formality in delineating positions and rules, and in allocating authority to participants.

Lin's notion of social structure implies an authority hierarchy which tends to have a pyramidal shape in terms of position distribution: the higher up the command chain, the fewer the number of positions and occupants. An important consequence of pyramid-shaped hierarchical structures is that comprehensive information is usually concentrated in the few positions and occupants at the top (Lin, 2001). Similarly, a position higher up in the hierarchy, by definition, can exercise authority over lower positions. How is this applied to the Kenyan credit cooperative?

Kenyan cooperative legislation (*Cooperative Societies Act of 2004*) outlines a structure that consists of three organizational levels of members. The general assembly of all members is the highest governing body of the cooperative and meets annually for a general meeting (AGM). It is governed by a set of by-laws which are ratified by the members and represent the constitution of the cooperative. A management committee (also referred to as board of directors), elected from the membership, is responsible for the implementation of general assembly resolutions through the formulation of operational policies. A supervisory committee, also elected from the membership, is responsible for ensuring regulatory compliance, internal control and oversight. The board of directors and the supervisory committee jointly constitute the routine governing body of the cooperative. Management employees are hired by the board of directors to oversee the implementation of policies and administrative affairs of the cooperative. Employees of the cooperative constitute the third level of members.

The credit cooperative can thus be depicted as a pyramid that consists of three tiers of positions. The positions are occupied by members who act in accordance with certain rules and procedures which guide social interactions among the positions. In this way, the differentiation of the positions is achieved by their different roles. On the basis of position distribution, the bottom tier comprises the general assembly of members while the middle tier is the management and administrative employees. The top tier consists of the board of directors. On the basis of power relations, however, the cooperative microstructure assumes the shape of an inverted pyramid. This is in recognition of the supreme decision-making powers of the AGM.

The conceptual model of the cooperative microstructure on the basis of position distribution (normal pyramid) is illustrated in Figure 2.1 below.

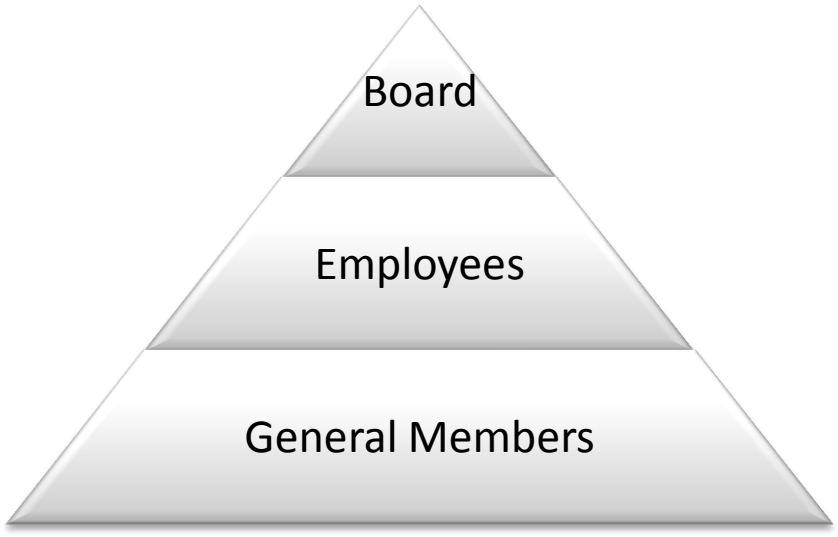

Figure 2.1: The cooperative microstructure

Although, in principle, the general assembly of members constitutes the highest decision-making authority in the cooperative, the practice is that the board wields considerable power in making decisions on behalf of the collective body of members (Niederkohr & Ikeda, 2005). The day-to-day running of the cooperative is left to the management which receives its mandate from the board. The management is also empowered to enforce contracts among members and may design operational policies that further guide its interaction with both the board and the general members. In Kenya, the apex position within management is the position of General Manager.

The position of board member enjoys a high status in the form of personal prestige and reputation which makes it a highly desirable position. Additional benefits exist in the form of access to privileged information on members, travel and training opportunities, and the payment of honoraria for voluntary service. As the number of board positions ranges from 5-9 members, further differentiation in terms of an executive committee and non-executive subcommittees is possible. The supervisory committee consists of three positions and is considered to be part of

the board of directors in the study. The interactions among the different levels of members in the credit cooperatives are analyzed with the help of the third conceptual component of economic cooperation – the concept of social capital – which is discussed in the next section.

2.3 THE CONCEPT OF SOCIAL CAPITAL

2.3.1 Definitions and Features

The concept of social capital has been widely applied in economics, sociology and political science[8]. Nevertheless, it remains a contested concept in terms of its definition, measurement and effects (Schuller, 2007; Reimer, Lyons, Ferguson & Polanco, 2008; Fulkerson & Thompson, 2008). It is associated with the social norms, networks and trust that facilitate cooperation within or between groups of people according to the Productivity Commission of Australia (PCA, 2003). Social norms can be defined as "shared understandings, informal rules and conventions that prescribe, proscribe or modulate certain behaviours in various circumstances" (PCA, 2003: 9). An underlying theme of reciprocity – do unto others what you would have them do unto you – is the foundation of most social norms (Putnam, 2000). This cultural norm facilitates a predictable and often beneficial behaviour pattern from individuals in society.

Social networks are interconnected groups of people who often have an attribute in common. The attribute could be informal family ties, membership in a voluntary organization or affiliation to a professional institution (PCA, 2003). Being part of a network provides individuals with benefits such as a greater pool of social support when needed, greater access to information (with lower search costs) and a wider range of opportunities (Putnam, 2000; Licht & Siegel, 2006). Network size, density and diversity have been regarded as positive indicators of social capital (Licht & Siegel, 2006). A distinction is made between dense and diffuse networks: dense networks facilitate and enforce group cooperative behaviour while diffuse networks are more useful for obtaining information (Sobel, 2002).

[8] A sample of studies includes Putnam, 1993, 2000; Knack & Keefer, 1997; Portes, 1998, 2000; Paxton, 1999; and Van Staveren & Knorringa, 2007.

Trust may be defined as the optimistic expectation or beliefs regarding the behaviour of other agents (Fafchamps, 2006). It has been construed to be both a measure and a source of social capital which has heightened confusion about its effects (Portes & Landolt, 2000). As a key component of social relations, Van Staveren and Knorringa (2007) argue that trust should not only be viewed in terms of its instrumental value (e.g. it is beneficial for economic efficiency) but as an intrinsically valuable quality.

The concept of social capital is premised on the idea that social networks can affect the productivity of individuals and groups in much the same way that physical capital (such as tools) and human capital (such as a college education) can increase individual and collective productivity (Putnam, 2000). However, the use of the term 'capital' is still contested by some economists due to the ambiguities of what has been invested in social terms (Schuller, 2007). Lin (2001) provides some clarity by referring to social capital as an investment in social relations that may have returns in the marketplace (Lin, 2001). However, the scope of social capital is not limited to the marketplace[9]. Investment in social relations is usually likely to occur over a period of recurrent activity among a group of individuals who then develop a shared knowledge and understanding characterized by norms, rules and expectations about the patterns of interactions (Ostrom & Ahn, 2007).

An instrumental view of social capital was first advanced by Bourdieu (1986/1997) whose theoretical treatment of the concept was based on the individual as the unit of analysis. He hypothesized that people intentionally invested in social relations for the benefits they would accrue later. He therefore defined social capital as the sum total of the actual or potential resources that were linked to membership in a group. These resources provided each member with the assurance of a "collectively-owned capital that entitled them to credit in its variety of forms" (1986/1997: 51). Bourdieu applied the economic notion of "fungibility" in which non-

[9] Other authors have extended the returns to better democracies, cohesive communities and economic development (See Putnam, 1993, 2000; PCA, 2003; Woolcock & Narayan, 2000).

material forms of capital could be transformed into tangible forms of capital (Portes, 2000). Thus, cultural capital (which is related to human capital) and social capital were convertible, in certain conditions, into economic capital and vice versa. The giving of a gift, for example, symbolized the conversion of economic capital into social capital and diluted the monetary significance as well as infused meaning into the exchange. Similarly, the acquisition of cultural capital over a period of time required economic capital to make it possible.

The notion that most forms of capital are fungible underlined Bourdieu's belief that economic capital was at the root of other types of capital. In a rather convoluted statement, he argued that non-material forms of capital such as cultural, social and symbolic capital were actually "disguised forms of economic capital which produce their most specific effects only to the extent that they conceal the fact that economic capital is at the root of their effects" (1986/1997: 54). Even so, he acknowledged the paradox that while an economic calculation lay behind every action, every action could not be reduced to an economic calculation.

A rational choice theoretical approach to understanding the concept of social capital was advanced by Coleman (1990) who based his development of the concept on small groups as the unit of analysis. He claimed that the productivity of groups could be explained by the presence of social mechanisms that promoted cooperative behaviour. Thus, social capital was created when the relations among individuals were transformed in ways that promoted collective action. He defined social capital as consisting of features of social organization that facilitate specific actions of individuals – whether persons or corporate actors – who are within the structure. These associational features include a system of obligations and expectations between individuals; information channels and exchange; the presence of norms and effective sanctions; authority relations; and the purposive creation of organizations to further collective interests.

Portes and Sensenbrenner (1993) extend and refine the idea of associational features by identifying four sources of social capital and their operating principles. The operating principles

of these four sources, which have been reconceptualised as associational features, provide a compelling logic of how individual behaviour can be influenced to facilitate collective action. In addition, they qualify as context-independent aspects of social capital that can be operationalized and measured in any group situation (Edwards & Foley, 1997). They also combine a principled and instrumental approach to social capital due to the recognition of cultural values and norms as an additional motivation to self-interest in securing benefits. The four sources of social capital and their associational attributes are discussed in the next section.

Portes (1998) asserts that it is important to ground the concept in its sociological context in order to establish the effects of social capital in social relationships. Several writers argue that this approach is conceptually stronger than approaches that use proxy empirical measures to determine the effects of social capital (Sobel, 2002; Schuller, 2007; Wong, 2004). My interpretation of the concept is therefore based on the tradition established by Bourdieu and Coleman who both emphasized the relational and qualitative nature of social capital. In addition, they identified the instrumental value of social capital as a source of individual benefits.

This study defines social capital as *an interrelated set of associational features which facilitate collective action and by which actors can secure individual benefits*.

2.3.2 Associational Features of Social Capital and Their Theoretical Roots

The four sources and operating principles of social capital identified by Portes and Sensenbrenner (1993) are rooted in processes of social interaction that can be explained by at least four sociological traditions. Specifically, the authors identify the theoretical contributions of Emile Durkheim, Georg Simmel, Karl Marx and Max Weber. This has led to the charge that the concept of social capital is really old wine in new wineskins because entire schools of thought in the sociological tradition have been devoted to identifying some of the associational features that underlie the concept (Portes, 2000). These were briefly captured in the literature review presented in Section 2.1.

A fifth operating principle was separately identified by the researcher and derived from the work of Pierre Bourdieu and Max Weber. These five associational features specifically target individual action in a group setting which makes them a suitable basis for a qualitative inquiry into the presence and effects of social capital in credit cooperatives.

- *Common set of values*

The first source of social capital is "value introjection" derived from Emile Durkheim's (1893/1933) treatise that claimed every society was a moral society because individuals were connected by a common set of values and beliefs. Parsons (1949) expounded this point by asserting that the analysis of human action could not be understood apart from a system of ultimate values. Even contractual law, expressed through formal contracts and economic transactions, had an "intrinsic morality" because it was based on a moral foundation (Durkheim 1893/1933: 228). Thus, groups that organized on a cooperative basis were not just economic groupings but were held together by a common set of beliefs. Portes and Sensenbrenner (1993) have interpreted this to mean that a common set of values and beliefs in society is achieved through a socialization process that establishes common beliefs by consensus.

According to Durkheim, the adherence to a common set of values and beliefs prompted individuals to act in ways other than plain self-interest e.g. to make concessions or to consider interests higher than their own. In this way, an individual's behaviour could benefit others in the group either through self-sacrifice or other altruistic goals. Durkheim's thesis remains central to the sociological perspective and gives a strong justification for the inclusion of values as a primary source of social capital (Portes & Sensenbrenner, 1993).

- *Reciprocity exchanges*

The second source of social capital is derived from Simmel's (1950) analysis of dyadic exchanges and gratitude as a motivation for reciprocity. Simmel asserted that "all contacts among men rest on the schema of giving and returning the equivalence" (1950: 387). His analysis distinguished between contractual and social exchanges: in contractual exchanges, the legal order enforces and guarantees the reciprocity of services rendered but in social exchanges, it is gratitude that supplements the legal order and ensures the reciprocity of giving and taking. Blau (1964) extends Simmel's analysis by asserting that exchange transactions are the basis of social interaction and must be analyzed in their own right in order to arrive at an understanding of the dynamics of social structures.

Simmel's analysis of dyadic exchanges was based on an ideal type consisting of two individuals who had rights and duties toward each other. Extending this idea to a group setting, the social life of the group is characterized by a variety of routine transactions where favours, information, approval, and other valued items are given and received (Blau, 1964). The accumulation of routine exchanges between members of a group generates the norm of reciprocity to regulate and limit the exchange transactions. According to Portes and Sensenbrenner (1993), the norm of reciprocity in exchange transactions forms the mechanism by which social capital is accumulated.

- *Bounded solidarity*

Karl Marx's analysis of the rise of proletarian consciousness and the transformation of workers into a social class is the basis of the notion of "bounded solidarity" which forms the third source of social capital (Portes & Sensenbrenner, 1993). The Communist Manifesto (Marx & Engels, 1848/1964) outlined the process by which the working class would take advantage of an internal solidarity that was initiated by a common awareness of capitalist exploitation and eventually emerge as the dominant class. According to Portes and Sensenbrenner (1993) this source of social capital arises out of a situational reaction of a group of people faced with a common

adversary. The collective response to a common problem forms the mechanism by which bonds of solidarity are built. They cite the example of strong solidarity bonds that emerge among immigrant and ethnic communities in the United States as a modern application of this notion.

- *Enforcement capacity*

The fourth source of social capital is "enforceable trust" which refers to the internal monitoring and sanctioning capacity of a group that enables disciplined compliance with group expectations (Portes & Sensenbrenner, 1993). This idea is derived from Weber's analysis of economically oriented action in which the economic considerations of an individual are secondary to the pursuit of other ends by the group. Portes and Sensenbrenner (1993) take this analysis to mean that individuals are capable of subordinating their present economic interests in anticipation of long-term market advantages that are available through their group membership.

Coleman (1990) attributed the existence of an internal group sanctioning mechanism to the "closure" of social networks. According to Coleman, closure was necessary for the development of effective norms in which failure to discharge obligations was subject to group sanctions. Portes and Sensenbrenner (1993) posit that predictable behaviour patterns among members are likely to be directly proportional to the group's sanctioning capacity. Thus, in the realm of economic behaviour, the authors argue that trust will exist "precisely because it is enforceable by means that transcend the individuals involved" (1993: 1332).

- *Representation*

A fifth source of social capital arises from the group mechanism of delegation and representation. The term "institutionalised social capital" was used by Bourdieu (1986/1997) to describe the common feature among most social groups to have an institutionalised form of delegation that authorizes a single agent or small group of agents to speak and act on the group's behalf. In this way, the delegated agents draw upon the collectively owned social capital and

exercise a power that is disproportionate to their personal contribution. His example of institutionalised social capital was a title of nobility which guarantees privileged access. He was quick to point out, however, that mechanisms of delegation and representation were not exempt from abuse of power that may lead to embezzlement and misappropriation of the accumulated capital. Instead, Bourdieu noted the paradox that effective social existence requires representation which carries a threat of embezzlement.

A similar point of view was earlier expressed by Weber (1922/1968: 46) who referred to the 'imputation' of social action through representation. In communal or associative relationships, the action of certain members (the "representatives") may be attributed to the others (the "represented"). Members then share the resulting advantages as well as the disadvantages. The power of representation may be delegated to the representatives, in accordance with specific characteristics and procedures either permanently or for a limited term. Imputation in closed social groups implies the passive mutual responsibility of the members exemplified in their acceptance of a representative's decisions as legally binding. Weber cites the example of the 'legitimacy' of decisions made by the executive committee of a voluntary association. In particular, representation may include powers over economic resources that are meant to serve the group's purposes.

The insights of Bourdieu and Weber are highly relevant to the management structures of Kenyan credit cooperatives. In this case, the institutionalised form of delegation and representation is the voluntary board of directors which is expected to operate with the management as a cohesive unit and ensure the best collective interest of the cooperative's members. Yet, the risks of representation are epitomized by challenges in attaining good corporate governance at the board and management levels of the cooperatives (Mudibo, 2005; Chavez, 2006).

A summary of the associational features and their characteristics is presented in Table 2.1 below. They formed the basis of the measures of social capital applied in the study. Further rationale for the use of these associational features is provided in the section on measuring social capital.

Table 2.1: Associational features of social capital

Associational feature	**Sociological origin**	**Orientation to economic action**	**Individual motivation for adherence**
Common set of values	Socialization processes that establish societal values and beliefs	Facilitates the formation of groups on a cooperative basis	Principled (non-economic)
Reciprocity exchanges	Routine social exchange transactions among actors	Norm of reciprocity regulates exchange transactions among actors who seek to secure benefits	Instrumental
Bounded solidarity	Collective consciousness and response to a perceived injustice	Facilitates the creation of groups to further member economic interests	Principled
Enforcement capacity	Internal group monitoring system outlining rules and conditions of membership	Facilitates the monitoring of agreements between actors to ensure compliance	Instrumental
Representation	Powers conferred on a small number of representatives to act in a group's collective interest	Delegation of certain decision-making powers over collective economic resources	Instrumental

Theoretical sources: Portes and Sensenbrenner, 1993; Bourdieu, 1986/1997; Weber, 1922/1968.

2.3.3 Factors Influencing the Effectiveness of Social Capital

- *Power relations, cohesion and equity*

The ability of social capital to facilitate cooperative behaviour may be affected by the social relations in groups. For example, the mechanism of delegated representation introduces power asymmetries that may lead to entrenched interests which affect the productivity of the group.

According to Van Staveren and Knorringa (2007), social structures inevitably incorporate power asymmetries that may result in potentially perverse effects such as exclusion, inequality and domination in and between groups of people. In addition, power asymmetries may exempt powerful individuals from social sanctions that would normally apply (Coleman, 1990).

Besides power, other elements of social relations such as cohesion, patronage, influence, trust, and sociability that characterize social interactions are likely to influence the creation, distribution and effectiveness of social capital. This diversity of social relations highlights issues of class, status and conflict nested in social structures that need to be considered in an analysis of social capital (Lin, 2001).

The literature on social capital often presupposes that social capital is accompanied by equity (Fafchamps, 2006). However, due to closure, formal associations and informal networks may indulge in discriminatory practices such as restricted entry, unrepresentative composition and the persistence of entrenched interests. Governments may sometimes need to provide incentives to protect equity through legislation (Van Staveren & Knorringa, 2007). In addition, closure within structures with role differentiation may lead to exclusionary practices such as collusion among firms in one industry (e.g. suppliers) or boycotts and embargoes among customer firms (Coleman, 1990).

- *Social position*

The ability to secure individual benefits through membership in groups was central to Bourdieu's conceptualisation of social capital. These benefits were either material benefits such as services that accrued from useful relationships or symbolic benefits that arose from being associated with a rare, prestigious group. According to Bourdieu (1986/1997), individuals who were lower down the social hierarchy tended to value these benefits because they were more threatened by economic and social decline. The history of the cooperative movement confirms Bourdieu's point: the Rochdale Pioneers were the founders of the modern cooperative society. They were a

group of 28 artisans working in the cotton mills of Rochdale town in the north of England. The cotton weavers faced miserable working conditions and low wages and could not afford the high prices of food and household goods. They decided to pool their scarce resources and work together to access basic goods at a lower price. This strategy was so successful that the modern cooperative society was born (Birchall, 1997). The point is further corroborated by Coleman (1990) who argues that there is greater potential for the creation of social capital when people extensively call on each other for aid. Thus, affluence may actually contribute to the destruction of social capital.

- *Access and capacity to utilize resources*

Edwards and Foley (1997) argue that the usefulness of social capital depends not only on the social location of the individuals and groups but also in their capacity to create, negotiate and appropriate it in much the same way that other forms of capital are differentially available. Thus, merely having access to social capital does not automatically translate into economic prosperity. Woolcock and Narayan (2000) provide evidence from the developing world that demonstrates why simply having high levels of social solidarity in the form of informal groups does not necessarily lead to economic prosperity. They refer to a World Bank participatory poverty assessment in Kenya that recorded over 200,000 community groups, most of which were unconnected to outside resources and were unable to improve the lot of the poor (see also Narayan, 1999). Similarly, indigenous groups in many Latin American countries are marked by high levels of social solidarity but they remain economically excluded due to the lack of resources and access to power that is necessary to shift the rules of the game in their favour (Woolcock & Narayan, 2000).

The uneven access to social capital that exists across societies leads Edwards and Foley (1997: 673) to boldly assert that "not all social capital is created equal". They illustrate their point with a case based on an employment analysis of two groups of low income inner city youth in the United States over a 10-year period. The predominantly white peer group had access to rich resources of social capital through family and neighbourhood ties that enabled them to easily

secure blue-collar employment. Despite this rich reserve of social capital, their long term employment prospects were diminished because the social capital they accessed embedded them more deeply in a declining sector of the economy.

By contrast, the African American peer group did not have access to comparable reserves of work, family or neighbourhood social capital. They therefore sought the human capital of getting an education and, over time, appropriated school-related social capital that helped improve their job prospects in the expanding service sector of the job market. Edwards and Foley (1997) conclude that there is a need to incorporate an analysis of the broader economic and socio-political context in which social capital is found in order to understand the effects of uneven access to social capital.

- *The broader economic and socio-political context*

In their comparative study of the cooperative movements in Denmark and Poland, Svendsen and Svendsen (2004) infer that the different political climate in the two countries may have contributed to the different outcomes for the respective cooperative movements. Prior to the Second World War, a well-organized cooperative movement based on trust and voluntary cooperation reflected valuable stocks of bridging social capital[10] in both countries. After the War, Denmark continued to follow a democratic path of economic development and the cooperative movement maintained a crucial role in the success of agriculture. In contrast, Poland experienced a totalitarian style of governance that first resisted the cooperative ideology and then controlled the movement leading to lower levels of voluntary cooperation and economic decline.

Svendsen and Svendsen (2004) further claim that the initial establishment of cooperative farmer networks in Denmark was dependent on the existence of three key elements: democracy, trust

[10] This term was popularized by Putnam (2000) and refers to inclusive networks that encompass people from heterogeneous groups. It is usually contrasted with bonding social capital which refers to exclusive networks made up of homogeneous groups.

and the equal possibility of making a profit. They posit that bridging social capital within the farmer networks acted as a production factor as it enabled local entrepreneurs to exploit economic incentives to provide collective goods (cooperative dairies). This led to marked improvements in infrastructure and contributed to economic growth in formerly poor rural areas. In the 1960s, however, the Danish cooperative movement declined following mergers of agricultural enterprises and the centralization of production. The decline was attributed to closures of cooperative dairies that had been the platforms of bridging social capital.

From a related perspective, Woolcock (1998) argues that the vitality of social networks and civil society is largely the product of the political, legal and bureaucratic environment. This means that a particular historical context and regulatory framework can strengthen or undermine the capacity of independent groups in civil society to organize in their own collective interest. Furthermore, the nature of state-society relations may determine the developmental prospects of social groups due to the willingness and capacity of the state to act in a developmental manner. This has a direct bearing on the combinations and consequences of social capital in any given society.

The socio-political setting in which social capital operates is therefore linked to the pace and outcomes of development. Woolcock (1998) asserts that the slow pace of the development process experienced in most of sub-Saharan Africa, South Asia and southern Italy can partly be attributed to socio-political environments where there is integration (intra-community ties) without linkages (extra-community networks). High levels of integration or strong intra-community ties are beneficial to the extent that they help create social capital. However, to be fully effective, high levels of integration need to be complemented by some measure of external linkage in order to ensure more sustainable and beneficial development initiatives.

The idea of linkages or extra-community networks has led to an additional dimension of "linking social capital" which seeks to highlight the potential linkages between individuals and groups in

different social strata in a hierarchy where power, status and wealth are accessed by different groups (Szreter, 2002). According to Szreter, the analytical category of linking social capital enables the critical interrogation of the nature of any institutionalized pattern of social relationships within a society that occurs in the context of manifest imbalances of power e.g. public-private; state-market; formal-informal; and rich-poor. Szreter suggests that an "optimal dynamic balance of bonding, bridging and linking social capital can simultaneously facilitate democratic governance, economic efficiency and widely-dispersed human welfare, capabilities and functioning" (2002: 580). The implications of the economic and socio-political context will be further explored in the literature review of the concept of institutions.

2.3.4 Measuring social capital

The conceptual ambiguity surrounding social capital has resulted in inherent difficulties in operationalizing and measuring it. Much of the ambiguity around social capital is derived from its imprecise definition and the application of different units of analysis ranging from individuals, groups, urban cities and rural communities, to entire countries (PCA, 2003; Portes, 2000). Consequently, a wide variety of measures or indicators have been utilized in empirical studies. These include: survey responses to questions about trust; evidence of associational memberships; the density of credit cooperatives (in developing countries); household or family characteristics; and voter turnout or adherence to civic norms (Paxton, 1999; Narayan & Cassidy, 2001; PCA, 2003).

Schuller (2007) argues that these conventional measures of social capital should be treated with caution due to the inadequate information they provide. For example, details of associational memberships (popularly used to measure social capital as civic participation) are of limited value if they are not embedded in an account of how the organizations function and what membership actually means. This point is illustrated by Van Staveren and Knorringa (2007) in their empirical study of entrepreneur networks. The authors found that conventional measures such as trust indicators, associational membership and civic norms did not generate an adequate understanding of how these networks related with one another. Instead, they found that context-

dependent questions that assessed what networks of entrepreneurs were actually doing to develop trust were more important than conventional survey questions on trusting attitudes.

Furthermore, studies of the social interactions in small groups or networks may provide more compelling evidence of social capital than studies that claim to link social capital with national trends due to the difficulty of aggregating social capital measures across different networks (Durlauf, 2002; Sobel, 2002; Schuller, 2007). In particular, insufficient theorization between indicators at the individual and aggregate levels in the social capital literature makes empirical studies prone to ecological fallacies (Van Oorschot, Arts and Gelissen, 2006). The ambiguity of the concept also limits its theoretical application in economic analysis which relies on variable precision and clarity (Durlauf, 2002). Thus, any inferences concerning the explanatory significance of social capital are rendered dubious at best.

The concern with the use of conventional measures of social capital appears to be the fact that they are proxy measures. This means that they tend to capture the potential and not the actual utility of the concept (Wong, 2004). Consequently, it is often unclear whether the effects associated with social capital are causal, associational or even spurious. Furthermore, Reimer et al. (2008) assert that their empirical research has revealed a weak relationship between available social capital and the use of social capital. They conclude that it cannot always be assumed that available social capital is fully utilized. This implies that there are causal limitations in studies that attempt to correlate the effect of social capital on socioeconomic variables such as economic performance or government efficacy (Durlauf, 2002; PCA, 2003). In addition, empirical studies tend to overlook pertinent contextual factors such as politics, history and the state in their analysis of national trends on social capital (Szreter, 2002). These points highlight the need for greater refinement between theory and measurement to avoid the use of questionable indicators of social capital (Portes, 1998).

In view of the foregoing, the researcher chose to use associational features that had clear theoretical roots as non-conventional indicators of social capital. The identification of five associational features also enabled a multi-dimensional assessment of the concept which has often been narrowly defined in terms of a single variable such as trust or associational memberships (Van Staveren & Knorringa, 2007). The multi-dimensional approach to social capital was informed by Narayan and Cassidy (2001) who dissect the concept into multiple dimensions/features that are then linked to specific measurable indicators. For the study, the five associational features were operationalized into specific observable indicators based on patterns of interaction between members of a credit cooperative. They are illustrated in Table 2.2 below.

Table 2.2: Social Capital Indicators for a Kenyan Credit Cooperative

Associational feature of social capital	**Observable indicator**
1. Common set of values	Presence of cultural values and norms that promote cooperative behaviour.
2. Reciprocity exchanges	System of peer guarantors (based on the practice of loan applicants using personal guarantees from fellow members as a form of security against default).
3. Bounded solidarity	History of the cooperative detailing the circumstances that led to its formation. Also, the presence of a strong group identity among current members.
4. Enforcement capacity	Specific mechanisms employed by the cooperative to enforce member agreements.
5. Representation	Democratic governance processes.

2.4 THE CONCEPT OF INSTITUTIONS

The concept of institutions comprises the last conceptual component of economic cooperation. Economic cooperation is considered to occur within a specific institutional context that is shaped by cultural, economic and socio-political factors. The purpose of examining institutions in the study is provided by the sociological concept of economic action in which the institutional environment is assumed to influence the economic action of actors. This section discusses the concept of institutions and broadly examines their implications for economic and socio-political development with a specific focus on African countries.

Institutions may be defined as the formal (governmental) and informal (non-governmental) social systems and their underlying values, rules, norms of behaviour and traditions that govern social relations (Kumssa & Mbeche, 2004). An alternative definition is "humanly devised constraints that structure political, economic and social interaction" (North, 1991: 97). These include both formal rules (such as constitutions, laws and property rights) and informal rules (such as sanctions, taboos, customs, traditions and codes of conduct) whose function is to structure incentives in political, social or economic exchange. These two definitions highlight two roles of institutions: they govern social relations at the macro level as well as define the incentive structure for economic exchange. These two roles have an impact on economic development.

2.4.1 Institutions and Economic Development

Formal institutions affect the performance of the economy by determining the costs of exchange and production as well as the opportunities in line with the constraints of economic theory (North, 1990). Economic organizations are thereby created to exploit these opportunities and as they evolve, they alter the institutional arrangements. North argues that institutional change happens incrementally rather than radically because actors in political and economic markets frequently make decisions based on incomplete information and subjective mental constructs that influence how they process the information they receive.

He compares the different outcomes of institutional change followed by the United States and many developing countries. The growth of the US economy in the nineteenth century was facilitated by an underlying institutional framework that persistently reinforced incentives for organizations to engage in productive activity. In contrast, many developing countries have pursued institutional change that overwhelmingly favours redistributive over productive activity, creates monopolies rather than competitive conditions and restrains opportunities rather than expands them (North, 1990).

To illustrate, most countries in sub Saharan Africa are rent-orientated economies around agriculture and mining (Hugon, 2004; Reinert, 2006). According to Hugon, these economies tend to be characterized by high fluctuations linked to the valuation of rent; weak linkages between labour remuneration and factor productivity; and distortions between production and consumption methods. The bulk of surplus capital (or rent) obtained from the primary sector and foreign aid is usually channelled into the importation of goods and services as well as recurrent expenditure such as public sector salaries and debt obligations, with hardly any left over for productive activities. The rent also tends to be predominantly monopolized by political elites who distribute it through clientelistic networks or transfer it outside the country in their private capacity. In this way, an imbalanced economic system that undermines productivity is perpetuated.

The relationship between institutions and economic productivity has also been discussed by Baumol (1968, 1990) in his analysis of the relationship between entrepreneurship and economic growth. Baumol (1990) links productivity with entrepreneurship and argues that institutions determine the distribution of entrepreneurial resources according to three categories – productive, unproductive and destructive entrepreneurship. Productive entrepreneurship involves activities that lead to wealth and net gains for society. Unproductive entrepreneurship involves activities that lead to wealth for a minority and are of questionable value for society such as innovative rent-seeking, which is a non-productive pursuit of economic profit.

Destructive entrepreneurship is manifested in activities that are parasitic and damaging to the economy and society such as warfare and mercenary activities.

Unproductive entrepreneurial activity such as rent-seeking slows down economic growth. Murphy, Schleifer and Vishny (1993) explore some of the reasons why rent-seeking or redistributive activities are so costly to economic growth. They argue that when more resources are allocated to rent-seeking, the lower incentives to produce result in a reduced output in the economy. This means that the returns to production may fall faster than returns to rent-seeking. Rent-seeking activities therefore tend to exhibit increasing returns and may become self-sustaining. Secondly, they argue that public rent seeking (by government officials in particular) may discourage innovative activity and hence sharply reduce the rate of economic growth.

The reasons provided by Murphy et al. (1993) are supported by a recent study on corruption, firm growth and export propensity in Kenya (Kimuyu, 2007). The study found that corruption reduces the ability of manufacturing firms to grow and compete in external markets. It also undermines firm growth, reduces returns on investment and denies the economy employment and wealth creating opportunities. Kimuyu concludes that the dynamism of private enterprise in Kenya is constrained by systemic corruption with negative implications for economic growth. Systemic corruption may thus be likened to Baumol's destructive entrepreneurship.

Based on the foregoing, it is not surprising that economic under-development in sub-Saharan Africa has often been explained in terms of inefficient and unproductive institutions (Geda, 2006; ECA, 2005; Kumssa & Mbeche, 2004). Indeed, it has become "conventional wisdom" to say that "institutions are the critical variable in development" (Fukuyama, 2005: 29). Yet, Fukuyama argues, it is not always acknowledged how difficult it is to integrate aspects of institutional development such as the design and management of public administration systems; political system design and its basis of legitimization; and informal norms, values and culture.

These aspects deserve equal recognition because they influence development outcomes (Sen, 1999).

2.4.2 The Need for Effective State Institutions

The state is an essential institution for economic development. Its role is to provide public goods and services; design formal rules that regulate social relations; and ensure the efficient allocation and equitable distribution of resources to enhance the welfare of the people (Kumssa and Mbeche, 2004). The authors note the experience of several East Asian countries, such as South Korea, Taiwan and Singapore, in fulfilling these key functions which affirms the role of well-functioning governments in promoting economic growth and reducing poverty. The authors also point out the importance of supportive socio-political bases that enabled the governments in these countries to implement effective and coherent development strategies.

In contrast, governments in a number of African states have had little impact on sustained economic development. Their inability to provide secure property rights; an independent judiciary that arbitrates and enforces contracts; and an efficient bureaucracy in addition to the occurrence of widespread corruption have all contributed to an unfavourable investment climate that undermines long term investment. Furthermore, the disproportionate use of government expenditure on non-productive channels such as the military, a bloated public service and non-performing state enterprises diverts resources from productive capital investment and much-needed social services like health and education. Finally, many African governments have alienated rather than consolidated their socio-political bases leading to exclusion and internal conflict (Odhiambo, 1988; Kimenyi, 2002; Kumssa & Mbeche, 2004).

Qian (2003) argues that the unilateral approach adopted by Western agencies and donors to "get institutions right" among developing and transition states tends to confuse the goal (best practice institutions) with the process (how to get there). The governments of developing and transition countries are often faced with a long list of recommendations for institutional reform reflecting

benchmarks of best practice institutions found in the developed economies. This approach tends to ignore unfamiliar "transition paths" that connect the starting point (institutional deficiency) and the goal (best practice institutions) (Qian, 2003: 304). Qian's point is corroborated by Block and Evans (2005: 508) who argue that the logic of global neo-liberalism has imposed a kind of "institutional mono-cropping" which restricts the possibilities for institutional innovation in developing countries.

Beyond institutional reform, state competence and capacity at the macro level is closely associated with sustainable economic development (Woolcock, 1998; Fukuyama, 2005; Stern, Dethier & Rogers, 2005). Fukuyama (2005) describes how the austerity measures imposed by international financial institutions on many sub-Saharan countries had an unintended and counterproductive effect by causing a contraction in state capacity. He explains that the neo-patrimonial regimes that characterized many of these countries were often threatened by the existence of 'Weberian-style' bureaucracies which were their main competitors for resources. As a result of their ultimate political dominance, neo-patrimonial regimes used donor conditions as excuses to cut back on modern state sectors. Thus, investment in basic infrastructure and services declined dramatically over a twenty year period (1980-1990s) and had negative consequences on development.

2.4.3 Institutions and their Socio-Political Context

Many authors acknowledge the close relationship that exists between political stability and economic development (Sen, 1999; Stern et al., 2005; Geda, 2006; Korten, 1990; Woolcock, 1998; UNDP, 2005). Yet, a persistent feature of several African countries is a crisis of legitimacy and credibility in political governance (Odhiambo, 1988). The crisis of legitimacy is often reflected in electoral processes that are marred by irregularities and whose results are sometimes contested[11] while the credibility crisis often relates to the prevalence of high levels of corruption and insufficient measures taken to deter the practice. A critical analysis of socio-

[11] A case in point is the 2007 elections in Kenya.

political factors is therefore important in understanding the role of institutions in economic development (Hugon, 2004).

Poor governance that results in political instability and ethnic conflicts in some African countries can be attributed to the monopolization of political power by one ethnic group, skewed redistribution of resources, social exclusion policies, undemocratic electoral processes, violation of human rights, vast income inequalities and widespread corruption and nepotism (Kumssa & Mbeche, 2004). The concepts of 'good governance' and 'participative democracy' are also perceived by some African governments to be imposed by Western donors and governments. The slow implementation of these concepts through institutional reform can be explained by the fact that most of the reform measures are in direct conflict with the interests of the ruling elite (Miruka, 2007). In addition, many political and economic reforms in these countries are undermined because they are pursued under conditions of weak or inexistent institutions (Woolcock, 1998; Fukuyama, 2005). A case in point is Somalia which qualifies as a 'collapsed state' despite regional[12] attempts to install an elected government and establish the rule of law.

Bratton (2007: 98) identifies three informal political institutions that seem especially relevant to establishing democracy in Africa: "clientelism, corruption (defined as the misuse of public office for private gain), and 'Big Man' presidentialism". He claims that in a number of African countries, formal political institutions (such as adherence to a constitution and regular election processes) appear to be so closely interwoven with the informal institutions as to create a hybrid system of neo-patrimonial rule. Using multiple-year survey data to assess the institutionalization of democracy in eighteen African countries, Bratton reports that informal values and patterns of behaviour continue to shape African citizens' orientations towards their respective polities. Thus, citizens assess the quality of democracy in their own countries based on their perceptions of trust in the Big Man president (who personifies the government and the political regime) and the distribution of material benefits either to loyal clients (seen to be legitimate) or predominantly to political elites (a form of corruption).

[12] African Union and the Inter-Governmental Authority on Development (IGAD).

The impact of an over-concentration of political power in the institution of the presidency is well illustrated by Kumssa and Mbeche (2004) who cite examples from the three East African countries. In Uganda, the dramatic economic decline experienced during the reign of President Idi Amin was directly attributed to his destructive policies that included the arbitrary expulsion of Indian capitalists. In neighbouring Tanzania, policy implementation based on the socialist ideology of President Julius Nyerere was not accompanied by an accountable and transparent government bureaucracy or the emergence of a vibrant civil society. Finally in Kenya, President Moi's populist approach to public policy failed to deliver feasible policies and his authoritarian rule encouraged corruption and the abuse of power which led to a political and economic crisis in the country.

In Kenya, a colonial legacy that created and reinforced localised and ethnic-based clientelism has resulted in a history of strong patron-client networks in the Kenyan political system (Mboya, 1963; Leonard 1991; Orvis, 2006). Leonard (1991) distinguishes between associational politics and patron-client politics. Associational politics groups those with a common interest and results in the direct representation of these interests by large or powerful groups in society. In contrast, patron-client politics brings together people with dissimilar interests except for common kinship ties. Patron-client politics tend to mask the interests of the multitude, who constitute the clients, because they are represented by privileged patrons, whose personal interests may be markedly different from those of their followers.

Associational politics usually result in the creation of "public goods" or policies that serve the interests of the most powerful groups while patron-client politics favour the creation of "private goods" in the form of discrete products and services that can be redistributed to individuals through clientelist networks (Leonard, 1991: 81). Patron-client politics may also create public goods that further enhance the personal wealth of the patrons and which they subsequently draw upon to maintain their clientelist networks. Leonard (1991) concludes that a mixture of the two political systems in Kenya has led to the systematic marginalization of the interests of poor rural

and urban citizens who have neither the resources nor the capacity to organize themselves into powerful lobbies.

In summary, the socio-political context, state competence and capacity, and the ability of formal institutions to foster economic productivity are some of the factors that are important in understanding the institutional environment of economic cooperation. The next section narrows down the focus to the specific interactions between Kenyan credit cooperatives and their institutional context. It presents a conceptual model that seeks to explain the attainment of collective economic action in terms of linkages between micro-level actors and macro-level institutions.

2.5 A CONCEPTUAL MODEL OF ECONOMIC COOPERATION

Cooperatives are formal entities and are subject to formal rules that structure economic exchange. The formal institutional realm is represented by the economy in which credit cooperatives assume identity as economic organizations. The informal institutional realm represents the socio-political setting which defines the informal rules that govern relations between the state and the cooperatives. The cooperatives function as social organizations in the informal institutional realm because they involve specific groupings in society e.g. rural farmers or urban employees. The institutional realm is therefore conceptualized as a space in which formal and informal rules facilitate, motivate and govern economic actors – both individuals and organizations – as they pursue their economic interests (Nee, 2005).

The formal rules define the incentive structure for economic organizations by imposing constraints through state regulation and market mechanisms that shape the way economic organizations compete for survival and profits (Nee, 2005; North, 1990). Economic organizations may engage in lobbying action to seek changes to the formal rules in order to better align them with their interests. Nee argues that the definition of institutions needs to acknowledge the role of actors because they are the ones who pursue real interests in concrete

institutional structures. Thus, institutions encompass "socially constructed arenas" in which actors actively identify and pursue their interests (Nee, 2005: 65). This definition implies that institutional change involves not just the amendment of formal rules but a broad realignment of economic interests and power.

The conceptual model of economic cooperation in credit cooperatives (see Figure 2.2 below) consists of three interrelated levels representing the macro-level institutional realm (formal and informal rules); meso-level economic organizations (cooperatives); and micro-level actors (members of the cooperatives). The formal rules consist of state regulation and market mechanisms that define the incentive structure for the credit cooperatives and are depicted by a downward arrow to the credit cooperatives in the conceptual model. The informal rules are defined by the socio-political setting which describes cooperative-state linkages. The informal rules exert an influence on the economy by determining the alignment of economic interests and political power.

The cooperatives respond to the defined incentive structure by ensuring compliance to the formal rules. They may also engage in lobbying action that seeks to influence changes to the formal rules in ways that better serve their interests. Compliance and lobbying action are depicted by an upward arrow toward the formal institutional realm or the economy. As economic organizations, credit cooperatives represent an avenue for collective action by organizing and facilitating the economic interests of their members. The cooperatives monitor the economic action of their members and enforce their agreements. These two roles are depicted by a downward arrow toward the individual members. The monitoring role of credit cooperatives is done in close association with the members because of the personal guarantee system that provides surety for members' loans.

Individual actors (credit cooperative members) engage in collective action with the help of the associational features of social capital. They also participate in providing governance because

cooperatives are member-owned organizations and governance is the joint responsibility of all members. Collective action and governance are depicted by an upward arrow from the members to the cooperatives. The conceptual model depicting the relationships between the institutional realm, credit cooperatives and individual members is illustrated in Figure 2.2.

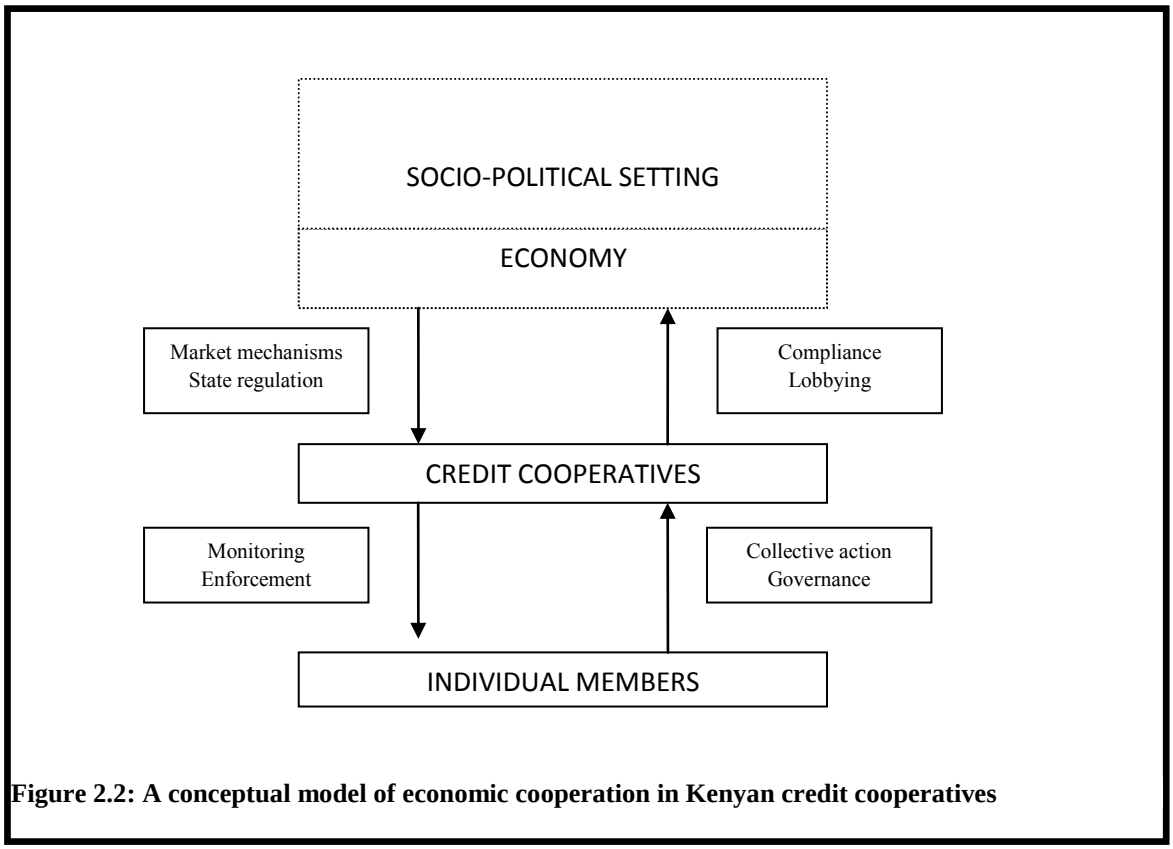

Figure 2.2: A conceptual model of economic cooperation in Kenyan credit cooperatives

Conclusion

This chapter began with a general definition of economic cooperation as the explicit or implicit objective that voluntarily brings people together to meet their economic interests. In the study, economic cooperation was conceptualised as collective economic action that enables individual actors to secure economic benefits through associational membership. Four conceptual components of economic cooperation were discussed. These were: the actor who is in interaction with others and engages in economic action; social structure that represents the mode of organization by which cooperation occurs; social capital consisting of five associational features that facilitate collective economic action; and institutions that define the incentive structure for economic actors and govern cooperative-state relations.

The chapter introduced the analytic model of the cooperative microstructure to enable a sociological analysis of group relations among members of the credit cooperatives. The cooperative microstructure was depicted as a pyramid that consists of three tiers of members: general members, employees and board of directors. In terms of position distribution, the cooperative microstructure takes the form of a normal pyramid but assumes the shape of an inverted pyramid in terms of power relations. This inversion is in recognition of the supreme governing authority vested in the general assembly of members.

Social capital was conceptualised in the study as an interrelated set of associational features which facilitate collective economic action. Five features were identified from the sociological literature. They were common values, bounded solidarity, reciprocity exchanges, enforcement ability and representation. These features were operationalized into observable indicators based on interaction patterns of the cooperative membership. In this way, a link between theory and measurement was established. Institutions were conceptualised as a space in which formal and informal rules facilitate, motivate and govern economic organizations and individual actors as they pursue their interests.

A conceptual model of economic cooperation was developed to specify and explain the nature of interaction between individual members, their cooperatives and the institutional realm. The model therefore achieves a micro-macro transition by linking the economic action of individual members with the formal and informal institutional realm. This link is important in seeking to understand institutional influences on individual and collective economic action. The empirical application of the conceptual framework began with the identification of an appropriate research methodology for the study which is the subject of the next chapter.

CHAPTER 3

NOTES ON METHODOLOGY

The purpose of this chapter is to provide an account of the methodological framework that guided the study. The chapter begins with a brief reflective account of the epistemological basis of the study and then states the philosophical and methodological assumptions associated with the constructivist paradigm. A justification of the case study research design is then presented followed by a narrative account of the data collection procedures employed in the study. The penultimate section deals with the analytic approaches and techniques applied in the study. The chapter concludes with a summary.

3.1 AN EPISTEMOLOGICAL JOURNEY

I started my career as an assistant research scientist firmly ensconced in the positivist paradigm as a result of my undergraduate training in biology. I unquestioningly accepted that there was a single concrete reality which could be objectively determined through experimental means and explained by causal laws. The positivist researcher was a "neutral" observer who "discovered" knowledge with the help of quantitative methods and paid close attention to conventional benchmarks of rigour such as internal and external validity. The material nature of reality meant that it operated independently of social forces affecting human activity and therefore there was no place for individual values, opinions, attitudes or beliefs in the knowledge accumulation process. The researcher was expected to present the study results with minimal literary devices, adopting the detached voice of a professional scientist (Day, 1995; Neuman, 2006).

Two years later, I embarked on a Masters programme in environmental science which introduced me to a broader realm of science as natural and social sciences converged in the weighty considerations of environmental policy-making processes. I subsequently adopted a post-positivist or critical realist stance in the social sciences which acknowledges "multiple perceptions about a single mind-independent reality" (Krauss, 2005: 761). Thus, critical realism

does not just assume a shared subjective understanding of the empirical world (like positivist science) but goes ahead to probe the content of this intersubjectivity by investigating the thoughts, beliefs and ideas of social actors. As a result, critical realism accommodates the use of both qualitative and quantitative methods and is also cognizant of values, both of human systems and of researchers. I enjoyed grappling with social issues enough to precipitate a professional shift to the social sciences. This led to new career prospects as a social development practitioner working with rural communities and identifying issues for policy research and advocacy. My experiences with local communities gradually taught me that, contrary to my expectations of being an expert by virtue of my advanced scientific training, the local people were invariably more knowledgeable about their situation than I could ever hope to be and I was the one with a lot to learn from them.

I began to realize that a developmental mindset that saw local people as predominantly ignorant and expected them to be passive recipients of new ideas and technologies was fundamentally flawed. Instead, it was more constructive to view development as a process of facilitating and negotiating ideas among local communities for positive change. In this alternative view, local people comprised knowledgeable actors and the development process consisted of shared learning and understanding between the facilitators of new ideas and the local people who adopted and adapted the ideas to better suit their conditions. The change in mindset was part of an organizational strategic review which presented critiques of prevailing development practice and generated lively debate on the deconstruction of development. I am indeed grateful to the progressive non-governmental organization with which I was working for actively encouraging self-reflection and providing the space for experiential learning.

The central place of the actor and the relativity of experiences in the development process predisposed me towards the constructivist paradigm. This is because the relativity of development experiences represented multiple constructions and interpretations of reality among different development actors. I became motivated to study the unique experiences of people participating in self-sustaining local development initiatives (as opposed to non-governmental

initiatives that are often dependent on foreign aid) that were making a significant contribution to economic and social development. After a few false starts, I finally settled on savings and credit cooperatives which are jointly-owned and democratically controlled by their members. The idea of collective pooling of economic resources is neither indigenous nor new to Kenyans. Nonetheless, a combination of political, economic and social factors has played a role in promoting the growth of that idea into Africa's largest credit cooperative movement. I was curious to find out how that combination of factors could explain the phenomenon of economic cooperation and this constituted the subject matter of the study.

I myself have been a member of two credit cooperatives and even been privileged to serve on the management committee of one of them. I have personally benefited from the savings and credit facilities of the cooperatives and I can attest to their unrivalled contribution to the social and economic welfare of their members. I therefore embarked on the study as an 'interested observer' who sought to provide an interpretive account of members' experiences that could enhance the heuristic understanding of economic cooperation.

3.2 A CONSTRUCTIVIST PERSPECTIVE

The constructivist paradigm is an interpretive approach to social science that is concerned with how people interact and get along with one another. It aims to provide a "holistic understanding and interpretation of how people create and maintain their social worlds" (Neuman, 2006: 88). It obliges the researcher to take on a relativist ontology which assumes multiple realities: an external reality that is independent of human volition and cannot be wished away; an experiential reality which consists of the varied individual interpretations of the external reality; and a subjective reality that is constructed through socialization processes (Berger & Luckmann, 1966; Stake, 1995). This view is contrasted with positivist sociology in which social phenomena only consist of an independent and objective existence. The constructivist view draws on a social constructionist orientation towards social reality which assumes that the interactions and beliefs of people fundamentally shape what reality is for them (Neuman, 2006).

A constructivist perspective is based on the premise that knowledge is socially constructed rather than discovered. Our understanding of the social world is created from our experience and from socialization processes, not by discovering knowledge "whirling there untouched by experience" (Stake, 1995: 100). For that reason, the researcher and her participants jointly contribute to the construction of knowledge (Creswell, 1998; Guba & Lincoln, 2005). A subjectivist epistemology results in a narrative that reflects the researcher's own interpretation as well as the interpretations of the participants. The nature of knowledge produced in this way has been described as "individual or collective reconstructions coalescing around consensus" (Guba & Lincoln, 2005: 194).

The axiological assumption of the constructivist paradigm recognizes the research process as value-laden and subject to bias (Creswell, 1998; Guba & Lincoln, 2005). Unlike positivist social science which eschews values in the research process, constructivism views values and the search for meaning as an integral part of the social world. It obliges the researcher to reflect on and analyze personal points of view and feelings as part of the process of studying others (Merriam, 2002). This should enhance the researcher's ability to better understand participant frames of reference or value commitments which is required for an interpretive understanding of social action. In addition, the researcher adopts the position of relativism with regard to values (Neuman, 2006; Stake, 1995).

The rhetorical assumption of constructivist research allows the researcher to take on the voice of a "passionate participant" who facilitates "multi-voice reconstruction" (Guba & Lincoln, 2005). The language of the study may include the use of metaphors and narratives. Definitions may also evolve during the study rather than being defined by the researcher at the outset of the study because they are derived from terms identified by participants. A distinct set of 'trustworthiness' criteria are used to assess the validity of the research. In the following list of criteria, the traditional measures of scientific rigor have been shown in parentheses. They include credibility (internal validity); transferability (external validity); confirmability (objectivity); dependability

(reliability) and authenticity or fairness in representing all stakeholder views (Creswell, 1998; Guba & Lincoln, 2005; Merriam, 2002).

Finally, the methodological assumptions orient the research towards naturalistic procedures that require the researcher to examine events as they occur in their real-life context (Neuman, 2006). The use of multiple methods is encouraged to promote an in-depth understanding of the phenomenon under study (Denzin & Lincoln, 2003). The design of the study is emergent and responsive, with progressive focussing of emic issues, and its reporting aims to provide vicarious experience (Guba & Lincoln, 2005; Stake, 1995).

3.2.1 Implications for the Study

The researcher was specifically interested in examining how associational features, which arise from social processes of interaction, enhance economic cooperation. A constructivist approach to the investigation acknowledges people's volition and their ability to make conscious decisions to engage in cooperative activity. Thus, membership in a credit cooperative consists of meaningful social action that is amenable to qualitative inquiry. In this regard, social action is action to which the actor attaches subjective meaning and is oriented towards the activities of other people (Weber, 1922/1968). A qualitative inquiry implies the consideration of the social actor's reasons and motivations as well as the social context of action (Neuman, 2006).

A relativist ontology calls for the researcher to provide evidence of different perspectives through the use of participants' quotes and themes. Denzin and Lincoln (2003: 9) liken the researcher to a quilt-maker who "stitches, edits and puts slices of reality together" in a way that captures the different voices, perspectives and points of view going on at the same time. The distinct roles and diverse personalities epitomized by ordinary members, employees and governing representatives provide the different perspectives of social reality that characterize each cooperative. The qualitative case researcher takes on the chief role of an interpreter who

aims to thoroughly understand the case and preserve the multiple realities in her presentation (Stake, 1995).

A subjectivist epistemology requires the researcher to lessen the distance between herself and the participants in order to gain an insider's view (Creswell, 1998). This implies the use of ethnographic techniques in the study of the cooperatives. The collection of empirical materials is therefore field-oriented and non-interventionist. The naturalistic nature of the inquiry reflects a holistic approach by accepting the complexity of its real-life context. In particular, the researcher acknowledges that understanding the phenomenon of economic cooperation requires examining a wide sweep of contexts including temporal, spatial, historical, political, economic and socio-cultural contexts (Stake, 1995). This point was incorporated in the research design.

The aim of a qualitative inquiry adopting a constructivist perspective is to promote understanding by providing a reconstruction of the research participant's social world. In the study, the reconstruction consists of a detailed description of associational features based on member accounts of the interaction patterns within each cooperative. The description is guided by concepts but contains limited generalizations (Neuman, 2006). The interpretive approach to building theory of social reality is therefore idiographic and inductive. The study aimed to generate knowledge through an informed reconstruction that would provide readers with sufficient material for their own generalizing (Guba & Lincoln, 2005; Stake, 1995).

3.3 THE RESEARCH DESIGN

3.3.1 Qualitative Case Studies

The qualitative case study can be defined as an "intensive, holistic description and analysis of a single entity, phenomenon or social unit" (Merriam, 2001: 34). The unit of study (the case) consists of a complex and functioning system that is intrinsically bounded by time and space (Stake, 1995). The two cooperatives that served as the cases in the study satisfied this

requirement. The overall intent of the study guides the selection of the case(s). Thus there are exploratory, descriptive and explanatory case studies (Yin, 1994) or descriptive, interpretive and evaluative case studies (Merriam, 2001). I chose to do an interpretive case study in which descriptive data were used to illustrate and refine conceptual categories that had been developed prior to the collection of data. Interpretive case studies are differentiated from basic descriptive case studies by their in-depth analysis and theoretical orientation.

The strengths of the qualitative case study as a research design are elaborated by Merriam (2001). First, the case study design offers a means of investigating multiple variables of potential importance in understanding the phenomenon of interest. My investigation of the sociological factors that enhance economic cooperation led me to consider multiple variables ranging from shared values and organizational culture to perceptions on cooperative leadership and enforcement mechanisms. The holistic description that characterizes the qualitative case study attempts to illustrate the complexities of a phenomenon by including as many variables as possible and portraying their interaction over a period of time. The variables of the phenomenon under study are usually inseparable from their context and Yin (1994) asserts that the case study design is well suited for studies where the focus is on a contemporary phenomenon within its real-life context. The case study may therefore include an embedded analysis of the political, social, economic or historical contexts.

Second, the qualitative case study design permits an in-depth inquiry into a research issue with careful attention to detail, context and nuance (Patton, 2002). Qualitative case studies are therefore particularistic, with a specific focus on understanding the phenomenon under inquiry. Cases are selected on the basis that they can offer useful manifestations of the phenomenon. For that reason, a purposeful sampling strategy is usually employed in the selection of cases. The application of a purposeful sampling strategy means that the qualitative case study design is not suited for empirical generalization (Stake, 1995). Instead, the design aims at insight and in-depth understanding about a phenomenon and not empirical generalization from a sample to a

population (Patton, 2002). Therefore, the qualitative case report seeks to represent the case rather than to "represent the world" (Stake, 2003: 156).

Third, the qualitative case study design possesses a heuristic ability which arises from its overall aim to offer insight, discovery and interpretation. As a result of their richly descriptive analyses, qualitative case studies tend to illuminate the reader's understanding of the phenomenon under study. Merriam (2001) argues that the knowledge learned from case studies is likely to resonate with the reader's own experience, thereby enhancing their interpretation and understanding. This is because the descriptive analysis of the case study is rooted in context which is more vivid or concrete than the abstract, formal knowledge derived from other research designs. The insights obtained from case studies may be construed as tentative hypotheses which can help shape future research. The case study design can therefore play an important role in advancing the knowledge base of a field of study. In addition, the potential applicability of the case study findings may be enhanced if the case researcher adopts an evaluative role in which careful attention is given to the case's merits and shortcomings (Stake, 1995; Merriam, 2001).

3.3.2 An Embedded Multiple-Case Design

A multiple-case design in case study research is usually preferred because the evidence from multiple cases is considered more compelling and the overall study is therefore considered to be more robust (Merriam, 2002; Yin, 1994). Each case in a multiple-case design should serve a specific purpose within the overall scope of inquiry. Yin (1994) refers to a replication logic in which multiple cases serve as complete studies in themselves and the findings of each case either yield similar results (literal replication) or contrasting results (theoretical replication) for predictable reasons. Although Yin writes from a post-positivist perspective in which theoretical propositions are developed prior to data collection, his rationale for a replication logic still holds for inductive inquiries. For example, qualitative case studies may rely on 'sensitizing concepts' or evaluative criteria to focus the inquiry and guide the analysis. The findings may then be used to develop analytical inferences that can be generalized to other cases or concepts (Merriam,

2002; Patton, 2002). In the study, the sensitizing concepts were social capital and institutions; the qualitative inquiry sought to investigate their role in enhancing economic cooperation.

The logic underlying the use of a multiple-case design for the study was a literal replication. Yin (1994) recommends a minimum of 2-3 cases for literal replications. In addition, an embedded design was incorporated to the two cases by including several subunits of analysis. The subunits included the cooperative microstructure; economic context (comprising the financial landscape, cooperative sector and the economic sector of each case); socio-political context; and the historical context of cooperatives in Kenya. An embedded multiple-case design is both time-consuming and expensive to conduct and the available resources were sufficient for only two cases during the fieldwork phase. The fieldwork was conducted over a period of five months from July to November 2008.

3.3.3 The Choice of Cases (Study population)

The qualitative inquiry sought to understand the meaning of economic cooperation from the perspectives of the cooperative members so it was important to select cases that could potentially offer the most insights about cooperation. Patton (2002) refers to 'information-rich' cases which can be identified using several different strategies of purposeful sampling. I chose to employ an intensity sampling strategy whose logic was to identify above average examples of cooperation based on documentary analysis and interviews with technical consultants who had interacted with the potential sample of cooperatives. In addition, I introduced heterogeneity in the sampling by selecting a rural and an urban credit cooperative. The rural credit cooperative was agriculture-based while the urban credit cooperative was employee-based. These two types represent the typical categorization of Kenyan credit cooperatives by the Ministry of Cooperative Development and Marketing (MoCDM, 2008a).

An important selection criterion for the cases was that they had to be formal entities which enhanced access to information from a variety of sources. Using formal structures helps to

strengthen the research findings by enabling comparisons between cases in the domestic and the international context. Formality was assessed by the presence of legal registration and the explicit articulation of economic objectives, cooperative values and principles. The cases had to be at least five years old and reasonably established. Lastly, and most importantly, they had to be offering the required financial services (savings and loans). I enlisted the help of a technical agency that was working with a national sample of credit cooperatives in a capacity-building programme. In reality, I found that purposeful sampling was constrained by the available sample of cases which was narrowed down to five cooperatives from an initial group of eleven.

Furthermore, the period of fieldwork occurred soon after the devastating post-election violence in early-2008 and this event also influenced my choice of cases. I found that I needed to select cases where it would be easier to cultivate rapport given the prevailing ethnic animosity. I chose a rural cooperative in Central Kenya and an urban cooperative in Nairobi because I believed I would not be perceived as an enemy and evoke hostile responses in these two areas. This proved to be true and was even affirmed by other people unrelated to the study.

Rural communities in Kenya are largely illiterate and I had to consider the language of interviewing. I chose to conduct the interviews in the local language interspersed with Kiswahili, which is the national language, and write down the responses in English. I had employed the services of a graduate research assistant with whom I had discussed the requirements of the exercise. The research assistant was also conversant with the local and national languages.

Gaining entry to the research sites required me to use the 'known sponsor approach' in which I used the legitimacy and credibility of another person – the executive director of the technical agency – to establish my own legitimacy and credibility as the researcher (Patton, 2002). Even so, I quickly discovered that access was not guaranteed as my request for access still had to be approved by the management committee/board of directors of each cooperative. My initial point

of contact in each case was the General Manager who conveyed my request to the management committee. The mangers therefore acted as gatekeepers for the research sites (Neuman, 2006).

My credentials included a formal letter from the director of the Graduate School of Public and Development Management that introduced me as a doctoral student in the school. I also prepared a letter that explained the purpose and process of the research thereby providing full disclosure to the potential research participants. The letter included my contact details and I invited the gatekeepers to seek any further clarification. In one case, I was asked for a copy of the interview schedule that was to be used. The period between my request and the granting of access ranged from a couple of days in one case to two months in the other case.

3.4 DATA COLLECTION

3.4.1 Ethical Considerations

Ethical concerns regarding the study of human subjects were guided by the Wits University code of ethics which provides guidelines for conducting ethical research. Prior to data collection, the proposed interview schedules were presented to the Faculty Graduate Studies Committee as part of the approval requirements for candidature. The research design included commitments for the protection of informant privacy by not reporting any identifying information and the possibility of holding debriefing sessions with research participants or producing a summarized report of findings to enhance the ethical principle of reciprocity as recommended by Kvale (1996).

Once access to the research sites had been granted, I sought voluntary participation by obtaining informed consent from the participants in the study. This was achieved by a 1-page consent form that all participants were invited to read and sign before the interviews (see Appendix I). Consent was separately requested for the audio recording of individual interviews. All participants were assured of member confidentiality with regard to their responses as well as their right to withdraw from the interview at any time. It should be pointed out that the

participating cooperatives expressly requested me not to disclose their identity as a condition for access. The cooperatives are therefore not referred to by name in this report and details which may possibly allow them to be identified have also been withheld.

It was not feasible to hold debriefing sessions with all the research participants and therefore I produced summarized reports of preliminary findings for each case. The aim of the reports was to provide an opportunity to members to critically assess my interpretation of the data. However, I did not receive any feedback on the reports. Stake (1995) confirms that it is not unusual for researchers to receive little or no response from participants after the production of case study reports. Nevertheless, I sought peer reviewers from people unrelated to the research to enhance the credibility and confirmability of the findings.

3.4.2 Sources of Data

I used three main methods for data collection: semi-structured interviews, direct observations and document reviews. I collected the data with the assistance of key contacts within the cooperatives who had been assigned to assist me with my research needs. The key contacts, who were coincidentally both women staff members, provided invaluable assistance by accommodating me in their offices, providing background information to help me understand the organizational context and facilitating interviews with other staff members. Given my limited stay in the research sites, I realized that the data collection would proceed more efficiently if both my research assistant and I were engaged in collecting the data. We therefore shared roles in conducting direct observations, member interviews and retrieving or collecting documentation. Even so, the primary responsibility in collecting the data remained mine.

- *Interviews*

The member interviews were designed to explore motivations, beliefs and values about cooperative membership. They also sought to ascertain member satisfaction, perceptions about

cooperative leadership and desired changes or improvements. Interviews with the cooperative management and board members sought their perceptions of government support for the sector, networking opportunities with other cooperatives, and short and long-term plans for their cooperatives. All member interviews were conducted in the FOSA Branches during office hours (8:30-3pm). In the rural cooperative, members would stream in from mid-morning (10-11am) while members of the urban cooperative were available from 8:30am. More interviews were conducted in the urban case because there was only one FOSA branch unlike the rural case in which travelling time to the five branches had to be factored in.

In the rural cooperative, the Branch Managers would walk into the banking hall and introduce the research team (my research assistant and I) to the members. He or she would request members who had some time to spare, after being served, to participate in the research. This process introduced an element of randomness as the members were not pre-selected. I employed a different approach in the urban cooperative to achieve arbitrary selection. My strategy was to sit in the banking hall and invite members to participate in the research after establishing some rapport through casual conversation. The seating arrangement (side by side) was ideal because it was non-threatening and congenial. I chose not to record any of the member interviews due to logistical implications and the potential risks of causing participant anxiety or discomfort, or receiving guarded responses from participants (Booysen, 2007). Member interviews took an average of 35 minutes to conduct. I then used a further ten minutes to jot down incomplete quotes or responses and brief reflections on the interview.

Other stakeholders including cooperative ministry officers, apex body representatives and technical consultants were also interviewed. Most of these interviews were audio recorded and later transcribed. They took on average 45-60 minutes to conduct. Snowball or chain sampling was used to identify research participants in the Ministry of Cooperative Development and Marketing. Interviews with the ministry officers centred on the policy and regulatory framework for the cooperative sector as well as the challenges encountered in policy implementation.

The apex body representatives recounted their experiences in networking, capacity-building and policy advocacy as well as the challenges they were facing. It should be noted that the urban cooperative apex body, the Kenya Union of Savings and Credit Cooperatives (KUSCCO), has been in existence longer, and is therefore better established than the rural cooperative apex body, the Kenya Rural Savings and Credit Cooperatives Union (KERUSSU). Interviews with the technical consultants yielded useful contextual information that guided the selection of cases and data collection.

A total of 148 semi-structured interviews were conducted (see Table 3.1). The interview schedules appear in Appendix II.

Table 3.1: Number of research participants who were interviewed

Research participants	Urban Cooperative	Rural Cooperative
General members	50	38
Employees	16	16
Board members	4	(FGD) 9
Sub-total for the cases	**70**	**63**
Other stakeholders		
Co-op ministry officers	4	2
Apex bodies	1	1
Technical consultants	5	
Stakeholder & member pilot interviews	2	
TOTAL NO. OF INTERVIEWS	**148**	

- *Direct Observations*

This method involved being within the ongoing social setting of the cooperative in order to make a qualitative analysis of it. It enabled me to acquire a better understanding of the context within which ordinary members, staff members and board members interacted on a regular basis. The direct observations of each cooperative setting took place over a three week period and were spread out to capture different times of the day and activities. The observations took 1-1½ hours at a time. I adopted the stance of "observer as participant" in which the researcher's observer activities are known to the group. The researcher has access to many people and a selected range

of information that is controlled by the group members being investigated (Merriam, 2001). The control of information was demonstrated when my request to review the minutes of board meetings was denied due to the sensitivity of the information contained. However, access to information such as annual general meeting (AGM) minutes, marketing strategies and institutional assessments was readily availed.

The direct observations in the rural cooperative involved sitting in the FOSA banking hall and observing as members (referred to as clients) walked in through the door and moved through the various stages of the different transactions e.g. clients making withdrawals or deposits would line up and wait to be served by the teller while those who were applying for a loan waited to converse with the credit officers. Others would wait at the Enquiries counter to get their account statements before they decided their next course of action. I did not record the number of people observed, preferring instead to focus on the processes and their duration for the clients. Several times, I was approached by a member who sought to know who was dealing with a specific issue. If I happened to know, I would direct them to the right counter or person. If not, I would politely refer them to the Enquiries counter. I varied the observation times between the morning and afternoon.

The urban cooperative provided greater variety in observation sites. The credit department (for loan applications) was situated a floor above the FOSA banking hall. It was therefore possible to vary the observations between the sites. Most members wore their employee identity cards when they visited the credit or FOSA sections. There was similarity in process between the rural and urban cooperatives with regard to banking transactions and loan applications. The member traffic sometimes occurred in waves during the day: there were moments of low activity followed by peaks of activity occasioned by the almost simultaneous arrival of a large group of members. I also learnt that end-month was usually a busy time for the staff. My temporary base in the key contact's office meant that some general members occasionally mistook me for a staff member as they sought specialized information.

My focus on the naturally occurring, ordinary events in both cooperative settings meant that the data were collected in close proximity to the specific situation and were therefore locally grounded in context (Miles & Huberman, 1994). The data obtained from direct observations is limited to contemporary events and so I turned to documentation in order to investigate the influence of past events.

- *Documentation*

The use of documentation as a source of data has several advantages: stability (documents can be reviewed repeatedly); offers precise and quantitative information; provides broad coverage in time and events; and it is usually unobtrusive – not created as a result of the inquiry (Yin, 1994). However, access to documents may be constrained by poor or weak systems of retrieval and confidentiality or privacy reasons. In addition, documents may reflect a reporting bias created by the authors. The review of documentation in the qualitative inquiry served the important role of corroborating or augmenting information from other sources. Moreover, a review of organizational documents conducted before staff or board interviews provided material that could be further probed in interviews.

In both cooperatives, I reviewed organizational documents such as annual reports (which included financial statements), strategic plans and the by-laws in addition to technical reports such as institutional analyses, market research and product audit reports which had been commissioned with the help of the technical agency. Long serving staff members, who had institutional memory, were particularly helpful in providing an overview of the cooperative's development and the rationale for some of the decisions recorded in organizational reports. I also needed to understand the external context in order to build a holistic perspective (Patton, 2002). This meant reviewing government policy documents, cooperative legislation, media reports and miscellaneous reports on the economic and political context. Two reports from the Commission of Inquiry into the 2008 Post-election Violence (CIPEV) and the Independent Review Commission (IREC) probing the electoral process were released during the period of data collection and included as sources of data on the socio-political context.

3.4.3 Limitations of Data Collection

All cooperatives are legally required to hold their annual general meetings (AGMs) within four months after the end of the calendar year. As the research occurred in the latter half of the year, I did not have the opportunity to attend any AGMs. In addition, there were no member education days that were scheduled during the data collection phase. My reconstruction of member interaction was therefore based on my direct observations, review of AGM minutes and member interviews. I was not granted access to any board meeting or the minutes which was quite understandable as I was a virtual stranger who posed an information risk to the cooperatives. Nevertheless, I was able to conduct individual interviews with board members of the urban cooperative and a focus group discussion with board members of the rural cooperative.

Even though I had planned to visit the tea factories in the environs of the rural cooperative as part of my research into the external context, a combination of timing errors, logistical hitches and farmer strikes conspired to prevent my visit. I dealt with this unanticipated obstacle by visiting the Kenya Tea Development Agency (KTDA) Head Office in Nairobi and examining the Annual Reports. I also obtained copies of payslips of a smallholder tea farmer in a neighbouring district's tea factory in order to compare with member accounts of fluctuating tea prices.

3.4.4 Case Study Database

The creation of a case study database is recommended in order to increase the reliability and credibility of the case study (Yin, 1994). The principle of constructing a case study database is to establish a chain of evidence that allows the reader of the case study to follow the source of any evidence from initial research questions to ultimate case study conclusions as well as to trace the steps in either direction – from conclusion to research questions and vice versa. A case study database requires empirical materials to be organized, categorized, complete and available for later access. For the study, empirical materials were organized into three storage forms: A5 manuscript books for the fieldwork notes; separate lever arch files for the documentation of each case; computerized files for data analysis memos, data displays and interview transcripts. This dissertation also provides adequate citation to the relevant sections of the case study database by

citing specific interviews through footnotes and documents through bibliographical references. In this way, the reader can tell what sources were used and independently judge the reliability of the information.

3.5 ANALYSIS OF THE DATA

In qualitative inquiries, the analysis of data usually occurs simultaneously with data collection. This is because qualitative research designs are emergent and flexible, allowing for responsiveness to new issues as they emerge (Merriam, 2002; Patton, 2002; Stake, 1995). Preliminary data analysis involved preparing field contact summaries that consisted of single sheets of paper containing some focusing questions about the various field contacts. The purpose of the field contact summary was to develop an overall summary of the main points that occurred to the researcher during the interview encounter with the contact (Miles & Huberman, 1994). The contact summaries were only written for interviews that had been audio-recorded, which assisted recall of the encounters. For those interviews that were not recorded, such as member interviews, I relied on the researcher notes that I wrote immediately after the interviews. These notes and the contact summaries proved to be useful in the iterative stages of data analysis and enhanced reflexivity.

I also developed interim case summaries to capture the preliminary findings for each research site. These interim case summaries formed the basis of the case study reports that I prepared in lieu of debriefing sessions with the research participants. Each report included a brief description of the setting, methodology employed, analysis of the interview data and institutional context and a discussion of the findings. The reports concluded with practical recommendations in place of analytical lessons which were deemed to be more useful to the audience of the reports. A significant outcome of the preliminary data analysis was the decision to drop entrepreneurship as a key research theme.

The next stage of analysis involved a series of steps that could best be described as spiral rather than linear to reflect the iterative nature of qualitative analysis (Dey, 1993). A close and repeated reading of the interview transcripts led to first-level coding which involved assigning descriptive labels (open codes) to text passages. Second-level coding involved clustering similar codes and assigning inferential labels or pattern codes (Miles & Huberman, 1994). I then generated tentative hypotheses or propositions and sought to integrate them in the conceptual framework that was developed for the study.

This last step is aligned with the literal replication logic in which a "rich" conceptual framework is developed that elaborates the conditions under which a particular phenomenon is likely to found (Yin, 1994). The conceptual framework then becomes the medium for generalizing to new cases and is an example of analytic generalization. This point of view is supported by Dey (1993) who observes that qualitative research can sharpen our conceptual tools even if it does not result in highly abstract theories – a process he describes as the "construction of walls [rather] than the creation of palaces" (1993: 52). Stake (2003) also asserts that qualitative case studies can refine theory and suggest complexities for further investigation.

The overall strategy for the contextual analysis (which comprised the embedded units of analysis) was to first develop a detailed description of each case and themes within the case (within-case analysis) followed by a thematic analysis across the cases (cross-case analysis). Each case was systematically analyzed according to the associational features of social capital, the cooperative microstructure, economic and socio-political contexts. The two cases were then comparatively analyzed to generate themes that were synthesized to provide a holistic description of the phenomenon of inquiry (Creswell, 1998; Patton, 2002).

3.5.1 The use of CAQDAS

The use of computer-assisted qualitative data analysis software (CAQDAS) has spawned a debate in the methodological literature about the role of researchers in the qualitative data

analysis process. There are concerns that the mechanistic application of coding procedures stifles the creativity of researchers while others believe the rapid coding and retrieval features enable researchers to spend more time theorizing and less time organizing the data (De Wet & Erasmus, 2005; Marshall, 2002; Miles & Huberman, 1994; Weitzman, 2000). My decision to use CAQDAS was influenced by the personal recommendation of a fellow doctoral student who had successfully used CAQDAS to manage large amounts of data created by her qualitative inquiry in education. I chose *Atlas.ti* software which has its roots in grounded theory methodology and retains most of the latter's terminology. I certainly found the software to be a highly efficient tool for data organization and management as well as a secure facility for data storage.

My experience with CAQDAS taught me that my role as a qualitative researcher required a mix of creativity and order. I found the process of creating, revising and grouping codes to be highly inductive and iterative. The software imposed some order to this process by systematically generating the code lists which I could revise manually on paper. The marvel of CAQDAS was that it allowed various effortless iterations about how different categories of data were related to each other. In this way, I found the use of CAQDAS to be conceptually enriching as it stimulated new ideas about the data. My use of the software was only limited by the fact that the purpose of my data analysis was exploratory rather than explanatory (as with grounded theory).

3.5.2 Notes on Terminology and Citation

In order to protect the identity of the cooperatives which served as cases in the study, pseudonyms have been used. Thus, Wakulima Rural and Uwezo Urban credit cooperatives represent the two cases in the study. I have also limited the description of specific characteristics that may reveal identifying information. It should be noted that credit cooperatives in Kenya are known by their full title which is 'Savings and credit cooperative societies' or 'Saccos'. The term credit cooperative has been adopted in the study for reasons of brevity.

The terminology used to cite specific interviews in the study reflects user-defined classifications of the primary documents in the CAQDAS database and is illustrated in Table 3.2.

Table 3.2: Key to interview transcript citations

Members	*Other stakeholders*
P1: RM1 – rural member transcript 1	P1: CO – cooperative officer
P1: UM2 – urban member transcript 2	P1: ARR – apex representative rural
P1: RS2 – rural staff member transcript 2	P1: ARU – apex representative urban
P1: US4 – urban staff member transcript 4	P1: TC – technical consultant
P1: FGD – rural board focus group discussion	
P1: BM1 – urban board member 1	

Conclusion

This chapter has provided a narrative account of the research process for the qualitative study. It began with a rationale for the epistemological stance adopted in the study and presented the philosophical and methodological assumptions of the constructivist paradigm. An interpretive case study method was chosen to illustrate the phenomenon of economic cooperation. This method entailed an embedded multiple-case research design that consisted of two cases that were purposefully sampled to provide evidence of cooperation and maximum variation.

Three major sources of data – interviews, direct observations and documentation – were used in the study. The data analysis process was inductive and involved the generation of themes from the qualitative data. The contextual analysis entailed the construction of detailed descriptions for each case which formed the basis for a cross-case analysis. The emergent themes from the member perspectives and contextual analysis were later used to refine the conceptual framework in the discussion chapter. For now, our attention shifts to the situational analysis of cooperatives in Kenya which is the subject of the next chapter.

CHAPTER 4

COOPERATIVES IN KENYA

This chapter aims to provide a historical account of the development of cooperatives in Kenya that ends with their status as of 2008. The account is divided into four phases of cooperative development that are discussed according to the corresponding periods of economic and socio-political developments in Kenya. The policy direction and regulation for the cooperative sector in the four phases is examined in a subsequent section. An overview of the trends in cooperative development is also presented followed by a brief discussion of recent regulatory developments in the Kenyan financial sector. A summary of the main points concludes the chapter.

4.1 PHASES OF COOPERATIVE DEVELOPMENT

4.1.1 Colonial Era (1908-1962)

The modern cooperative society was first introduced in Kenya by British settlers and later by the colonial government. In 1908, a group of British settlers founded the Lumbwa Farmers Cooperative Society to market their agricultural produce (Gatheru & Shaw, 1998). In 1931, the first Cooperative Societies Ordinance was enacted by the colonial government. This ordinance forbade Africans from growing cash crops such as coffee and pyrethrum and joining cooperatives. This restrictive rule was replaced in 1946 by a new ordinance that permitted the formation of cooperative societies by Africans. It also established the office of the Registrar of cooperatives and a special government department responsible for registration, audit, supervision and dissolution of societies (Birchall, 1997; Hyden, 1973).

At first, the attempts by the colonial government to register cooperative societies were more successful in the western region of the country (Nyanza Province). A number of women's groups that had been formed to supply eggs on a wholesale basis to a colonial government organization during the Second World War were registered as cooperatives. However, this

organization was wound up in 1947 which ended the ready market for eggs and the formal trade of the cooperatives (Hyden, 1973).

The introduction of cooperatives in the Central Province was initially met with stiff opposition by most educated Africans who viewed the concept with suspicion and chose to compete as individual traders or businesspeople against the Asians and Europeans in a capitalist system. This was unlike the case in Tanzania where spontaneous initiatives of African farmers led to the formation of cooperatives such as the Kilimanjaro Native Planters' Association in 1925 and the Bukoba Cooperative Union which was registered in 1950 along with 48 affiliated primary societies (Westergaard, 1970). A notable exception in Western Kenya was the cotton cooperatives which grew out of general peasant dissatisfaction with unfair payments and short-weighing of their seed cotton by a zonal monopoly of Asian agents around 1950-1952 (Migot-Adholla, 1970).

In October 1952, the colonial government declared a State of Emergency in response to the Mau Mau uprising in Central Kenya. The uprising was caused by the colonial government's policy of expropriating land from the local Kikuyu people and forbidding their participation in the cash crop economy (Bates, 1989; Elkins, 2005). The colonial government responded by establishing a Royal Commission on Land in East Africa which led to the Swynnerton Plan that proposed to accelerate the development of African agriculture (Cowen & Shenton, 1996; Mboya, 1963). Land consolidation and registration activities were subsequently undertaken in the mid-1950s in which smallholdings were demarcated for the cultivation of coffee and other cash crops such as tea and pyrethrum. Cooperative societies were promoted for the purpose of marketing the crops produced by the smallholders. The aim of the colonial government was to create a middle class of African farmers who would support the status quo. The cooperatives were therefore not designed to be rebellious to the establishment (Hyden, 1973). As a result, increasing numbers of marketing cooperatives were registered in the main coffee-growing areas of Central Kenya as well as other coffee-growing areas in Western Kenya, notably Kisii and Bungoma districts.

The colonial phase introduced a dual economy in terms of cooperative structure: while primary cooperatives were promoted to cater for smallholder farmers, the settlers who were large-scale farmers retained control of national cooperative unions that promoted their economic interests. These national unions included the Kenya Planters Cooperative Union (coffee processing); Kenya Farmers Association (cereals); and Kenya Cooperative Creameries (dairy products). These cooperative unions operated on a commercial basis and were economically strong. They were also dually registered as cooperatives and as companies. In contrast, the primary cooperatives were economically weak and prone to mismanagement due to a general lack of understanding of business principles among their members. The colonial registrar adopted very rigorous standards while assessing cooperatives. Many were liquidated for not being economically viable or for lacking proper management (Hyden, 1973; Migot-Adholla, 1970).

In 1961, the colonial government initiated the Million Acre Settlement Scheme with financial support from the British government and the World Bank. The aim of the scheme was to resettle landless people on one million acres in the large scale farming areas formerly owned by British settlers (Bates, 1989; Swamy, 1994). This led to the formation of many land-buying cooperatives in the first decade after Independence. Swamy (1994) reports that about one-third of the large scale mixed farm area was officially subdivided by 1976.

In summary, the main reason for creating cooperatives during the colonial period was economic: cooperative marketing was seen to be the only way to ensure economies of scale for agricultural processing, first for the British settlers and later for smallholder farmers. The administration of cooperatives was assessed purely on economic grounds by the colonial registrar and non-performance was not tolerated. It can also be argued that political grievances (which resulted in the Mau Mau uprising) accelerated the introduction of smallholder agriculture and cooperative development in Kenya. Lastly, the colonial phase saw the emergence of a dual cooperative structure for the settlers and for the smallholder farmers which persisted well after Independence.

4.1.2 The Harambee Era (1963-1979)

In the period leading up to Independence in 1963 and immediately after, there was a noticeable increase in the registration of cooperative societies in Kenya (see Table 4.1).

Table 4.1: Cooperative Societies Statistics

Period	Registrations	Liquidations	Still in register
1932-50	258	183	75
1951-59	511	168	343
1960-64	647	65	582
1965-69	478	29	449
Total	**1,894**	**445**	**1,449**

Source: Hyden, 1973

Similar to other newly independent African countries, cooperatives in Kenya were regarded as the principal means to achieve "African socialism" by political leaders (Mboya, 1963; Westergaard, 1970). At that time, it appeared as if "the cooperative society was to African socialism as the private firm was to capitalism and the public corporation was to communism" (Hyden, 1973: 3). It was expected that the participation of smallholder farmers in cooperatives would integrate them into the monetary economy and would also result in capital accumulation. In this way, cooperatives would contribute to and promote African participation in development.

The growth of the cooperative movement in Kenya was boosted by the national slogan – Harambee – which called on every Kenyan to pull together in a spirit of self-help and mutual assistance. Agriculture was identified as the dominant sector of the Kenyan economy and the government pledged to develop this sector through national farms, cooperatives, companies and individual farms (ROK, 1965). As in the colonial phase, the production and marketing of agricultural produce would be organized through cooperatives to exploit economies of scale.

Thus, cooperative development in the post-independence phase was guided by both political ideology and economic rationale.

The Cooperative Department replaced the colonial office of the registrar after Independence. The key task of the Department was to support the government's promotion of smallholder agriculture and this led to the registration of many smallholder producer cooperatives and marketing cooperatives for dairy, coffee, cotton and pyrethrum. An agricultural extension service was established to work through cooperative organizations. The distribution of cooperatives in Kenya also reflected the agricultural orientation and economic strength of geographical regions. Thus, the largest number of agricultural cooperatives was located in the Rift Valley and Central provinces followed by Nyanza, Western and Eastern provinces. The Coast and North Eastern provinces had the fewest agricultural cooperatives (Hyden, 1973).

By 1970, there were 1,409 primary cooperatives that catered mainly for the smallholder farmers with an estimated 600,000 members. The majority of these were the land purchase cooperatives (numbering 324) that were formed in response to the government's settlement scheme. The next biggest categories were producer cooperatives for cereals and grains (157), coffee (156), multi-produce (150) and dairy products (108). Savings and credit cooperatives constituted a mere 8% of the primary societies (119 in total) and they were mainly located in Nairobi (Hyden, 1973).

The cooperative movement was vertically structured along a four tier pyramidal system. Thus, primary cooperatives whose membership consisted of individuals within a given locality formed the bottom tier. The second tier consisted of secondary cooperatives or unions whose membership was restricted to primary cooperatives and which operated on a district basis. National cooperative organizations formed the third tier and their membership was drawn from the secondary cooperatives and primary cooperatives that were not affiliated to a union. The top tier consisted of the apex organization, the Kenya National Federation of Cooperatives (KNFC), which was formed in 1964 to become the representative body for the movement.

The government established the Cooperative College of Kenya in 1967 and licensed the Cooperative Bank of Kenya in 1968 to support the movement. These developments were achieved with extensive donor support – with an estimated expenditure of US$ 50 million between 1962 and 1992 (Gatheru & Shaw, 1998). The Cooperative Bank has since grown to become the fourth largest bank in Kenya, serving over 7 million members of the cooperative movement (Co-op Bank, 2008). The Cooperative College is a semi-autonomous government agency that develops human resource capacity for the cooperative movement. As a result, Kenya has one of the best developed support structures for cooperatives in Africa.

Meanwhile, the national cooperative unions such as the Kenya Cooperative Creameries (KCC), Kenya Farmers Association (KFA) and the Kenya Planters Cooperative Union (KPCU) continued to enjoy monopoly rights that had been established in the colonial era. Thus, KCC enjoyed monopoly rights in the urban milk markets while KFA had monopoly rights in the fertilizer supply and KPCU held the monopoly in the wholesale milling of coffee (Ariga, Jayne & Nyoro, 2006; Atieno & Kanyinga, 2008; Karanja & Nyoro, 2002). However, large-scale farmers were gradually overtaken in numbers and output by the smallholder farmers. By the mid-1970s, for instance, smallholder dairy farmers had overtaken the large-scale farmers as the major producers of milk in Kenya.

A similar scenario unfolded in the coffee subsector with smallholder coffee farmers controlling a greater acreage under coffee and producing a bigger output of clean coffee compared to large estates (Karanja & Nyoro, 2002). The process of 'Africanization' led to the incorporation of many primary cooperatives into the national cooperative unions even though the decision-making powers remained in favour of the ruling elite. Thus, although the unions provided valuable services to smallholder farmers, they were now subject to the control of powerful political interests (Atieno & Kanyinga, 2008).

During this phase of cooperative development, the agriculture and cooperative sectors enjoyed various forms of donor support. This meant that smallholders benefitted from subsidized support services such as veterinary services, subsidized fertilizer inputs and agricultural credit services. As a result, Leonard (1991) reports that the dairy industry witnessed a four-fold increase in production between 1963 and 1980. In 1963, there were 332,000 grade cattle (mainly owned by European farmers) and the KCC milk intake in 1963 was 14 million gallons. By 1980, the national grade dairy herd was estimated to be 1.5 million cattle and milk intake had increased to 51.5 million gallons. Similarly, smallholder share of coffee and tea production increased from practically nil in 1955 to 40% and 70% respectively in the 1980s. This impetus for smallholder activities helped rural incomes to grow by 4.2% annually from 1974 to 1982 (Swamy, 1994).

4.1.3 The Liberalization Era (1980-1999)

In order to understand the circumstances that led to the introduction of market liberalization measures in the Kenyan economy, a brief account of cooperative performance within the agricultural sector is now provided.

- *Cooperative performance in the 1980s*

By 1980, the cooperative movement had played an important role in establishing smallholder agriculture and enhancing its economic contribution to the country. In 1984, cooperatives were responsible for marketing 87% of the pyrethrum crop, 60% of the coffee crop, 95% of the cotton crop and 96% of dairy products. Cooperative savings schemes that had been established in a number of marketing societies and unions had mobilized about Ksh. 726 million (US$ 51 million[13]) in rural savings while urban savings and credit cooperatives had accumulated over Ksh. 2.7 billion (US$ 190 million) in members' savings as at 31 December 1984 (ROK, 1987). A total of 1,309 out of 3,500 active cooperatives had marketing and/or primary processing of agricultural produce as their major function compared to 1,022 savings and credit cooperatives which comprised the next biggest segment of the movement (ROK, 1987).

[13] Calculated at a yearly average of 1 US dollar exchanging for Ksh. 14.20 in 1984 (World Bank Statistics)

Most of the rural marketing cooperatives were affiliated to district unions with the aim of exploiting economies of scale. Essential services such as accounting, banking, transportation, and bulk procurement of storage and farm inputs were provided by the unions at varying levels of efficiency (ROK, 1987; Wanyama, Develtere & Pollet, 2009). The processing and marketing of coffee and dairy products was handled by national cooperative unions thereby exhibiting vertical integration. Fertilizer wholesaling and retailing was dominated by KFA which had 69 distribution outlets (Ariga et al., 2006). By the late 1980s, this hierarchical cooperative structure had already encountered some problems: some of the cooperative unions and national cooperative organizations (NACOs) were accused of excessive bureaucracy, general apathy and the lack of accountability toward collective member interests (ROK, 1987).

Other problems included the fact that the bulk of the cooperative membership remained largely uninformed about the cooperative philosophy and business principles as well as duties and responsibilities of members and committees (Sira & Craig, 1989). The organizational autonomy of the primary cooperatives and unions was also considerably limited by the administrative oversight of the Ministry of Cooperative Development (Argwings-Kodhek, 1998; Hamer, 1981; Wanyama, 2007). Finally, the NACOs were highly susceptible to political interference (Hedlund, 1988a; Were, Ngugi, Makau, Wambua, & Oyugi, 2005).

Coffee and dairy marketing cooperatives were the most active in the agricultural sector. In the coffee subsector, primary cooperatives received the coffee cherry from their respective members and processed it into parchment which was delivered to the KPCU for further processing and milling into clean (green) coffee that was then graded and delivered to the Coffee Board of Kenya for sale. Upon sale of the coffee, the Board would deduct its expenses and remit the proceeds to KPCU which would also deduct its expenses before channelling the balance back to the farmers through their respective cooperatives. This lengthy route of payment to the coffee farmers was subject to delays and hefty deductions that reduced the farmers' margins (Karanja & Nyoro, 2002). The smallholder coffee farmers had no effective control over the KPCU and the

Coffee Board and the operational efficiency of these two organizations had a considerable effect on the net income of the farmers (Gatheru & Shaw, 1998; Karanja & Nyoro, 2002).

A similar scenario existed in the dairy industry where KCC was the national body with the overall responsibility of collection, processing and distribution of surplus milk and milk products. Despite increasing volumes of business in the 1980s, the performance of KCC was undermined by an increasingly politicized and inefficient management (Atieno & Kanyinga, 2008). As a result of sluggish economic growth, real producer prices for milk began to decline during this phase. The government's policy paper on cooperative development highlighted the structural problems and pledged to review the organizational structures of KPCU and KCC to ensure that they were responsive to the needs of smallholder coffee and dairy farmers and that there was equitable representation of both large-scale and small-scale farmers in their management boards (ROK, 1987).

- *Cooperative decline in some sectors*

By the mid-1980s, the cooperative share in the production and marketing of pyrethrum, sugar and cotton was in decline. For example, the cooperative share of the national total output of pyrethrum flowers had declined from 87% in 1972 to 59% in 1985 (ROK, 1987). Part of the decline was attributed to a drop in the international market demand for natural pyrethrum extract in favour of synthetic varieties which provided a more reliable supply. The pyrethrum marketing board was forced to retain considerable stocks of unsold pyrethrum thereby making it difficult to pay farmers on time. In the case of cotton, the cooperative share of national production had sharply fallen from 95% in 1984 to 72% in 1985/86 (ROK, 1987).

The cotton industry was characterized by serious inefficiencies in the production, processing and marketing processes due to several factors. First, the Cotton Lint and Seed Marketing Board had virtual monopoly over the industry: it was solely responsible for selling the seed cotton to farmers, processing and marketing the crop. The cooperatives acted as statutory agents of the

Cotton Board and were paid a service fee that was fixed by the board. In 1980, the service fee to private buyers and cooperatives was reduced by 16% just as industry figures supported a 38% increase (Gatheru & Shaw, 1998). This meant that the service fees were inadequate to meet the operational costs of the cooperatives and the shortfall was invariably recovered from the funds intended for farmer payments (ROK, 1987).

Second, the producer price of cotton was determined by the government in consultation with the Cotton Board. For most of the 1980s, the producer price remained unchanged and did not accurately reflect the high input costs incurred in procuring good seed varieties and frequent pesticide application. Moreover, the Cotton Board owned the crop which meant that farmers could not leverage the crop to obtain crop advances and development loans (ROK, 1987). On the marketing end, the Cotton Board's monopoly meant that even when the market price for cotton was higher than the producer price fixed by the government, the Board was not obliged to remit the surplus income to the farmers. As a result, the institutional arrangements for cotton production presented great disincentives for smallholder cotton growers (Gitau, Kimenju, Kibaara, Nyoro, Bruntrup & Zimmermann, 2009).

In the case of sugar production, the cooperative share was almost insignificant at 4% of total production (ROK, 1987). The government-owned sugar processing factories preferred to organize smallholders into out-grower programmes which supplemented the large estates in the supply of sugarcane. Similar to other agricultural subsectors, smallholders faced challenges in accessing credit and farm inputs, incurring high transport costs due to a poor road network and receiving delayed payments from the factories (Argwings-Kodhek, 1998). The smallholders were also not represented in the management boards of the sugar factories which meant that their interests were generally ignored. Furthermore, the factories were not always efficiently run and there were allegations of mismanagement (Gatheru & Shaw, 1998).

Structural Adjustment

It was in this context that Kenya began to implement structural adjustment programmes as a condition for external financial assistance from the International Monetary Fund (IMF) and the World Bank in the 1980s. Structural reforms in the agricultural sector aimed at minimizing government's participation in agricultural processing and marketing systems through price decontrols and the removal of restrictions on private sector participation (Swamy 1994). The underlying rationale for market liberalization was that the entry of the private sector would improve efficiency in processing and marketing systems which would result in higher producer prices while the efficiency gains would translate into lower consumer prices (Karanja, 2003).

On the broader economic front, structural reforms aimed at government budget rationalization, divestiture and privatization of state-owned enterprises, public sector reform, trade liberalization and financial sector reforms (Gamba & Kibaara, 2007). The extent and pace of reform between 1980 and 1991, however, proved unsatisfactory as funded structural adjustment programmes (SAPs) were not complied with (Swamy, 1994). Poor economic management and fiscal indiscipline characterized the reform period largely due to exogenous factors such as political patronage and excessive powers of the Presidency which undermined government's capacity to implement reform (Were et al., 2005). Meanwhile, political unrest was growing as a result of the declining economic performance and an increasingly authoritarian regime. The average real GDP dropped from 4.2% during 1985-1989 to 2.3% in 1991 and continued to plummet to a rate of 0.1% in 1993. The most serious shortfall was in agriculture whose output fell by 4.2% (ROK, 1994; Were et al., 2005).

A number of factors may have contributed to this sharp fall in agricultural output: over the five year period (1988-1993), development expenditures declined from 7.2% to 4.8% as the government gradually withdrew from agricultural input subsidies and services (ROK, 1994; Gamba & Kibaara, 2007). The collapse of the International Coffee Agreement in 1989 caused a sharp decline in international coffee prices which significantly affected coffee export revenues and smallholder incomes (Gatheru & Shaw, 1998). Agricultural productivity also declined

during this period as fertilizer use declined. The steady decline of fertilizer use among smallholder farmers was as a result of distribution inefficiencies which led to frequent cycles of oversupply and deficit coupled with price controls which created a disincentive to fertilizer supply in remote areas (Ariga et al., 2006). Economic reforms that were intended to spur growth and reduce poverty by enhancing production efficiency and subsequent output achieved disappointing results as poverty increased and agricultural productivity declined (Gamba & Kibaara, 2007).

The suspension of donor aid flows in 1991 amidst a deepening budgetary crisis and poor economic performance provided fresh impetus for the speedy implementation of reforms. Economic reforms were aggressively initiated in virtually all the key sectors: trade, finance, social sector (education and health), agriculture and the public sector. These included: decontrol of consumer and producer prices, removal of import licensing; removal of foreign exchange controls; liberalization of pricing and movement of maize; liberalization of the petroleum market; and partial reform of the civil service (ROK, 1996; Were et al., 2005). In contrast to the 1980s when economic reforms were the sole requirement, this time donors called for political reforms as well. Were et al. (2005) describe these reforms as the 'second generation of reforms' because they included the demand for good governance, democratization and institutional infrastructure to the implementation of market liberalization policies. At that time, the prevailing view among donors was that democracy and good economic performance went together (Bienen & Herbst, 1996).

- *Effects of market reforms on the agricultural cooperatives*

Following market liberalization, there were mixed outcomes in the performance of the national cooperative unions and the smallholder cooperatives which were mainly concentrated in the coffee and dairy industries. In the dairy industry, the decontrol of milk prices in 1992 and the revocation of KCC's marketing monopoly in urban markets led to the entry of two groups of players: informal milk traders and formal private processors. The informal milk market (representing the sale of unprocessed milk) rapidly grew in the country and was estimated to

cover 80% of total milk sold by smallholders (Karanja, 2003). The growth of the informal milk trade contributed to the collapse of some dairy cooperatives as smallholder farmers withdrew from poorly managed cooperatives and found better prices through informal marketing channels (Gamba & Kibaara, 2007). A few well-managed and progressive cooperatives invested in cooling or processing plants in a bid to claim a share of the lucrative urban markets (Karanja, 2003; Wanyama, 2007).

A number of smallholder dairy farmers opted to sell their milk to the large private processors as an alternative to KCC. The private processors were more efficient than KCC and steadily eroded KCC's market share. Farmers who continued to deliver milk to KCC were subjected to delayed payments for milk deliveries, sometimes for several months, which eroded their confidence and subsequently led to reduced milk supplies to KCC. Exposed to market competition, KCC's performance worsened with the high cost of operations, high level of indebtedness and loss of market share. In 1999, KCC was put under receivership after it became insolvent and left many farmers unpaid for their milk deliveries (Atieno & Kanyinga, 2008; Wanyama, 2007).

The net effect of liberalization on the coffee industry was largely negative. Smallholder coffee cooperatives witnessed a decline in output from the late 1980s onwards following the drop in coffee prices (Karanja & Nyoro, 2002). Other factors that contributed to the decline in the 1990s included higher costs of farm inputs, labour and fuel which eroded farm profits; excessive processing, handling and marketing costs incurred by the cooperatives, KPCU and the Coffee Board of Kenya which translated to lower farmer payments; and outdated legal and regulatory constraints that prevented uprooting of coffee trees and the practice of intercropping. These constraints led to neglect of the coffee crop by frustrated farmers (Gatheru & Shaw, 1998).

Furthermore, the licensing of private commercial millers to compete with KPCU and the floatation of the foreign exchange rate did not translate into tangible benefits for smallholder farmers. For example, the increase in installed milling capacity against a backdrop of declining

production resulted in low capacity use of about 40% which was expensive to maintain and did not result in lower milling charges as originally envisioned (Karanja & Nyoro, 2002). Also, the smallholder coffee cooperatives did not possess the necessary skills to competently engage with the money markets in order to gain from foreign exchange transactions (Were et al., 2005).

Prior to liberalization, KPCU was the sole milling company and therefore the sole commission agent responsible for processing payments to farmers through their cooperatives. This vertically integrated structure provided donor-funded government programmes with an avenue for reaching all coffee farmers (smallholders and estate farmers) with various credit schemes. However, in 1994, the government appointed the Cooperative Bank and the Coffee Board of Kenya as additional donor financing channels for the coffee industry which effectively neutralized KPCU's ability to attract donor funds (Karanja & Nyoro, 2002; Co-op Bank, 2008). After the revocation of KPCU's milling monopoly in 1993, the newly licensed private millers doubled up as additional commission agents for the Coffee Board of Kenya and farmers could now choose their preferred commission agent. Many coffee farmers who had received farm input loans from KPCU defected to other commission agents without clearing their debts (Wahome, 2008a; Wanyama, 2007). As a result, KPCU was left with a heavy debt burden that had crippled its operations by 2008 (Wahome, 2008a).

Liberalization of the cooperative sector

In 1997, the government released Sessional Paper No. 6 of 1997 titled *Cooperatives in a liberalized economic environment.* The policy document signalled the withdrawal of state control over the cooperative sector with the aim of making cooperatives autonomous, self-reliant and commercially viable organizations. For the first time, elected management committees of primary cooperatives were responsible for all business operations (ranging from the recruitment of staff to ordering audit services) that had been conducted through their unions under the supervision of the Cooperatives Ministry. It was assumed that the cooperatives would develop self-regulating mechanisms in place of bureaucratic controls. Instead, some elected committees abused their newly acquired freedom to the detriment of many primary cooperatives. The sector

began to experience increasing cases of corruption and mismanagement such as fraud and misappropriation of resources; nepotism in the hiring and dismissal of staff; refusal of management committees to hold elections or vacate their positions after elections; and unauthorised investments or illegal payments to management committees (Gatheru & Shaw, 1998; MoCDM, 2004; Mudibo, 2005; Wanyama, 2007).

Large district farmer cooperatives, particularly in the coffee industry, were faced with splits as members sought to devolve decision-making to the local level. Consequently, the number of coffee cooperatives increased from 207 in 1990 to 462 in 2001 (Karanja & Nyoro, 2002). The increase in number, however, coincided with a downward trend in turnover and throughput (tonnes of clean coffee produced) per cooperative which eroded the capital base of the cooperatives. In addition, the splitting of cooperatives involved a formal liquidation process that had to be paid for by the farmers and was therefore expensive. Another issue that further eroded the financial base of the cooperatives was the opportunistic trade practices of their members: some smallholder farmers sought to bypass the cooperative marketing channel by selling their produce to private traders despite having received farm inputs on credit from their cooperatives (Karanja & Nyoro, 2002).

The liberalization of the cooperative sector dealt a severe blow to the national apex body and district-based cooperative unions as primary cooperatives were no longer obliged to depend on them for the supply of services. For example, prior to liberalization, KNFC had a virtual monopoly in the printing and supply of stationery and office equipment to the cooperatives (ROK, 1987). The abrupt removal of bureaucratic controls and state marketing monopolies that accompanied liberalization rendered most agricultural cooperative unions redundant. Furthermore, the Cooperatives Ministry had encouraged the secession of union banking sections from their mother unions into autonomous rural savings and credit cooperatives in order to safeguard member deposits from performance risks of the unions and potential misuse by the union management (ROK, 1987). The vertical structure of agricultural cooperatives therefore underwent a major transformation after liberalization as district cooperative unions, national

agricultural unions (KPCU and KCC) and the apex organization (KNFC) increasingly lost their members (Wanyama, 2007).

- *The growth of the financial cooperative segment*

In contrast to the agricultural cooperatives, the vertical structure of the financial cooperatives survived with minimal changes after liberalization. Prior to the liberalization of the sector, primary and secondary financial cooperatives had been encouraged to affiliate to the Kenya Union of Savings and Credit Cooperatives (KUSCCO) which was mooted as a sectoral apex body (ROK, 1987). KUSCCO subsequently developed five programmes that offered centralized services which became well established. Thus, the Central Finance Programme is a revolving fund that enables member cooperatives to boost their loaning capital; the Risk Management Programme is an insurance scheme for cooperatives that offsets outstanding loans caused by the death of individual loan recipients and includes funeral cover; the Education and Training Programme offers training courses for members, management committees and employees; KUSCCO Housing fund is a mortgage product for individuals affiliated to member cooperatives; and Business Development, Research and Consultancy services undertakes feasibility studies for front office service activities (FOSA) and assists cooperatives in the development of strategic plans or conducting institutional analyses (Owen, 2007).

As a result, KUSCCO retained a loyal membership base and continued to attract new members (Wanyama, 2007). Other national cooperative organizations in the financial services sector such as the Cooperative Bank and the Cooperative Insurance Company were forced to expand their businesses beyond traditional clients in the cooperative sector so as to remain afloat in the market. In this regard, both organizations were successful as they diversified their customer base to serve the corporate and public sectors, individual customers, and small and medium enterprises (Co-op Bank, 2008; Kwama, 2008; Wanyama, 2009).

During the liberalization phase, savings and credit cooperatives recorded the most substantial growth in the cooperative sector. There were 2,891 credit cooperatives in 1995, up from 1,022 recorded in 1984, reflecting a 65% increase (Gatheru & Shaw, 1998; ROK, 1987). The credit cooperatives operated in both rural and urban areas and provided essential financial services to their members. Between 1997 and 2000, commercial banks shut down 230 rural branches and increased minimum opening balance requirements claiming that the rural and low-end markets were unprofitable (Kang'aru, 2008). In addition, the commercial banks charged high lending interest rates (well over 30% in some years) driven by the government's issuance of treasury bills at excessively high rates. Large commercial banks held over 50% of the total stock of treasury bills which meant that they preferred lending to the government rather than to the private sector or the retail customers (Ndung'u, 2003). As a result, credit cooperatives were increasingly seen as alternative financial institutions.

A major innovation within the credit cooperatives was the introduction of front office service activities (FOSAs). The traditional credit cooperative operations (also known as back office savings activity or BOSA) mobilized their lending capital from members' savings which could not be withdrawn unless a member was leaving the cooperative. This meant that the only savings option for members was the 'locked' savings. The FOSAs introduced savings accounts in which members could voluntarily save while enjoying access to their savings. In addition, the FOSAs offered quasi-banking services such as fixed deposit accounts, sale of banker's cheques, salary or crop advances and money transfers. The first urban FOSA was opened in 1995 (Owen, 2007). Rural credit cooperatives were much quicker to embrace the FOSAs due to the subsequent withdrawal of banks from the rural areas which would have left a sizeable proportion of the rural population without any banking access. Another benefit of the FOSAs was the relaxation of member requirements: in most cases, opening an account at the FOSA was the only requirement to become a member. This meant that the credit cooperatives could expand their membership beyond the original common bond of association (MoCDM, 2008a).

In summary, the liberalization phase transformed the cooperative sector in several ways. First, the downturn experienced in the agricultural sector was mirrored in the cooperative sector due to the predominance of agricultural marketing cooperatives. This supports the claim by Hedlund (1988a) that cooperative development will follow the trend of national development for better or for worse. Second, the nature of cooperatives as autonomous, member-owned and democratically controlled organizations was formally recognized by the government even though the manner in which it withdrew its regulatory control produced detrimental effects to the members and the public image of the sector. Third, the exposure to market competition led to the severe weakening of the apex body (KNFC) and the vertical agricultural cooperative structure as KPCU and KCC either floundered or failed. However, other national cooperative organizations in the banking and insurance industries thrived. Fourth, both rural and urban credit cooperatives exploited an opportunity to serve rural and low-end segments of the financial market following the exit of commercial banks from rural areas. In this regard, the introduction of FOSAs was instrumental in providing quasi-banking services.

4.1.4 The Economic Recovery Era (2000-2008)

At the dawn of a new millennium, the reform agenda of the international financial institutions (IFIs) shifted to a worldwide focus on poverty. This was precipitated by several reports and studies[14] which showed the adverse effects of SAPs on the poor and vulnerable in developing countries. The World Bank itself conducted participatory poverty assessments in several countries, including Kenya. In August 2000, the IMF pledged lending to Kenya under the Poverty Reduction and Growth Facility (PRGF) which had replaced the Enhanced Structural Adjustment Facility (ESAF). The previous lack of public consultation in policy formulation was replaced by the roll-out of a broadly consultative process with donor support in 2001. The result was the Poverty Reduction Strategy Paper (2001-4), to which the medium term expenditure framework was to be linked. It was the first time that the general public had been consulted about their policy preferences. The consultative process was a great success, and identified

[14] See Action Aid Kenya, 1998; Korten, 1990; World Bank, 1995.

agriculture and rural development as the key sector by which to tackle the increasing levels of poverty (ROK, 2001; Shiverenje, 2005).

Within the agricultural sector, the poverty reduction strategy paper (PRSP) identified low agricultural productivity and poor marketing systems as the major causes of poverty. These were attributed to poor extension services, inefficient rural financial systems, poor state of rural infrastructure and ineffective marketing and distribution channels. The high cost and inadequate supply of inputs (seeds, fertilizers and pesticides) as well as mismanagement in cooperative societies were also cited as some of the production constraints while marketing constraints included the lack of subsidies (guaranteed minimum returns) and value addition facilities (ROK, 2001). The uneasy climate preceding the 2002 general elections led donors to adopt a wait-and-see attitude with regard to funding of the PRSP. A coalition of opposition political parties won the elections in a landslide victory that ushered in a new era of hope for political reform and economic recovery. The National Rainbow Coalition (NARC) government came to power on a reform platform that included pledges to eliminate corruption, revive the economy and implement pending reforms to restore IFI support (Shiverenje, 2005).

In order to signify a departure from the past, the NARC government unveiled the *Economic Recovery Strategy for Wealth and Employment Creation* (ERS) in 2003. The ERS was a consolidation of the PRSP, NARC manifesto and the Post-Election Action Plan (IMF, 2005). It identified agriculture, trade and industry, and tourism as the key engines of growth in the economic recovery programme. Consequently, the *Strategy for Revitalizing Agriculture (2004-2014)* was developed and is currently being implemented. The Strategy envisages the transformation of smallholder agriculture into a profitable activity through the adoption of modern farming practices and market-oriented production as well as increased levels of integration with other sectors of the economy (Gamba & Kibaara, 2007). As a result of the renewed focus on agriculture, the sector recorded a growth rate of 4.4% in 2006 up from 1.5% in 2003 (Gitau et al., 2009). Targeted fiscal injections to reduce poverty and inequality were also

implemented and have contributed to the decline in the overall incidence of poverty from 57% in 2000 to 46% in 2006 (ROK, 2007).

Despite the challenges of poverty and liberalization, the number of registered cooperatives has continued to grow over the years. It is worth bearing in mind, however, that the cumulative total of registered cooperatives in the ministry's register does not indicate how many of these cooperatives are active or dormant. Wanyama (2009) posits that up to 35% of the 11,635 registered cooperatives in 2007 may be dormant. A ten-year analysis of cooperative statistics reveals that in 2003, for the first time in Kenyan cooperative history, savings and credit cooperatives surpassed the total number of agricultural cooperatives (see Table 4.2).

Table 4.2: Number of cooperatives by type, 1997-2007

Type of cooperative	1997	1999	2001	2003	2005	2007
Agricultural	3,784	4,199	4,372	4,166	4,304	4,414
Savings & Credit	3,179	3,538	3,925	4,200	4,678	5,122
Other non-agricultural	1,276	1,325	1,382	1,838	1,885	2,000
Cooperative Unions	83	89	89	93	99	99
TOTAL	8,312	9,151	9,768	10,297	10,966	11,635

Source: MoCDM statistics; Kenya Economic Surveys, 2002-2008.

The cooperative movement was estimated to have 7.9 million members in 2007: agricultural cooperatives had a membership of 1.3 million, of whom 50% were estimated to be active while savings and credit cooperatives had 6.3 million members, 98% of whom were active. The other non-agricultural cooperatives had a total membership of 334,000, with 50% of members estimated to be active (Wanyama, 2009). According to the 2008 statistical report of the World

Council of Credit Unions, Kenya has the largest membership of credit unions (savings and credit cooperatives) in Africa with 3.7 million members[15] (WOCCU, 2008).

The annual turnover represents another indicator of growth which demonstrates the strong growth pattern that savings and credit cooperatives have continued to show compared to their agricultural counterparts in the economic recovery phase. Figure 4.1 shows the growth in annual turnover per type of cooperative during the economic recovery phase. Over the five year period, savings and credit cooperatives averaged 58% of total turnover.

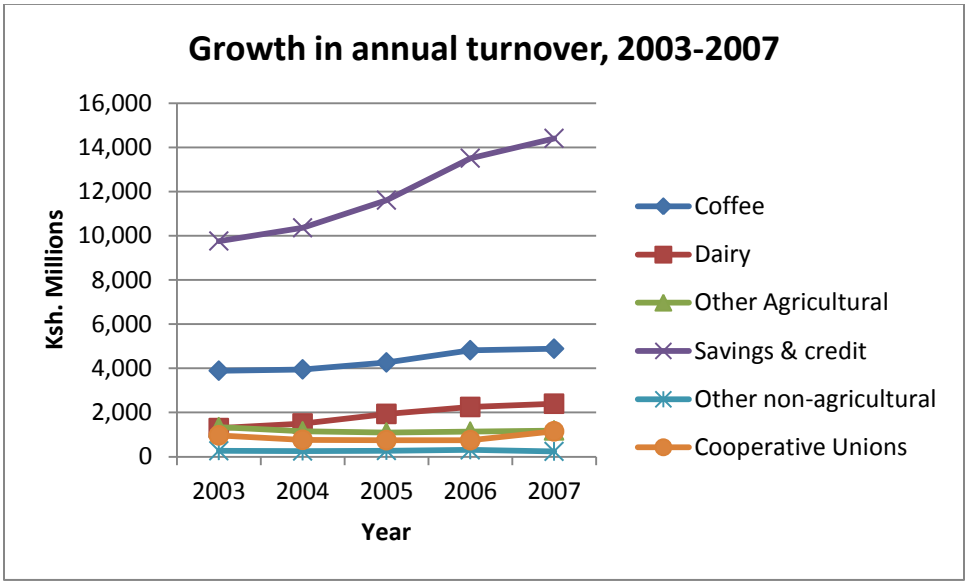

Figure 4.1: Growth in annual turnover by cooperative type

A persistent challenge for the cooperatives in the post-liberalization era has been the lack of appropriate management systems to deal with the competitive market economy. The business models of many cooperatives are still not informed by strategic plans nor are they supported by adequate financial management policies and systems. In the rural areas, the low level of information technology (IT) awareness and utilization, coupled with high illiteracy rates among the members is a management constraint. The generally low levels of skills and competencies in

[15] The discrepancy in official figures and WOCCU statistics can be explained by the fact that not all Kenyan credit cooperatives are affiliated to WOCCU through KUSCCO.

the sector have also led to the erosion of a competitive edge in the provision of services (KERUSSU, 2004).

- *Persistent challenges in cooperative governance*

During the economic recovery phase, the government has restored regulatory supervision of the cooperative sector in an attempt to rectify the negative public image that cooperatives were associated with after the sector was liberalized. The Cooperative Societies Act of 1997 was amended in 2004 to broaden the supervisory scope of the government. Another key reform was the establishment of an Ethics Commission for cooperative societies based on the Public Servants Ethics Act of 2003. The Cooperatives Ministry established the Commission in order to curb cases of improper enrichment by management committees and to improve governance and ethics in the sector (MoCDM, 2006).

Despite these government initiatives, some governance problems still persist due to the nature of cooperatives as member-owned organizations. At the board level, there is the lack of professional expertise among elected board members due to voting based on non-technical criteria such as popularity or outspokenness. At the management and administrative staff level, there are poor terms and conditions of service exacerbated by the absence of personnel and administration policies; job insecurity due to the ability of Board members to arbitrarily dismiss staff; and unprofessional recruitment processes that encourage nepotism or ethnocentrism. At the individual member level, there is a lack of member education and training; insufficient safeguards against opportunistic practices among members; and inadequate representation of members in large cooperatives by their Board members (Mudibo, 2005).

- *Current status of national cooperative organizations – 2008*

In the economic recovery phase, the national apex organization (KNFC) has remained weak with some of its representative functions being assumed by activity-based national unions such as the Kenya Union of Savings and Credit Cooperatives (KUSCCO), Kenya Rural Savings and Credit

Cooperatives Union (KERUSSU) and the National Cooperative Housing Union (NACHU). Nevertheless, efforts have been intensified among the NACOs to revive the organization (Wanyama, 2009).

The fate of the national agricultural cooperative organizations, KCC and KPCU, has attracted government attention during this phase. In 2005, the NARC government acquired the former KCC from private investors who had purchased the company in 2000 following its collapse in 1999 (Atieno & Kanyinga, 2008). The company is now a state corporation and has been renamed New KCC. The government plans to sell it back to the cooperative movement (with a majority shareholding by farmers) once it is financially stable (Wanyama, 2009).

The financial status of KPCU was brought into the limelight in 2008 after media reports[16] based on a study funded by the European Union warned of imminent collapse of the company. The media reports revealed that the coffee miller was struggling with a heavy debt burden occasioned by unpaid bank loans and farmer debts. The farmer debts had been accrued from various farm input credit programmes that KPCU had advanced to coffee farmers to boost production. A "staggering" Ksh. 3.7 billion (USD 55 million[17]) was owed to the miller even though only 20% of the debt was considered recoverable (Wahome, 2008a). In addition to the heavy debts, there was evidence of mismanagement at the coffee miller. The European Union report had therefore recommended drastic cost-cutting measures and the sale of non-core assets to improve the financial status of the company.

Subsequent attempts by the Commissioner of Cooperatives to implement the recommendations had stalled after the board of directors sued him arguing that he had no powers to intervene in a registered company (Wahome, 2008a). This brought the dual registration of the miller, as a national cooperative organization and as a public company, into sharp focus. According to the

[16] See Mburu, 2008; Wahome, 2008a; Wahome, 2008b; Wahome, 2008c; Wanyoro, 2008.
[17] Based on 2007 yearly average exchange rate of 1US dollar to Ksh. 67.35 (World Bank Statistics)

Cooperatives Ministry, serious problems of mismanagement at KPCU had arisen due to the overlapping roles between the board of directors and the executive management. This could be attributed to its dual registration status. In July 2008, ten senior managers led by the managing director resigned en masse citing intimidation by an overbearing board. Meanwhile the board approached the Cooperatives Ministry seeking a government bailout. In October 2008, during its annual general meeting, the Minister of Cooperatives announced that KPCU had to lose its dual registration status if it was to receive a government bailout. This appeared to resonate with the farmer shareholders (Wahome, 2008c).

In contrast to the financial misfortunes of KPCU, the Cooperative Bank of Kenya recorded a Ksh 2.3 billion (USD 34 million) pre-tax profit for the year 2007. This was a complete turnaround for the bank after it registered a similar amount (Ksh 2.3 billion) in losses in the year 2001 that triggered a critical restructuring of its business and operations (Co-op Bank, 2008). During the liberalization phase, the bank had transformed into a fully fledged commercial bank offering a comprehensive range of financial services to individual, corporate and institutional customers beyond the captive cooperative sector. In July 2008, the Cooperative Bank converted to a public limited liability company in order to comply with capital market requirements for an initial listing on the stock exchange. The new company, Co-opholdings Cooperative Society Limited, holds the equivalent shareholding previously held by 3,805 cooperative societies countrywide and remains the majority shareholder of the bank (Co-op Bank, 2008).

The Cooperative Bank held a successful Initial Public Offer of 19.3% of its shareholding which concluded in November 2008. Although the move has resulted in considerable inflows of investment capital for the bank, it has in effect diluted the cooperatives' shareholding in the bank from 77% to 62% (Co-op Bank, 2008). Nevertheless, the bank is poised for greater business expansion in a bid to increase shareholder value and to improve its service delivery platforms. One of its targeted investments is the continued technological integration of the savings and credit cooperatives which makes them partnering outlets of the bank's products.

In summary, the economic recovery phase has seen a definitive return of government involvement in the cooperative sector. This has been achieved through stronger provisions for regulatory supervision and direct cash injections into some national cooperative organizations in the agricultural sector. For the first time, savings and credit cooperatives have overtaken agricultural cooperatives in number and membership. The government's strategic focus on agriculture has reversed some of the downslide experienced by agricultural cooperatives and their members during the liberalization phase. The economic recovery phase has also recorded the dominance of the financial cooperatives in the cooperative sector. The competitiveness of cooperatives in a liberalized economy coupled with persistent cooperative governance challenges remain ongoing concerns for the sector.

4.2 POLICY DIRECTION AND STATE REGULATION

This section is composed of three phases that capture notable policy and legislative events during the phases of cooperative development. The description of the three phases also attempts to portray the nature of policy direction and state regulation and its effects on the cooperatives. The phases have been labelled 'paternalistic-interventionist' for the post-independence era, 'laissez faire-minimalist' for the liberalization era and 'facilitative-regulatory' for the post-liberalization era. The colonial phase of cooperative development is not considered in this section because there was no national cooperative policy that deliberately guided government action at the time.[18]

4.2.1 Paternalistic-Interventionist Phase

In the post-independence era, the cooperative sector was governed by the Cooperative Societies Act Cap 490 first published in 1966 and the Cooperative Societies Rules initially published in 1969. The legislation was comprehensive in scope, stipulating the conditions under which a cooperative society could be registered and outlining the activities and internal organization of primary cooperatives and secondary cooperatives (unions). The Act established a Commissioner

[18] Gyllstrom (1988) refers to the Swynnerton Plan in the 1950s which offered a systematic promotion of cooperatives during the colonial era. However, the Plan was in response to political unrest rather than deliberate efforts to promote cooperatives.

of Cooperative Development (whose precursor was the Registrar of Cooperatives during the colonial phase) who was responsible for the control and supervision of the cooperative societies. The commissioner was given broad ranging powers to ensure compliance. For example, the commissioner was empowered to inspect the books of accounts of any society at any time; appoint or approve auditors of societies; hold an inquiry into the operations of a society; appoint a care-taker committee for troubled societies or dissolve them as a last resort (Gyllstrom, 1988). In this way, the Act and Rules laid the foundation for an interventionist approach by the state.

Wanyama (2007) argues that direct state control of the cooperative movement was espoused by the International Labour Organization (ILO) which had called on newly-independent governments to develop a comprehensive strategy in which one central body would be the instrument for implementing a policy of donor aid and support to cooperatives in developing countries. Subsequently, the government signed a formal technical assistance agreement with four Nordic countries – Denmark, Finland, Norway and Sweden – in 1967 that was known as the Nordic Cooperative Project (Hyden, 1973). This project significantly boosted the resources of the Cooperative Department.

The publication of the first cooperative development policy in 1970 outlined plans for an increase in human and budgetary resources to the Department of Cooperative Development. Five new divisions were created in the Department to oversee education and training; credit and finance; audit services; development planning; and dispute settlement. These technical divisions were directly supervised by the commissioner while the deputy commissioner was responsible for the administrative divisions which included finance and administration, legal matters and field services. Field services comprised all provincial and district cooperative offices (Gyllstrom, 1988). The role of the Cooperative Department was to foster the growth of the cooperative movement by registering cooperatives and providing guidance, supervision and control to enable them achieve their objectives (ROK, 1987).

The Department was upgraded to a Ministry of Cooperative Development in 1974 with the primary objective of "developing cooperatives into viable, self-sustaining business entities with responsible leadership and competent management capable of fulfilling the aspirations of their respective members" (ROK, 1987: 31). The creation of a ministry led to a rapid expansion in the total number of staff employed. However, the number of professional or technical officers increased at a lower rate than the administrative staff (Gyllstrom, 1988). Most of the expansion took place at the district cooperative offices. Gyllstrom attributes the rapid staff expansion to four reasons: first, the rapid increase in the number of societies in the early 1970s may have justified an increase in the staff establishment; second, the extended scope of the ministry's responsibilities – from supervisory control of cooperative societies to their promotion and support – led to the introduction of new administrative procedures that required skilled staff; third, an increase in the number of donor projects and programmes led to an "inbuilt staff-expanding mechanism" within the ministry; fourth, the staff expansion was a typical case of bureaucratic proliferation (Gyllstrom, 1988: 50-51).

The management standards for cooperatives implied in the legislation and policy documents were quite high: it was expected that primary and secondary cooperatives would function like any highly developed business enterprise. Cooperative officers were expected to support business practices within the cooperatives that would engender efficient management. However, the prescriptive manner in which the rules were applied, with few or no qualifications, led to many conflicts between the Department and the cooperatives with the result that the business principles underlying the rules were not appreciated or learned in any meaningful way (Hyden, 1973). Consequently, poor management in the cooperatives was not necessarily averted or halted.

Another feature of the interventionist approach was the limited autonomy of primary cooperatives over their business operations. For example, both managerial and administrative employees of the primary cooperatives were employed by the district unions rather than by the management committees (Hyden, 1973). In addition, district cooperative officers acting on

behalf of the Commissioner were responsible for approving annual budgets and monthly expenditures; countersigning cheques and purchase orders of both primary and secondary cooperatives; approving loans to members and cooperative investments; and approving recruitment and dismissal of cooperative employees (Gyllstrom, 1988). As a result, the management committees of primary cooperatives had limited decision-making functions which created dependency on the government and fostered a level of indifference to the implementation of decisions (Sira & Craig, 1989).

Meanwhile, a second policy paper, *Sessional Paper No. 14 of 1975 on Cooperative Development Policy,* was published by the ministry. The policy paper asserted that the main priority of cooperative development would continue to be in the smallholder agricultural sector. However, it alluded to tensions between the agricultural marketing cooperatives and the national marketing boards and sought to clearly demarcate their roles in a relationship that was to be seen as complementary rather than competitive (Gyllstrom, 1988). The bureaucratic nature of the marketing boards and delayed payments to the cooperatives was an issue that eventually caused a significant decline in smallholder cooperatives engaged in cotton, pyrethrum and sugarcane production (ROK, 1987; Sira & Craig, 1989). This theme was highlighted in the third policy paper, *Sessional Paper No. 4 of 1987 on Renewed Growth through the Cooperative Movement*. The policy paper suggested the formation of an agricultural commodities cooperative union[19] that would bring together all cooperative organizations involved in the production and marketing of agricultural commodities. The union would present a forum for discussing common problems and interests including pricing, representation of farmers in agricultural parastatals and the centralized provision of computer, accounting and education services (ROK, 1987).

However, the idea of an agricultural commodity cooperative union did not attract a following like KUSCCO did among the savings and credit cooperatives or the National Cooperative Housing Union (NACHU) to which all housing cooperatives were affiliated. The reasons for this are not well known but it is likely that the creation of a strong autonomous farmers' union

[19] The union was to be known as the Kenya Agricultural Commodities Cooperative Union (KACCU).

would have been construed as a threat to the political establishment at the time. During the late 1980s, Hedlund (1988a: 11) notes that no African government appeared ready to tolerate an autonomous and strong cooperative movement particularly when it was involved with export or "political" crops because of the state's high economic dependency on these crops. The Kenyan political scene at the time was indeed characterized by an authoritarian political regime which dealt harshly with criticism or opposing voices (Cohen, 1993; Holmquist & Ford, 1992; Were et al., 2005). The political conditions were therefore not ideal for the galvanization of a farmers' union.

Furthermore, each agricultural commodity faced specific problems and therefore the common interests of various stakeholders were in reality quite disparate and this weakened the prospect of establishing a united farmer lobby group. Nevertheless, the agricultural sector did suffer from the lack of a national lobby group as the experiences with liberalization have shown. An opportunity for meaningful policy dialogue was also lost: for example, the agricultural policy relegated marketing cooperatives to the bottom of the value chain. Instead of being involved in marketing, they were little more than bulk delivery agents to the state marketing boards (Hyden, 1973). In addition, most cooperatives were formed around anchor crops rather than on a multiple produce basis which made them and their members especially vulnerable to price fluctuations or variations in output (Gyllstrom, 1988). As a result, the development of many agricultural cooperatives as viable business entities was stunted.

The rapid growth of the cooperative movement presented fresh challenges to the government department (and later ministry) tasked with providing cooperative education and training to the general membership, management committees and cooperative officers. The government was constrained by a shortage of competent personnel and budgetary resources to adequately provide the services required (ROK, 1987). One of the objectives of the Nordic Cooperative Project was to establish a Cooperative College and construction began in 1969 and ended in 1971[20]. The College was to be the main training institution for the cooperative movement. It organized

[20] An overview of the Cooperative College of Kenya – Advertising feature, *Daily Nation*, October 16, 2008.

training courses for cooperative managers and union staff which were popular and the demand often exceeded the capacity of the college (Hyden, 1973). The Department of Cooperative Development focussed its field education programmes on the management committees which naturally widened the knowledge gap between the general members and their leadership.

Hyden (1973) observes that cooperative education should have been oriented towards the general members to enhance their understanding of the cooperative philosophy and encourage informed and meaningful participation in their societies. Instead, the knowledge gap between the general members and their leadership meant that the general members had little opportunity to exert their control over the leadership as most of the business issues were alien to them. It was therefore not surprising that the voting criteria for management committees tended to focus on non-technical criteria such as personality clashes and local politics (Hyden, 1970, 1973).

Some authors argue that high levels of illiteracy among the general membership also contributed to the lack of business knowledge and organizational management skills required for the cooperatives. This was evidenced by the fact that the majority of rural cooperative members could neither read nor understand the accounts and balance sheets of their societies (Sira & Craig, 1989). The charge of illiteracy needs to be understood in the context of an imposed organizational form of cooperation that did not allow local adaptation (Develtere, 1994). In support of this claim, Hyden (1970) observed that self-help or *Harambee* groups were more successful in mobilizing support for their activities than the rural marketing cooperatives. This suggests that it was the degree of unfamiliarity with technical requirements among members rather than the practical understanding of cooperation that contributed to the unsatisfactory performance of the cooperatives.

The issue of an uninformed cooperative membership draws attention to the 'error' of many African states and development agencies to build a cooperative movement from above. Unlike the self-determined operational principles of cooperatives in 19th century Europe, the

introduction of cooperatives in Africa, first by colonial governments and then by newly-independent governments, followed a blueprint approach in which cooperative organizational principles were predetermined and imposed on the members (Develtere, 1994). As a result, the efforts of colonial agencies and nationalist governments generally laid the basis for a cooperative sector rather than a spontaneous, self-determined and self-propelled cooperative movement.

This review of the paternalistic-interventionist phase suggests that Kenyan cooperatives, particularly agricultural cooperatives, were conditioned to emerge and operate as semi-state organizations. The interventionist approach to regulation, numerous administrative requirements and bureaucratic controls served to erode the character of cooperatives as voluntary, autonomous and member-oriented organizations (McAuslan, 1970). This view is corroborated by Wanyama (2007) who notes that cooperative organizations during the era of state control tended to reflect the state's interests rather than the common interests and motivations of the people. Direct intervention by the government also weakened the value of self-reliance and the participatory development of normative controls as members relied on the government to protect their interests (Gatheru & Shaw, 1998; Hamer, 1981). However, Gyllstrom (1988: 43) argues that the evolution of cooperatives in Kenya was "not simply a mode of organization imposed on a passive peasantry" but that in many cases, peasants actively contributed to the establishment of societies. Even so, their mode of organization was defined by the government.

4.2.2 Laissez Faire-Minimalist Phase

The neo-liberal influence of the structural adjustment programmes introduced during the liberalization era set the tone for reduced government involvement in the economy. The release of Sessional Paper No. 6 of 1997 entitled *Cooperatives in a Liberalized Economic Environment* signalled the withdrawal of government from the cooperative sector. The policy acknowledged the new economic environment and sought to provide favourable conditions for the growth and development of cooperatives as privately owned business enterprises. The aim of the policy was to make cooperatives "autonomous, self-reliant, self-controlled and commercially viable"

organizations (Wanyama, 2007: 13). The policy formally incorporated the ICA cooperative values and principles that were outlined in the introductory chapter.

The new policy necessitated changes in the legislative framework and therefore the Cooperative Societies Act of 1966 was repealed and replaced by the Cooperative Societies Act No. 12 of 1997. The new Act provided greater autonomy to the cooperatives by transferring the responsibility of routine management duties from the Commissioner of Cooperative Development to the members through their elected management committees. Cooperatives were no longer required to seek the permission of the Commissioner to invest, spend or borrow; instead, that authority was now vested in the annual general meeting and the management committees. Cooperatives were also permitted to hire and dismiss employees without the Commissioner's consent. The role of the Cooperatives Ministry was confined to regulatory aspects such as the registration and liquidation of cooperative societies; formulation of cooperative policy; and enforcement of the Cooperative Societies Act (Wanyama, 2007).

In 1999, the Cooperatives Ministry was downgraded to a department in the Ministry of Agriculture and Rural Development (MoCDM, 2006). This development had several budgetary and policy implications. First, the department experienced budget cuts due to the public sector reform programme and it also had to compete with other agricultural departments for budgetary allocations. The budget cuts had direct implications on staffing levels and operations. Second, the 1997 Act re-established the office of the Registrar of cooperative societies (which had existed in colonial times) and the main activity of the department was limited to registration services for cooperative societies. Third, the abrupt removal of bureaucratic controls left a regulatory vacuum as cooperatives had not developed alternative mechanisms to curb mismanagement. As a result, unscrupulous leaders took advantage of their new-found autonomy to mismanage assets entrusted to them (MoCDM, 2006; Wanyama, 2007).

Mismanagement in the cooperative sector was manifested by the misappropriation of funds; poor financial management; lack of updated basic records such as asset and member registers as well as property inventories; and the lack of regular audits. It was not only confined to primary cooperatives but affected unions, national cooperative organizations and even the national apex body (Wanyama, 2007). There was limited government capacity to inspect the cooperatives and detect such management failures including the will to act on them after they happened. For example, despite the fact that the Act contained a specific clause that allowed the Registrar to surcharge those responsible for incurring losses in cooperatives, there was minimal application of it. Sira and Craig (1989) observe that even though the general membership bears the ultimate responsibility to safeguard cooperative property, they need to be sufficiently aware of their options in the event of mismanagement.

The sharp contraction in government support to the cooperative sector also affected education and training opportunities. The Cooperative College witnessed a drop in the number of trainees from cooperatives attending their courses. This was attributed to the lack of government sponsorship and the inability of most cooperatives, particularly those in the agricultural sector, to raise the required fees for their staff to train at the college (Wanyama, 2009). The savings and credit cooperatives fared better as their national union (KUSCCO) developed a strong niche in the sector for providing education and training courses to its members (Owen, 2007).

In the financial services segment, the Cooperative Insurance Company (CIC) and Cooperative Bank were already providing various education and financial programmes to member cooperatives. For example, CIC was providing awareness on risk protection and management to cooperatives in addition to its core business of underwriting risk insurance for cooperatives. The Cooperative Bank was providing loaning capital and became closely involved in the establishment of FOSAs and the training of FOSA employees. The Kenya Rural Savings and Credit Cooperative Societies Union (KERUSSU), a lobbying and advocacy organization that was registered in 1998, also became involved in education and training for its target membership which was rural credit cooperatives.

In summary, the minimalist phase was marked by a sharp reduction in government involvement and support to the cooperative movement. The withdrawal of bureaucratic controls and reduction in regulatory oversight had serious and mostly negative implications on the governance of cooperatives and their public image. The agricultural cooperatives were hardest hit by the contraction of government support in the provision of education and training services. Financial cooperatives fared better and were well positioned to respond to the opportunities presented by the liberalization of the sector. The visibility of cooperatives in national development also suffered from the downgrading of the ministry to a department within the larger agriculture ministry.

4.2.3 Facilitative-Regulatory Phase

The NARC government re-established a ministry for cooperatives in 2003 and named it the Ministry of Cooperative Development and Marketing (MoCDM). It immediately undertook a review of the policy and legal framework for the sector. The Cooperative Societies Act No. 12 of 1997 was amended resulting in the Cooperative Societies (Amendment) Act No. 2 of 2004. Subsidiary legislation in the form of the Cooperative Societies Rules of 2004 was also published. The amended legal framework was in response to the low levels of public confidence and accountability that were prevalent in the sector. It strengthened the regulatory oversight of the government and introduced stiff penalties for cooperative leaders who mismanaged their organizations. In order to comply with the new Act, all cooperative societies were required to amend their by-laws and hold fresh elections. The terms for elected management committees were also specified in the Act to be a maximum period of six years to reduce the practice of entrenched committees.

An Ethics Commission for Cooperative Societies was created within the ministry to improve governance and ethics in the sector. The Commission was tasked with monitoring compliance based on annual wealth declarations received from all cooperative employee and management

committee members. Newly elected management committees also had to submit indemnity forms within 14 days of election into office. Routine inspections and inquiries were intensified to enhance good corporate governance while the Cooperative Audit Services was elevated to a full department in order to strengthen its oversight role in the financial management of cooperatives (MoCDM, 2006).

The Cooperative Tribunal had been established by the 1997 Act with the aim of settling disputes within the sector. The tribunal was decentralized to the provinces in the 2004 Act in order to reduce travelling costs in the settlement of cooperative disputes. Seven provincial registries were therefore established where complaints could be lodged and heard. A major complaint was the practice of some employers to deduct but not remit member contributions to their credit cooperatives. The amended Act of 2004 empowered the Commissioner of Cooperative Development to directly recover unremitted member contributions from employers. This proved to be an effective provision; by 2008, the Ministry reported it had recovered 82% of the outstanding dues since 2003 (MoCDM, 2008b).

In 2004, stakeholder consultations were initiated within the credit cooperative segment with a view to reaching agreement on a separate regulatory framework for credit cooperatives. The provisions of the amended Act were considered to be inadequate for the development of credit cooperatives as fully-fledged financial institutions. It was particularly relevant to those credit cooperatives that offered quasi-banking services through their front office service activities (FOSAs). A regulatory impact study based on a sample of 148 credit cooperatives found that credit cooperatives were generally weak in fiscal discipline characterized by inadequate financial, operational and internal controls, and poor risk management (Chavez, 2006). Yet a national survey on financial access conducted in 2006 revealed that an estimated 8% of the population used the financial services of credit cooperatives (FSD, 2007). A draft *Sacco Societies Bill* was prepared in 2007 but it lapsed and was subsequently reintroduced in Parliament in May 2008. The Bill was passed with amendments in November 2008 and received presidential assent in December 2008.

The new *Sacco Societies Act (2008)* creates an institutional framework for improved regulation and supervision of credit cooperatives based on international prudential standards. The creation of a regulatory authority to license, supervise and enforce prudential standards is aimed at enhancing public confidence in the credit cooperatives. The law establishes a Deposit Guarantee Fund which provides a fixed amount of compensation (up to Ksh. 100,000) to members in the event of the collapse of their cooperative. The Cooperatives Ministry will still register credit cooperatives according to the requirements stipulated in the Cooperative Societies Act while the new Sacco regulatory authority will license cooperatives which apply to operate FOSAs. The regulatory authority is also empowered by the new law to prescribe the activities that credit cooperatives may engage in.

The Cooperatives Ministry has also formulated guidelines on cooperative education and training in order to standardize content. The variable content and quality of cooperative education provided by many training institutes has been a concern for the ministry. The ministry guidelines were released to all its cooperative field offices in October 2008. Ministry guidelines have also been drafted to guide cooperative investments, governance and ethics (MoCDM, 2008b). The supervisory capacity of the ministry, however, remains fairly limited. According to a senior cooperatives officer[21], there were only 700 technical officers against a total of over 10,000 cooperatives as of October 2008. Interviews with other cooperative officers[22] revealed that their technical skills were also lagging behind those of the cooperative employees they were supposed to supervise. In particular, the officers mentioned the lack of computer skills as a major constraint to providing relevant and up-to-date business advice to the cooperatives.

A new objective of the ministry during this phase is the mainstreaming of gender issues in policy implementation. This is in response to the gender imbalance that has been noted in cooperative membership (MoCDM, 2004). The typical cooperative member has tended to be a male

[21] Interview transcript P2: CO2
[22] Interview transcripts P1: CO1; P3: CO3

household head in either employee-based urban or farmer-based rural cooperatives. In rural cooperatives, the male household head will also be the registered crop or livestock owner due to cultural norms that prohibit land and property ownership by women. The ministry acknowledges that although cooperative development policies advocate for equal participation of both men and women at all levels of cooperative leadership, cultural and religious norms may contribute to inhibiting women's representation (MoCDM, 2004).

The facilitative-regulatory phase has been characterized by targeted government involvement in the cooperative sector to improve its regulatory oversight. This oversight includes the establishment of a new regulatory framework for credit cooperatives. The phase has also been characterized by consultative stakeholder engagement between the Ministry and the cooperatives which reflects the government's adoption of a facilitative role in economic development. The capacity within the Ministry to offer adequate technical advice and supervision, however, remains constrained in terms of personnel and skills.

4.3 TRENDS IN COOPERATIVE DEVELOPMENT

The trends in cooperative development over the three policy phases have been summarized in Table 4.3.

Table 4.3: Trends in Cooperative Development

Phase of cooperative development	Harambee era 1963-1979	Liberalization era 1980-1999	Economic recovery era 2000-2008
Main features	• Rapid increase in smallholder agricultural cooperatives. • Smallholders benefit from subsidized agricultural services. • Establishment of cooperative support structures (bank, college).	• Implementation of SAPs. • Decline in agricultural sector. • Weakening of vertical structure for agricultural cooperatives. • Financial cooperatives and their national cooperative organizations adapt to new market economy.	• Stakeholder engagement. • New government with reform agenda. • Strategic focus on agriculture. • Dominance of credit cooperatives.
Policy direction	***Paternalistic*** • Promoting & nurturing the cooperative movement.	***Laissez faire*** • Cooperatives need to compete in a free market economy.	***Facilitative*** • Moving agricultural cooperatives up the value chain. • Promoting good governance in cooperatives. • Introducing prudential standards for credit cooperatives. • Gender focus in policy implementation
Regulation	***Interventionist approach*** • Direct administrative oversight and supervisory control.	***Minimalist approach*** • Focus on registration services and limited supervision.	***Regulatory approach*** • Stronger enforcement ability with focus on governance and ethics. • Specific legislation for credit cooperatives.
Bureaucratic capacity	• Department upgraded to a ministry. • Growth of co-operatives outpaces staff capacity to adequately supervise & provide education services.	• Downgrading of ministry to department. • Reduction of staff & budgetary resources.	• Re-establishment of ministry. • Recruitment of staff. • Expanded mandate e.g. ethics commission, marketing function.

4.4 NEW REGULATORY DEVELOPMENTS IN THE FINANCIAL SECTOR

In the new long term economic policy for the government, *Kenya Vision 2030*, the government has committed itself to streamlining the microfinance and credit cooperative sectors in a bid to make the financial services sector globally competitive. The enactment of the *Microfinance Act (2006)* and the *Sacco Societies Act (2008)* were important milestones in the realization of this goal. The Microfinance Act brought the regulation of large microfinance institutions under the control of the Central Bank of Kenya. By mid-2009, the Central Bank had licensed two large microfinance institutions to become deposit-taking institutions which broadened their mandate from being solely microcredit lenders and allowed them to mobilize funds domestically (CBK, 2009). The Microfinance Act also offers new business opportunities to microfinance institutions that will enable them to offer a wider range of financial services and products including savings products, lending facilities, money transfers and micro-insurance. This new law has therefore introduced direct competition between microfinance institutions and credit cooperatives in the provision of savings products and other financial services.

The Sacco Societies Act of 2008 has established a regulatory authority that will be responsible for the licensing, regulation and supervision of savings and credit cooperatives. Credit cooperatives will be allowed to engage in trade or investment activities to diversify their income; foreign trade operations such as money transfers; and other banking services prescribed by the regulatory authority. The Act has also introduced prudential standards such as minimum liquidity and capital requirements that credit cooperatives will now have to comply with. The financial statements of credit cooperatives will need to comply with the prescribed disclosure requirements outlined in the international financial reporting standards.

The financial landscape in Kenya has therefore become more regulated and more competitive with these legislative developments. An immediate implication for the credit cooperatives is their compliance with the new prudential standards. Under the Cooperative Societies Act, the credit cooperatives were only required to retain 20% of their surpluses in statutory reserves and would usually pay off the rest in the form of interest or dividends to their members. The

introduction of minimum capital and liquidity requirements is likely to force the cooperatives to retain more of their earnings and pay out less as interest or dividends. Interviews with Cooperative Ministry officers[23] directly involved in the regulatory process indicated that mergers and liquidations of some cooperatives were expected with the introduction of the prudential standards.

The new regulatory framework for credit cooperatives aims to enhance member protection with the creation of a deposit guarantee fund that will protect depositors in the event of collapse of a licensed credit cooperative. It is also likely to boost public confidence in the sector which has faced a number of incidents of fraud and mismanagement. These include large-scale losses of member deposits occasioned by the collapse of pyramid schemes registered as credit cooperatives (Menya & Kiragu, 2008). The regulatory framework signifies that credit cooperatives have been formally recognized by the government as significant actors in the Kenyan financial sector. This is affirmed by the Central Bank which reports that credit cooperatives serve an estimated 6.3 million members with a shares and deposit base of Ksh. 177 billion (US$ 2.3 billion[24]) and an outstanding loan portfolio of Ksh. 105 billion (US$ 1.3 billion) (CBK, 2009).

Conclusion

This chapter has examined the history and development of cooperatives in Kenya over four phases of cooperative development spanning a period of just over a century. The findings indicate that the emergence of smallholder cooperatives was accelerated as a result of political unrest in Central Kenya. Upon independence, the growth of smallholder cooperatives continued at a rapid pace as the government sought to involve smallholders in the monetary economy and national development. This strategy was largely successful as smallholder farmers became engaged in the production of export crops such as tea, coffee and pyrethrum as well as the domestic production of milk, sugarcane, and cotton. The government also established a ministry

[23] Interview transcripts P1: CO1; P9: CO4

[24] Based on the Central Bank June 2009 exchange rate of 1US$ = 78 Kenyan shillings (CBK, 2009).

of cooperative development in the mid-1970s whose priority was to promote smallholder cooperatives.

In the liberalization phase, agricultural cooperatives were the largest number of cooperatives followed by savings and credit cooperatives. The advent of market and trade liberalization in the national economy resulted in the withdrawal of state involvement in most sectors of the economy. Smallholder agriculture was worst affected due to the reduction in subsidized agricultural extension, veterinary services and fertilizer inputs. These factors contributed to the decline in fortunes of smallholder cooperatives during the liberalization phase. Savings and credit cooperatives fared better as they were relatively self-sufficient and their vertical structures provided centralized services. The government liberalized the cooperative sector by withdrawing its administrative oversight and downgrading the ministry to a department. This move was ill-timed as the abrupt removal of bureaucratic controls resulted in numerous cases of mismanagement in the cooperatives which had not developed internal controls.

A new government that was elected in December 2002 ushered in an era of economic recovery. The economic recovery phase, implemented over a five year period, focused on smallholder agriculture with a view to transforming it into a profitable activity through value addition and improved market access. A marketing function was added to the re-established Ministry of Cooperative Development. The government redefined its role as facilitative in terms of providing a favourable macroeconomic environment and building or strengthening the institutional framework.

A new regulatory framework for savings and credit cooperatives has recently been introduced and aims to guide their development into fully-fledged financial institutions with the introduction of international prudential standards. The regulatory focus on financial cooperatives affirms their significance in the national financial sector. Some implications of the new framework include the possibility of mergers and liquidations of some credit cooperatives; reduced member

pay-outs in the form of dividends or interest; enhanced member protection and public confidence in the sector.

The story of cooperative development in Kenya has largely been a success story: Kenya boasts the largest cooperative membership in Africa with seven million members and about 63% of the population directly or indirectly involved in cooperative activities. The growth of savings and credit cooperatives coupled with the introduction of quasi-banking services has provided valuable financial access to rural and urban populations in the absence of alternative financial institutions. The strengthened regulatory provisions and the facilitative stance of government, if sustained, hold great promise to the development of a professional, well-managed and profitable cooperative sector. The focus of the study now shifts from a general overview of cooperatives to the specific perspectives of members as we investigate the presence of social capital in the two cases of the study.

CHAPTER 5

SOCIAL CAPITAL IN CREDIT COOPERATIVES

This chapter presents the study findings that aim to illustrate how social capital facilitates collective economic action in credit cooperatives. Social capital was earlier conceptualised as an interrelated set of five associational features which may be directed towards economic action. The study findings comprise detailed descriptions of each associational feature based on member accounts of interaction patterns within each credit cooperative. The findings follow a literal replication logic in which each case is considered to yield similar results by revealing the presence of social capital. A description of the five associational features of social capital is now presented and discussed in turn.

5.1 HARAMBEE: A NATIONAL SELF-HELP IDEOLOGY

A common set of values is the first associational feature of social capital. It results from socialization processes within society that consensually establish beliefs and their underlying values. This consensus facilitates the formation of groups on a cooperative basis (Portes & Sensenbrenner, 1993). With specific reference to credit cooperatives, the creation of collective economic resources may be enhanced by shared beliefs and values among members. Thus, a group may be held together not only by economic interests but also by a common set of beliefs (Durkheim, 1893/1933). My approach to examining this associational feature in the study was to investigate the presence of common beliefs in the Kenyan society that could explain the emergence of the credit cooperatives.

It can be argued that the *Harambee*[25] philosophy of self-help and mutual assistance in Kenya functions as a basis for group cooperation. According to Mbithi and Rasmusson (1977: 13), the

[25] The word 'Harambee' appears to have a disputed linguistic origin: some scholars claim it has an Arabic origin (Orora & Spiegel, 1980) while others claim it has a Hindu origin (http://en.wikipedia.org/wiki/Harambee).

concept of *Harambee*, which embodies notions of "mutual assistance, joint effort, mutual social responsibility, [and] community self-reliance", is indigenous to many ethnic groups in Kenya. This is exemplified by the fact that many local languages have a term for the concept: it is known as *Mwethia* by the Kamba, *Konyir Kende* by the Luo, *Obwasio* by the Luhya, *Ngwatio* by the Kikuyu and *Emantonyok* by the Maasai (Mbithi & Rasmusson, 1977). It was applied to the activities of a village or kin group such as collective house-building, weeding, bush clearing, irrigation, harvesting and fundraising. Thus, prior to Kenya's independence, the communities in Kenya had been socialized into the concept of *Harambee* as a localized form of labour exchange and other forms of mutual assistance (Mbithi & Rasmusson, 1977).

President Kenyatta made *Harambee* into a national slogan referring to the need for collective efforts in nation-building and welfare improvement. In a speech to mark Kenya's transition to self-rule, he announced:

> "…but you must know that Kenyatta alone cannot give you everything. All things we must do together to develop our country, to get education for our children, to have doctors, to build roads, to improve or provide all day-to-day essentials…*Harambee*!"
>
> President Kenyatta's speech on Independence Day, 12 December 1963 (Mbithi & Rasmusson, 1977; Ngau, 1987)

The underlying principle of self-help in *Harambee* was reiterated in the first policy document of the new government, Sessional paper No. 10 of 1965, in which the president declared:

> "Let this [policy] paper be used from now as the unifying voice of our people and let us all settle down to build our nation. Let all the people of our country roll up their sleeves in a spirit of self-help to create the true fruits of UHURU [Independence]. This is what we mean by *Harambee*. (ROK, 1965: Foreword)

However, the *Harambee* call to action, first expressed in 1963, did not firmly take root until the reality of the slow pace of 'development' (interpreted as the provision of infrastructure) resulted in grassroots disillusionment with the government (Mbithi & Rasmusson, 1977). The local people thereafter understood the term *Harambee* to mean "Get up and demonstrate the capacity

to develop yourselves!" *Harambee* came to symbolize collective effort, community self-reliance and cooperative enterprise at the local, district and national level; subsequently, the *Harambee* movement was born. It became a national development campaign that emphasized collective self-reliance through the use of traditional forms of social organization and the principles of self-help and mutual assistance (Mbithi & Rasmusson, 1977).

The social organization upon which *Harambee* was established was a significant factor in community mobilization. According to Mbithi and Rasmusson, the *Harambee* or self-help groups were not simply "associations of people who decided to come together and organize themselves for their particular interest". Instead, the self-help groups were bound by "pre-existing social ties, rights and duties" which continued to exist beyond the requirements of a specific project (1977: 147). In a similar manner, the original English consumer cooperatives and German rural credit cooperatives were organized around a common geographical area which enabled monitoring of member activities due to pre-existing social ties (Birchall, 1997; Prinz, 2002). This organizational base provided the rationale for social norms of reciprocity and the enforcement of sanctions.

The rapid growth and vibrancy of the *Harambee* movement in the first two decades after Kenya's Independence resulted in a highly successful bottom-up development strategy. People at the grassroots actively participated in the planning and implementation of many self-help projects that were initiated on the basis of a "superabundance of local initiative and enthusiasm" (Cowen & Shenton, 1996: 311). The majority of *Harambee* or self-help projects during this time involved the physical construction of schools, water supply and health facilities, churches and mosques, and cattle dips (enclosed troughs filled with medicated water that cattle wade through for the treatment of ticks) (Mbithi & Rasmusson, 1977; Ngau, 1987). The choice of projects was therefore in response to the felt needs of the local people. The self-help movement was guided by the principles of collective good rather than individual gain and it maximized the mobilization and use of local resources. In addition, many projects involved a participative selection process

for their leadership which provided them with broad based legitimacy in the communities (Mbithi & Rasmusson, 1977).

Between 1965 and 1984, Cowen and Shenton (1996: 311) report that 37,300 *Harambee* projects were completed, contributing 12 per cent of national gross capital formation. This fact was corroborated by Ngau (1987: 526) who had earlier noted that the total nominal valuation of *Harambee* projects over that period was Ksh. 3.2 billion (about US$ 225 million in 1984[26]) representing an average of 11.8% of national gross capital formation. Although the overwhelming majority of *Harambee* projects were of a physical nature, Orora and Spiegel (1980) observed the growing importance of a "non-physical component" of the *Harambee* movement with the emergence of cooperative organizations that adopted a *Harambee* model of self-help to meet the "wide-ranging needs" of Kenya's rural populace and urban low-income groups (1980: 252).

Other authors corroborate this view by attributing the growth of the cooperative movement to the *Harambee* philosophy (Gatheru & Shaw, 1998). Documentary evidence supports the claim that the rapid growth of the cooperative movement occurred in tandem with the growth of the *Harambee* movement. For example, Hyden (1973) has shown that the number of registered cooperatives increased dramatically after Independence and into the early 1970s. It was partly as a result of the rapid growth of the cooperative movement that a Ministry of Cooperative Development was established in 1974 (ROK, 1987). The government also acknowledged the widespread participation of Kenyans in the development process through the *Harambee* spirit. As a result, available statistics show that Kenya has the largest cooperative movement in Africa involving 7 million members or 20% of the population (ICA, 2007b; Co-op Bank, 2008). This includes the highest resource mobilization by credit cooperatives in Africa (WOCCU, 2008).

[26] Based on 1984 annual average exchange rate of 1US$: 14.20 Ksh (World Bank Indicators).

Several factors can explain how socialization into *Harambee* resulted in the rapid formation of cooperatives. First, the societal acceptance of *Harambee* (and its association with indigenous forms of self-help) provided a wide base of 'like-minded' individuals. It was not difficult to find people who were willing to establish groups on a cooperative basis. Second, the *Harambee* principles of self-help and mutual self assistance were similar to the cooperative values of self-help, self-responsibility and solidarity. These principles were the basis for the organization of collective effort. Third, the *Harambee* call to action was legitimated by the President himself and was incorporated in policy papers. As a direct consequence of this, government structures were set up to facilitate the emergence of self-help groups and cooperatives.

At this juncture, I would like to distinguish the emergence of credit cooperatives from the formation of agricultural marketing cooperatives. The majority of credit cooperatives were formed on a purely voluntary basis, similar to *Harambee* groups. This was unlike agricultural cooperatives which required smallholder farmers to register with them as the only outlet for marketing their produce (Wanyama, 2007). Thus, they were not seen as entirely spontaneous or autonomous products of the cooperative movement (Develtere, 1994; Hedlund, 1988a). The dramatic growth of credit cooperatives in Kenya should therefore be understood in the light of voluntary and spontaneous groups emerging to meet the needs of their members (Orora & Spiegel, 1980).

5.1.1 'Cooperation Helps People Develop Together'

The belief in pooling resources for mutual self-help, here described as the *Harambee* ethic, was demonstrated during the fieldwork. For example, it was often acknowledged that one of the best ways to help oneself was through a collective initiative. In addition, when the researcher asked if it was important to cooperate with others for mutual benefit, all the respondents strongly agreed with the statement. The overwhelming rationale for cooperation provided by the respondents was that pooling resources 'helped people develop together'. There was also an overriding theme that one could not achieve their development goals single-handedly as illustrated by these quotes:

"Cooperation is important. No one can do development alone."[27]

"Of course you cannot achieve your goals alone."[28]

"Yes, it is very important [to cooperate with others] because it helps people develop together."[29]

"Yes, it is very important because you cannot do it alone. No one has any monopoly of knowledge and business. Cooperation is vital. Lone rangers never succeed."[30]

The socialization into a *Harambee* ethic was not limited to participation in cooperatives. In Uwezo cooperative, several members indicated they were also members of informal self-help groups such as employee welfare groups, investment clubs and rotating savings and credit associations (commonly known in Kenya as merry-go-rounds). It should be noted that to retain the authenticity of respondent accounts, the use of the word 'Sacco' (an acronym for savings and credit cooperative) has been maintained.

"... Even outside the Sacco, we have women's groups who lend to each other with interest. At work, I participate in a driver's welfare group."[31]

"... In the branch offices, we have introduced welfare groups to meet various needs such as funeral expenses, wedding expenses, hospital bills, farewell send-offs at retirement and even cash bails when members are arrested by the police."[32]

"... Out of my own initiative, I got some members together in an investment club and we have invested a lot. If someone needs money, they borrow it from the Sacco and then we invest the money."[33]

[27] Interview transcript P21: UM28
[28] Interview transcript P9: UM17
[29] Interview transcript P19: UM26
[30] Interview transcript P20: UM27
[31] Interview transcript P27: UM33
[32] Interview transcript P30: UM36
[33] Interview transcript P34: UM4

In Wakulima cooperative, the *Harambee* ethic was seen as a strategy to solve joint problems as these founder members of the rural cooperative recounted:

> *"…One of our biggest problems was affording food during the dry season. For example, we used to buy a 90kg bag of maize for up to ten times its cost price because we had no alternative. But when we pooled resources through the Sacco, we improved our bargaining power and it made a huge difference in price… In fact the needs that made us start the Sacco can be summarized as "food, health and education."*[34]

> *"I am a founder member…I joined in order to help myself. I cannot help myself on my own. Before the Sacco came, things were expensive e.g. food, school fees…"*[35]

The *Harambee* ethic therefore functioned as the basis for organized collective effort in both cooperatives. In addition, almost everyone the researcher spoke to – government officers, technical consultants, apex body representatives, ordinary citizens, cooperative employees and members – seemed to take the existence of cooperatives for granted. It was an indication of the prevailing thread of organized cooperation in the fabric of Kenyan social life. The following quote from one of the technical consultants that I interviewed illustrates the wide societal acceptance of credit cooperatives in Kenya:

> *"…The strength of Saccos is [that] Kenyans love their Saccos. Their basic model is simple which means they can reach a lot of people and they offer their services at affordable rates. Most parents I know, including my own, have educated their children using Sacco loans. Most people who own property in Kenya have usually financed it through their Saccos. The banks have only recently started giving loans so people have more faith in Saccos. It's a historical affiliation…"*[36]

[34] Interview transcript P12: RM12
[35] Interview transcript P10: RM9
[36] Interview transcript P5: TC1

5.1.2 Member Motivations: The Element of Self-Interest

Although there was wide acceptance of credit cooperatives, I did not presume that individuals would automatically follow the societal pattern and join the cooperatives. Instead, I asked members in both cooperatives about their motivations to join and remain in the cooperative. This was to prevent the charge of "over socialization" in which socialization processes are often treated in a deterministic fashion by sociologists and seen as overriding individual choice (Giddens, 1984; Granovetter, 1985; Wrong, 1961).

My analysis of member motivations revealed that members were more interested in cooperating to help themselves than for altruistic purposes. Cooperation appeared to be a disguised form of self-interest. For example, the main motivation for members to join and remain in Wakulima rural cooperative was the assurance of credit when they needed it. Loans were referred to as "assistance" and the process of loan application was referred to as "getting help" as these quotes show. Each quote is ascribed to a different member:

> *"There is security in the knowledge that loans are easily accessible".*[37]
>
> *"When I have problems, I can get help. This matters a lot to me".*[38]
>
> *"The most important thing is a place to turn to for assistance".*[39]
>
> *"What matters most is being able to get help when I need it"*[40]

Thus, while people instinctively recognized the importance of cooperating with others and could be said to ascribe to a common set of beliefs that valued cooperation, there was also an important role played by self-interest. This has been explained by theories of group formation on the basis of a rationally-motivated set of economic interests among social actors expounded by Georg Simmel (1908/1955) and Max Weber (1922/1968).

[37] Interview transcript P19: RM19
[38] Interview transcript P24: RM24
[39] Interview transcript P28: RM28
[40] Interview transcript P3: RM2

- *'I joined to pay school fees'*

In Wakulima rural cooperative, an important motivation for members to join the cooperative was the opportunity to educate their children. Education was highly valued in the rural community and parents were keen to offer the best education for their children. However, the education costs were high relative to member's income levels from small scale farming and small enterprises. In addition, school fees were usually required in lump sums, which was a challenge to many parents. The school fees loan was therefore popular because it allowed parents to pay fees at the beginning of the school year in January and then repay in instalments during the year. The following quotes capture the gist of the benefit: *"I [joined] to pay school fees. So far, I have educated 8 children through secondary"*[41] and *"I have paid school fees for my little girl. The [tea] bonus will offset the remaining balance."*[42]

- *'You cannot rely on your payslip alone'*

In Uwezo urban cooperative, forty out of fifty respondents indicated the primary reason for joining the Sacco was to access the loan facility. The common theme among Uwezo members was that it was difficult to survive on one's payslip alone without some form of credit. The cooperative was therefore their first port of call when they needed to take a loan. The cooperative relied on a system of peer guarantors to provide security for the loans unlike commercial banks which usually required a material form of collateral. As a result, members regarded the cooperative requirements as an easier way to secure a loan than going to a bank. Furthermore, as the loan conditions were internally agreed upon, there was some assurance of personalized service. Below are some quotes from members who explained their rationale:

> *"The Sacco is important because you cannot rely on your payslip alone. I was inspired to join when other members told me of the investments they had done through the Sacco. I became*

[41] Interview transcript P4: RM3
[42] Interview transcript P27: RM27

motivated to join the Sacco and get loans for personal development."[43]

"I wanted to access the loan facilities because the interest rate was low. Access to funds is also easier than other financial institutions. It is in-house: problems are discussed and they attend to you personally."[44]

"The salary we get is too little for us to save substantially. But in the Sacco, you can save money, borrow and get [the repayments] deducted without strain. You can also get a loan three times your savings and make something out of it."[45]

5.1.3 Member Benefits

The majority of Uwezo respondents indicated they had invested their loans in assets and property. A list of the various benefits identified by members is given below:

- Purchase of assets e.g. plots of land, farms, vehicles, livestock and farming equipment.
- Construction of residential property – usually included purchase of the plot of land.
- Payment of school fees.
- Investment projects e.g. small business, financial stocks, rental property.
- Dividends.

Some members appreciated the presence of quasi-banking services provided by the front office service activity (FOSA) which offered savings products such as children's and retirement savings accounts and loan restructuring facilities. Other members mentioned that the cooperative had enabled them to meet their personal and social responsibilities e.g. settle debts, finance weddings and cater for emergencies.

The majority of Wakulima respondents mentioned the ability to educate their children as a major benefit of membership. Other benefits were the availability and close proximity of banking

[43] Interview transcript P18: UM25
[44] Interview transcript P20: UM27
[45] Interview transcript P41: UM46

services; improved crop yields; purchase of land or dairy cows; and home improvements. It appeared as if Wakulima members appreciated the opportunity to enhance their livelihoods and meet basic needs. This was unlike Uwezo members whose benefits were predominantly of an investment nature. It demonstrated the difference in priorities between rural and urban members that could have been attributed to differential financial capabilities.

In conclusion, the *Harambee* ethic was a source of shared beliefs and values that facilitated the formation of groups on a cooperative basis. Even so, the economic interest of members, primarily the need to access credit, was an important contributing factor in the establishment of credit cooperatives.

5.2 BOUNDED SOLIDARITY

This associational feature relies on the reactive sentiments of a group of people against a perceived injustice that activates them to take a collective response. It involves a principled (non-economic) approach to solving a common problem among a group of people. Historical accounts of the reasons that led to the establishment of the two cooperatives revealed the origin of solidarity bonds.

The Uwezo cooperative was created by employees of a state corporation who were shut out of the modern banking sector due to the financial and literacy requirements. When they were informed about cooperatives, they realized how the cooperative model could immediately solve their financial access problem. This is illustrated by the following two quotes:

> "*We founded the Sacco for employees of the [state corporation]. In those days (the early 1970s), you could not open a bank account if you were not educated. We wanted a vehicle to boost our economic growth and investment and that's why we started the Sacco. At that time, we used to receive a salary of 303.80 shillings. Through the Sacco, we could take a loan of 1,000 shillings*

repayable over 4 years. We only had development and emergency loans in the early days. "[46]

"*I joined [state corporation] in 1975. A senior person visited us and talked about cooperatives. He had given talks to different organizations. His message was well received by most people. We joined the Sacco by contributing 20 shillings in 1975. The Sacco was then based in a small office…*"[47]

The founders of the Wakulima rural cooperative were tea farmers who were tired of exploitation by middlemen in the acquisition of food. They had therefore developed a consciousness to unite and solve their collective problems:

"*I was born in 1932 and I am a founder member. We started the Sacco after being exposed to other Saccos… and seeing how they help people. We used to buy a 90kg bag of maize for 4000 shillings but when we got the Sacco, we saw the difference it made. We were able to buy food at a wholesale price because we pooled resources. We also learnt that Saccos could help us educate our children by providing loans to pay the school fees and also help us deal with hospital emergencies through savings for unexpected purposes. In fact the needs that made us start the Sacco can be summarized as health, food and education*."[48]

Another founder member corroborated this view:

"*The main motivation for [starting] the Sacco was the education of children and to alleviate hunger. We wanted to be able to afford food during the dry season and not be exploited by middlemen e.g. a sack of maize that would be bought for 600-800 shillings would be sold to us for 3,000 shillings*."[49]

[46] Interview transcript P14: UM21
[47] Interview transcript P39: UM44
[48] Interview transcript P12: RM12
[49] Interview transcript P1:RM1

5.2.1 The Creation of Collective Capital

The cooperative model introduces the idea that the creation of capital is not limited to the efforts of individuals acting alone but it can also be created by the collective effort of individuals. In both cases of the study, the creation of collective capital conferred rights on lower-income urban employees and rural farmers to participate in the economic sphere which was otherwise dominated by high-income individuals in banks. A similar desire to improve the economic leverage of disadvantaged people led to the invention of the credit cooperative in Germany. Thus, credit cooperatives were formed to meet the financial needs of small farmers in the rural areas and of artisans and small business people in the towns (Birchall, 1997; Guinnane, 2001; Prinz, 2002). The ability of low power or low status groups to create collective economic resources can therefore address power relations in the market place.

The cooperative principle of member economic participation obliges members to contribute equitably to, and democratically control the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. This means that a portion of the cooperative's reserves are held in common and are not all the property of individual members (ICA, 2007c). In longstanding cooperatives, current members benefit from the efforts of past members and are obliged to hold that collective capital in trust for the future (Birchall, 1997).

5.2.2 Loyalty Arising From Solidarity Bonds

Over the years, the solidarity among the Uwezo members had grown so strong that when they were faced with the prospect of opening their common bond of association in order to grow the deposit base, the membership was highly suspicious of the idea. This excerpt is taken from a feasibility report that had been commissioned by the management.

> *Uwezo members are uncertain [about] what to expect if the common bond is opened up. There is a general perception from at least 50% of the members interviewed that introduction of external members/clients would lead to higher incidents of defaulters, who would be difficult to follow up…The current members seem to be very loyal to the Sacco and with a strong sense of ownership. (Feasibility report, p. 20)*

The findings of the feasibility report were corroborated by my research findings. In response to the question if members had considered resigning or opting out of the cooperative, almost two thirds of respondents (32 out of 50) said No citing reasons like the returns on investment and financial access:

> "*… To leave is very difficult. Our dividends are very good compared to other Saccos*. *Even after I retire, I will continue to be a member.*" [50]

> "*No, my salary comes through here. Here, you build yourself and the returns come back to you in form of dividends. Even if we are charged at the counter, it will come back to you.*"[51]

> "*No, I've been in employment for 20 years and I couldn't afford a bank account then. Now, I hold a FOSA account*."[52]

One member answered with a rhetorical question: "*No. If you leave, how will you survive?*"[53] Another member expressed confidence in the safety of deposits: "*No. At Uwezo, you never lose your money*."[54] The decision to remain a member even after retirement was also a common theme: "*No, even when I retire I will remain a member*"[55] and "*No, I have 4 years before retirement and I plan to continue being a member*."[56]

[50] Interview transcript P30: UM36
[51] Interview transcript P37: UM42
[52] Interview transcript P28: UM34
[53] Interview transcript P29: UM35
[54] Interview transcript P22: UM29
[55] Interview transcript P38: UM43
[56] Interview transcript P27: UM33

The members who had considered resigning from the cooperative (12 out of 50) cited reasons like frustrations with the loan conditions and with slow or deteriorating services: "*Yes, I've been frustrated by the loan conditions - I must save first before I get a loan. Furthermore, if I apply, I may not get the amount I asked for*."[57]; "*Well, if services continue deteriorating, we will leave…*"[58]; "*Yes, because of their slow services… Before (about 2 years ago), it was not like this… But now, there's no guarantee you'll be served the same day*."[59]

However, one member regarded the cooperative as a safety net (fall-back option):

> "*Yes, there is a time I thought of leaving and joining Equity [Bank]. When I weighed the options, I decided to remain a Sacco member because if I took a loan at Equity and faced difficulties in servicing it, I could always come here and take a loan to offset it*."[60]

Similarly, most Wakulima respondents, and especially the founder members, expressed a strong sense of ownership and loyalty to the cooperative. These sentiments are captured in the following passage from a market research report that was part of the organizational documents reviewed for the study.

> *There is a strong sense of ownership among the majority of the Sacco members. They are proud of their Sacco and the involvement in decision-making through the AGMs. Majority of the members who participated in the discussions referred to Wakulima Sacco as 'our bank' while they referred to commercial banks as 'banks for the rich.' The members preferred to support business for an institution that they were a part of. (Market Research Report, p. 16)*

In response to the question if they had considered resigning from the cooperative, 25 out of 28 members from the tea growing branches said No for reasons ranging from perceived need for financial services to accrued benefits and investment as the following quotes show:

[57] Interview transcript P31: UM37
[58] Interview transcript P11: UM19
[59] Interview transcript P50: UM9
[60] Interview transcript P5: UM13

"*No. As a founder member, I knew why we needed [the Sacco]. At first, it was difficult to convince people because they thought we were out to make money from them. But after a while, they began to see that it was benefiting people and they started to ask to become members*."[61]

"*No. Where else would I go?*"[62]

"*No. My wealth is here! I have shares in all the branches so why should I leave it? My wife is also a shareholder and she is my nominee to take care of my wealth. Tea is the source of my wealth*."[63]

"*No. I have invested here. All these branches are owned by members*."[64]

Other members explained their loyalty in terms of the compassionate service they received at the cooperative compared to the commercial banks:

"*No. I can always go to the executive committee to ask for assistance. It is unlike a bank where the bank manager can say no and there is no recourse*."[65]

"*No. You know, you cannot tell Equity [Bank] your problems. At least in the Sacco when you have a big problem, you can go and see the [executive] committee. They will listen to you because they know you and if they grant the loan, they know you will repay*."[66]

"*No. I would not get the same assistance from other banks.*"[67]

"*No. The Sacco listens to your problems. Equity [Bank] does not listen. You have to go to the District Commissioner and many places to get signatures for loans.*"[68]

[61] Interview transcript P10: RM9
[62] Interview transcript P12: RM12
[63] Interview transcript P1: RM1
[64] Interview transcript P20: RM20
[65] Interview transcript P16: RM16
[66] Interview transcript P18: RM18
[67] Interview transcript P22: RM22
[68] Interview transcript P27: RM27

However, one member cited a heavy debt burden as a reason why she could not leave the cooperative: "*No. I cannot leave because of my debts*."[69] This member highlighted a certain category of members who felt 'trapped' in loans. According to the Wakulima market research report, there was a cross-section of members who, despite having a sense of ownership, harboured feelings of hopelessness due to over-indebtedness. Members described how their income was spent on repaying loans and other expenditures such as school fees, farm inputs, and farm activities such as planting, weeding, spraying and pruning. As a result of the multiple needs of the farming community, there was little left over to save.

5.2.3 Opening the Common Bond: Implications for Solidarity

In Kenyan cooperative legislation, the common bond of association is defined as a shared occupation or geographic locality such as a neighbourhood, community or rural district. The common bond is also recognized in the first operating principle of the International Credit Union (ICU) movement: "membership in a credit cooperative is voluntary and open to all within the accepted common bond of association who can make use of its services and are willing to accept the corresponding responsibilities" (WOCCU, 2005: para 1).

In the case of Wakulima, the common bond of association originally comprised tea farmers in a specific locality. In 2005, the cooperative's by-laws were amended to allow membership of dairy, coffee and horticultural farmers as well as registered microfinance groups. In addition, organizations and individuals who opened an account with the cooperative through its FOSA were registered as members although they had no voting rights. This latter group of members was known as Class B members. The expansion of Wakulima's common bond of association was necessitated by the need to grow its member and deposit base in the light of unstable proceeds from tea farming. A bold step was taken to launch a new FOSA Branch whose purpose was to serve Class B members located in a neighbouring district.

[69] Interview transcript P28: RM28

As a result of opening the common bond of association, Wakulima cooperative was faced with the prospect of having to clarify or change some of its defining characteristics in order to accommodate a wider assembly of members. For example, an immediate consequence of opening a FOSA branch in the neighbouring district was to clarify the cooperative's affiliation with tea farming as this board member narrated:

> *"…In the neighbouring district, the people were wondering why tea farmers were interested in them. They were questioning our agenda. We explained to them that the Sacco had come to offer them financial services and had nothing to do with tea. Tea was benefiting the farmers but the local business people in the area would benefit in the form of financial services."*[70]

Another issue that emerged was confusion among members of the wider community who could not distinguish between the management of the cooperative and that of the local tea factory due to the close relation in name between the cooperative and the tea factory. A different board member explained:

> *"I would like to add that even before the confusion over the name affected us, we had begun thinking of changing the name. We would like to have a name that is no longer connected to tea because even now people are saying 'we are hearing that you are eating our money just like in the factory'. Also, when farmers affiliated to the factory go on strike and it is reported in the news, people hear the name and immediately associate us with problems."*[71]

The impetus for a name change of the cooperative was further strengthened by a market survey of non-members which revealed that the inclusion of the phrase 'tea growers' in the cooperative's name was perceived to mean that it only served tea farmers. This perception implied that the identity of the cooperative had to change to accommodate a diverse membership. Even the tagline of the cooperative, depicting the cooperative as a granary to meet the future needs of members, was highlighted as a possible item for change due to its association with farming.

[70] FGD with Wakulima Board members
[71] FGD with Wakulima Board members

The opening of the common bond of association in Wakulima cooperative to include non-farmers therefore had implications on its original identity and image. It was not clear what effect, if any, these changes would have on the 'bounded solidarity' of the original members. Furthermore, the introduction of two categories of members – original members with voting rights and new account holders without voting rights – meant that the membership structure of the cooperative could potentially change in the future with original members becoming the minority.

In summary, the data from both cooperatives revealed that the associational feature of bounded solidarity arose from circumstances of financial exclusion and exploitation. This was similar to the origin and growth of the German credit cooperatives (Birchall, 1997; Prinz, 2002). The ability of financial cooperatives to mobilize savings and provide credit based on a collective consciousness disproves conventional beliefs in the banking industry that poor people are not bankable. This point has been persuasively argued by Robinson (2001) in her pioneering analysis of microfinance and Yunus (2007), founder of the Grameen Bank in Bangladesh.

5.3 RECIPROCITY EXCHANGES: RISKS AND REWARDS

The associational feature of reciprocity emerges from the accumulation of routine exchange transactions that occur in the social life of a group. Individuals recognize they have rights and duties first toward specific others and then to the general group (Anthony, 2005). Reciprocity exchanges in the two credit cooperatives were evidenced by the practice of peer guarantors in which members provided personal guarantees to each other as a form of security for loans. The notion of peer guarantors implies that two people entering into such an arrangement know each other well enough to make them confident of each other's ability to return the favour when required. Even so, social exchanges always run the risk of unreciprocated favours (Blau, 1964).

The Raiffeisen model of the rural credit cooperative chose to apply the personal knowledge of members in granting loans in order to reduce the transaction costs of information-gathering and prevent the possibility of granting bad debts (Guinnane, 2001). This was achieved by strictly limiting the rural credit cooperative to a group of people who were no strangers to each other and knew each other well most of their lives: "knowing who is a drunkard, whose farm is in trouble, [and] who has a reputation for not paying his debt" (Prinz, 2002: 11). In this way, the local knowledge network acted as a cost-effective risk management system for the rural credit cooperatives. Raiffeisen is thus credited with introducing the use of personal guarantees from members as security for loans, an innovation which departed from the traditional banking practice that required a tangible form of collateral.

Both cooperatives in the research study used the system of peer guarantors. The system was well-accepted and did not appear to have many problems. An indication of this was that most of the respondents had obtained loans with the help of guarantors for various purposes ranging from personal development, emergency needs, school fees and crop or salary advances. In Wakulima cooperative, respondents preferred peer guarantors to collateral security. Organizational documents reported a general fear among members of giving away land title deeds as security for loans (a common requirement in commercial banks) because of the lack of recourse when one faced difficulties in repaying the loan. This is illustrated by the following quote:

> "*I am happy with the Sacco…I heard of a case where a local bank sent an auctioneer to recover their money. At least here we don't give up our title deeds as collateral. We refused [that option] because even when we face problems, we will eventually pay for the loans*."[72]

Similarly, in Uwezo cooperative, the use of peer guarantors was seen as a less onerous condition for getting a loan:

[72] Interview transcript P16:RM16

"*…The Sacco has favourable conditions. They only ask for your salary slip and fellow members to guarantee you. They don't ask for your [vehicle] logbook. The loan is repaid through the [salary] check-off system*."[73]

The requirement of peer guarantors to secure loans provided the main evidence of reciprocity among cooperative members. Members were well aware that they needed to identify those who could guarantee them when the need arose: *"You must know your neighbours because they are the ones who will guarantee you or know when you have a real problem."*[74] The process of becoming a guarantor involved simply appending one's signature to the loan application form: *"When you need a loan, you have to look for 3 guarantors. They sign as witnesses."*[75]

In 19th century Germany, co-signers needed to physically accompany the borrower to the bank before the loan was approved. In this way, the identity of the co-signers was as important as that of the borrower in determining whether or not to grant the loan (Guinnane, 2001). According to Guinnane, the co-signers did not have to be richer than the borrower. He recounts a case where two labourers who were brothers borrowed 50 Deutsche marks each and co-signed each other's loans on the same day. This example implied that the cooperative had good information and enforcement capabilities in two related ways: First, it meant that the cooperative was less concerned with security by accepting a less wealthy co-signer. Second, accepting these poorer co-signers meant that the cooperative knew a great deal about the co-signer.

5.3.1 The Importance of Regular Member Interaction

The system of peer guarantors in the two credit cooperatives emphasized the importance of ongoing social interaction among members as a low-cost source of information. The main source of routine interaction for the cooperative members was their occupational activities. Thus, for Wakulima cooperative, male members narrated meeting at the Tea Buying Centres

[73] Interview transcript P28: UM34
[74] Interview transcript P15: RM15
[75] Interview transcript P17: RM17

while female members mentioned neighbourly visits and helping one another in tea harvesting. Another source of interaction for Wakulima members was the annual AGMs in which all members were invited to attend. The situation was different in Uwezo because only elected delegates attended the AGMs. Hence, Uwezo members mainly interacted at their work stations in the various corporation offices. In both cooperatives, however, Member Education Days that were held twice a year were another source of interaction.

The system of peer guarantors implies that members are routinely expected to screen potential borrowers and monitor those who have received loans. In this way, members can impose economic and non-economic sanctions at low cost (Guinnane, 2001). Although my research did not yield any narrative accounts of the imposition of sanctions, members tacitly understood that failure to honour one's obligations meant the possibility of informal sanctions of isolation when one needed to find guarantors: "*…You must complete your payments otherwise who will sign for you?*"[76]

In addition to routine monitoring activity, member interaction was a source of investment advice or consultation. To the members, guaranteeing one another was part of a social exchange that included the exchange of ideas and advice. This was perceived to be one of the benefits of cooperation as these quotes illustrate: *"…Other members also give you advice for investment."*[77]; *"…Through advice from others, one can know how to invest."*[78]; *"Yes, [cooperation] is important because you get more information from others."*[79]; *"It's definitely important to cooperate with others! We advise one another."*[80]; *"Yes, we help one another with different views and ideas."*[81]; *"Yes, it is important to cooperate with others because you can get advice. It also enhances the unity of the members."*[82]

[76] Interview transcript P37: UM42
[77] Interview transcript P3: UM11
[78] Interview transcript P18: UM25
[79] Interview transcript P22: UM29
[80] Interview transcript P33: UM39
[81] Interview transcript P36: UM41
[82] Interview transcript P48: UM7

Even though there was great benefit in receiving ideas and advice within the collective, one was still expected to take individual responsibility in planning for one's needs: *"[Although] economic cooperation is important, an individual still needs to know and plan for their financial goals e.g. education, retirement [and] investment."*[83] Taking individual responsibility also meant accepting some level of risk in securing loans: *"Cooperation is definitely important. Yet there are people who want you to take a loan so they can borrow from you. They don't want to take risks themselves."*[84] Thus, according to these members, cooperation involved a certain level of individual responsibility.

5.3.2 The Risks of Reciprocity

An interesting finding was that reciprocity exchanges that were initiated downwards (superior to subordinate) were not always returned as this member explained: *"...I have faced difficulties getting senior people to guarantee me even when the amount is small (e.g. 20,000 shillings). Yet I have guaranteed so many of them (seniors) for very large amounts!"*[85] It appeared easier to acquiesce to a request from one's seniors than to ask them for a reciprocal favour. In any case, it was unlikely that sanctions which governed reciprocity exchanges would be imposed upwards on a superior. Putnam explains: "…only a bold or foolhardy subordinate lacking ties of solidarity with peers, would seek to punish a superior" (1993: 174).

Vertical exchanges were also discovered in Wakulima cooperative concerning the selection of members who went on educational tours. The tea buying centres were divided into zones and several members from each zone were selected for the tours. It was the responsibility of the board members, who were themselves elected per zone, to choose the participants for the educational tours. There were no written criteria for the selection of educational tour participants thus it was clearly a subjective process, based on the board member's discretion. During the

[83] Interview transcript P2: UM10
[84] Interview transcript P49: UM8
[85] Interview transcript P9: UM17

interviews, some of the respondents affirmed they had benefited from the education tours while others expressed discontent about the method of choosing tour participants.

This finding was corroborated by the Wakulima market research report which referred to "discontented" members who complained of unfairness in member selection for education tours. According to these members, only the "preferred" members (those who supported the existing administration) were selected, and they did not disseminate the information they had gained.

It was possible that some board members may have felt obligated to use their prerogative to 'reward' supporters while some members may have expected to benefit from voting for the board members. Given the pervasive culture of patron-client relationships in Kenya's socio-political environment, it would not be too far-fetched to infer the possibility of vertical exchanges in the credit cooperative. According to Putnam (1993), vertical exchanges are characterized by asymmetric obligations because they involve agents of unequal status and power. They therefore embody the risks of reciprocity.

5.4 ENFORCEMENT OF AGREEMENTS

The ability to monitor and enforce agreements is the fourth associational feature of social capital. In informal groups or rotating savings and credit associations, the task of monitoring and enforcing falls on the members. In formal credit cooperatives, the monitoring and enforcing function is the role of both members and employees. In order to access the credit facility, a cooperative member typically applies for a loan and provides surety in the form of his shares or savings and the personal guarantee of at least three other members. These members are known as guarantors and in the event of the member defaulting on his loan repayments, the credit cooperative is obliged to recover the money from the guarantors. This information is usually captured in the loan application form which serves as the formal contract once the loan is approved.

On a day to day basis, the employees formed the communication interface between the general members and the board members who were ultimately responsible for loan approvals. Thus, loan applications were received by the management employees and, depending on the authority levels, decisions were made on the applications. In the FOSAs, the administrative employees served the members based on their banking transactions. As both cooperatives consisted of over six thousand members, there was a great deal of interaction between the members and the employees. Unsurprisingly, member-based issues comprised the majority of the operational challenges that employees faced on a routine basis.

5.4.1 Dealing with Loan Defaulters

An important operational challenge in Wakulima cooperative was the persistent threat of loan defaulters. According to interviews with FOSA branch managers and a review of organizational documents, some members took loans and then attempted to sell off or lease their land thereby absconding from their loan repayment obligations. In such cases, the managers relied on guarantors to alert them of such developments so that they could take appropriate action. This account from one of the branch managers describes the problem:

> "*A major problem is members who change their pay-points once they have been awarded loans. The Tea Agency [which pays the farmers] has been very supportive. It asks its farmers to get clearance from their previous pay-points before they can be allowed to change. There are also some members with existing loans who attempt to sell or sub-divide their farms without informing the Sacco. We ask the guarantors to be alert and inform us of such plans because it is them who will have to pay in the event of the member defaulting. Once we are alerted, we write a letter to the Land Board seeking to block the sale. There are members who also try to rent out their tea bushes. Again, we rely on guarantors to advise us in good time if the member is planning on renting out the tea bushes*." [86]

[86] Interview transcript P49: RS10

During member education days, the Wakulima employees regularly emphasized the risks and responsibilities of guarantors and the need for members to 'know your borrower'. The threat of default had also spread to other loan products targeting microfinance groups and small-scale traders and the cooperative had enlisted the help of the Chief to follow up on defaulters. This threat underscored the need for Wakulima to develop an effective risk management strategy beyond the use of peer guarantors.

It was probably easier to monitor the activities of a neighbouring tea farmer that it was to monitor the activities of a fellow colleague whom you met only at work. In Uwezo, some members were not honest with their guarantors to alert them of difficulties in repayment or even the pending termination of employment. This may have been the reason why one member qualified his belief in cooperation: *"Although it is important to cooperate with others, we should strive to be transparent amongst ourselves when guaranteed. When one has a problem [that may affect loan repayment], he should let others [guarantors] know."*[87]

Some Uwezo guarantors only got to know there was a problem when the employees enforced the terms of the agreement and recovered the monies from the guarantor. For example, one member described his response to the unpleasant experience of paying for a defaulter: *"Yes, the issue of guarantors made me think of resigning. I am now paying for a defaulter a total sum of 49,000 shillings*."[88] An Uwezo board member acknowledged the problem of defaulters and suggested that cooperative policy needed to address the problem.

> *"...Also, [I think] cooperatives must come up with a policy of how to handle defaulters. We use the system of guarantors but people are becoming less trustworthy and reliable – they default easily. You find that even when some people can afford to pay, they don't want to pay, they don't bother. I deal with staff issues and sometimes members come and tell me 'I guaranteed so and*

[87] Interview transcript P1: UM1
[88] Interview transcript P18: UM25

so' when that person has been dismissed and gone. So the loan is repaid by the guarantor and it's painful."[89]

The need to 'know your borrower' became very clear to me when, during one of my Uwezo member interviews, a man approached the respondent and asked him to be his guarantor. The respondent respectfully declined saying that he did not know the loan applicant well enough to guarantee him. This cautious response suggests that members are not likely to bear the risk of just anyone in the group. Instead, the process of selecting a guarantor is designed to ensure compliance because it obliges the consenting member (guarantor) to assume the credit risk of the loan applicant with the ensuing penalties in the event of loan default.

5.4.2 Voluntary vs. Compulsory Member Contributions

Member savings contributions comprised another issue that was subject to enforcement. In the traditional cooperative model, enforcement is achieved by ensuring members' deposits cannot be readily withdrawn because they form the source of funds for the granting of loans. The incentive for members to build up their savings is that loan amounts are pegged to the amount of shares or deposits held by the individual member. In addition, the by-laws may stipulate a regular minimum contribution to be made by members.

In Uwezo cooperative, the minimum contribution was one thousand shillings. However, this requirement was noticeably absent in Wakulima cooperative. Beyond the mandatory share requirements of four thousand shillings, each member of Wakulima cooperative was simply encouraged to build up their shares to a minimum of ten thousand shillings. A review of the AGM minutes revealed that this had proved to be an elusive goal for the majority of members. As a result, the demand for loans in Wakulima far exceeded the available amount of loan capital forcing the cooperative to borrow funds from external sources.

[89] Interview transcript P71: BM2

The chronic shortfall in loan capital was attributed to the 'low savings culture' among members. It was also cited as a serious operational challenge. According to one employee, members tended to "*borrow and then save rather than save and then borrow*."[90] These sentiments were echoed by the district cooperative officer who affirmed that building savings was a major challenge among rural credit cooperatives:

> "…*One of the biggest problems that cooperatives face is insufficient funds… Even though their members are farmers and produce a lot of tea, they have a low savings capacity. In fact the members feel like they are being 'forced' to save. There is a lack of a savings culture unlike the western countries. When you consider how these [rural] cooperative societies start, you find their institutional capital is usually very low because there is a higher demand for taking loans than building savings.*"[91]

However, it was also acknowledged that the prevailing economic climate had generally been unfavourable towards smallholder farmers and exacerbated the situation of low savings among members. The District Cooperative Officer explained it thus:

> "*The other major challenge I can say is the low market prices which also affect [the savings capacity of] the farmers. For example, when the tea is sold, we expect high prices but when the prices become low, there is loan default and the cooperative's funds become insufficient… The other thing is [that] as the prices of household commodities keep on rising due to inflation, people are unable to save as much as they would have wanted. So, when the economy of the country is affected, the cooperative is partly affected because the buying power and the saving power are not in tandem."*

Another factor that may have contributed to the low level of savings among Wakulima members was the disincentive created by the relatively low returns earned on their shares (or deposits). The high interest rates charged on the loans compared to the low dividend rates earned on the

[90] Interview transcript P51: RS14
[91] FGD with Wakulima Board members

shares made some members discontented: "*Members are being sucked! The interest rate is high but the dividends are low*"[92] and "*I feel angry because the interest rate is too high for loan repayment. Yet the interest rate on our shares is low…For example I only got 2,000 shillings as a dividend for my 40,000 Sacco shares*."[93] Another member suggested a lower spread between the rates: "*the interest rate is 17% compared to a dividend rate of 5%. The latter should be 10-11%. They should balance how much they are repaying us and what they are receiving from loan interest*."[94]

In Uwezo cooperative, the problem of low savings among members did not appear to be as acute. The fact that each member was obliged to pay a minimum monthly contribution of one thousand shillings meant that the cooperative was assured of a steady income flow from its members. According to a detailed financial analysis report, Uwezo had consistently financed loans from member deposits over a five-year period. All assets had also been financed with internal resources and external borrowing was less than 5% of the total assets. The report concluded that Uwezo had an effective financial structure that affirmed it had stayed true to its core business of saving and lending.

5.4.3 The Problem of Low Financial Literacy

The majority of Wakulima members were smallholder farmers, with relatively low levels of education. As a result of low financial literacy among members, the employees devoted considerable time attending to members' queries and issues as depicted by the following quote: *"It is a challenge…those who are illiterate don't understand quickly so you have to take time to explain*."[95] It was also a challenge to explain the rules and procedures *"…Then there are semi-literate members for whom it takes time to explain our procedures"*[96] and *"Illiteracy is a problem. It is difficult to explain to a person who doesn't keep records or understand them."*[97]

[92] Interview transcript P25: RM25
[93] Interview transcript P18: RM18
[94] Interview transcript P26: RM26
[95] Interview transcript P42: RS3
[96] Interview transcript P48: RS8
[97] Interview transcript P51: RS14

The low levels of education (and understanding) among members was also evident in the neighbouring district FOSA branch that catered for small-scale traders. One of the employees explained:

> "*Illiteracy is a big problem. Some customers don't understand even when you try your best to tell them about their accounts. At times, I have to ask the customer to wait while I consult with the manager and then refer the customer to him. We are a new branch so we're careful not to put off people and show that the Sacco cares about them*."[98]

In my direct observations, it was evident that an outsider (who didn't understand the local language) would struggle to perform the member advisory services in the branches. A senior employee confirmed this: "*The illiteracy of the members means that you must be prepared to take a long time to explain yourself. If you don't speak the language, the language barrier [becomes] a challenge*.[99]

While higher levels of education were generally present in the urban areas, the issue of low financial literacy was also a problem among the lower cadre of employees in the state corporation. An Uwezo employee described it as part of the dynamics of dealing with a normal population:

> "*You know we're dealing with a population that is mixed – from top executives to semi-skilled manual labourers. When you understand that you're dealing with a normal population, it is not strange that you can respond to a query from a top executive via email and the person is satisfied. On the other end, you cannot write an email to the semi-literate member. You have to meet the person, put financial language into lay man's terms and repeat until the person understands. Sometimes, they still don't understand. But it is a normal population."*[100]

[98] Interview transcript P43: RS4
[99] Interview transcript P52: RS13
[100] Interview transcript P67: US14

5.4.4 Member-Employee Relations

A significant determinant of member satisfaction in both cooperatives was their relationship with the credit officers who were responsible for loan appraisals. For example, the Uwezo credit manager was consistently and highly recommended for her role in assisting members to access a loan or solve their immediate financial needs. Members appreciated the fact that the cooperative was more interested in helping them than recovering their loans as this member explained:

> *"…I would not be where I am without the Sacco. It is more important than the bank because they have a compassionate approach. They are not quick to call auctioneers. They will find a way to help you repay your loan. I have not heard of a Sacco repossessing someone's property."*[101]

A staff member mentioned that they were sometimes obligated to help members rather than rigidly enforce operational procedures:

> *"… Some savings accounts have restricted withdrawals e.g. one can only withdraw after 3 months. But some account holders may insist they want the money before then. As a cooperative, we sometimes bend the rules and the bank manager may/ may not authorize payment, depending on the case. Member-owned institutions, unlike commercial banks, may bend the rules for members"*[102]

However, it was inevitable that there were some members who sought to exert their wishes over loaning procedures particularly when the latter did not favour them. As another staff member explained:

> *"… You know the cooperative setup is [the] owners are the customers. If you don't give them [loans], they remind you of that fact. It's not like the bank where the policy is fixed. Here, when the policy doesn't favour them, you get on the wrong side of the customers. They now behave with an attitude of 'I must be helped because this [cooperative] exists to help us.'"*[103]

[101] Interview transcript P4: UM12
[102] Interview transcript P60: US3
[103] Interview transcript P54: US12

In a similar scenario, the Wakulima employees were sometimes faced with members' problems which presented operational dilemmas and required their discretion to act.

> *"One of the challenges we face is members who don't qualify for loans. Sometimes, they are referred to us by board members with the message 'Please see how you can help so and so'. You have to be careful how you handle them because they can accuse you of speaking rudely. Then there are [other] genuine cases and you have to make a decision [to help].*[104]

Some employees relied on their personal knowledge of the members who approached them with repayment problems: *"…When members come to see me with a problem, I usually rely on what I know of the character of that person to decide how I can assist."*[105]

The social pressure of granting Wakulima members a hearing had led to the designation of two days in the week when the general manager could attend to 'referral' cases. He explained it thus:

> *"…when some members are not satisfied at the branch level, they come to see the manager. They insist they have to see me, whether they qualify for a loan or not, because they have to hear it from me. In some cases you find that I have to reconsider my tough stance and to concede to some things. Remember this person may have exhausted his entitlement for a loan. But he has a kid in school and no other source of income so I have to assess how to squeeze [the system] and assist the member accordingly.*[106]

5.4.5 Management-Board Relations

Effective enforcement is also influenced by the relationship between the management and the board. Successful credit cooperatives are characterized by a collaborative and professional relationship between the board and the management (Niederkohr & Ikeda, 2005). One of the key observations of the research was a positive relationship that was discernible between the board

[104] Interview transcript P52: RS13
[105] Interview transcript P49: RS10
[106] Interview transcript P54: RS16

and the management in the two credit cooperatives. This good relationship was confirmed during interviews with the employees and touted as one of the success factors. It also produced feelings of satisfaction among the management employees:

> *"I must say [the working relationship] between the office of the general manager and the board of directors is very cordial as opposed to what I've seen in Saccos in general. One reason is that I have a unique board that does not want to interfere with what the management does. This is unlike many other cooperatives where you find the board does not leave you alone and you don't have the opportunity to do what you really want to do."*
>
> *In fact, when I want to recommend something [to the board], I feel very free because I know the issue will be looked at very objectively. I have never left the board room feeling disappointed that something was shot down just for the sake of being shot down. I've found most members of the board being very objective… All in all, I think that process helps us to be very professional in the way we approach issues and also in the way we run the affairs of the Sacco."*[107]

Another management employee had this to say:

> *"One thing I can say is that my satisfaction has come from working [well] with the board members. For a long time, I've enjoyed a cordial relationship with them. All the way through I have had an understanding board whereby we discuss things and implement some of them. The board has also been keen to listen to my ideas, which has been very crucial to me. Things can change later but up to now, I've been very happy with the board because we discuss and agree where to take action. We commit to do A B C D, and we do it, and in that way, they have given me their support."*[108]

The good working relationship between the management and the board in Uwezo cooperative was credited to the professionalism of the board which was a source of admiration and motivation for some senior employees:

> "*I like the professionalism in the board and the management… which extends into issues of integrity. This being a financial institution, you really get worried when you're working with*

[107] Interview transcript P73: US15
[108] Interview transcript P54: RS16

people and you're thinking 'I'm not sure what those people are likely to do tomorrow'. But when you know you're dealing with people whose integrity is beyond reproach, you feel comfortable."[109]

"*One thing that I like about working here is that we have a very professional and supportive board. I like the way the board is stepping aside for the management to work without interference."*[110]

In Wakulima, regular meetings between the board and the management employees had led to a greater understanding of expectations between the two parties particularly with regard to dealings with general members.

"In those meetings, we discuss things like when members don't qualify for loans. We agree that board members must refer any member seeking any service, including financial assistance, to the office where we will make an assessment. If it is a loan that is required and the member qualifies, well and good. But if he does not, we advise him accordingly. What we don't want is for the board members to push the general members to us because it will create a rift between us and the members. In those meetings, we have been able to explain this to the board members so they can act on it."[111]

- *The need for board training*

The dynamics of rural cooperatives appeared to require an additional approach to build collaboration between the management and the board. This was because representatives were often elected on the basis of populism rather than technical competence. In the case of Wakulima, continuous efforts to train the board on their responsibilities had also contributed to the collaborative relationship between the management and the board.

[109] Interview transcript P67: US14
[110] Interview transcript P68: US13
[111] Interview transcript P54: RS16

The general manager, who had over twenty years' experience in cooperative management, was well aware of the need to distinguish the role of the board from that of the management particularly in rural cooperatives where the levels of understanding were low:

> *"You know, when somebody is elected because he's a tea farmer and has never been exposed to cooperative management, he cannot understand when you tell him 'The by-laws are saying this' with regard to the qualifications for getting a loan. He has to understand the implications – in case of mismanagement, what happens? So we invite external facilitators to train the board on cooperative matters."*[112]

The focus group discussion with the board members confirmed that they had indeed benefited from training as this member explained:

> *"As board members, we have attended training seminars to learn how to interpret financial statements, how to look at balance sheets, how to do planning, and that has helped us to do our strategic planning. It is important because we come from different backgrounds and it helps us to learn… we're very open and ready to learn and implement new ideas."*

5.4.6 The Case for Member Education

The need for board training in Wakulima cooperative drew attention to a related need for education and training for the general members. The Rochdale Pioneers, in their foresight, had realized that people were unlikely to appreciate or support that which they did not understand. They therefore agreed to allocate an annual levy of 2.5% of their surpluses to provide basic literacy and technical education to a largely uneducated membership (Birchall, 1997). Today, the fifth ICA principle commits cooperatives to "provide education and training for their members, elected representatives, managers and employees so they can contribute effectively to the development of their cooperatives" (ICA, 2007c).

[112] Interview transcript P54: RS16

A review of organizational documents revealed that the education strategy of Wakulima cooperative involved exchange visits to other credit cooperatives and Member Education Days. The exchange visits were described as educational tours and had been organized for members of the board, employees and general members. The member education days served to raise awareness of the various products and services as well as educate general members on the provisions of the by-laws. As a result of these efforts, the cooperative had been awarded several trophies over the years in recognition of its education activities.

In Uwezo cooperative, member education activities largely comprised informal meetings that were held in the various branch offices. These meetings were convened at least twice a year. Members described the meetings as "open and free sessions" in which they were informed of new products and provided feedback on existing products to the employees. Members could also discuss any problems that they had encountered as well as receive updates on membership, loans and any other pertinent information. One member remarked "*…I find the Sacco staff are always ready to offer advice to members [during the meetings]*."[113]

Educational trips in Uwezo appeared to be reserved for board members and management staff, and included international conferences. It was evident that the Uwezo board aspired to benchmark their cooperative with the best in the world and saw the international conferences as opportunities to be informed of the latest trends in the global credit cooperative movement. The international exposure also served as memorable experiences as this board member explained:

> *"…The cooperative has enabled me to travel all around the world to forums and meetings. I've been to the USA, to Hong Kong, and within East Africa for regional meetings. Those have been memorable times because I have interacted internationally and seen what other people do. I realize we have a long way to go. Even when people say 'Uwezo, you're doing well', I know we could do a lot better than now."*[114]

[113] Interview transcript P17: UM24
[114] Interview transcript P72: BM3

One of the management employees also narrated his experience:

> *"In 2004, I attended a seminar organized by the Association of Savings and Credit Cooperatives of Africa (ACOSCCA) in Swaziland. It was quite helpful. We discussed our experiences in Africa, the challenges that we were facing as Saccos, the different interventions that we had in our countries, and recommendations for the way forward. When we share experiences in a forum like that, then one can assess whether some of our problems are really unique or they are also being experienced elsewhere."*[115]

The active observance of the education principle in Uwezo and Wakulima cooperatives is likely to have contributed to a better understanding of cooperative norms among the general membership and enhanced the effective enforcement of agreements. In tribute to the Rochdale pioneers, it can be concluded that the greatest threat to the well-being of any cooperative is an uninformed membership.

[115] Interview transcript P73: US15

5.5 REPRESENTATION AND TRUST

The fifth associational feature of representation refers to the powers conferred on a small number of representatives to act in a group's collective interest. This includes decision-making powers over collective economic resources. Although the supreme authority of the cooperative is vested in the general assembly of members, there are provisions for a governing body known as the board of directors or the management committee. According to the *Cooperative Societies Act (2004)*, it must consist of five to nine members elected from the general assembly. The board is responsible for directing the affairs of the cooperative with powers to:

i. Enter into contracts.
ii. Institute and defend suits and other legal proceedings brought in the name of or against the cooperative society.
iii. Do all other things necessary to achieve the objectives of the society in accordance with its by-laws.

The cooperative legislation and by-laws also provide for the establishment of a supervisory committee. At least one member has to have an accounting background. Members of the board and supervisory committee can serve for a maximum of two consecutive terms of three years each.

5.5.1 Mode of Representation

The Wakulima cooperative followed a direct mode of representation in which nine members of the board were directly elected by the general members according to three electoral zones. Each zone was represented by three board members. Direct representation meant that attendance of the annual general meeting (AGM) was open to all members. The by-laws stipulated the presence of at least 150 members to constitute a quorum for the conduct of business at a general meeting. Members were required to present their membership card and/or their national identity card as evidence of membership at the AGM. The supervisory committee, consisting of three

members, was also elected by the general members in their respective electoral zones. Each committee member represented an electoral zone.

The Uwezo cooperative operated under the delegate mode of representation. This meant that only delegates were entitled to attend the AGM. Delegates were elected from electoral zones in which every cooperative member was entitled to vote. The electoral zones represented all the local offices of the state corporation. The delegates were then clustered into branches which consisted of one or more electoral zones. The branches represented regional units of the corporation. The term of the delegate was 1 year, renewable. It was from this general assembly of delegates that the board of directors, consisting of nine members, was elected. Three members of the supervisory committee were also elected from the delegates.

Just as in political systems, there is some debate as to which is a better system of representation. Direct representation is fair because all members get the chance to vote for their board of directors. For the potential candidates, direct election provides them with an equal opportunity to get elected. It is therefore truly democratic. However, in a large group, the diverse needs of members may pressure the elected agents to behave more like patrons rather than impartial representatives. Delegate representation introduces an extra layer of representation between the general members and their board of directors. It therefore creates more distance and impersonal representation. Hypothetically, members of the board can then operate relatively free from clientelistic demands. However, the election of board members is also vulnerable to capture by special interest groups among the delegates.

The delegate mode of representation appeared to be well-accepted by the majority of Uwezo respondents. Some respondents felt that the delegate system of representation was also a cost-effective system because it enhanced more effective participation than having all members attend the AGM. It was also seen as a practical compromise given the logistical considerations of

having all the members attend the AGM: "*It's not the best system but we can't all vote. Delegates are within reach or accessible and we trust they will choose good leaders at the board level.*"[116]

5.5.2 The Role of Elections in Engendering Trust

In both cooperatives, elections were by a show of hands, secret ballot or queuing as was specifically requested by the majority of members present. Most members confirmed that consensus was sought on the voting method to be used. In Uwezo, show of hands was preferred to secret ballot. Elections appeared to be conducted in a straightforward manner. It was clearly stated in the by-laws that "an election candidate who is evidently known to engage in bribery, corruption, undue inducement of other members or an election malpractice of any description, shall stand disqualified regardless of the seat he seeks" (Uwezo by-laws, p. 14).

Elections in Wakulima cooperative were conducted using the queue-voting method. This method elicited mixed responses among the Wakulima respondents with fifteen out of twenty eight respondents believing that it met the needs of all members. They preferred this method because they felt it was open and transparent.

> *"…It is a transparent system unlike the national elections where it was announced that someone who had died had been elected. Secret ballot might introduce 'stolen votes' stashed in boxes*."[117]

> "*In queue-voting, one can easily see who has been chosen. Secret ballot is not good*."[118]

> "*We agreed at the AGM for queue-voting. There are no conflicts because it is visible. One cannot claim rigging*."[119]

> "*Members agreed on queue-voting to reduce the corruption of secret ballot*."[120]

[116] Interview transcript P17: UM24
[117] Interview transcript P3: RM2
[118] Interview transcript P9: RM8
[119] Interview transcript P10: RM9
[120] Interview transcript P13: RM13

However, ten respondents did not favour queue-voting. Some members associated it with vote-buying while others preferred the privacy of secret ballot:

> *"We vote using queue-voting but I think it attracts 'vote-buying'.*[121]

> *"I prefer secret ballot. Corruption is evident. People are paid money and when they come to line up, even though they would have preferred someone else, they are forced to stand behind the one who paid them. They feel ashamed to stand elsewhere."*[122]

> *"We use queue-voting. There are those who like it and those who don't. I prefer secret ballot because it gives me choice and privacy."*[123]

> *"I would prefer secret ballot because everyone is free to make a choice."*[124]

Three respondents qualified their responses with these observations:

> "*It's hard to say if the voting system meets the needs of all members. You know, rich members may get in and not care for the needs of others*."[125]

> *"I think the youth are easily influenced and they are 'hired' to vote for committee members. They also make noise and disrupt meetings. They outnumber the older and more sober members. The youth have increased in number because of the subdivision of farms. That's why you will see someone with 5,000 shares voting alongside someone with 30,000 shares. Instead I favour a system where those with more shares have more clout because they have more at stake."*[126]

> *"I think that sometimes people just follow the crowd. Whoever has many people, others follow."*[127]

[121] Interview transcript P1: RM1
[122] Interview transcript P2: RM10
[123] Interview transcript P6: RM5
[124] Interview transcript P24: RM24
[125] Interview transcript P15: RM15
[126] Interview transcript P16: RM16
[127] Interview transcript P18: RM18

The allegations of 'vote-buying' were not surprising as the practice is rampant in the political scene in Kenya. The Retired Judge Johann Kriegler, who chaired an Independent Review Commission (IREC) that probed the contentious 2007 general elections, affirmed this during an interview with a local newspaper:

> "*…But one feature that is shocking but which Kenyans don't find shocking is that vote buying is endemic throughout the country. It is common and it is acknowledged as a normal feature of the electoral scene in Kenya*" (*Saturday Nation*, 2008, August 30, p. 16).

His sentiments were echoed in the Commission's report which stated that voter bribery and vote-buying practices were widespread during the 2007 elections. The report contended that "vote-buying and ballot stuffing appear to be such extensive and universally condoned practices in Kenyan elections that the question of whether free and fair elections are genuinely possible can be justified" (IREC, 2008: 9).

The association of secret ballot with vote-rigging and corruption among some Wakulima members demonstrated the extent to which the electoral practices in cooperatives were perceived to mirror those of the national elections. This perception was particularly evident in Wakulima compared to Uwezo, perhaps because the former did not have explicit regulations banning electoral malpractices like Uwezo did. The researcher's conclusion was that member perceptions of the transparency of their elections played a critical role in engendering trust in their representatives.

5.5.3 Voting Considerations for Member Representatives

In terms of the voting considerations for their choice of delegate, Uwezo members mentioned the following characteristics (similar responses have been clustered together):

1. A person who was sociable: "*talks easily with people", "sociable and friendly", enjoys good rapport" and "a good communicator".*
2. A person with good character and trustworthy: *"honest", "responsible", "reliable", "keeps member issues confidential".*

3. A person who was service-oriented: *"ready to work for people", committed to members' welfare", "supportive", "knowledgeable and gives good advice".*
4. A person with good leadership skills: *"influential person who delivers results", "competently represents members' issues", "boldly asks questions".*
5. An educated person: *"possesses the right qualifications", "person who is financially literate and capable".*
6. A person who was accessible: *"available to perform duties", "approachable", "dedicates time for member issues".*

There was an overwhelming expectation of service from the delegate representatives: members wanted someone who was ready to act on behalf of others and who was committed to members' welfare. One member summarized the expectations as follows:

> *"[We look for] someone who is educated, bold to speak out and who is able to bring back feedback: Someone who can deliver a clean and understandable output. The delegate acts as the liaison between the board and other members. He must be responsible to follow up on issues raised by members.*[128]

In Wakulima, the top five voting considerations for board members were found to be largely similar to the desired behaviour and character of Uwezo delegates:

- A person who listens when members face difficult times.

> *"It should be someone who listens. Our development loan has been extended in previous years because the committee listened to us about the difficulties we had in repaying the loan.*"[129]

- A person with good character.

> *"He must be of good character – not serving just to be paid an allowance or someone who abuses people. He must not be greedy but protect the Sacco's resources."*[130]

[128] Interview transcript P14: UM21
[129] Interview transcript P18: RM18
[130] Interview transcript P1: RM1

- A person with an ability to get on with people.

  "I consider what kind of person they are. Can they help people? Because we live in community, how does one conduct himself in speech, actions and character? So it has to be someone who is sociable and talks well with people."[131]

- A person with a helping/serving attitude.

  "It should be someone who listens to other people, who is not there for self-interest but to serve others."[132]

- An educated person who understands what needs to be done.

  "It should be someone who is educated so they are not deceived by junior staff."[133]

The desired qualities of member representatives have been summarized in Table 5.1.

Table 5.1: Member-defined qualities of a good representative

✓ Service-oriented
✓ Good character
✓ Sociable
✓ Educated
✓ Good leadership skills

5.5.4 Governance Responsibilities of Board Members

In the two cooperatives, members of the board were well aware of their responsibilities and appeared to be committed to their role of providing leadership. For example, Uwezo board respondents indicated that they attended three meetings, on average, in a month – one full board meeting and two subcommittee meetings. In Wakulima, members of the executive committee met every week to attend to administrative matters in addition to a full board meeting every

[131] Interview transcript P10: RM9
[132] Interview transcript P2: RM10
[133] Interview transcript P14: RM14

month. Other non-executive board members met in subcommittee meetings at least once a month.

In order to accomplish its mandate, the Wakulima board had formed four subcommittees: Executive, Education, Credit and FOSA. The executive committee consisted of the executive officers who were responsible for signing cheques and contract documents on behalf of the cooperative. The education subcommittee was responsible for organizing education programmes for the members and preparing budget proposals for education activities. The credit subcommittee was responsible for the loaning policy and the cooperative's adherence to it. The FOSA subcommittee was responsible for the marketing policy of the cooperative's products to its members and potential members. Each board member participated in at least two subcommittees.

The Uwezo board had formed five subcommittees: Audit, FOSA operations, Marketing, Staff, and Strategy. The audit subcommittee was responsible for overseeing the internal audit function while the FOSA subcommittee was tasked with determining interest rates for FOSA products, based on the prevailing market rates, and enhancing customer service. The marketing subcommittee was responsible for the marketing strategies of the various products and services. The staff subcommittee was responsible for the welfare of Uwezo employees and the human resource policy. The strategy subcommittee was a recent addition and had been tasked with developing a new strategic plan for the cooperative. The reports of the various subcommittees were tabled before the full board meeting for deliberation and possible action.

The tenure of service for the board members varied between 4-12 years for Uwezo and 7-12 years for Wakulima. The Cooperative Societies Act of 2004 has limited the terms of all board positions to a maximum period of six years. This means that succession planning is likely to take on new significance in the governance of the cooperatives.

5.5.5 Board Considerations in Decision-Making

The primary responsibility of the Uwezo board was to make decisions in the best interest of the collective body of members. As one board respondent remarked "*we put ourselves in the shoes of our members and ask 'if you were the member yourself, what would be good for you?*' "[134] As members of the cooperatives themselves, the board members had an incentive to make decisions that ultimately added value to the members. This value was reflected in prudent financial decisions that enhanced the growth and safety of members' funds as well as yielded consistent returns to members.

Members of the Uwezo board observed that their internal decision-making process tended to be thorough, examining the various options from all angles: "*each decision undergoes scrutiny – what is the reason for this decision? Is it the right decision? What is the alternative? Is it the cheaper option?*"[135] At times, the board members sought external expertise in an area that they were uncertain or uninformed about. In this way, the board ensured that it made informed decisions on behalf of the members.

Another board respondent remarked that they were also keen to "*integrate integrity with professionalism.*"[136] They were therefore careful to ensure ethical behaviour and compliance of the law. This was a particularly important point because the image of cooperatives and their leadership had suffered from pervasive and negative perceptions of mismanagement and corruption. In the case of the Uwezo board, it appeared as if they were keen to take a proactive stance regarding ethical governance rather than simply relying on the law to dictate the expected standards.

[134] Interview transcript P72: BM3
[135] Interview transcript P72: BM3
[136] Interview transcript P69: BM1

The influence of a corporate environment may also have led the Uwezo board to adopt a business-like approach in their decision-making processes. For example, the board members had adopted a strategic approach to policy formulation by identifying the challenges that the cooperative was likely to face in the short to medium term and preparing strategies to address them. This entailed empowering the management staff to take on more operational responsibilities in preparation of organizational change in a fast-changing market environment. Thus, the board sought to stride ahead of the members in terms of providing strategic leadership.

In contrast, the Wakulima board preferred to move in tandem with the general members. According to one respondent, it was important for the general members to understand the rationale for certain decisions. The board therefore adopted a targeted educational approach to its decision-making processes as this member explained:

> *"…We take education to our members very seriously. Every year we organize meetings in each branch and talk to the members. We also take them all over the country so that they can network with other Saccos. And the knowledge we gain helps us [the board] very much because we learn together with them [the members]."*[137]

A consequence to this approach was that members who attended educational tours felt free to suggest new ideas and these would then be considered by the board.

> *"The other point is that when these members learn something new, they consult with the board members on how they can benefit from what they've learnt."*

Another Wakulima board member mentioned that they had to consider the prevailing circumstances (e.g. weather conditions) in the farming community because they directly contributed to the difficulties that members faced at any particular time.

> *"We also consider the community members and their problems. We may wish to pay a high or a very low dividend but we consider the prevailing circumstances: there may be a shortage of food and therefore hunger so we end up paying a higher dividend even though we were supposed to*

[137] FGD with Wakulima Board members

reserve some for institutional capital. You know, a hungry man is an angry man."

The board members therefore had to remain sensitive to the plight of the general members in their decision-making considerations.

5.5.6 Negotiations in Decision-Making at the AGMs

Despite the board's professed sensitivity to members' needs in both cooperatives, it was inevitable that the cooperative's democratic structure would influence the outcome of the board's proposals. The supreme decision-making body was the general assembly and it could exert its authority by rejecting some of the board's proposals. A review of the AGM minutes in both cooperatives provided evidence of this.

In 2004, the Wakulima board proposed a dividend rate of 5% citing a drop in the surplus generated that financial year. However, upon discussion of the treasurer's report, members approved a dividend rate of 6% instead. The following year, members overturned the board's proposal for a dividend rate of 4.5% and approved a rate of 9%. They also proposed not to pay honoraria to the board and gave authority to the board to secure an external loan to cover the deficit occasioned by the higher dividend payout.

The general manager of Wakulima cooperative also alluded to the tough negotiations that typically characterized the decision-making process in the AGMs:

> *"…Sometimes these [meetings] are very hot and furthermore, the members may want to pass resolutions which, even if you try to implement, are not possible. As a staff member, I have to step in and advise them because, sometimes, they may not be ready to listen to the people they have elected. At times, even the board members have some fears addressing the general members so I have to come out boldly and say 'please, this [thing] is not possible and we cannot move in*

that direction.' So I have to assist the chairman to resolve some of these matters in the [general] meetings."[138]

The Uwezo board had likewise faced resistance to some of their proposals. A contentious issue that had been recorded in the AGM minutes was the establishment of the FOSA. Two board members described the process of convincing members to adopt the innovation:

"...the other one was when we [proposed] the FOSA. There was an uprising. We were told 'So now you guys, this is the way you're going to eat [our] money, eh? Because [once we start] the bank, you will just enter, withdraw and go away with our money.' We had to convince them that the FOSA was just another window to add money into their pockets. We had to go round and convince members. In the end, we were successful. I can assure you [that] if you now told them we want to close this FOSA, they will tell you 'never!' and they will vote you out instead..."[139]

"There was a lot of war before the members agreed to a banking facility called Front Office [FOSA]. People would say 'now when we start the banking facility, people will be easily loaning out money and it will be misused.' You know, we had to address those fears. It took time before they agreed. It's only now that they are realizing that it was worthwhile. People are even allowing their salaries to pass through the FOSA and getting loans so they can now see the benefit. But, in the beginning, that was not the case."[140]

Another contentious issue in Uwezo was the prospect of opening the common bond of association as this board member narrated:

"In the last AGM, we floated an issue that was not agreed upon. When we looked at the organization's future, one of the challenges we identified was growth; now, growth can be in terms of savings or membership. We were growing in terms of savings but in terms of membership we have been in a plateau for the last 5 years. When we reviewed the options that

[138] Interview transcript P54: RS16
[139] Interview transcript P72: BM3
[140] Interview transcript P71: BM2

were available to us, one of the limiting factors we identified was the fact that we have limited membership to a common bond of [state corporation] staff. We therefore wanted to open it up. In fact we even invited some experts to make a presentation but the delegates started getting jittery. They thought we were bringing things that they were not happy about…so it wasn't agreed upon."[141]

In both cooperatives, it was clear that the general members displayed a healthy scepticism towards their elected representatives. It seemed as if the board members continually had to earn the trust and confidence of the members. The litmus test of members' trust and confidence was expressed in the AGMs when the board proposals were negotiated and either passed or rejected.

Conclusion

This chapter has presented the qualitative data as evidence of the associational features of social capital. The findings suggest that a national self-help ideology, referred to as the *Harambee* ethic, exists in Kenya and may be responsible for the rapid growth of cooperatives in the post-independence era. The *Harambee* ethic was associated with traditional forms of social organization and mutual self-help that may have enhanced societal acceptance. Additionally, *Harambee* was legitimated by the political leadership and government structures. The findings also suggest that the *Harambee* ethic may have moderated individual self-interest in such a way that people preferred to engage in a collective enterprise as a strategy for self-help.

Bounded solidarity arose from situations of financial exclusion (Uwezo) and exploitation (Wakulima). This situational solidarity, bounded in time and space, played a foundational role in the creation of collective capital. The collective capital addressed power relations in the economic sphere by enabling low-income groups to participate in the financial marketplace. The study found that solidarity bonds had also created a strong group identity and sense of ownership among members of each cooperative over time. The strong group identity in Uwezo was

[141] Interview transcript P69: BM1

demonstrated by the resistance of members to open their common bond of association. On the other hand, Wakulima members had consented to the opening of their common bond of association due to financial pressures. An expanded membership, however, implied possible changes to some of Wakulima's defining characteristics such as its name and tagline.

The system of peer guarantors was the main evidence of reciprocity exchanges in both cooperatives. It was well accepted by members and considered to be a relatively easy condition for securing a loan. Regular member interaction functioned as a form of monitoring activity and provided the cooperatives with a low-cost source of information. An interesting finding was that the risks of unreciprocated favours were most likely to occur in vertical exchanges because they tend to involve agents of unequal status and power and therefore result in asymmetrical obligations.

The effective enforcement of agreements was the main responsibility of the employees of the cooperatives and required a collaborative relationship between the management and the board. The enforcement of rules and procedures also required continuous education on member rights and obligations particularly due to low levels of financial literacy among members. The findings suggest that the biggest threat to the well-being of any cooperative appears to be an uninformed membership.

Finally, the transparency of the electoral system and the behaviour of candidates were found to play an important role in engendering member trust and confidence in the cooperatives. There was a high degree of similarity in the member-defined qualities of a good representative in both cooperatives. However, the style of leadership in the cooperatives was found to be different: the Uwezo board took on a strategic approach while the Wakulima board appeared to be more consultative. Member trust and confidence in their elected representatives was ultimately expressed in the annual general meetings where board proposals were discussed and either accepted or rejected.

CHAPTER 6

CREDIT COOPERATIVES AS SOCIAL AND ECONOMIC ORGANIZATIONS

This chapter continues to present the study findings. It provides a descriptive and analytical account of the two credit cooperatives and their economic and socio-political context. The aim of the chapter is to illustrate the role of contextual factors in understanding economic cooperation. The chapter also examines the credit cooperatives operating as social and economic organizations in the Kenyan context. The rural and urban contexts of the credit cooperatives provide the specific basis for comparison.

The descriptive accounts of the cooperatives are modelled after Hedlund's (1988b) case study approach in which he examined a single Kenyan cooperative as an open and integrated social and economic system. He also incorporated members' views to gain an insider perspective on the economic and socio-political context of the cooperative. Each case description therefore incorporates primary data collected during the fieldwork as well as secondary data sources in its construction. The names of the credit cooperatives portrayed in the descriptive accounts are fictitious in order to protect their identity.

A descriptive account of the rural credit cooperative is first presented followed by an analytical section on the tea sector. The tea sector forms the economic context of the rural credit cooperative and is examined in a chronological format from its historical roots up to the year 2008 which was the specific period of the fieldwork. Likewise, the third section presents a descriptive account of the urban credit cooperative followed by an analytical section on the public enterprises sector. A comparative analysis of the rural and urban credit cooperatives operating as social organizations within the socio-political context is then presented. It is followed by a similar analysis of the two cooperatives operating as economic organizations as well as financial institutions in the national economy. The chapter concludes with a summary of the main points.

6.1 WAKULIMA RURAL CREDIT COOPERATIVE

The Wakulima Rural Credit Cooperative was situated in one of the highland districts bordering Mt. Kenya and had an agro-ecological profile that was favourable for the growth of export crops like coffee, tea and pyrethrum. Smallholder tea farms were evident and provided a panoramic view of green patchwork across the rolling hills of the countryside. As in most other areas of Central Kenya, there was evidence of high population density. The road leading to the cooperative was an all-weather gravel road that was in the process of being upgraded. The road provided a gentle ascent into the higher altitude and cooler temperatures that were required for tea production.

The rural cooperative was formally registered on 16th April 1991. It was established to cater for the financial needs of tea farmers in the locality and had an initial membership of 700 members. By June 2008, there were 7,124 registered members. Organizational documents stated that the "overwhelming majority" of members were men. According to cultural traditions, men were usually registered as the formal owners of land belonging to a household. The age profile of the membership revealed that 60% of members were 18-45 years old while 30% of members were 45-65 years. A further 10% of members were 66 years and above. There were two tea factories in the vicinity of the cooperative serving a total of 15,436 tea farmers. This meant that the cooperative was serving almost half of all the tea farmers in the area.

The main economic activity of the members was tea, dairy and coffee farming. The majority of members earned an average net income of Ksh 3,000 per month (about US$ 45[142]) which would have classified them as low income earners[143]. The average landholding was about 1.2 hectares per family according to the district development plan. The land was heavily cultivated with rows of tea bushes that were interspersed with patches of bananas, potatoes, and beans. Tall

[142] Based on 2007 annual average exchange rate of 1US$: 66.35 Kenyan shillings (KSh).
[143] In 2009, the official minimum wage for agricultural workers in formal employment was Ksh. 3,043.

deciduous trees served as biological fences and wind-breaks. The hilly terrain coupled with intensive crop cultivation made the area susceptible to soil erosion making it necessary for farmers to practise terracing. The area was sufficiently watered by streams from the nearby mountain as well as a bimodal rainfall pattern.

The head office of Wakulima credit cooperative was located at one of the divisional headquarters of the district and about 13 km from the provincial centre. The divisional headquarters was a typical Kenyan rural town centre with a few single storey stone buildings that housed several small retail shops and bars. A police post and chief's office were located at the periphery of the rural town centre. The cooperative's head office was housed at the end of a line of retail shops that overlooked an open field which served as a recreational ground. About a hundred metres from the head office was the division officer's office[144]. The annual general meetings of the cooperative were held at the grounds of this office.

The cooperative established a quasi-banking section known as a Front Office Service Activity (FOSA) on 1st October 1996. The FOSA had grown to include five branches by 2006. The head office of the cooperative, hereafter referred to as Main Branch, accommodated the management staff as well as the branch staff. It was officially opened by the managing director of Cooperative Bank in March 1998. The other FOSA branches had been officially opened on dates ranging from 2003 to 2006. Four of the FOSA branches had been built with funds contributed by members as part of an institutional development fund. The member contributions were regarded as development shares which earned dividends at the end of each financial year.

The management committee (or board of directors) of the cooperative was mandated to appoint a general manager who was the chief executive officer of the cooperative. The general manager was generally responsible for providing advice to the committee and implementing its policies

[144] The division officer is part of the government's administrative structure known as the provincial administration. Holders of these offices are civil servants and not elected representatives.

and decisions. The general manager achieved this responsibility with a team of employees who were also appointed by the committee. At the time of the fieldwork, the staff establishment of the cooperative was 36. The length of service among the cooperative's employees ranged from 1½ years to 13 years.

6.1.1 Physical Description of the FOSA Branches

The Main Branch consisted of a medium-sized banking hall that was mainly illuminated by the open wooden double door at the entrance. To the left of the entrance were five customer counters which were labelled with numbers and secured with metal grilles. One of these counters was visibly marked 'Enquiries Counter'. At the far right of the counters, a photocopier was clearly visible through the metal grilles. Directly opposite the main entrance was a wall with opaque glass sections that led to the inner offices. There were also two metal doors with an automated opening device for security purposes. The right side of the banking hall had a notice board and a wooden suggestion box. Benches were placed along the wall on each side of the main entrance. A lone desk and chair, reserved for Customer Service, were the only other furniture in the banking hall. However, they were hardly used as all enquiries were handled at the designated counter. Three FOSA branches were built in a similar style to the Main Branch. They were, on average, a distance of 5-6 km from the Main Branch headquarters. Two of the FOSA branches were in close proximity (about 1 km) to the two tea factories in the area.

The fifth FOSA branch was situated in a neighbouring district, about 50 km from the Main Branch. It was in a lowland area with flat and rocky terrain that was classified as a semi-arid agro-pastoral zone. This FOSA branch was different from the rest as its main target was local traders of the small market centre and not tea farmers. All FOSA branches were open Monday to Friday from 8:30am – 3pm and on Saturday from 8:30am – 1pm. The following page contains pictures of one of the FOSA branches (Figure 6.1) and a smallholder tea farm in the study area (Figure 6.2). A black and white picture masks the branding colours of Wakulima cooperative.



Figure 6.1: FOSA clients at Wakulima credit cooperative



Figure 6.2: A smallholder tea farm in Central Kenya

- *FOSA Branch statistics*

At the inception of the FOSA in Main Branch in 1997, initial FOSA accounts were 1,943. By June 2008, this number had risen to 14,263 due to an expanded branch network and the incorporation of new members. In 2005, the cooperative's membership, then exclusively drawn from tea farmers, had amended its by-laws to expand the common bond of association to include four new categories of members. These were: dairy, coffee and horticulture farmers; members of the immediate family of the primary member; registered microfinance groups; organizations (such as churches and businesses) and individuals who opened FOSA accounts. The latter two categories were known as Class B members and were distinguished by the fact that they did not hold voting rights in the cooperative. All the members of the fifth FOSA Branch were Class B members. The member statistics per FOSA branch are shown below.

Table 6.1: FOSA Branch statistics for Wakulima Credit Cooperative, 2008

Branch	No. of members	FOSA customers
Main	1,593	3,041
2	2,023	3,474
3	1,980	3,428
4	1,528	2,976
5	-	1,344
TOTAL	**7,124**	**14,263**

The table reveals that the total number of FOSA customers exceeded the number of registered members. The term FOSA customer was used to refer to any person holding a FOSA account in the cooperative. This meant that the tally of FOSA customers combined primary members (tea farmers, spouses, microfinance groups) and Class B members (organizations and individuals). Only the fifth FOSA branch consisted exclusively of Class B members. As a result, the number of FOSA account holders surpassed the number of primary or registered members.

6.1.2 Financial Products and Services at Wakulima Credit Cooperative

Wakulima credit cooperative was established to meet the financial needs of smallholder tea farmers. The savings and loan products as well as the modes of repayment were therefore geared

towards this clientele. For example, the most popular loan products were the Normal and Development loans whose repayments were based on tea production. The Normal loan was a 1-year loan that was recovered once during the tea bonus period. The bonuses paid to farmers were dependent on their individual tea production and the prevailing world market prices. The Development loan was repaid over 3 years based on monthly tea payments. Other loan products were Crop Advances to enable farmers to pay for the picking of tea and which were recovered on a monthly basis and School Fees loans which were recovered once a year during bonus time. These loans were only available to primary members and were referred to as back office loan products.

In the traditional back office model of the Kenyan credit cooperative, the cooperative's savings are dominated by member share deposits which cannot be readily withdrawn as one of the conditions for membership. The savings constitute the pool of funds that enables the cooperative to offer loans to its members. To the members, however, the savings represent 'locked' deposits because they can only access their savings upon leaving the cooperative. The FOSA was introduced as an innovation to the traditional cooperative model in the mid-1990s to allow members to access their savings without having to leave the membership (Owen, 2007). The Wakulima FOSA therefore offered savings products that were designed to mobilize voluntary deposits among the members that could readily be withdrawn. These included ordinary savings accounts for day-to-day transactions; fixed deposit accounts that earned interest over a predetermined period; business accounts to build business capital; medical savings accounts to cater for medical expenses and children savings accounts to encourage the children of members to save.

The introduction of the FOSA also enabled the cooperative to diversity its loan products in order to cater for the new categories of members who were not tea farmers. For example, the FOSA offered group-based microfinance loans, business loans to small-scale entrepreneurs and salary advances to public sector employees such as civil servants and teachers.

Figure 6.3 below illustrates the performance of back office (BOSA) and FOSA products between 2005 and 2007. The results indicate that although BOSA deposits continued to dominate total deposits, their overall contribution had declined in favour of FOSA deposits which showed positive growth over the 3-year period. The loan portfolio, however, remained heavily skewed in favour of the traditional back office loan products targeting tea farmers. Even so, a modest growth trend observed for FOSA loan products meant that the FOSA presented a promising growth opportunity for the cooperative beyond its reliance on traditional farmer clients.

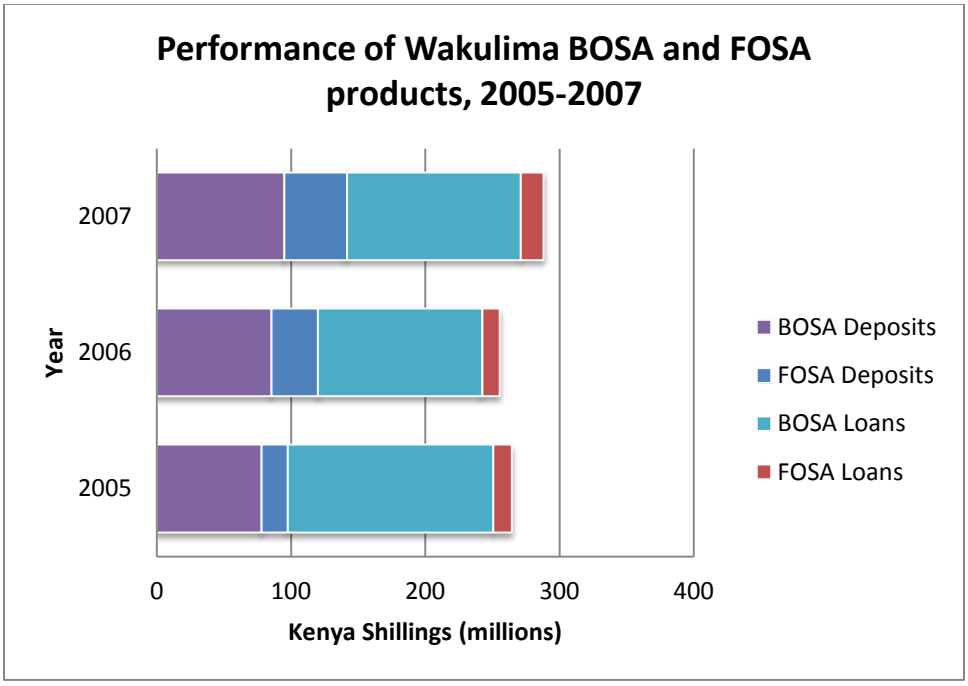

Figure 6.3: Performance of Wakulima BOSA and FOSA products, 2005-2007

A similar positive growth result for voluntary savings products was reported for the credit unions of Latin America (Branch & Klaehn, 2002). Branch and Klaehn interpreted the positive growth in voluntary savings as a confirmation that cooperative members save more when they have ready access to their funds.

In mid-2008, the Wakulima FOSA introduced new loan products for dairy and cereal farming as well as market day advances targeted at local traders in the fifth FOSA branch. In addition to the savings and loan products, the FOSA Branches offered photocopying services; sale of banker's cheques; insurance cover to offset member loans in the event of death (including a contribution towards funeral expenses); safe depository services for personal documents; and member advisory and education services.

From my direct observations and FOSA branch visits, it was evident that the credit cooperative was providing essential yet localized banking services to its members. This was later confirmed by the member interviews. The access to financial services was particularly important in the absence of alternative banking institutions. It is worth noting that all the branches of the major commercial and microfinance banks were located in the major provincial centre thirteen kilometres away from the Main Branch of the cooperative. This meant that the commercial banks were at least twenty kilometres away from the highland branches and fifty kilometres from the lowland branch in the neighbouring district.

6.2 THE TEA SECTOR

The economic context of Wakulima credit cooperative was defined by the tea sector[145] as smallholder tea production was the main source of income for the members. An overview of the tea sector is presented in order to provide an understanding of some of the contextual factors that affected the farmer members. The liberalization of the country's economic sectors has been the single most important development affecting the tea sector. The analysis of the tea sector is therefore divided into three distinct phases that describe the development of the sector prior to, during and after liberalization.

[145] The tea sector is a subsector of the larger agricultural sector in Kenya.

6.2.1 The Pre Liberalization Phase: 1964-1992

Prior to Kenya's independence in 1963, smallholder tea production had been introduced in two small areas of Central Kenya by the colonial Department of Agriculture in the early 1950s. It was part of a general attempt to quell African rebellion through economic integration. In 1957, a tea processing factory at Ragati in Nyeri was built by the African Grown Tea Marketing Board, which was the precursor of the Special Crops Development Authority (SCDA) that was later established in 1960 (Gitonga, 2007). After Independence, the SCDA was restricted to the production of tea and was renamed the Kenya Tea Development Authority (KTDA) in 1964.

It was expected to become self-sustaining with every aspect of production, including agricultural extension, being financed from the sales of the tea growers (Leonard, 1991). The extensive development of feeder roads was to be financed by a tea cess that was levied on the growers by KTDA on behalf of the government. Tea was therefore exempted from the general state taxes that other farmers had to pay in return for extension and road services. It is possible that the comprehensive responsibility that KTDA undertook in return for no additional taxes enhanced its autonomy by making it self sufficient in most of the resources it required (Lamb & Muller, 1982).

The origin of KTDA's comprehensive oversight of its growers was based on the colonial organizational model that emphasized control as it sought to incorporate African peasants into the market and transform them into petty-bourgeois (Leonard, 1991). Farmers had to commit themselves to planting a minimum of one acre of tea or approximately 1,000 tea bushes (Gitonga, 2007). KTDA maintained that plantings below this minimum would not be viable. This requirement inclined tea production towards the more advantaged, who had more land and other sources of income as tea produces no income for the first three years after it is planted (Leonard, 1991).

The post-colonial organizational model of KTDA also demonstrated fears about the imperfect working of the market: its officers did not believe that the multiple services required for commercial tea production would be brought about simply by market pressure. They therefore devised a single, vertically integrated organization that provided all the planting materials, extension, transport, processing and marketing services (Leonard, 1991). As a result, the KTDA had monopoly and monopsony powers as well as multiple controls over grower behaviour e.g. the planting stumps could only be obtained from KTDA; fertilizer was provided on credit to farmers; picked leaf could only be sold to the KTDA. In addition, extension agents were required to inspect and grade the crop as well as advise the growers on good husbandry practices. The processing factories reserved the right to reject lower quality tea (Lamb & Muller, 1982). The oversight provided by KTDA was therefore sufficiently tight to ensure the production of high-quality tea by the smallholders. By 1971, Kenyan teas commanded the world's highest prices at 6% above the average (Leonard, 1991).

Throughout the 1970s, the KTDA undertook an aggressive growth strategy that included the rapid expansion of acreage under smallholder tea; the construction of tea processing factories; and the diversification into wholesale marketing and retailing of tea. By 1981, KTDA had organized the planting of about 54,000 hectares of tea by some 138,000 smallholders and had become a major processor and exporter of black tea in the world. In the crop year 1980/81, smallholders produced 146,000 metric tonnes of green leaf which was processed into approximately 33,000 metric tonnes of made tea, 85% of it destined for export (Lamb & Muller, 1982). In the same year, KTDA was managing 27 factories and had 12 more under construction (Leonard, 1991).

Several writers acknowledge that the KTDA was a highly successful institution: it managed the largest and most successful smallholder tea scheme in the world and was also an efficient, well-managed state corporation (Chege, 1998; Lamb & Muller, 1982; Leonard, 1991). A buoyant world market for tea, the availability of donor resources for factory expansion and the effective price transfer to growers were some of the reasons for the remarkable success of KTDA. In

addition, high operational efficiency through strong managerial vigilance and the political ability to maintain KTDA's autonomy were also success factors (Leonard, 1991).

Lamb and Muller (1982) also attribute success to the incentive structure that was created for both smallholder farmers and factory management. For example, KTDA provided a fixed "first payment" for green leaf on a monthly basis all year round which assured farmers of a steady income that was based on their previous month's deliveries rather than having to wait till their crop was processed and sold. The regularity of payment offered farmers a "security" incentive that was supplemented by a price incentive in the variable annual "second payment". The aggregate second payment was declared annually by the Authority and its distribution among farmers reflected their leaf deliveries by weight as well as the world market prices actually fetched by the tea factory at which the particular grower's leaf was processed. This meant that there was a direct link between the quantity and quality of plucked leaf received from the farmer and the second payment ("bonus") returns. In addition, the processing quality was determined by the factory management whose output was closely monitored through the market price that it fetched. This incentive structure for both farmers and factory management ensured constant motivation for the production of high quality tea.

In the early stages of the smallholder tea development scheme, an important determinant of the scheme's success was the ability of SCDA (and later KTDA) to control the quality both of the productive stock (planting material) and of the producers themselves. From the outset, therefore, prospective growers had to be registered with the Authority and obtained a licence permitting the release of a specified number of tea stumps from government nurseries. Even though the process of registering growers was subject to some manipulation, Lamb and Muller (1982: 32) argue that the quality of planting material may have compensated for any "errors of judgement" in the selection process.

As smallholder tea production expanded, new vegetative propagation techniques allowed farmers to develop their own nurseries and eventually removed KTDA's control over planting material (Leonard, 1991). The licensing procedure provided the Authority with residual control and oversight of grower access. The importance of KTDA's strategic control over planting and processing became evident over the years in the sustained quality of the tea. It also helped reduce the inherent uncertainties of dealing with a large number of small producers (Lamb & Muller, 1982). As we shall see later, the removal of controls in the liberalization phase had a negative effect on the quality of tea.

On the broader economic front, the 1980s ushered in a period of transition from a protected, state-driven economy to an outward-looking market-driven economy. This occurred with the adoption of Structural Adjustment Programmes (SAPs) that were based on a neo-liberal ideology that emphasized trade liberalization and an export-led economic growth strategy. In 1986, the government prepared a long term policy document – *Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth*– in which it outlined a focus on promoting exports. Tea production was identified as a key growth area for agricultural exports. The government proposed several measures which included the expansion of smallholder tea production through KTDA; the establishment of state-owned tea estates on the perimeters of indigenous forests; and the gradual increase of the domestic price of tea towards export parity to encourage exports (ROK, 1986). As a result, there was an increase in smallholder tea area from 54,000 hectares in 1981 to 67,000 hectares in 1990 (Nyangito, 2000).

In conclusion, KTDA achieved an outstanding record in developing a successful smallholder tea industry in the first two and a half decades after its establishment. It was a highly specialized, vertically integrated, efficient and effective public enterprise. Through its policy of maximizing returns to growers, the KTDA contributed to a relatively comfortable, above-average standard of living for the smallholder farmers (Lamb & Muller, 1982; Leonard, 1991; Nyangito, 2000).

6.2.2 The Liberalization Phase: 1993-2000

The broad aim of economic liberalization in the early 1990s was to remove production constraints in order to generate improved incomes for the majority of the population and increased export earnings for the country. The liberalization of the agricultural sector involved three policy reforms: the deregulation of markets and prices; macroeconomic reforms; and institutional reforms. Markets and prices were deregulated to encourage the private sector to play a more central role in producing, processing and marketing agricultural commodities. This meant that KTDA lost its monopsonist role over the sale of smallholder tea.

Macroeconomic reforms involved the removal of exchange rate restrictions and the liberalization of interest rates. The removal of restrictions on foreign exchange allowed exporters to keep most earnings in foreign currency. As most smallholder farmers were paid through their management agency, KTDA, this did not translate into any material benefit. However, the fluctuations in the exchange rate exposed smallholder farmers to price volatility due to currency devaluation, inflation and performance risks of marketing organizations (Karanja & Nyoro, 2002).

Institutional reforms involved the reform and privatisation of public enterprises that was guided by a government policy paper prepared in 1992[146]. These reforms led to the transfer of the government's majority stake (held by KTDA) in 43 tea factories to smallholder farmers by the end of 1995 (ROK, 1996). The tea factories were limited liability companies that had been jointly owned by KTDA, smallholder tea farmers, and in some cases, the funding agency, which was mainly the Commonwealth Development Corporation (CDC). Over the years, KTDA had exercised substantial administrative and financial control over the farmers. For example, it had established a quality control policy in which the processed tea from its factories was to compete at the premium end of the market. In the liberalization era, the performance monitoring function was shared between KTDA and elected farmer directors. This assumed that the elected directors

[146] The 'Public Enterprises Reform and Privatization' policy paper was part of the conditions for a World Bank credit project titled Parastatal Reform and Privatization TA Credit Project which was approved in 1992 and ended in June 2000.

had proven managerial experience and were equally as knowledgeable as KTDA staff. In reality, the elected farmer directors had different management capacities which led to differential performance among the factories with corresponding effects on the bonus payments to farmers (Nyangito, 2000).

Despite the change in ownership structure of the tea factories, there was little change in the accountability structure to farmers. For example, farmers complained that the non disclosure of factory operating costs by KTDA made it difficult for them to monitor the performance of the organization. In 1998, factory expenses comprised 23% of the gross value of sales and were the largest cost component for KTDA (Nyangito, 2000). These expenses collectively reduced payments to farmers and became a major source of agitation among farmers who accused some factory boards of allegedly "wasting" farmer resources. Furthermore, KTDA itself incurred high operating costs due to managerial weaknesses and political interference which resulted in civil society calls for its privatization (Gatheru & Shaw, 1998).

Other institutional reforms included the reconstitution of the KTDA board of directors to be under the control of elected farmer representatives. Prior to the reforms, the KTDA board included representation from the Ministry of Agriculture, the Office of the President and the Ministry of Finance through their permanent secretaries (similar to director generals in South Africa) and only two elected representatives from tea-grower districts. In addition, the chairman of the board and the managing director were directly appointed by the minister of agriculture. In the pre-liberalization phase, KTDA had enjoyed relative freedom from constant government interference (Leonard, 1991; Lamb & Muller, 1982). The political basis for KTDA's autonomy dissipated with the transition to a new political regime in the 1980s. The new regime increasingly used state corporations to reward political supporters which led to low accountability to their clients (Were et al., 2005). It was on this account that donors imposed conditions for the privatization and reform of public enterprises to shield them from political manipulation.

In July 2000, KTDA was incorporated as a public limited liability company which marked the final step in privatizing the state corporation. Its corporate shareholders consisted of 45 factory companies that were owned by smallholders (KTDA, 2001). The new Kenya Tea Development Agency was commissioned as a Management Agent for the collection and processing of smallholder tea with retained control over its marketing (Nyangito, 2000). It was also responsible for developing new tea factories. A 2.5% management fee was to be levied on the tea factories in place of the tea cess that had been levied on tea growers for the development of rural feeder roads.

In the pre-liberalization phase, the growing of tea was controlled. Farmers were restricted to growing a minimum of 800 tea bushes, which was considered economically viable. In 1999, these controls were removed and many tea farmers sub-divided their existing land to their children, creating numerous small and uneconomical units. The uncontrolled fragmentation of tea farms remains a problem that is fuelled by population growth and cultural traditions of land inheritance (Mburu, 2007; Riungu, 2008). According to quoted Tea Board of Kenya figures, farmers with ¼ acre currently harvest about 1,300kg of tea and earn a monthly sum of US$ 15. In comparison, an acre of land produces 5,250kg of tea giving a monthly income of US$ 66 (Mburu, 2007).

The liberalization phase was characterized by a slow-down in the successes of the smallholder tea sector. The average yields for smallholder farmers recorded consistently lower figures than the large scale tea estates (on average 56% of the estates) as shown in Figure 6.4 below. Lower tea yields among smallholders were attributed to the low or sub-optimal use of fertilizers; poor husbandry practices that affected leaf quality; logistical delays in tea leaf collection; and payment delays (Nyangito, 2000). Most farmers considered the cost of fertilizer to be prohibitive despite the fact that KTDA provided it on credit.

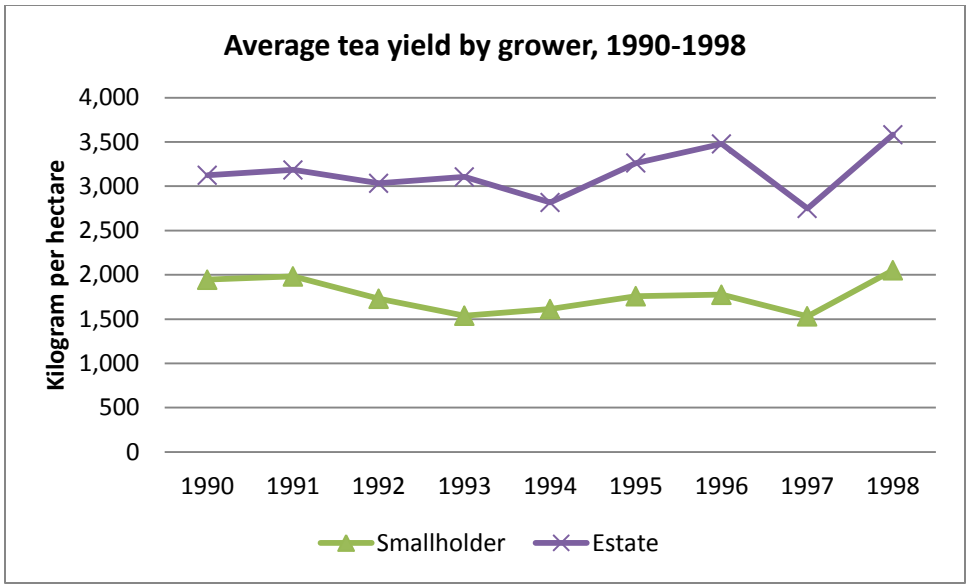

Figure 6.4: Average tea yield by grower, 1990-1998 (kilograms per hectare)

In addition to lower tea yields, the provision of services by KTDA to smallholders became increasingly inefficient due to managerial weaknesses and excessive government intervention which led to high operating costs and reduced farmer earnings (Gatheru & Shaw, 1998). KTDA's control over all processing and marketing activities was also perceived by farmers to exhibit features of monopolistic and exploitative behaviour (Nyangito, 2000).

6.2.3 The Post Liberalization Phase: 2001-2008

In 2003, Kenya was the fourth largest tea producer in the world with an annual production of 300,000 tonnes grown on acreage of 130,000 hectares (Kenya Economic Survey, 2006). There were 400,000 smallholder tea growers in the country producing a cumulative total of 200,000 tonnes (Kenya Economic Survey, 2008). This constituted about 60% of the total crop in the country. The remaining 40% was produced by large scale tea estates that were managed by major multinational firms. An estimated 10% of Kenya's population was directly or indirectly employed by the tea industry which was the single largest commodity sub-sector in the agricultural sector (Kinyili, 2003).

The sustained growth in the tea industry has been attributed to an enabling investment climate for the large scale tea estates, professional management of smallholder tea production through the Kenya Tea Development Agency (KTDA) and the non-interference stance of the Tea Board on production, processing and marketing activities (Kinyili, 2003). Nevertheless, the tea industry has experienced some challenges along with its successes. The main challenges have been tea price fluctuations on the world market and the uncontrolled production among smallholder farmers. In 2005, a glut hit the world tea market and depressed prices. At the same time, the Kenyan shilling strengthened further reducing export revenues. The rising costs of inputs – electricity, fuel and fertilizers – eroded the gains of a stronger currency and served to negatively impact farmers' incomes (KTDA, 2005). By mid 2008, global tea prices remained depressed due to over-supply in the world market. In a newspaper article, the KTDA Managing Director observed that reduced earnings were likely to continue unless Kenya controlled its production which stood at 22% of the world's total output (Riungu, 2008).

The year 2008 appears to have been a pivotal year for the smallholder tea industry. The first quarter of the year was marked by the post-election crisis which had a destabilizing effect on the country and a contraction in tea output. In the second quarter, an unprecedented spike in international crude oil prices (which averaged $134 a barrel in June 2008) led to high and volatile domestic markets (CBK, 2008). The high prices contributed to a corresponding spike in fertilizer prices and led KTDA to suspend its annual fertilizer procurement (Okoth, 2009).

During this period, some tea farmers attracted media attention after they uprooted their crop decrying the low returns. The President was forced to intervene and asked the minister of agriculture to resolve the problem. The ministry's response was to publish new regulations in the fourth quarter of the year which sought to return the licensing procedure through the Tea Board of Kenya. The new Tea (Licensing, Registration and Trade) Regulations 2008 sought to provide for annual renewal of all licenses and registration certificates under revised terms and conditions for all tea growers; manufacturing factories, tea exporters, tea packers and

management agents (TBK, 2008). It appeared to be an attempt by the ministry to control smallholder tea production.

In the post liberalization phase, several factors have converged to reduce the fortunes of the smallholder farmers. First, the depressed world prices coupled with rising production costs have eroded the profit margin for smallholder farmers. For example, it was reported that the farmers, through their management agent KTDA, received only 30% of earnings while farm costs and factory expenses took up 35% of the earnings (Weru & Kathuri, 2008). Second, more than 350,000 smallholder farmers had less than half an acre under cultivation which made tea farming an uneconomical and unviable enterprise. The strict restrictions on entry and exit that had been imposed during the pre-liberalization phase seemed to have foreseen this problem. In the face of this negative development, the Tea Board of Kenya was urging the consolidation of small tea farms to enhance viability (Mburu, 2007).

The third contributing factor has been inadequate value addition to the bulk of tea produced by farmers (Kinyili, 2003). Traditionally, the bulk of Kenyan tea has been sold to the world market as a generic product where it is much sought after by leading tea companies to blend and add taste to lower quality teas. Value addition involves the branding and packaging of the tea as high quality Kenyan tea which would yield prices up to six times higher than bulk exports (Nyangito, 2000). Countries like Sri Lanka and India have substantially enhanced their earnings in the world market through packaging and branding their tea exports as Ceylon and Darjeeling tea respectively (Oxfam, 2002).

The main source of value addition for smallholder tea has been through the Kenya Tea Packers Limited (KETEPA) which was registered as a private company in September 1977 and started operations in January 1978. KETEPA is majority owned by KTDA with minority shareholding held by the Kenya Tea Growers Association (KTGA). At its inception, it was restricted by law to serve the domestic market only but the law was changed in 1992 to allow the export of tea. It

now exports packed tea to destinations around the world. Nevertheless, there exists a huge potential for increased value addition within the tea industry (EPZA, 2005).

Another issue of concern to smallholder farmers has been the insufficient information provided by KTDA on the management costs of all the services rendered to them by the agency. These services are broadly categorized into agricultural services (field extension, leaf inspection and collection); factory operations; and wholesale marketing and distribution. The costs are recovered from farmer earnings through the management levy on factories as well as individual farmer deductions. It is highly probable that providing agricultural services such as extension, fertilizer and gunny bags (used for leaf collection) allows KTDA to enjoy economies of scale which translates to lower costs for the farmers. Indeed this was one of the reasons why the smallholder tea industry was the best performing sub-sector in the agricultural sector (Argwings-Kodhek, 2004). Nonetheless, a study into the effects of liberalization in the tea industry revealed high levels of mistrust between smallholder farmers and KTDA (Nyangito, 2000). The report recommended greater transparency on the management costs which would increase understanding among farmers about the capital outlay required for tea processing and thereby reduce suspicion of the agency.

The fact that the smallholders now have an opportunity to elect their factory directors has not lessened their suspicion of KTDA. The elected factory directors are perceived to be co-opted agents of KTDA who are not sensitive to the plights of the farmers (Ondari, 2008; Weru & Kathuri, 2008). A related issue is that the election of factory directors has not always been based on their technical competence (Nyangito, 2000). In 2008, KTDA announced new election procedures for factory directors in a bid to address the issue of director competence. However, it created a fresh storm of controversy among the farmers. The previous voting system was based on the cooperative model of one man-one vote and relied on a queue-voting method. It was therefore prone to populism.

According to the KTDA management, this system was deemed inappropriate for a public limited liability company such as KTDA. The new system introduced voting based on share strength which meant that voting rights would be pegged on crop deliveries to the factories. A secret ballot system was also adopted to replace the queue-voting method. The controversy among some farmers revolved around fears that the new system would permit a few farmers with large shareholding to impose unpopular leaders within a factory zone due to their higher number of allotted votes (Menya, 2009).

A final issue of concern has been disagreement among farmer groups about KTDA's continued dominance over the smallholder tea industry. One group, the Kenya Small Tea Growers Association (KSTGA) supports the existence of KTDA while the other group, the Kenya Union of Small Scale Tea Owners (KUSSTO) has called for the dissolution of KTDA (Nyangito, 2000). The management contract between KTDA and the smallholder tea factories lapsed in 2008 and reignited the divergence in opinion. In its draft new agreement, KTDA proposes to retain control over the marketing of smallholder tea. Some farmers argue they should have more say into the marketing of their produce because it directly impacts on their earnings (Mburu, 2009; Ngumo, 2009). Even though KTDA has built a reputable and well-organized system for the processing and marketing of smallholder tea, there are concerns about its ability to provide maximum returns for the large pool of tea producers. A related issue is KTDA's ability to maintain high operational efficiency due to its corresponding link with farmer earnings.

In conclusion, the Kenyan smallholder tea industry appears to be at a crossroads four and a half decades after its inception. A key determinant of the future competitiveness and survival of the industry will be the broad acceptance of effective institutional arrangements which address the concerns of various stakeholders (Nyangito, Argwings-Kodhek, Omiti & Nyoro, 2003). However, the rival representation among the smallholder farmers means that they are in a relatively weak position in lobbying for their interests with the KTDA as they do not have a single, well-organized and structured national lobby group (Ngumo, 2009).

World prices for tea will remain an exogenous factor even though the government can reduce market and price risks by a policy shift from production to market expansion. The government also needs to improve investment opportunities for value adding activities which would boost farmer incomes and create off-farm employment (Nyangito et al., 2003). The authors also recommend the development of a land use policy which addresses the subdivision of land into uneconomical units.

6.3 UWEZO URBAN CREDIT COOPERATIVE

Uwezo credit cooperative was incorporated on 2nd November 1974. It was established to facilitate savings and the provision of affordable credit to employees of a state corporation in the services sector. It had an initial membership of 656 which rose to a high of 9,759 in 1990 and then settled at 7,195 in March 2008. The membership comprised 97% of common bond employees, 2% retired staff and 1% consisting of the spouses of employees. The headquarters of Uwezo cooperative were located close to the main offices of the state corporation within the bustling city of Nairobi. The cooperative had only one FOSA branch. In order to serve its members in distant stations, the cooperative had established eleven service centres country-wide where elected branch officials provided specific services to members. The total staff establishment was 39 permanent employees headed by a general manager.

Uwezo Urban was one of the older credit cooperatives and was ranked among the top 20 largest credit cooperatives in Kenya in terms of total assets. The 2007 audited accounts indicated that Uwezo's assets stood at Ksh. 3.6 billion (US$ 53 million[147]). Members' shares and deposits were Ksh. 2.5 billion (US$ 37 million) while the loan portfolio stood at Ksh. 2.3 billion (US$ 34 million). A five-year financial analysis report concluded that Uwezo Urban had an effective financial structure that had stayed true to its core business of saving and lending. For example, between 2002 and 2006, loans were mostly financed by member deposits. All assets, as at the end of 2006, were financed with internal resources and external borrowing was less than 5% of the total assets.

[147] Based on 2007 annual average exchange rate of 1US$: 66.35 Kenyan shillings (KSh).

The age profile of Uwezo's membership revealed that over 75% of the employees were in the age range 31-50 years old while 18% were over 50 years old and only 6% were between 21 and 30 years old. This meant that over the next 5-10 years, a substantial number of members would be retired or nearing retirement. Given that the state corporation was also reducing the number of employees through retirements, retrenchments and the employment of contract rather than permanent staff, the Uwezo cooperative faced a declining membership over time. A gender profile of the membership also revealed that about 75% of the members were men due to the physical and technical nature of the employment.

Despite a relative stagnation in membership between 2002 and 2006, Uwezo had recorded growth in its gross income. The growth was attributed to the establishment of the front office service activity (FOSA) in 2003. The 2007 Annual Report stated that revenue growth generated by the FOSA had almost doubled from Ksh. 59.8 million in 2006 to Ksh. 104.5 million (about US$ 1.6 million[148]) in 2006. Total deposits in FOSA rose by 40.2% from Ksh. 482 million to Ksh. 675 million (about US$ 10 million) at the close of 2006. It can be deduced that although the number of members was not increasing, the size of the average transaction in terms of loans and deposits must have been larger, resulting in an increase in aggregate income.

Uwezo cooperative had to contend with intense competition from commercial banks due to their high concentration in the capital city. In their study of the access to financial services in rural Kenya, Mutua and Oyugi (2005) found that the location of financial institutions was heavily skewed towards the urban areas. For example, Nairobi province alone contained 77 out of 270 branches of the major commercial banks. The banks had recently identified the personal loans segment as a key growth area for their loan books and had embarked on aggressive marketing campaigns targeting urban residents. Uwezo had countered this threat by introducing a marketing department to diligently promote its products and services among its members.

[148] Based on 2007 annual average exchange rate of 1US$ for Ksh. 66.35 (World Bank Indicators)

The application of technology was evident in Uwezo cooperative. Their information system compared favourably with that used in a small microfinance bank. The database software had been purchased in early 2006 as part of the strategic plan targets. A data recovery and backup service was provided offsite by an internet service provider. According to users in the finance department, the system was user-friendly and flexible to accommodate different types of financial reports. It also integrated back office (credit) and front office (banking) transactions. The information system supported short message service (SMS) banking in which account balance queries from members received automatic responses via text messages.

6.3.1 Physical Description of the FOSA Branch

The FOSA banking hall was housed in spacious and modern premises that were accessed through a heavy glass revolving door. The Enquiries Desk was well-marked and directly faced the revolving door at the far right corner. A low black leather sofa was placed along the wall to the right for customers waiting to be served while a customer's chair was placed next to the Enquiries desk. The right wall also contained large translucent windows which illuminated the banking hall. Adjacent to the Enquiries desk was a Customer Relations desk which was also well designated. A set of chairs was discreetly placed some distance from the Customer Relations desk. Another leather sofa was placed along the wall next to the Customer Relations desk.

To the left of the entrance were five teller counters which were partly partitioned to provide customers with some privacy. The décor was modern and attractive. Across the room were three cubicles that were being remodelled for 'Private Banking', a differentiated service that was being introduced for high net worth clients. There were two customer counters near the tellers which had banking forms for cash or cheque deposits, applications for automated teller machine (ATM) cards, electronic fund transfers (EFT) and other financial services. Two security guards monitored proceedings from the main entrance and the banking staff entrance.

Above the FOSA banking hall was the back office credit department and the marketing department. These two departments could be accessed via a staircase and an elevator that were outside the FOSA banking hall. The credit department received the loan applications while the FOSA paid out the funds. The credit department consisted of an Enquiries Desk and three customer cubicles that afforded the members a level of privacy. The cubicles had comfortable chairs on both sides of the counter. Along the walls of the credit department was a set of chairs for customers waiting to be served. The marketing department consisted of a separate office that had two desks for the marketing officers and another desk for the marketing assistants. Figure 6.5 shows the FOSA banking hall of Uwezo credit cooperative.



Figure 6.5: FOSA banking hall of Uwezo credit cooperative

6.3.2 Financial Products and Services at Uwezo Credit Cooperative

Uwezo credit cooperative had a wide range of products and services that were offered to its members through the credit department and FOSA facility. The credit department provided the traditional products of the Back Office Savings Activity (BOSA) which comprised the conventional model of Kenyan employee-based savings and credit cooperatives. In this model, members accumulated savings or shares which were illiquid and from which they could leverage loans up to three times what they had accumulated. As members repaid loans, a portion of their repayment went into their savings accounts so that they could continue to build up their savings. In Uwezo, the BOSA savings account was a long term savings product as it was contractual. The minimum contribution was Ksh. 1,000 per month (about US$14[149]). The savings earned interest that was paid annually. There were no charges levied against the savings accounts.

New members were eligible to apply for loans after a mandatory saving period of 6 months. In order to get a loan, the member was required to find three to four fellow members who acted as peer guarantors to underwrite the loan. In addition, the Uwezo management considered the applicant's ability to repay the loan. A rigid formula known as the 2/3 rule was applied which sought to ensure that the total number of deductions would not exceed 2/3 of the member's gross salary. The credit department dealt with three main types of loans: emergency, school fees and development loans. Emergency and school fees loans were repayable over a 12-month period while development loans were payable within 48 months. The introduction of the FOSA had expanded the credit products to include salary and special advances; FOSA loans which had a maximum term of 24 months; and bridging loans that could offset existing loans.

In Uwezo, the FOSA savings products included ordinary savings accounts which were linked to ATM services; term deposit accounts that enabled customers to save for future needs such as holidays, weddings or school fees; children's savings accounts; retirement savings accounts; and fixed or call deposit accounts. Other financial services provided at the FOSA included salary

[149] Based on 2008 annual average exchange rate of 1US$: 69.09 Ksh (World Bank Indicators)

processing; electronic fund transfers; safe custody of valuables; sale of banker's cheques; cheque clearance; and standing order services.

In 2006, Uwezo had pioneered the provision of ATM cards to its members and was currently offering two types of ATM cards through partnerships with two ATM service providers. This enabled the cooperative to have an extensive ATM coverage which provided some competitive advantage. In a bid to offer more services to its members, Uwezo's management had signed a contract with Safaricom to provide the popular mobile money transfer service, M-Pesa. They also facilitated the purchase of Cooperative Bank shares for interested members during the Bank's Initial Public Offer in November 2008.

6.4 THE PUBLIC ENTERPRISES SECTOR

The economic context of Uwezo Urban credit cooperative was the public enterprises sector as the members were employees of a state corporation. The analysis of this sector is presented according to four phases that denote government policy shifts with a direct bearing on the sector. These phases are named according to the strategic focus of the economic policy papers that precipitated the change in direction.

6.4.1 A State-Driven Economy

The economic aims of the newly independent Kenyan government were expounded in the Sessional Paper Number 10 of 1965 titled *African Socialism and its Application to Planning in Kenya*. The paper underscored the need for the government to "Africanize" the economy and promote industrialization. This was to be achieved through state-owned enterprises and joint ventures by the state and private investors as well as cooperatives, companies and partnerships which lay emphasis on African ownership and management. Strategic emphasis was placed on economic growth led by agriculture and manufacturing and the development of the social sector (Wagacha, 2003). The government initiated state-owned enterprises in all the major productive

sectors such as industry, commerce, tourism, agriculture, public utilities and development finance (ROK, 1965). The period after Independence was therefore marked by a deliberate government policy to directly participate in the production and trade sectors of the economy.

An analysis of the parastatal[150] contribution to the gross domestic product (GDP) in 1976 revealed that public enterprises in manufacturing, electricity and water supply, and finance and business services contributed up to 92% of the parastatal share of GDP (Leys, Borges & Gold, 1980). The total number of public enterprises responsible for these earnings was about sixty in total. In addition to these enterprises, a total of 129 companies had received equity or loan capital from three major industrial development finance institutions which increased government's shareholding even further. The majority of these companies were in the manufacturing sector and comprised a wide range of subsectors including food processing, textiles, paper products and transport equipment (Leys et al, 1980).

By the early 1980s, it was apparent that government participation in the economy had grown well beyond its original intentions. The majority of these enterprises increasingly posted operating losses and inadequate returns on investment which further eroded their weak capital base (Muindi, 1992; Swamy, 1994). The collapse of the East African Community (EAC) common market, which had been an important market for Kenyan exports, in 1977 and an oil price shock in 1979 also created considerable economic turbulence in the Kenyan economy (Glenday & Ryan, 2003; Were, Ngugi, Makau, Wambua & Oyugi, 2005). The economy was in a serious crisis and the government turned to the World Bank and the International Monetary Fund (IMF) for assistance.

The international finance institutions devised an economic restructuring plan in the form of Structural Adjustment Programmes (SAPs). The rationale for structural adjustment was argued

[150] The term parastatal refers to a state corporation or a public enterprise. These terms will be used interchangeably.

on the basis that the economic growth policies pursued to date – import substitution and public investment – had revealed serious shortcomings e.g. the state-owned enterprises had failed to engender industrialization and were characterized by inefficiencies, high costs and low productivity (Swamy, 1994). Furthermore, there were growing concerns about the quality of public sector expenditures (Glenday & Ryan, 2003). Structural adjustment was therefore based on a neo-liberal ideology which minimized the role of the state in the economy.

6.4.2 Structural Adjustment

In 1982, the government released the findings of a Working Party on Public Expenditure which detailed many serious deficiencies in the financial and economic performance of the public enterprises. The report suggested a series of reforms and proposed a reduction in the role of public enterprises that was to be supplanted by increased private sector activity. As a result of the Working Party report, direct budgetary transfers to the public enterprises declined by 32% between 1982 and 1984 (Muindi, 1992).

The government published *Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth* in which it announced a major policy shift aimed at restructuring the economy. Adopting the neo-liberal stance of the international finance institutions, the policy document acknowledged the need to limit government's participation in economic activities and instead facilitate the growth of the private sector. The policy paper proposed structural reforms in the major economic sectors which sought to reduce the protection they had enjoyed during the 1970s and increase productivity through market-driven incentives. It also proposed budget rationalization in the public sector. All public enterprises were thus expected to demonstrate greater financial and operational efficiency (ROK, 1986).

Despite the clear policy articulation, the pace of structural adjustment during the 1980s was slow while the extent of reform was minimal (Swamy, 1994). In particular, the reform of the public enterprise sector followed a firm-by-firm approach which resulted in a slow and uncoordinated

process (Muindi, 1992). Even with competitive advantages derived from their monopoly positions, the public enterprises lagged behind the rest of the economy. For example, although the parastatals consumed 11% of GDP, net inflows to the central government budget were either negative or near zero between 1986 and 1990 (Swamy, 1994). Moreover, while the growth of labour inputs in the parastatal sector was half that of the private sector, the growth of capital inputs was twice as high, indicating an inefficient use of resources. Glenday and Ryan (2003) note that high levels of corruption and inefficiency in the public sector during that period resulted in a negative relationship between public sector inputs of labour, capital, materials and services, and the value of public sector outputs.

Meanwhile, public sector employment (which includes government officers, teachers, and parastatal employees) grew from 30% of total formal sector employment in 1965 to a peak of 50% in 1989 (Glenday & Ryan, 2003). In particular, parastatals and entities with a government controlling stake witnessed a 250% growth in employment from 46,700 in 1963 to 117,300 in 1991 (Cohen, 1993). Some of the reasons for the rapid increase in public sector employment included an increased population which created a higher demand for public services; the absorption of Kenyan public servants following the dissolution of the East African Community; and the failure of the manufacturing sector to grow as expected which led to the government becoming the employer of last resort (Cohen, 1993).

The growth in the public sector also increased opportunities for political patronage. According to Cohen, the Kenyan public sector operated like a "giant patronage machine" in which a large proportion of jobs in public enterprises, regulatory boards and authorities were handed out to political cronies (1993: 456). As public enterprises increasingly became "conduits of patronage", the government was loath to introduce or act on proposed parastatal reforms that were part of structural adjustment (Swamy, 1994; Were et al., 2005: 17). Many political beneficiaries lacked the experience or personal accountability to competently manage the organizations further contributing to the dismal performance of the parastatal sector (CGD, 2005).

The year 1991 marked the last year of the enhanced structural adjustment loan facility from the international financial institutions. The donors found that funded sectoral adjustment programmes in agriculture, trade and industry, finance and education had not been implemented according to plan; the fiscal balance had steadily deteriorated; and domestic inflation had accelerated (Swamy, 1994). Donors also expressed concern about the lack of transparency and accountability in the use of public funds. This led to the suspension of structural adjustment lending in late 1991.

6.4.3 Public Sector Reforms and Privatization of Public Enterprises

The suspension of financial aid inflows in 1991 in the midst of declining economic performance and a deepening budgetary crisis gave the multilateral and bilateral donors an upper hand over the government in demanding the speedy implementation of reforms (Cohen, 1993; Holmquist & Ford, 1992). On July 1, 1992, the government prepared a technical paper on Parastatal Reform and Privatization in Kenya. The paper described a comprehensive public enterprise reform programme whose overall aims were to enhance the role of the private sector in the economy; reduce the demand on the Exchequer by public enterprises; rationalize the operations of public enterprises; reduce conflicts of interest between the regulatory and commercial functions of public enterprises; and broaden the base of ownership of viable enterprises through capital market development (Muindi, 1992).

The government held equity in about 240 public enterprises. About 50 enterprises were directly owned by the government while equity in the remaining enterprises was held through state-owned development finance institutions and holding companies. Sixty percent of the public enterprises were in manufacturing and mining while 18% were in distribution services; 15% in finance; and 7% in transport, electricity and other services (Swamy, 1994). The technical paper announced plans to divest government holdings in 207 ‘non strategic’ public enterprises which would constitute the privatization programme. The government was to retain ownership and

control of 33 public enterprises which were classified as 'strategic' if they provided essential services or were considered to play a key role in national security, health and environmental protection. The government also stated its intention to divest its interest in companies where it had a minority stake as a form of budgetary resource mobilization (Muindi, 1992).

The government released a policy framework paper on Kenya Economic Reforms for 1996-1998 which was prepared in collaboration with the IMF and the World Bank. The paper reported that the privatization of 211 non-strategic public enterprises had begun with the government divesting its holdings in over 100 enterprises. Privatisation was understood to mean that the government had divested its holdings in the enterprise to 30% or below the blocking share as stipulated in the terms of agreement. The government also reduced its holdings in another six enterprises including Kenya Airways, Kenya Commercial Bank and the National Bank of Kenya. The paper reported that initial steps to restructure strategic enterprises like the Kenya Ports Authority, Kenya Railways, Kenya Power & Lighting Company and Kenya Posts & Telecommunications Corporation had begun. It further outlined plans to initiate divestiture of three public enterprises: Kenya Pipeline Corporation; Kenya Petroleum Refineries; and Nyayo Bus Corporation (ROK, 1996).

The government created a senior policy-making body, the Parastatal Reform Programme Committee (PRPC), to provide effective oversight of the reform programme. Another body, the Executive Secretariat and Technical Unit (ESTU) was established to manage, coordinate and implement the privatization/divestiture programme as approved by the PRPC. The Department of Government Investments and Public Enterprises (DGIPE) was also established within the Ministry of Finance to oversee those aspects of the reform programme directly relating to state corporations (Muindi, 1992).

However, these institutional arrangements for the parastatal reform and privatization programme amounted to mere policy directives as they were not enforced by any statute. As a result, the

State Corporations Act, which gave wide-ranging powers to the president, took precedence over any proposed changes to the management of state corporations. Predictably, the Centre for Governance and Development (CGD) found that the pledges of the 1996 policy framework paper were "honoured more in breach than in fulfilment" in its review of the audited accounts of state corporations between 1993 and 2002. In particular, the absence of a binding legal framework meant that the parastatal reform and privatization process proceeded in a highly opaque manner that was driven by political expediency, donor conditions and the vested interests of politically connected investors (CGD, 2005: 7-8).

An example of irregular privatization based on political connections was the purchase of the national milk processor, KCC, by a group of investors who were allied to the government and the ruling party. In 1999, KCC was put under receivership after it failed to service a bank loan. A receiver manager and an interim board were subsequently appointed by the bank to run the company. In 2000, the receiver manager publicly issued a tender for the sale of KCC. Politically influential persons hurriedly formed a new company – KCC Holdings – and submitted a tender to buy the milk processor. Their bid was successful and the milk processor was sold for US$ 6 million even though the asset value of KCC was estimated at about US$ 86 million (Atieno & Kanyinga, 2008). The new owners renamed the milk processor as KCC 2000 Ltd in March 2001. Atieno and Kanyinga (2008) report that this move infuriated the majority of dairy farmers who had expected the government to prepare a rescue plan for the ailing company.

By 2001, the government had partially or fully divested or liquidated 168 enterprises of the original 207 public enterprises slated for divestiture (World Bank, 2001). The World Bank, which had advanced credit assistance for the privatization programme, reported that there had been some notable successes such as the completion of the privatization of Kenya Airways in 1996 and the separation of regulatory and commercial functions in the Kenya Posts and Telecommunications Corporation. Nevertheless, few efficiency improvements in the transportation and utilities sectors had been achieved. Subsequently, the impact of the public

enterprise privatization and reform programme on the economy remained relatively modest in relation to its potential (World Bank, 2001).

A global focus on poverty led the World Bank to replace Structural Adjustment Programmes with Poverty Reduction Strategy Papers (PRSPs). As part of its preparation of the Kenyan PRSP, the government outlined plans to accelerate the public enterprise reform and privatization programme with the creation of an appropriate regulatory framework; the adoption of competitive bidding and other modalities to ensure transparency and fairness; and the continued full or partial privatization of public enterprises (IMF, 2005). An uncertain atmosphere preceded the 2002 general elections which made donors adopt a cautious approach with regard to funding of the PRSP. A new political regime was elected providing new hope for accelerated public sector reform and economic recovery.

6.4.4 A Legal Framework for Privatization

The National Rainbow Coalition (NARC) government was elected on a strong reform campaign that included pledges to eliminate corruption, revive the economy and implement pending reforms to restore IMF and World Bank support (Shiverenje, 2005). The new parliament enacted a number of laws to strengthen the legal framework for public sector reform. These included the *Anti-Corruption and Economic Crimes Act (2003)* that established the Kenya Anti Corruption Commission (KACC) to investigate all aspects of corruption and economic crimes such as the misuse of public funds. The *Public Officers Ethics Act (2003)* required all public officers to declare their wealth annually and established the position of a permanent secretary for ethics that was based in the president's office. The *Public Audit Act (2003)* empowered the office of the controller and auditor-general to audit all public funds, including those of state corporations, and undertake value for money audits. Finally, the *Public Procurement and Disposal Act (2005)* established procedures for efficient public procurement and disposal of assets and equipment.

The *Privatization Act (2005)* now provides a legal framework for the privatization of public assets and operations, including state corporations, in a more transparent and publicly accessible way. It established a Privatization Commission that replaced the ESTU which had implemented the Parastatal Reform Programme since 1992. The law stipulates that proceeds from the sale of direct government equity holding are to be paid into a constitutionally mandated fund known as the Consolidated Fund. A Privatization Appeals Tribunal to arbitrate disputes arising in the process of privatization has also been established.

Despite a positive track record on public sector reforms, the NARC government applied its reform pledges selectively, particularly those related to the elimination of corruption, and raised doubts about its ability to undertake comprehensive reforms (Bertelsmann Siftung, 2009; Lansner, 2009; Wrong, 2009). Furthermore, events in the parastatal reform process revealed that it was still subject to political contestation and manipulation. For example, although the Privatization Act received presidential assent in 2005, it was not until days before the December 2007 general elections that the Finance Minister gazetted the Privatization Commission[151]. Serious issues remain regarding the procurement processes of public enterprises, weak enforcement of the parliamentary Public Investment Committee recommendations, inadequate prosecution of corrupt public officers and the wide scope of presidential powers provided in the State Corporations Act (CGD, 2005).

The state corporation which formed the basis of the Uwezo case study had undergone several reform measures. There had been staff retrenchments between 1990 and 2004 which had led to a corresponding decline in membership in the Uwezo credit cooperative. The cooperative's membership had almost stagnated since 2004 reflecting low employment growth in the corporation. There had also been a restructuring of the corporation's commercial operations to promote private investment in its specific sector. This included internal restructuring of its management and financial structure and the initiation of performance contracts for its top

[151] http://report.globalintegrity.org/Kenya/2009/scorecard/65

management executives. Donor commitments to the specific sector, which had declined during the late 1990s, were only resumed in 2003 following the change in government.

6.5 WAKULIMA AND UWEZO COOPERATIVES AS SOCIAL ORGANIZATIONS

The Wakulima cooperative was socially integrated into the rural community which meant that the social dynamics in the cooperative tended to reflect the general dynamics of the local community. For example, most Wakulima members had a common interest in the economic performance of their tea factories because tea farming was the dominant occupation in the area. They therefore had high expectations of their elected grower representatives who sat on the factory board of directors. A review of KTDA records revealed that two Wakulima board members were also elected grower representatives in the two tea factories. This may have explained why the economic performance of the cooperative was perceived to be linked to the performance of the KTDA-managed tea factories. In addition, the cooperative's democratic election system was similar to the one used in the tea factories (until 2008 when the system was changed to voting based on share strength). These points illustrate how the Wakulima cooperative was socially embedded in the local community.

In contrast, the Uwezo cooperative represented an organizational community of employees and members of the cooperative tended to reflect the organizational culture of the state corporation. This was evidenced by the fact that organizational norms appeared to dictate the behaviour of individuals who served as either Uwezo board members or delegates. The social dynamics in Uwezo also exhibited some influence of the socio-political environment. For instance, the state corporation brought together a heterogeneous community of employees drawn from all parts of Kenya. As a result, there were underlying perceptions of the ethnic or regional balance in the corporation's management structure which was extended to the cooperative. The fact that the chief executive of the state corporation was a political appointment also coloured people's perceptions of regional balance. The effects of the social environment of the cooperatives are further discussed in the following subsections.

6.5.1 The Influence of the Political Context

A prevailing feature of the national political scene in Kenya is the intense competition for leadership positions which tends to be mirrored in cooperatives. Cooperatives provide convenient political platforms for ambitious individuals to vie for leadership positions. In his analysis of the socio-political context of rural marketing cooperatives, Hyden (1970) found that elections turned into virtual battlefields for local political interests. Committee members were elected on the basis of local constituencies (a village, location or division) which meant that potential candidates saw their role as fighting for, first, their individual interests and then that of their constituents. In many ways, this practice has not changed over time. Thus, individualistic interests of potential candidates and an all-or-nothing attitude towards political contests continue to characterize elections in many Kenyan cooperatives.

In a similar vein, national leadership positions, starting with the presidency, are highly coveted because they are associated with overarching powers and they offer numerous opportunities for patronage. This was one of the key assertions of the Report of the Commission of Inquiry into the Post-Election Violence (CIPEV) popularly known as the Waki Report. According to the report, the acquisition of presidential power is perceived both by politicians and the public as a zero sum game in which losing is extremely costly and seen to be unacceptable. This perception has cultivated the tendency for various political actors to do anything, including engaging in violence, to obtain or retain political power (CIPEV, 2008).

Furthermore, the political system in Kenya is characterized by weak and ineffective public institutions described as a "vocal but relatively powerless" legislature and a "compliant" judiciary that do not provide the crucial mechanisms required for accountable leadership (IREC, 2008: 1). As a result, Maathai (2009) notes that politics in Kenya is a concept that is associated

with excessive powers, corruption and greed exemplified by the phrase 'It's our turn to eat'.[152] Cooperatives have not been unaffected by the political 'scourge' and have generally suffered a negative public image due to numerous incidents of mismanagement, leadership wrangles, corruption and a lack of controls (Gatheru & Shaw, 1998; Mudibo, 2005; Wanyama, 2007). It was partly as a result of these problems that the Cooperative Societies Act of 1997 was amended in 2004 to strengthen the supervisory oversight of the government and to provide stiff penalties for cooperative leaders who mismanaged their organizations.

Both Uwezo and Wakulima cooperatives had been spared the excesses of bad governance and were regarded as model cooperatives by their respective cooperative officers. In particular, Wakulima was ranked as the best rural cooperative in the district. The fact that it had attracted consistent donor support over the years also lent credence to the fact that it was a well-managed cooperative. Nevertheless, it was not immune to the influence of its socio-political environment. For example, there were some allegations of electoral malpractices such as vote-buying which is widespread in Kenya. The voting considerations among members also revealed a tendency towards patron-client relations. Elected committee members were expected to be responsive to individual member's problems even if it meant going against the set procedures of the cooperative. This finding corroborated the observations of Hyden (1970, 1973) who found that Kenyan cooperatives were often governed on the basis of pre-existing informal 'patron-client' relationships.

The patron-client relationships existed because most leadership positions tended to be occupied by the local elite (Hyden, 1970, 1973). According to Hyden, the rural elite were often elected into leadership positions on the belief that they were more capable of articulating the interests of the local community and securing benefits from the outside world. Hamer (1981) confirmed this finding when his research revealed that the local leadership of Kenyan cooperatives usually comprised teachers, traders, politicians or administrators. He suggested that the peasants

[152] This is the title of a book detailing a Kenyan whistle-blower's experience with government corruption (Wrong, 2009).

preferred to entrust their collective resources to the elite because their relative wealth was perceived to be a form of security against improper enrichment from collective resources.

Informal discussions with the Wakulima employees revealed that several of the board members were businessmen or retired civil servants in addition to being farmers. Two board members were also elected farmer representatives in the local tea factories. This finding supported the assertion that the local leadership of rural cooperatives tends to comprise the rural elite. However, the Wakulima by-laws distinctly barred politicians at all levels (civic, parliamentary and political party officials) from holding elective posts in the cooperative. Perhaps it was in recognition of the fact that politicians had a nasty reputation of fanning animosities and highlighting divisions within the community rather than uniting them towards a common purpose.

Tea farmers were particularly vulnerable to negative political interference given the role of tea as a major export crop. In the recent past, some angry farmers, decrying the low producer prices of tea, had threatened to uproot their tea bushes. It was in this context that I asked Wakulima board members if local tea farmers were also threatening to uproot their crop. There was a chorus of *"No, No, Not yet."* However, one member added cautiously: *"But we don't know. Anything is possible."* Another member spoke up:

> *"That is political interference. It is fuelled by politicians and they are not even farmers* (said with disgust). *They come and announce loudly 'Coffee is useless, tea is useless' and the simple farmer, who does not know any better, takes the politician at his word and says 'The politician has advised us so let us go and uproot the crop.' The farmer hangs himself with his actions!"*

There was another chorus of agreement. The member continued:

> *"Even farming is a business and there is no business that does not have challenges. These challenges can come at any time. We have a saying: 'when your mother has a wound on her leg, do you cut off her leg or take her to hospital?"* [I responded that you take her to the hospital]. *"Yes, that is what you do. So, we have many incidents of political interference and some of them*

are very negative."[153]

The prevailing political context therefore appeared to be a salient influencing factor in Wakulima cooperative. The effect of the political context was a little more subtle in Uwezo cooperative and based on perception. For instance, one employee suggested there was an implicit 'ethnic factor' in the cooperative's management structure which was directly influenced by the parent organization. In other words, the ethnicity of the top executives in the state corporation was presumed to match the ethnicity of the senior managers of the cooperative. Although this did not appear to be a widely held view among the employees, it is possible that the top management structure of the cooperative was susceptible to perceptions about its ethnic composition. Some of the general members that I interviewed also alluded to 'ethnic considerations' in their choice of delegate.

In addition to allusions about the ethnic composition of the cooperative's governance structure, two senior employees separately claimed that Uwezo members were highly suspicious of "political" agendas when new ideas were either proposed by the board or introduced by the management. This general suspicion tended to influence the way management employees conducted their work and, specifically, the communication of new ideas or proposals.

6.5.2 The Influence of an Organizational Context

One aspect of the Uwezo organizational culture that was immediately discernible was its hierarchical nature. A large number of senior managers held board positions meaning that the hierarchical structure of the corporation was reflected in the cooperative microstructure. The fact that ordinary members did not directly vote for their board members due to the delegate system may also have contributed to my general impression of distance between members and their governing representatives. A positive effect of the hierarchical nature was the seriousness with which cooperative governance was regarded. As one employee explained:

[153] FGD with Wakulima Board members

"... Here we have the tradition where [senior managers] have always been the directors which has helped us. It has kept jokers away because nobody will come and play with the cooperative when the bosses are the directors. People say we're not [being] democratic but democracy is too expensive."[154]

Even so, the general members exhibited a high level of employee solidarity that had resulted in a number of board proposals being rejected in the AGM. Whereas one would have expected that the top-heavy nature of the board would have resulted in its proposals being readily accepted, a review of the AGM minutes revealed that a number of the board's proposals had actually been opposed before being accepted. Interviews with individual board members also revealed they were keenly aware of the decision-making dynamics of AGMs and sought to ensure that they paid attention to the wellbeing of the general membership.

Another feature of the Uwezo organizational culture was the presence of organizational norms that influenced the behaviour of members who served in the cooperative. For example, I was informed that it was an unwritten rule that any board member or delegate who misused their power in the cooperative automatically lost their job. Several Uwezo board members also expressed their desire to have a professionally managed cooperative. This meant the avoidance of any kind of corrupt dealings as these two board members explained:

"I don't want to come here tomorrow and hear somebody say 'I have seen [Respondent] driving the car that he bought with the money he stole from us.' You know that is how the environment is but we don't want that here. It's very crucial to ensure that, at the board level, you have people who want to act professionally as much as possible and who don't want to interfere with management. Similarly, we must be able to recruit competent people on the management side."[155]

"We don't entertain corruption because we don't want to compromise ourselves. Even when we want to increase something that touches on the board (e.g. review the sitting allowances), the

[154] Interview transcript P54: US12
[155] Interview transcript P69: BM1

whole board must be there including the Cooperative Officer. The process is transparent and we inform the members."[156]

There was indeed evidence of high ethical standards upheld by the board. Financial decisions were well documented and the funds well accounted for, as evidenced in the audited annual reports. The Uwezo board appeared to prefer a professional and business-like management style which was unlike the prevailing practice in most cooperatives where leadership positions were hotly contested and often won on the basis of popularity.

A third aspect of the organizational context was the political leverage that the Uwezo cooperative appeared to enjoy within the cooperative sector. A review of the Uwezo AGM minutes revealed the high level of representation from the cooperatives ministry that regularly attended the meetings. In all cases reviewed, the minister, assistant minister or permanent secretary of the cooperatives ministry attended as chief guests. The high representation could be explained by the fact that the politically appointed leadership of the state corporation was perceived to be part of the ruling elite. The cooperative was therefore well informed of policy pronouncements which may have ensured that Uwezo remained on the forefront of new developments in the cooperative sector.

6.5.3 The Issue of Gender Inequality

An unexpected finding was the silent issue of gender imbalance that was reflected in the male-dominated leadership structure of both cooperatives. The gender imbalance in cooperative leadership occurs despite cooperative development policies that advocate for equal participation of both men and women at all levels of cooperative leadership and remains a policy concern. The policy paper on cooperatives attributes the imbalance to the fact that women have "neither lobbied nor strongly campaigned for leadership positions" although cultural and religious norms may also have contributed to inhibit their participation (MoCDM, 2004: 21).

[156] Interview transcript P72: BM3

I found that Wakulima cooperative exhibited a higher degree of gender imbalance in cooperative leadership than Uwezo cooperative. This was possibly due to the effects of social embeddedness in the local community for Wakulima while Uwezo was prone to the moderating effects of an organizational context. Nonetheless, the fact that both cooperatives had a majority of male members is worth bearing in mind.

One reason that may have explained the relative invisibility of women in leadership positions in Wakulima cooperative was the eligibility requirements. The Wakulima by-laws included the following eligibility requirements for members of the board and supervisory committee. A person had to be:

- An active member of the cooperative for the last five years.
- Able to read or write in both English and Kiswahili languages.
- Have an average production of 2,000 kilos of green tea for the immediate past three years from his/her own farm.
- Hold a minimum shareholding worth Ksh. 20,000 in the cooperative or as determined by the members from time to time.
- Above 30 years of age.

A nuanced reading of these requirements suggests that they had in effect served to exclude women for a number of reasons. First, the cultural traditions of the community did not allow women to own land or the tea crop. As a result, most of the registered members were men. Second, rural women were more likely to be illiterate than men, thus increasing the chances of their ineligibility. Third, the fact that membership was open to members of the immediate family of the primary member implied that the spouses (or women) were regarded as secondary members and were even perceived to lack full voting powers. These two quotes from women respondents illustrate this perception: "*No, I cannot attend [the AGM] because it is my husband who*

has shares so I am not eligible to vote"[157] and *"I know [the AGM] is important and I usually accompany my husband. It is the venue where **they** decide the borrowing powers of the [board] and… the dividend rate.*[158] [Bold emphasis added]

Furthermore, there appeared to be a strong cultural bias towards male leadership. When I asked women respondents about their willingness to serve in leadership positions, most of them said they would not consider leadership roles. Some cited family responsibilities and busy schedules while others cited ineligibility due to the lack of secondary education. Only one woman said she would consider it, if only to represent women. However, this was after some prodding from the researcher. As a result, it was hardly surprising that only one woman had served on the Wakulima board in its 17-year existence. The near invisibility of women leaders in the cooperative was replicated in the leadership structures of the two tea factories in the area. None of the elected directors was a woman and the only woman in leadership occupied a senior management position as one of the KTDA factory managers.

In the course of the fieldwork, I learnt that it was the women who mostly picked the tea on the farms owned by their husbands and yet they did not receive the proceeds because it was the man who was registered as the owner. I also learnt that it was a 'well-known' fact that tea farmers 'drank' a lot of the money they received as tea bonuses. One female respondent confirmed this when she confided how she received loans: "*You see, tea farmers drink a lot and sometimes the family doesn't benefit. It is only because I have my [own] account that I get assistance otherwise my husband tends to drink a lot*."[159]

As an observer of the weekly Wakulima executive committee meetings, I noted the minimum duration of the meetings was 4 hours (9am-1pm). I surmised that it would have been difficult for women to spare the time given their other household roles. Thus, the management practices of the board may also have contributed to discriminate against women. The situation was different

[157] Interview transcript P7: RM6
[158] Interview transcript P18: RM18
[159] Interview transcript P7: RM6

in Uwezo cooperative. There were no discernible requirements that may have discriminated against women. In fact, three women occupied leadership positions: two were board members while the third woman served in the supervisory committee. However, a review of the gender composition of the board from 1998-2007 revealed that only one woman had served on the board from 1998 to 2002. It was only in 2005 when there were three women in the board and supervisory committee.

Another difference between the two cooperatives was the age requirement of a board member. In Uwezo cooperative, an eligible member had to be over 21 years of age whereas in Wakulima, an eligible member had to be over 30 years of age. The higher age limit in Wakulima had fuelled community perceptions of an age and gender bias in the leadership structure of the cooperative. This was according to an independent report commissioned by the cooperative and reviewed for the study. The report stated that the prevailing tendency of the leadership to consist of "old men" due to the socio-cultural traditions of the community meant that women and the youth did not feel represented despite the fact that they constituted a large part of the community.

In conclusion, the male-dominated leadership structure of the two cooperatives reflected the cultural bias towards male leadership. There was no elected woman cooperative leader in Wakulima which may have served to validate the community perception of gender bias in the leadership structure of the cooperative. However, the organizational context of Uwezo cooperative may have moderated the effects of cultural dynamics because three women occupied leadership positions.

6.6 WAKULIMA AND UWEZO COOPERATIVES AS ECONOMIC ORGANIZATIONS

The Wakulima cooperative was integrated into the economic system at three levels: the global level through participation in the world tea trade; the national level through the smallholder tea industry managed by KTDA; and the local level through participation in the rural financial market. Each of these levels was subject to various pressures that translated into direct effects on farmer incomes. The smallholder tea farmers who formed the majority of the membership of Wakulima credit cooperative exhibited some of the issues described in the contextual analysis of the tea subsector. For example land subdivision was a common feature in the area and contributed to the threat of loan default. Reduced farmer earnings were also often cited by respondents as the main reason for the low savings capacity among the membership.

6.6.1 The Effect of Variable Tea Prices

A review of AGM minutes revealed that low tea prices had led to the default of loans in some years. It was abundantly clear how vulnerable the cooperative was to variations in tea prices and output which illustrated the effects of a narrow economic base on an individual cooperative society. Gyllstrom (1988) notes that negative changes, such as low commodity prices or drought, tend to have multiplying effects on agriculture-based cooperatives by affecting both the demand for loans and the members' ability to repay loans.

In a historical case study done on the Kibirigwi coffee cooperative in Kenya, Hedlund (1988b) found a direct correlation between world market prices for coffee and the participation of members. Thus, high and stable world market prices for coffee tended to strengthen the economy of the members and increase their local participation in the cooperative. Conversely, low or highly fluctuating prices weakened the active participation of the members and strengthened the tendency towards disorder in the cooperative. In the case of Wakulima cooperative, there appeared to be a correlation between reduced farmer earnings and heightened suspicion of KTDA factory management. For example, the relative discontent of the farmers

was demonstrated by a 3-day strike in September 2008 by tea farmers affiliated to one of the local tea factories. The farmers complained of factory mismanagement and had called for the immediate resignation of the factory directors. The strike received local media attention and there were calls for the minister of agriculture to intervene.

Figure 6.6 shows a trend analysis of KTDA payments to smallholder farmers for green leaf per kilo over a seventeen year period. The payments consist of a relatively stable monthly first payment and a variable annual second payment. The chart demonstrates that the prices have been erratic over the years reflecting price volatility. Although the general world tea prices have increased in nominal terms, the real prices have declined due to inflation and oversupply (Oxfam, 2002; Agritrade, 2010). It should be noted that the KTDA payments do not reflect fertilizer input costs and factory operating expenses which have been rising over the years. As a result, the net pay to farmers is much lower than the KTDA records indicate. These factors have had an impact on the savings capacity of smallholder farmers manifested in the financial status of rural credit cooperatives at the local level.

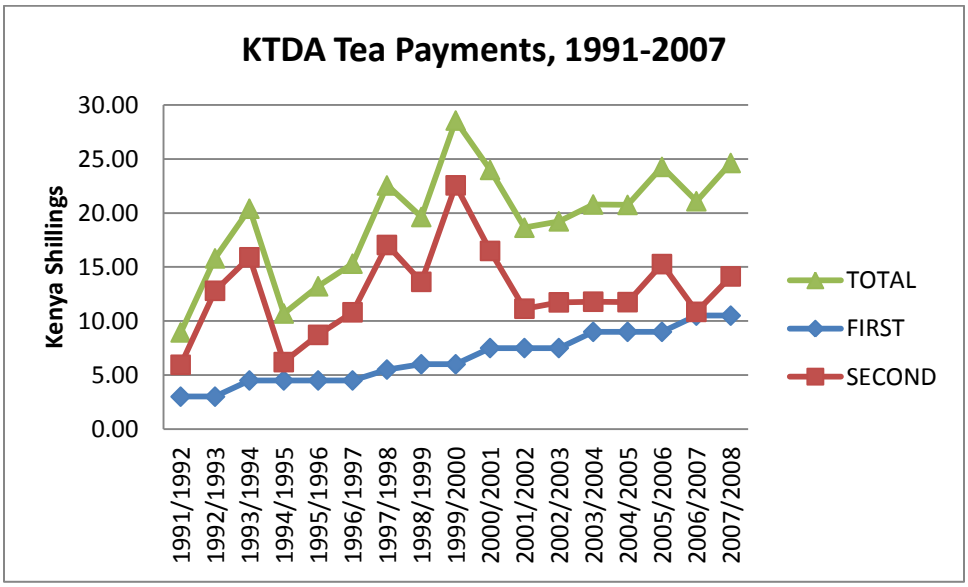

Figure 6.6: KTDA tea payments from 1991-2007 (Source: KTDA archives & records).

At the local level, the Wakulima cooperative is one of fifty two credit cooperatives reportedly serving an estimated 80% of smallholder tea farmers (Sambu, 2009). Although rural credit cooperatives have played a significant role in providing financial services to smallholder farmers, their savings capital base lags behind that of their urban counterparts by a significant margin. This margin is significant according to Nair and Kloeppinger-Todd (2007) who report that Nairobi-based credit cooperatives hold 80% of total savings even though they account for only 20% of the total number of Kenyan credit cooperatives.

6.6.2 The Effect of Stable Salaries

The Uwezo cooperative was integrated into the economic system at two levels: participation in the national economy as a state corporation and participation in the urban financial market at the local level. The state corporation was also subject to some international influence through donor commitments at the national level. Instead of commodity price fluctuations, the major risk to the savings capacity of Uwezo members was public sector retrenchments. The income flow to Uwezo cooperative had proved to be relatively stable over the years and as a result, Uwezo's financial status had grown from strength to strength as demonstrated by Figure 6.7.

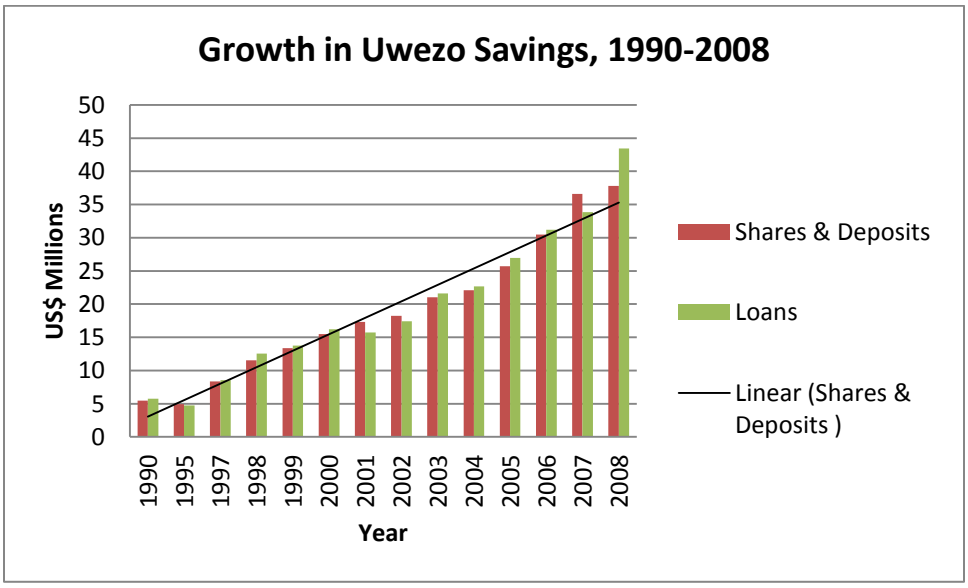

Figure 6.7: Growth in Uwezo member shares and deposits, 1990-2008

The figure illustrates a seven-fold increase in the value of Uwezo member shares and deposits from 1990 to mid-2008. The data therefore appear to support the claim by Nair and Kloeppinger-Todd (2007) that urban credit cooperatives hold significantly higher levels of savings than their rural counterparts. A direct consequence of Uwezo's impressive savings portfolio was that it was self-sufficient in terms of financing its assets and external borrowing was less than 5% of the total assets. The fact that the cooperative had grown to be among the top 20 credit cooperatives in the country also meant that it had considerable economic leverage.

6.7 WAKULIMA AND UWEZO COOPERATIVES AS FINANCIAL INSTITUTIONS

Credit cooperatives have been the fastest growing segment of the cooperative movement in Kenya (MoCDM, 2008a). Members of credit cooperatives have been typically drawn from salaried employees or self-employed individuals such as farmers. The credit facilities have been put to a wide range of uses of direct economic and social benefit to the borrowing members and their families such as the purchase of land (including smallholder farms and commercial plots); construction of residential homes and rental property; investment in small business ventures and farming; purchase of household furniture; and payment of school fees and medical bills (ROK, 1987; Wanyama, 2009).

The majority of rural credit cooperatives are farmer-based cooperatives. The economic fortunes of these cooperatives are therefore heavily determined by domestic and external factors related to the production and marketing of agricultural commodities. In this regard, they differ from urban credit cooperatives which rely on the salaries of employees and are therefore relatively more stable in terms of cash flow. The major risk for employee-based cooperatives has been non-remittance of employee contributions by the employers. This problem had become so acute that it necessitated the amendment of the cooperatives legislation in 2004 to empower the commissioner for cooperative development to recover the outstanding debts directly from defaulting employers. Another risk for employee-based cooperatives is large-scale public sector retrenchments or the liquidation of private companies.

The effect of erratic and stable cash flows over time in Wakulima and Uwezo cooperatives is illustrated in Table 6.2. It also demonstrates the wide margins in savings deposits, loan and asset portfolio in the two credit cooperatives.

Table 6.2: Comparative statistics for Wakulima and Uwezo credit cooperatives (2006)

Credit Cooperative	**Wakulima Rural**	**Uwezo Urban**
Membership	**6,769**	**6,886**
Savings deposits (US$ million[160])	**1.3**	**36.2**
Loans (US$ million)	**1.9**	**33.2**
Total assets (US$ million)	**4.0**	**42.0**
Average dividend rate	**7%** (over 5 years)	**10%** (over 10 years)

The lower financial indicators for Wakulima cooperative thus reflect its lower economic leverage compared to Uwezo cooperative. The relative decline of smallholder tea farmer incomes had triggered a move to diversify the economic base for Wakulima cooperative. The rural cooperative demonstrated an entrepreneurial mentality by opening its common bond relatively quickly in 2005 to grow its membership and exploit existing market opportunities. In contrast, the resistance to open the common bond in Uwezo cooperative demonstrated a conservative approach to change among the majority of members and a higher level of risk aversion.

Wakulima cooperative was characterized by market-driven interest rates and a quicker adoption of management decisions which indicated a higher degree of control by the board and the management. The higher degree of control and the business-oriented focus of the Wakulima management were probably in the best economic interest of the cooperative. Given that the Wakulima cooperative relied heavily on bank loans to sustain member borrowing needs, its

[160] Based on 2006 annual average exchange rate of 1US$: 72.10 (World Bank Indicators)

market-driven interest rates were more a reflection of business reality than an insensitive profit motive. The board and management frequently reiterated the need for the local membership to understand the importance of building institutional capital. Nevertheless, the fact that general members consistently decried the high interest rates seemed to suggest they were powerless to lower the rates through a general resolution. The ambiguous roles between the board and the AGM with regard to the determination of loan interest rates provided further evidence for the claim that the board and the management were powerful in exerting their influence over the general members.

The Uwezo board and management, in comparison, appeared to be more member-oriented in their decision-making and they could certainly afford the luxury of doing so. However, the consensus-driven decision-making process in Uwezo cooperative may have compromised its ability to be an entrepreneurial organization because the slow and deliberative process of consensus-building meant it was slower to adapt to change fuelled by competitor effects. For example, even though the FOSA innovation had first been proposed in 1999, it was only realized in 2003 after a feasibility study had been conducted and office space identified. The latest issue that had required consensus-building was the possibility of opening the common bond in order to forestall the risks of a stagnating or declining membership.

The slower adaptation to change highlights a perennial problem that cooperatives face in balancing the social welfare mentality with the business mentality (Birchall, 1997; ILO, 2001). As a result of staff training in credit union[161] best practice, Uwezo's managers had been exposed to the idea that having operational policies (such as lending policies) tied up in the by-laws was not only poor business practice but it actually hindered the cooperative's ability to be responsive to market realities and hence its competitiveness. Urban areas presented a highly competitive financial market place and credit cooperatives were increasingly expected to improve their prospects through entrepreneurial ventures. As a first step, the Uwezo by-laws had been revised to separate the FOSA operational policies from the general resolutions of AGMs and make them

[161] Credit union is the North American term for credit cooperative.

a responsibility of the board. The determination of FOSA interest rates for lending and saving were therefore market-driven and reviewed by the board every month.

The Uwezo back office credit facility, however, was still subject to AGM resolutions and the lending interest rate had remained fixed for a long time at 12% per annum. Given the persistent high interest rates in Kenya, this rate was actually quite competitive and had resulted in the back office credit products being the most popular products among the members. Even so, an independent financial analysis report based on the audited accounts of the 2006 and 2007 budgets recommended that the average interest rates on loans should have been 13.5% per annum to better reflect the business reality of the cooperative. The cooperative's management knew it would be a hard sale to convince the members, who were the main beneficiaries, to increase the loan interest rate.

6.7.1 The Role of Technology

The Uwezo board and management had done an impressive job in applying technology to improve their business prospects. Their relatively advanced management information system was comparable to one used in a small microfinance bank. It supported direct debit and ATM services as well as account balance enquiries via text messages, which were highly convenient for members. The information system also integrated back office and front office operations which allowed for quick and efficient loan processing as well as efficient and effective loan tracking. This meant that the risk management system was also effective: for example, the level of delinquent loans to the total loan portfolio (referred to as the delinquency ratio of the cooperative) was reported to be negligible at 0.28% at the end of 2006.

In contrast, the most frequently cited operational challenge in Wakulima cooperative was the lack of a suitable technological solution. The five FOSA branches were not inter-linked which meant that each branch processed its own transactions and the data disks were then manually transported to the Main Branch for reconciliation at the end of each day. Due to the distance

from the Main Branch, the fifth FOSA branch posted its reconciliations at the end of each week. At the time of the fieldwork, the cooperative was in the process of procuring a more sophisticated information system that would include a wide area network thus enabling branch inter-linking. The benefits of a new information system included the ability of members to make transactions in real time and get instant and updated balance statements.

Another anticipated benefit was improved report-generating capability. The Wakulima accountant reported that the cooperative was presently unable to efficiently track loans and identify those which were delinquent. Furthermore, loan tracking was done on a quarterly basis and a loan was considered delinquent 90 days after the due date. This grace period may have been too long especially when compared to Uwezo where loan tracking was done on a monthly basis and a loan was considered delinquent 30 days after the due date. The limited software options of the Wakulima management information system also meant that data compilation was tedious and inefficient. A senior employee confirmed that it could take several days to generate a report.

6.7.2 The Effects of Increased Competition

The Uwezo membership comprised employees of one of the better performing parastatals which meant that employees were relatively well paid and had stable incomes compared to other segments of the public sector. This made the Uwezo membership particularly attractive to other financial service providers such as commercial banks. The Uwezo management had been compelled to establish a marketing department in response to aggressive marketing campaigns that had been launched by the commercial banks. A few visits by the researcher to some of the commercial banks in the city revealed that most banks had loan products catering for employees in the public sector. These loans were not subject to traditional cooperative conditions such as the need for peer guarantors to underwrite the loan; pegging of loan amounts to share contributions; and the application of a rigid 2/3 formula to determine the ability to repay. They were therefore quite appealing to Uwezo members despite the fact that they were invariably priced higher than the cooperative's loans.

In the case of Wakulima cooperative, intense competition mainly came from microfinance banks (such as Equity Bank and Family Finance Bank[162]) and the Cooperative Bank. Other mainstream commercial banks provided competition to a lesser degree. This finding was based on a review of organizational documents, interviews and a rapid banking appraisal that the researcher conducted over three days in order to obtain an experience of customer service as well as information about products and pricing. The rapid appraisal was necessitated by the fact that almost everyone in the rural cooperative – staff, members and the board – referred to the commercial banks as the competition instead of their peer cooperatives.

Overall, the bank charges were found to be generally more expensive than those at the Wakulima FOSA, which gave the latter a competitive advantage. However, the superior technological innovations of the banks (ATM cards, inter-linked branches, electronic account statements), which enhanced the banking experience of customers, as well as the colourful and informative brochures put the FOSA at a definite disadvantage. It was therefore quite evident that the Wakulima cooperative faced a considerable challenge in retaining its members, particularly those who were more discerning or educated.

6.7.3 The 'Net Borrower' Effect

A common operational challenge in both Uwezo and Wakulima cooperatives was the high loan demand among the members. One Uwezo board member attributed this challenge to the fact that members were "net borrowers" rather than "net savers". He explained it thus:

> *"…Our members are net borrowers: they look for any opportunity to borrow – whatever loan product is developed, our people want it so that eventually they enter into a vicious cycle of debt and ultimately they don't manage themselves well. So you actually find that it's a challenge to*

[162] These banks originally operated as microfinance institutions and had upgraded to become commercial banks.

sustain their borrowing. ... We are saying that borrowing is okay, in fact that is how we make our money, but we want people to borrow sensibly and also to increase their savings."[163]

The challenge for the Uwezo board was to encourage members to regard their cooperative not only as a borrowing institution but also as a savings institution. Although Uwezo had registered impressive growth in terms of savings over the last eighteen years, there was a need to maintain the trend especially in the light of a stagnating membership.

Similarly, Wakulima cooperative had found itself struggling to satisfy the high loan demand from its members. The tea farmers' cooperative was heavily reliant on one income stream unlike the commercial banks which had a wide base of customers. The solution for Wakulima was to build its institutional capital through a higher proportion of retained earnings as well as savings mobilization among new and existing members as these two Wakulima respondents explained:

"One of our strategies is to really educate our members so that when we present the audited accounts, they will understand that it is not always necessary to plough all the dividends back to them. We should retain a certain percentage for building our own institutional capital. We have even gone an extra mile to make a provision in our by-laws so that it is now mandatory to reserve a certain percentage (25%) which is above the stipulated amount of 20%."

"We are also trying to build our own funds through what we call savings mobilization. If we can do so for the purpose of onward lending to our members, we will cut down on external borrowing which will enable us to save on costs and maximize on profit. We have already started by opening up the common bond so that our membership is not restricted to tea farmers only. We want the rest of the community to open accounts with us so that we can increase our business."[164]

[163] Interview transcript P69: BM1
[164] FGD with Wakulima Board members

The Uwezo and Wakulima board members were therefore cognizant of the business challenges that their respective cooperatives faced in terms of maintaining a competitive level of service. They understood that the cooperatives needed to increasingly benchmark their financial products and services against the commercial banks. This meant unrelenting savings mobilization efforts to build up institutional capital and the provision of innovative products and services to meet the changing needs of their members.

Conclusion

This chapter has provided a descriptive account of the two credit cooperatives that comprised the case studies. It has also presented a chronological account of the smallholder tea sector and the public enterprises sector which formed the basis of member economic participation in the credit cooperatives. The analysis of the smallholder tea sector revealed that the KTDA built an effective and well-regarded vertically integrated system for the production and marketing of smallholder tea. The liberalization of the agricultural sector introduced the effects of price volatility due to global tea price and currency fluctuations and increased the performance risks of marketing organizations. The post-liberalization phase has been characterized by the rising costs of production coupled with a long term global decline in real tea prices due to inflation and oversupply. These factors have eroded the economic power of smallholder tea farmers.

The public enterprises sector was established to facilitate direct state involvement in the economy after Kenya's independence. A proliferation of public enterprises, however, over-extended the government's role in the economy. The public enterprise sector was increasingly characterized by high operational inefficiencies and poor returns on investment which led to a drain on the government budget. A public enterprise reform and privatization programme was launched as part of wide ranging economic reforms but only modest gains were recorded. A change of government in 2002 led to the enactment of several laws to provide a legal basis for public sector reform. The reform process and the legal framework have enabled greater public scrutiny in the privatization of public assets.

The contextual analysis of the two credit cooperatives was examined in terms of the political, organizational and cultural contexts. The analysis revealed the predisposition towards patron-client relations in the rural cooperative as well as the dominance of the rural elite in cooperative leadership positions. The urban cooperative was characterized by a top-heavy leadership structure which reflected a hierarchical organizational context. It also exhibited organizational norms that discouraged corruption and the abuse of power by elected member representatives, and underlying perceptions about the ethno-regional balance in the cooperative's governance structure. In both cooperatives, a male-dominated leadership structure implied a cultural bias against women in leadership.

The comparative analysis of Wakulima and Uwezo cooperatives as economic organizations revealed that the savings of Uwezo members surpassed those of Wakulima by a factor of thirty. This margin could be attributed to the low savings capacity among smallholder farmers due to erratic commodity prices over time compared with relatively stable salaries for Uwezo members. The Wakulima cooperative displayed a business mentality in its adoption of market-driven interest rates and relatively quick decision-making processes while the Uwezo cooperative displayed a social welfare mentality that was evidenced by its slow and deliberative decision-making processes.

Both cooperatives were also analyzed as rural and urban financial institutions. The findings indicate that Wakulima rural cooperative faced greater technological and liquidity limitations than Uwezo urban cooperative. Both cooperatives, however, faced intense competitive pressures from commercial and microfinance banks which aggressively sought business from their members. In addition, both cooperatives were grappling with the high loan demand from their members due to the prevalent perception of cooperatives as loaning institutions rather than saving institutions. The findings suggest that rural and urban credit cooperatives will need to increasingly benchmark their financial products and services against the commercial banks if they are to survive in a highly competitive environment.

This chapter concludes the presentation of the research findings that began in the previous chapter with a descriptive analysis of the relational context of collective economic action and ended with an analysis of the institutional context of economic cooperation in the rural and urban cooperative cases. The next chapter attempts to build a theoretical picture of economic cooperation in Kenyan credit cooperatives that incorporates the role of the associational features of social capital and institutional influences on collective economic action.

CHAPTER 7

ECONOMIC COOPERATION IN CREDIT COOPERATIVES

This chapter presents a critical dialogue between the study findings, emergent theoretical positions and the conceptual framework developed for the study. The aim of the chapter is to interpret and theorize the study findings with a view to refining the conceptual framework of economic cooperation. The chapter begins with a discussion of the cooperative microstructure based on an analysis of the group relations in the two credit cooperatives. It then examines linkages between the cooperative microstructure and the societal macrostructure. The next section presents the emergent theoretical position on the role of social capital in economic cooperation. The interaction between credit cooperatives and their institutional environment is examined in a subsequent section that discusses the socio-political context in terms of cooperative-state linkages and the economic context in terms of the incentive structure for credit cooperatives. A revised conceptual model of economic cooperation is then presented. The chapter concludes with some lessons in cooperative development that may have implications for practice.

7.1 THE COOPERATIVE MICROSTRUCTURE

The study began with the cooperative conceptualized as a microstructure consisting of three tiers of members depicted as a normal pyramid in terms of position distribution. Thus, general members (about 6,000) make up the bottom tier while cooperative employees (about 30) comprise the middle tier and the board of directors, including members of the supervisory committee, (a total of 12) forms the top tier. With regard to power relations, the cooperative functions as an inverted pyramid (see Figure 7.1) in which the general assembly of members exerts ultimate authority. The general assembly of members entrusts the routine management of the cooperative to the board of directors which in turn delegates some aspects of administration to the management employees.

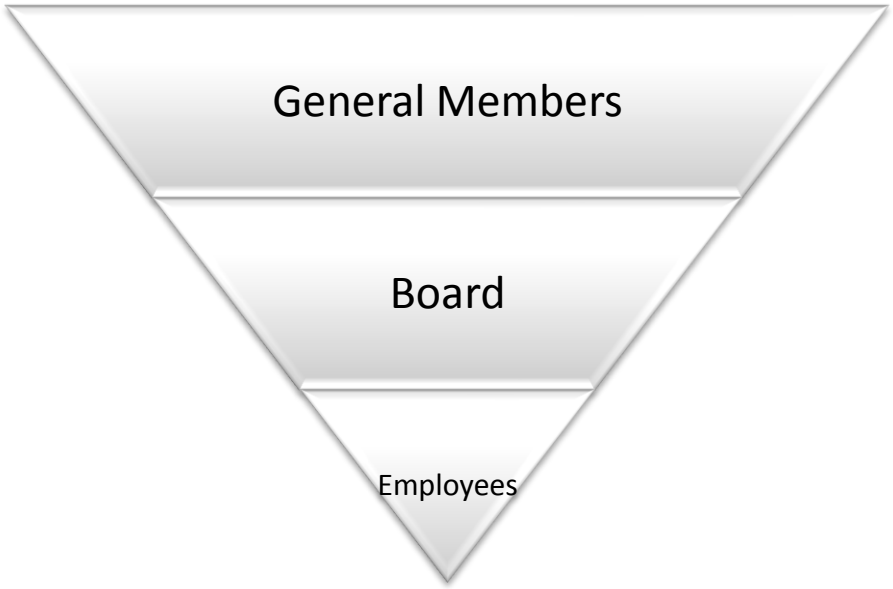

Figure 7.1: Inverted pyramid of the cooperative microstructure

The idea of an inverted pyramid appeared to apply to the Uwezo cooperative microstructure. The general members exhibited a high level of employee solidarity that had resulted in a strong veto power to a number of board proposals in the AGM. This was despite the fact that the composition of the board of directors reflected the leadership hierarchy of the parent organization. Thus, senior managers were disproportionately represented in the board.

Although the board members were cognizant of the fact that they received their executive mandate from the general assembly, they were keen to delegate most operational responsibilities to the management in order to focus on the strategic role of leadership. This proposed shift in roles suggested the influence of a corporate culture from the parent corporation in which the role of its board of directors was confined to a policy-setting mandate similar to other large firms. The disengagement of the Uwezo board from the routine management of the cooperative revealed that the board was not concerned about wielding power and control over the general members. Instead, it was comfortable with delegation whilst remaining aware of its ultimate accountability to the general assembly. This willingness to delegate further confirmed the notion of the Uwezo cooperative operating as an inverted pyramid.

In contrast, the Wakulima cooperative microstructure appeared to operate as a normal pyramid (see Figure 7.2) in which the board and the management exerted fairly strong control over the general members. This was demonstrated by the dissatisfaction among the general members over the market-driven interest rates and their relative powerlessness to change them via a general resolution. A strong business mentality, undoubtedly championed by the management, appeared to override the social welfare outlook that the general members desired.

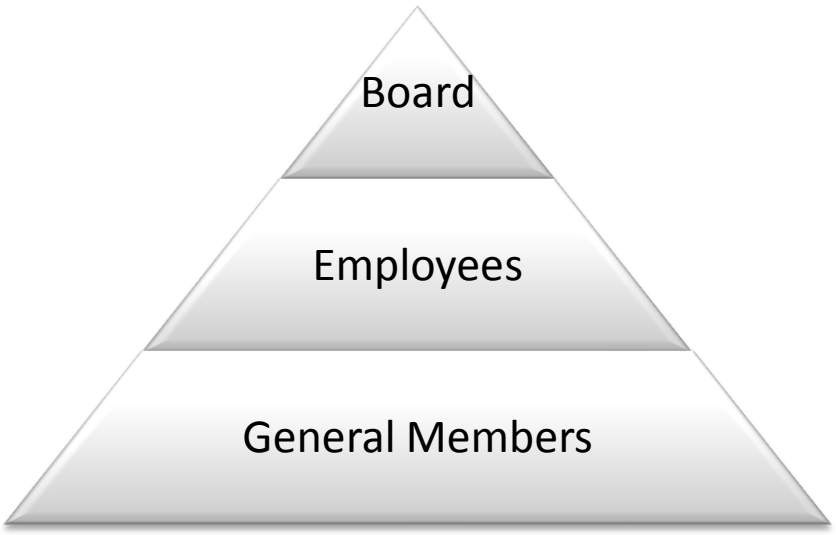

Figure 7.2: Normal pyramid of the cooperative microstructure

The strong control by the management could be justified by two reasons. First, the chronic shortfall in its loaning capital meant that the Wakulima cooperative had to rely on expensive bank loans to sustain member borrowing. Thus, although the general members may have desired cheaper loans, it is likely that the cooperative could not afford to provide them and remain in business. A strong business mentality was therefore necessary for the management. Second, there were low levels of financial literacy among Wakulima's general members. The fact that even the board members needed continuous training suggests that there was greater reliance on the management to provide business advice. The management employees were technically

qualified to offer professional advice in cooperative management. Thus, although the management received its mandate from the board, it was in a strong influencing position.

Individual competence for board members is one of the governance principles of the International Credit Union movement (Niederkohr & Ikeda, 2005). This governance principle means that members of the board need to possess basic skills and experience to understand financial operations in order to competently handle their responsibilities. The financial understanding should ideally be complemented by a strong focus on member needs and priorities. In the case of Wakulima, the board needed to balance the members' need for credit with business practices that ensured the cooperative remained a viable enterprise.

7.1.1 The Source of Power Relations

In the routine management of most Kenyan credit cooperatives, the board's authority to approve member loans forms the basis of its power over members. In small cooperatives, the member loan appraisals are conducted by a credit subcommittee which consists of at least three board members who meet once a month. The rationale is that the board members are sufficiently well-acquainted with the general members to form an opinion about a member's ability to repay and well-informed about their credit history from the cooperative's records. In this way, the cooperative relies on a local knowledge network to reduce its transaction costs and loaning risks.

In large cooperatives, the loan appraisal process is usually delegated to specific employees (credit officers) who then prepare a schedule of loans that is endorsed by the credit subcommittee or full board at the end of each month. In most cases, the loans are officially approved when cheques to the various loan applicants are signed by members of the board's executive committee.

The management of both Wakulima and Uwezo credit cooperatives was empowered to approve loans up to certain predetermined limits which meant that loans required for emergency needs, school fees, crop or salary advances could be dispensed relatively quickly while large development loans were approved by the boards on a monthly basis. The Wakulima executive committee members met once weekly to sign off cheques for the loans while the Uwezo board had delegated routine cheque-signing to the management and met once a month to sign off the large development loans.

The relatively direct involvement of the Wakulima board members in the approval of loans may have explained why they were perceived as patrons by the general members. Members knew that individual appeals to the executive committee members could determine the fate of a loan application. In contrast, Uwezo members considered a personal appeal to a board member as a daunting task for two reasons: one, it would have meant seeking a favour from a superior and second, the member would still be referred back to the management on procedural grounds. As a result, the Uwezo board operated relatively free from clientelistic demands.

The relationships between the board and the general members in both cooperatives therefore revealed vertical linkages from different sources. In Wakulima cooperative, the vertical linkages were of a patron-client nature while the vertical linkages in Uwezo reflected power relations of a hierarchical parent corporation. The fact that the Wakulima board members comprised the local elite while the majority of Uwezo board members were senior managers suggests that their source of authority in the cooperative microstructure also emanated from their status in society and the parent corporation respectively. This finding strengthens the claim that cooperative microstructures act as microcosms of the societal macrostructure which is itself differentiated on graduated parameters such as social class, economic wealth and political power (Blau, 1977; Lin, 2001).

7.1.2 The Social versus Business Nature of Cooperatives

According to one technical consultant[165], the Achilles' heel of most Kenyan credit cooperatives was their social nature. He explained that because board members were "social beings", they were prone to favouritism. Thus, some board members tended to instruct the credit officers of their cooperatives to 'give urgent attention' to certain loan applications in order to expedite the process for their cronies. The social nature therefore tended to subordinate the business nature of the cooperatives whose priority needed to be the efficient loan processing for all members. Another example of the social nature overriding a business mentality in cooperatives was in the democratic process of choosing representatives. The consultant observed that the choice of representatives was driven more by populism than by technical competence. As a result, the rationale for financial decisions was shaped more by social needs and political pressures than by the business reality.

This social practice tended to affect the cooperatives in a financially significant way. To illustrate, the annual return on members' savings was traditionally paid out in the form of dividends. A prudent approach to financial planning would be to make a forecast of the expected dividend yield based on a detailed business plan for the year. However, most cooperatives did not prepare business plans or financial performance targets. Thus, a common practice among candidates campaigning for board positions in the cooperatives was to promise high dividend rates which were rarely based on any financial criteria. The promise of high dividend rates was often coupled with the promise to satisfy the loan demand from members. Invariably, the high loan demand and member expectations of high dividend rates meant that the cooperatives had to borrow from external sources either to meet the loan demand or to pay dividends. This led to a chronic problem of external borrowing to meet shortfalls among many Kenyan cooperatives, which was not a sustainable financial practice in the long term (Chavez, 2006).

[165] Interview transcript P7: TC3

Moreover, the practice of offering high dividend yields and easy loans in many cooperatives went against an established prudential rule adopted by most financial institutions; the rule emphasizes the initial mobilization of savings to ensure sufficient liquidity for loans before declaring a yield on returns. This rule is known as the Savings-Liquidity-Yield (SLY) principle and it appeared to be applied in reverse in the credit cooperatives as Yield-Liquidity-Savings (YLS)[166]. This was a direct consequence of the prevailing operating practice of the cooperatives as social welfare clubs rather than as business entities. Although the cooperatives were regarded as alternative financial institutions, the harsh realities of a liberalized market meant that Kenyan cooperatives had to seriously reconsider their business models in order to survive and judiciously serve their members. Another technical consultant summed up the prospect of the cooperatives in this way: "*Even if the credit cooperatives are primarily for assisting people and not making profits, they may find that they will assist people for one season and die in the next because of poor financial planning!*"[167]

The prospect of survival was suitably high on the agenda of both Uwezo and Wakulima cooperatives. Perhaps the reality of intense competition from the commercial and microfinance banks could not simply be ignored. The general manager of Wakulima cooperative offered an interesting perspective with regard to the future survival of the credit cooperatives. He believed the new Sacco legislation would ensure the survival of the cooperatives by compelling them to become business-oriented rather than social-oriented. Whereas state legislation is sometimes discussed in terms of being a constraint to economic organizations (see North, 1990; Nee, 2005), this alternative view saw the Kenyan legislation for credit cooperatives as an opportunity for economic growth. Thus, the introduction of prudential standards meant that there would be no "short cuts" applied by board members to manipulate the administration of the cooperatives.

The idea of a business nature overriding the social nature of Kenyan cooperatives was also welcomed by the management employees of Uwezo cooperative. One respondent described it thus:

[166] Interview transcript P7: TC3
[167] Interview transcript P8: TC4

"It will be do or die for the Saccos. If we want to remain social entities without a business mind, we may not make it. A social organization does not think in business terms. Thus, when competition comes, it is unlikely to beat the competitor. Instead, we should aim to be business entities with a social mission… When the organization is business-minded, it can have a social agenda so that the focus starts from business to social rather than starting from social and moving to business."[168]

The introduction of prudential requirements in the new legislation for the Kenyan credit cooperatives therefore implied a diminished role for the social nature of the cooperatives.

7.1.3 Cooperative-Society Linkages

A discussion of the cooperative microstructure is incomplete without an examination of its interaction with the societal macrostructure. Society consists of interrelated social groups such as communities and organizations (Blau, 1964). According to Blau, these groups are microstructures which form the building blocks of the societal macrostructure. The societal macrostructure therefore refers to the interrelations between these diverse groups. An analysis of these interrelations is important in understanding how the cooperative microstructure is influenced by societal parameters. These parameters include cultural norms and values which play an important role in defining and shaping social status and societal interaction (Merton, 1968).

Social interaction between and within the many different social groups may be described by the three aspects of social structure introduced in Chapter Two: integration, differentiation and organization (Blau, 1964). Integration implies face-to-face associations among the various parts of the social structure and is portrayed by solidarity bonds within society. Differentiation refers to the distinct social strata found in society. It often implies barriers to face-to-face interactions among the diverse parts of the social structure. Thus, differentiation and integration may be considered to be complementary opposites in social structures (Blau, 1977). Organization

[168] Interview transcript P73: US15

involves the emergence of autonomy and centralized control and is characterized by the presence of political, economic and social institutions in society.

The typology of bonding and bridging networks of social capital is useful in the critical interrogation of the institutionalized patterns of social interaction within society. Bonding networks, characterized by intra-community ties, are manifested by high integration bonds which are beneficial to the extent that they facilitate the creation of cooperative groups. However, they tend to be exclusivist in nature because they are primarily made up of homogenous groups. The typical Kenyan credit cooperative which requires a defined bond of association is an example of a bonding network. Bridging networks are inclusive because they bring together heterogeneous groups of people for a common purpose. An example is the civil rights movement in the United States (Putnam, 2000). Cooperative movements can also qualify as types of bridging networks (Simmons & Birchall, 2008).

Blau (1977) argues that societal integration tends to be strengthened by extensive intergroup relations among heterogeneous groups while homogeneous groups with strong in-group loyalty tend to fragment society into groups with few interconnections. Using the typology of bonding-bridging networks, it can be argued that bridging networks are more beneficial to societal integration than bonding networks. Nevertheless, Putnam (2000) points out that many groups simultaneously bond along some social dimension and bridge across others. Thus bonding and bridging networks are not "either-or" categories into which social networks can be neatly divided but "more-or-less" dimensions along which we can compare different social networks.

The comparative analysis of the rural and urban cooperatives as economic organizations revealed income differences between the rural cooperative and the urban cooperative. A similar analysis of the two cooperatives as social organizations revealed the presence of patron-client relations in the rural cooperative and underlying perceptions about the ethnic heterogeneity of the urban cooperative's governance structure. The analysis also revealed gender biases in the leadership

of both cooperatives. How can these findings be explained in relation to linkages with the societal macrostructure?

The inequality and heterogeneity that is observable in society can be explained by differentiation in the social structure. Thus, group membership and status respectively give rise to the two basic types of differentiation that exist in social structures: heterogeneity and inequality (Blau, 1977). Heterogeneity or horizontal differentiation is the distribution of a population among groups that have distinct boundaries and no inherent rank-order (e.g. gender, religion, race, ethnic affiliation). Inequality or vertical differentiation refers to status distribution among groups along a graduated rank-order (e.g. income, wealth, education, power). These distinctions are important in the analysis of the conceptual linkages between the cooperative microstructure and the societal macrostructure.

- *Income inequality in the Kenyan social structure*

In the study, differentiation in incomes was evidenced by the high savings rates observed for Uwezo cooperative members compared to low savings rates for Wakulima cooperative members. This observed income inequality turned out to be a reflection of the various forms of inequality that exist at societal level. In 2004, the Society for International Development (SID) released an inaugural report on inequality in Kenya detailing the various types of inequality. The report revealed that the distribution of income and wealth was heavily skewed in favour of the rich: while the country's top 10% households controlled 42% of the total income, the bottom 10% controlled less than 1%. The rich were predominantly urban residents while the bottom poor were rural residents (SID, 2004).

In terms of the Gini index for selected survey years, the level of inequality in Kenya was found to be higher than that in Uganda, Tanzania and Nigeria while slightly lower than that in South Africa. This is illustrated in Table 7.1 below.

Table 7.1: Gini Index for Kenya and selected African countries

Country	Gini Index (%)
South Africa	59.3
Kenya	57.0
Nigeria	50.6
Tanzania	37.2
Uganda	37.4

Source: SID, 2004

The comparatively high income inequalities in Kenya also reflect highly uneven status distributions along the gradations of wealth, power and prestige. Thus, those who are wealthy are also likely to be politically powerful. This can be explained by the close interaction between political power and economic interests since colonial times. For example, the colonial phase of cooperative development revealed that the economic interests of the settlers were often protected by the colonial government. After Independence, the colonial administration was replaced by a presidency which increasingly centralized and consolidated power (Okoth-Ogendo, 1972; Kimenyi, 2002; Murunga, 2004).

As a result, the presidency wields immense power over the economy and the allocation of resources, most notably land (Gatheru & Shaw, 1998). It was during the reign of the second president that the irregular allocation of public land became widespread and was known as the 'Land Grabbing' phenomenon (CIPEV, 2008). The report of the Commission of Inquiry into the Illegal and Irregular Allocation of Public Land (known as the Ndung'u report) indicated that most illegal allocations occurred before or soon after the general elections of 1992, 1997 and 2002, confirming that public land was allocated as political reward or patronage (Southall, 2005).

The use of public finances has also been subject to the control of powerful elites suggesting state capture. Shortly after being elected in 2003, the Ninth Parliament unanimously voted to sharply increase members' pay, mileage, housing, constituency and severance allowances (Lansner,

2009). This has resulted in the excessively high salaries that Kenyan Members of Parliament earn. In July 2010, Kenyan MPs earned the equivalent of UK£ 8,920 compared to £50 for urban employees and £25 for rural farm workers[169]. A related theme is that this remuneration has, to a large extent, been exempt from tax. In his 2008 Budget Speech, the Minister of Finance attempted to get parliamentary approval for the taxation of allowances paid to Members of Parliament and other constitutional office holders. This proposal was rejected by the Tenth Parliament and drew angry condemnation from the general public[170]. I argue, however, that the numerous clientelistic demands that Kenyan constituents are reputed to make on their parliamentary representatives does appear to fuel an ongoing vicious cycle of dependency and exploitation.

The wide disparities in income, wealth and power correspond with vertical status distance and a pyramidal societal structure. Blau (1977) has argued that status distance translates to limited social association between the various social strata. This separation is explained by the principle of homophily where social interactions tend to take place among individuals with similar lifestyles and socio-economic characteristics (Lin, 2001). It means that actors whose lives are spent in one type of milieu may be relatively ignorant of what goes on in other milieux. This applies both in a lateral sense (spatial separation) as well as a vertical sense (elite vs. less privileged). Vertical stratification of milieux is nearly always reflected in a spatial segregation (Giddens, 1984).

Kenyan society therefore appears to be organized vertically rather than horizontally. The skewed concentration of political power and economic wealth among elites in Kenya has undermined the creation of a civic and egalitarian society in terms of political equality and economic opportunity. Furthermore, institutionalized patterns of social relationships in society have tended to exhibit high integration bonds among homogenous groups (bonding networks) instead

[169] http://www.guardian.co.uk/world/2010/jul/01/kenyan-mps-pay-rise

[170] This claim is based on a review of media reports, including Letters to the Editor, from July to November 2008.

of heterogeneous associations between members of different groups (bridging networks) (Miruka, 2007).

- *Gender inequality in the Kenyan social structure*

The underrepresentation of women in cooperative membership and leadership that was observed in the study can be attributed to cultural biases in property rights and gender disparities in income and employment opportunities. Gender disaggregated statistics in the SID report on inequality in Kenya reveal that men not only have higher monthly incomes but they also account for over 70% of formal employment and occupy 70% of the highest posts in the public sector (SID, 2004). Unemployment levels are almost two times higher among women than men. The statistics are presented in Table 7.2 below.

Table 7.2: Gender disparities in income and employment opportunities

Unit of analysis	Female	Male
Mean monthly earnings from paid employment (1999)		
Kenya Shillings	**5,752**	**8,440**
Labour force participation rates (1999)		
Informal sector employment	**45%**	**55%**
Formal sector employment	**28%**	**72%**
Unemployment rates	**19.3%**	**9.8%**
Public sector wage employment (2002)		
Bottom grade A Top grade U	**70%** **30%**	**30%** **70%**

Source: Pulling Apart – Facts and Figures on Inequality in Kenya, SID (2004)

The comparatively low numbers of elected women representatives in parliament (4%) and civic authorities (5%) based on the 2002 general election results also reflect gender inequalities in political representation (SID, 2004). This documented evidence of gender inequalities in society helps explain the relative invisibility of women in cooperative leadership positions observed in the study.

- *Ethnic heterogeneity in the Kenyan social structure*

The study findings suggest that differentiation based on ethnic heterogeneity may be an important factor in Kenya's societal integration. For example, knowledge of the local language was critical in the provision of member advisory services in Wakulima cooperative. Yet, it implied barriers to intergroup interaction based on ethnic origin. The effects of the 2008 post-election violence also contributed to an ethnically polarized environment that could not easily be ignored. The fact that ethno-regional considerations appeared to play a tacit role in the selection of delegates in Uwezo cooperative further justified the need to analyze ethnicity in the Kenyan society.

Kenya consists of 42 ethnic groups who live in eight regional provinces. Most areas outside the major towns and cities are relatively homogeneous ethnically. Problems of inequality and marginalization have often been viewed in ethno-regional terms and there have been latent perceptions that some ethnic communities have fared better than others (Murunga, 2004). According to the commission that probed the 2008 post-election violence, feelings of resentment and powerlessness were mobilized into acts of violence against members of different ethnic communities with devastating results (CIPEV, 2008). Kimenyi (2002) has argued that the political crises in many African countries that have resulted from ethnic strife should not be solely attributed to the presence of heterogeneous population groups but to the failure of political institutions to harmonize diverse ethnic interests. This is a plausible claim that explains what happened in Kenya culminating in the 2008 post-election violence.

A supporting view is offered by Professor Yash Pal Ghai, who led the first attempt to write a people-driven constitution in 2005 (known as the Bomas Draft). He argues that politics driven by clientelism and cronyism, rather than ethnicity, are at the heart of Kenya's problem in this excerpt:

> *Our problem, fundamentally, is not tribalism but poverty, underdevelopment, corruption, a predatory political and economic class which feeds on the resources that the state extracts from*

> *the people, the politics of patronage seemingly based on tribalism but more accurately based on clientelism and cronyism, disparities of wealth and opportunity, and the utter lack of accountability of the government and other public authorities.*[171]

Even though the benefits of apparent ethnic-based politics accrue to only a few individuals within and beyond a particular ethnic group, the general perception is that the entire ethnic group has gained as a result of its closeness to political power. Ethnic-based politics in Kenya has therefore seriously undermined the sense of nationhood among various ethnic groups and the formal institutionalization of democracy (Bratton, 2007; Murunga, 2004). In terms of societal integration, ethnicity has also contributed to social exclusion and marginalization because access to job opportunities in the public sector, lucrative state contracts and even entrepreneurial opportunities have been determined on this basis (Vandenberg, 2003).

Kimenyi (2002) further argues that ethnic groups in Kenya have tended to operate like interest groups which seek to maximize the well-being of their members by competing for political power that ensures wealth transfers from other groups. The problem with ethnic groups behaving like interest groups is that membership is permanent which makes competition for resources intense and continuous compared with other interest groups whose membership is non-permanent. Furthermore, the nature of Kenyan politics as a zero sum game makes the prospect of compromise and negotiation more difficult to achieve.

It is my view that achieving enduring societal integration in Kenya will depend on the ability of the country's political leadership and citizenry to eschew divisive ethno-regional politics and make concerted efforts to bridge existing ethnic fault lines. The Kenyan cooperative movement is an example of an inclusive and heterogeneous network that may have an important role to play in this process. The cooperative movement has achieved socio-economic heterogeneity through the incorporation of diverse occupations such as public and private sector employees, small-scale

[171] The Standard newspaper, Sunday August 24th 2008, p. 16

traders and businesspeople, and farmers. Geographical heterogeneity has also been achieved through rural and urban members dispersed widely across the country. Age and gender heterogeneity, albeit imperfectly, has been realized through the inclusion of the youth and retirees as well as both men and women.

In summary, the income and gender inequalities in the Kenyan societal macrostructure were reflected in the two cooperative microstructures. It would also appear that entrenched perceptions of ethnicity, so prevalent in Kenyan society, are likely to be revealed wherever there is a heterogeneous group of people. The heterogeneity of the Kenyan cooperative movement, however, provides hope that the Kenyan society can espouse differentiation as a source of cohesion rather than a source of division. The fact that the movement comprises almost 20% of the population suggests that it is possible to transcend socio-economic and ethnic differences in pursuit of a common goal to improve members' welfare through cooperative enterprises.

7.2 THE ROLE OF SOCIAL CAPITAL IN ECONOMIC COOPERATION

The concept of social capital formed part of the conceptual framework of economic cooperation and was defined as an interrelated set of five associational features that facilitate collective action and by which actors can secure individual benefits. These associational features were empirically investigated and then analyzed according to two functions – the creation and the maintenance of collective economic resources – that constitute collective economic action. The research findings suggest that the creation of collective economic resources involved a common self-help ideology and solidarity bonds that were bounded in time and space. The self-help ideology, referred to as the Harambee ethic, facilitated the formation of a group of like-minded individuals. Similarly, bounded solidarity among the members arose out of common experiences of financial exclusion (Uwezo case) and exploitation (Wakulima case). These situational experiences led to the creation of collective capital which played an important role in facilitating the participation of formally disadvantaged groups in the economic sphere.

The findings further suggest that principled or non-economic factors such as a common set of values and solidarity based on a collective sense of injustice play a role in motivating social actors to engage in the economic action of creating collective economic resources. The maintenance of the collective economic resources was found to involve reciprocal horizontal exchanges which facilitated the uptake of loans; the enforcement of agreements which ensured compliance; and democratic processes of representation that engendered members' trust and confidence in the cooperative. These three associational features reflected instrumental or rational motivations for economic action among members.

These findings also imply a time sequence in the application of the associational features of social capital. Thus, a common value set and bounded solidarity are first necessary to create a group on a cooperative basis while reciprocity exchanges and mechanisms of enforcement and representation are required to maintain the collective economic resources.

Figure 7.3 illustrates how the five associational features of social capital are placed in terms of their role in creating and maintaining collective economic resources.

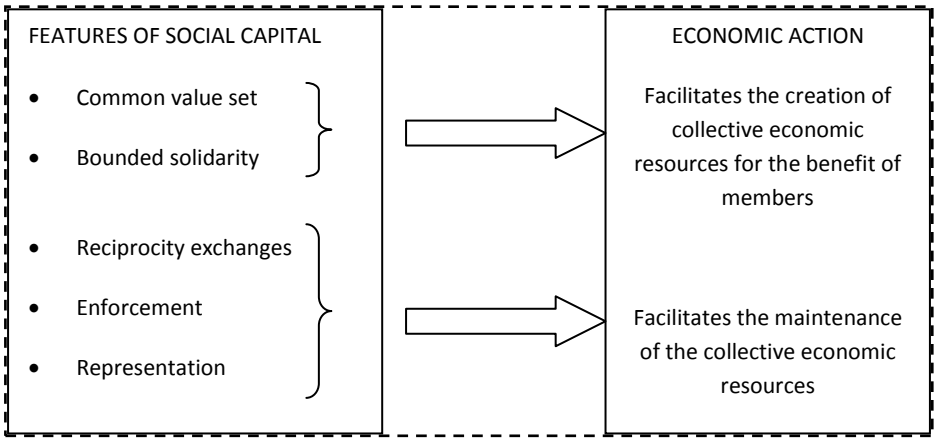

Figure 7.3: Emergent relationship between social capital and economic action

The findings therefore confirm that both principled and instrumental motivations are necessary for the creation and maintenance of collective economic resources. A common value set appeared to mediate individual self-interest so that even though people joined the cooperatives primarily to help themselves, they chose to do so in a collective enterprise. A collective enterprise also implied the acceptance of social roles and responsibilities such as monitoring loan recipients and participating in annual general meetings to elect representatives. The creation of collective capital by low-income or low status groups in society further demonstrates the power of solidarity in addressing a common need in a way that is mutually beneficial to the members and transforms power relations in the economic sphere.

7.2.1 Social Capital and the Influence of Social Structure

The literature on social capital suggests that its efficacy is likely to be influenced by several factors of the social structure such as power relations; social position; access and capacity to utilize resources; and the broader economic and socio-political context. These factors were briefly discussed in Chapter Two. Some scholars claim that the instrumental value of social capital and its differential effects in society can be explained by the inequalities in the social structure. For example, Loury (1976) has argued that low social position in a racially stratified society is likely to entail corresponding low amounts of social capital in the labour market. Lin (2001) has also theorized the concept of social capital in terms of social positions that possess differential amounts of valued resources categorized in three dimensions – political power, economic wealth and social status. The link between the effectiveness of social capital and its socio-economic location within the social structure has therefore led some scholars to conclude that "not all social capital is created equal" (Edwards & Foley, 1997: 673).

The study findings appear to confirm the literature because they reveal how the socio-economic status of members (rural farmers vs. urban employees) affected the size and quality of the collective capital in the credit cooperatives. Thus, although the cooperative model enhances the economic participation of low-income or low-status groups, it is still affected by the differential access to valued resources attributed to social position. The findings further suggest that the

efficacy of social capital in credit cooperatives may be enhanced by a well-informed membership and competence of the board and the management. A well-informed membership implies continuous member education to supplement relevant training of the board and the management. In this way, the sustainability of the collective capital can be ensured.

7.3 RELATIONS BETWEEN CREDIT COOPERATIVES AND INSTITUTIONS

The institutional environment for credit cooperatives was conceptualised as a space in which formal and informal rules facilitate, motivate and govern the cooperatives as they pursue their economic interests. In the formal institutional realm, the credit cooperatives assume identity as economic organizations. The formal rules consist of state regulation and market mechanisms that define the incentive structure for the credit cooperatives. Informal norms are defined by the socio-political setting of the cooperatives which determines the alignment of economic interests and political power. In this regard, the credit cooperatives act as social organizations and their interaction with the state is examined in terms of cooperative-state linkages. The cooperative-state linkages and incentive structure will now be discussed in turn.

7.3.1 Cooperative – State Linkages

This section examines relations between cooperatives and the state by comparing the political leverage of smallholder farmers (Wakulima members) and public sector employees (Uwezo members) as distinct social groups within the Kenyan society.

- *Smallholder farmers as a latent lobby group*

The number of smallholder tea farmers tripled from 130,000 in 1980 to 400,000 in 2003. This number represents a large group that is united by the common interest of receiving maximum returns for their produce. Although all the farmers have a common interest of obtaining this collective benefit, they have no common interest in paying the cost of providing the collective good (Olson, 1965/1971). According to Olson's theory of collective action, the larger the group,

the further it would fall short of obtaining an optimal supply of any collective good and the less likely it would act to obtain even a minimal amount of such a good. In other words, the larger the group, the less it would further its common interests. This is because in a large group, no single individual's contribution makes a perceptible difference to the group as a whole. Consequently, the individuals remain worse off because no one wants to pay the costs of mobilization. Olson referred to such large groups as "latent" groups because of their undeveloped potential for collective action.

The theory of collective action is quite relevant to the smallholder tea farmers in Kenya. The realization of the collective good, which is high returns for tea, is dependent on the collective action of tea farmers providing high quality green leaf for processing and the timeliness of the processing procedures at the factory. If the bulk of green leaf delivered to the factory is of lower quality, it diminishes the efforts of those farmers who do provide higher quality green leaf. As the quality of the tea is graded per factory, a single farmer's contribution makes no tangible effect to the final price declared at the auction. The collective delivery of green leaf therefore introduces the classic 'free rider' problem because "any individual grower may be tempted to deliver a greater weight of poorer quality leaf in the belief that he or she could benefit from the high quality plucking of others" (Lamb & Muller, 1982: 39). The authors note that common interest peer pressure was one of the incentives for smallholder farmers to provide high quality green leaf at their individual factories in the 1970s. The system of peer pressure may have worked well at that time because there was a smaller group of farmers registered per factory. However, it is highly likely that the increase in registered farmers over time may have diluted the peer pressure effect.

The notion of smallholder tea farmers as a large latent group is also applicable in the representation of their common interests at the national level. The absence of a single, well organized and structured national lobby group makes the farmers susceptible to political entrepreneurs who purport to champion the farmers' interests often with ill-conceived populist proposals. As a result, KTDA and by extension, the smallholder tea industry has been subjected

to a confusing medley of discordant voices that has prompted some farmers to ask politicians to stop interfering in their affairs (Gikandi, 2007; Kisero, 2007). As the second most important agricultural export commodity for Kenya, it is impossible for tea not to generate political interest. However, the absence of a strong united lobby group among the farmers severely erodes their political leverage.

The case is different for public sector employees, most of whom make up a politically powerful constituency (such as teachers and their strong national union), and some of whom (parastatal chief executives) owe their positions to political patronage (Cohen, 1993; Were et al., 2005). As a result of these direct links with the government, they may be said to attract the 'ear' of government. The review of the public enterprises sector attempted to show how exogenous factors such as patronage and excessive powers of the presidency affected the pace of public sector reforms. Given their central role in the economy, it is no surprise that parastatals are crucial sites of political patronage. Lansner (2009) attributes the "numerous opportunities for direct political interference, patronage and corruption" in the parastatal sector to the fact that chief executives report directly to politically appointed ministers. Thus, political institutions and interests continue to play a major role in the public enterprise sector. This finding suggests that public sector employees remain a politically important constituency and consequently enjoy higher political leverage than smallholder farmers.

- *Explaining the vertical linkages in Kenya's socio-political environment*

The Kenyan socio-political context is characterized by vertical linkages of a patron-client nature which impede the development of horizontal bonds of solidarity among individuals of a similar class (Leonard, 1991; Orvis, 2006). In the long term, Putnam (1993) argues that vertical relationships between patrons and clients tend to undermine the horizontal solidarity of clients and makes them vulnerable to exploitative behaviour from patrons. Putnam's argument is based on his comparative analysis of institutional performance in Northern and Southern Italy.

His description of public life in Southern Italy bears striking resemblance to Kenya in that public life is organized vertically rather than horizontally. Political participation appears to be triggered by personal dependency on the part of the constituents (clients) and private greed on the part of the politicians (patrons). Corruption is widely regarded as the norm and there is some cynicism about upholding democratic principles (Bratton, 2007). Lastly, compromise is viewed only in negative overtones – I lose, you win – a situation very similar to the zero sum game described in the quest for political power in Kenya (CIPEV, 2008).

Putnam (1993) concludes that the poorer institutional performance in the "uncivic" Southern Italy can be attributed to the absence of dense networks of civic engagement. In the civic Northern Italy, citizens interact as political equals bound together by horizontal relations of reciprocity and cooperation rather than as patrons and clients through the vertical relations of authority and dependency that characterize Southern Italy. In a similar manner, the Kenyan socio-political context is characterized by vertical relations between patrons and clients that appear to foster a vicious cycle of dependency and exploitation. The persistent tradition of ethnic-based politics also undermines the institutionalization of democracy and contributes to poor institutional performance (Bratton, 2007; Murunga, 2004).

Karl Marx (1869/1959) provides another compelling explanation for the enduring vertical linkages in the Kenyan socio-political environment. This is the lack of class consciousness among smallholder farmers derived from his analysis of the French peasantry. According to Marx, the smallholding French peasants of the 19th century formed a "vast mass" of members living in similar conditions yet without entering into multiple relations with one another. The smallholding offered little division of labour in its cultivation and therefore limited diversity of development which expressed itself in the paucity of rich social relationships among the peasants. As a result, the French peasantry functioned as an aggregation of individuals rather than a social class. Marx described them rather disparagingly as a "simple addition of homologous magnitudes, much as potatoes in a sack form a sack of potatoes" (1869/1959: 338).

Marx argued that that the lack of identification of common interests among the smallholding peasants meant that they could create neither a national bond of solidarity nor a political organization to defend their common interests. As a result, they were incapable of enforcing their class interest in their own name, whether through a parliament or through a convention. Their need for political representation made them susceptible to exploitative relations with the state described by Marx as "an unlimited government power that protects them against the other classes and sends them rain and sunshine from above" (1869/1959: 339). In this way, the political influence of the smallholding peasant was subordinated to the executive power of the state. These conditions appear to mirror those of smallholder farmers in the Kenyan socio-political context and support the earlier description of the farmers as a latent lobby group.

It would therefore seem as if there are dim prospects for linking networks in Kenya's vertically structured society. This category of social network represents an institutionalized pattern of civic engagement which has the potential to link groups with differential access to power, social status and wealth in a hierarchical social structure (Szreter, 2002). The credit cooperative movement, which brings together smallholder farmers with low political leverage and public sector employees with higher political leverage, however, offers an example of a linking network. Thus, linkages between the primary credit cooperatives and their national unions, KERUSSU and KUSCCO, enabled stakeholder engagement with the government and lobbying action on the regulation of the sector. [172]

The wider cooperative movement, however, remains relatively invisible in national policy debates due to an ineffectual national federation (Wanyama, 2009). Wanyama notes that there have been some recent attempts to revitalize KNFC. Until then, the collective voice of the Kenyan cooperatives is likely to remain weak and ineffective at the national and international levels.

[172] Interview transcripts P9: CO4; P4: ARR

7.3.2 The Incentive Structure for Credit Cooperatives

The incentive structure describes the interaction between credit cooperatives and the economy in terms of formal rules which regulate economic exchange and market mechanisms which promote competition. The historical review of cooperative development in Kenya revealed that the liberalization of the economy was an important event because it introduced macroeconomic policies that favoured free market mechanisms. Cooperatives in general and credit cooperatives in particular had to competitively adapt to the new business environment. Agricultural cooperatives were generally found to be unprepared for competition while financial cooperatives were better prepared for market forces (Wanyama, 2007, 2009).

The enactment of the *Sacco Societies Act (2008)* has introduced prudential standards such as minimum liquidity and capital requirements that credit cooperatives will now have to comply with. The introduction of these prudential standards is likely to force the cooperatives to retain more of their earnings and pay out less as interest or dividends (Wahome, 2009). In addition, the study findings indicate that increased competition for retail customers by commercial and microfinance banks means that credit cooperatives can no longer rely on a captive niche market of members. The credit cooperatives in the study provided evidence of competitive adaptation. For instance, Wakulima had opted to diversify its membership in order to attract more business while Uwezo had recorded higher revenue growth with the introduction of the FOSA.

The new regulatory environment implies the need for credit cooperatives to invest in advanced management information systems that provide an accurate picture of the financial status of the cooperatives. Better financial management of the cooperatives also means they will be required to improve their credit risk mitigation strategies and make provisions for bad loans that occur in the course of business. Instead of solely relying on guarantors to repay delinquent loans, the cooperatives will be expected to take an active role in mitigating the risks of loan delinquency by training their staff on advanced risk identification techniques and generating loan delinquency reports on a regular basis (Chavez, 2006).

Rural or commodity-based credit cooperatives face the biggest challenge in raising the capital required to invest in advanced management information systems as well as investing in staff and board training. This is based on the fact that they are poorly capitalized compared to their urban counterparts (KERUSSU, 2004; Nair & Kloeppinger-Todd, 2007). Rural credit cooperatives are also heavily reliant on the narrow economic base that is provided by the agricultural commodity their members produce and the Wakulima case illustrates the effects of variable commodity prices. The rural cooperatives stand to gain the most by diversifying their membership and thereby broadening their economic base. The government is also attempting to address the low economic position of smallholder farmers in the value chain by focussing on improved marketing and value addition strategies through the Cooperatives Ministry (MoCDM, 2009b).

Both rural and urban credit cooperatives will have to reconfigure the way they conduct business if they are to survive in an increasingly competitive and regulated environment. For instance, they will need to re-evaluate their capitalization strategies and incorporate financial best practices (Bonyo, 2008). The introduction of specific legislation for credit cooperatives means they are now recognized as fully-fledged financial institutions. The conventional practice of the social nature overriding the business nature of the cooperatives is unlikely to be tolerated in a stringent regulated environment. A regulatory impact study conducted on a sample of 148 Kenyan credit cooperatives recommended changes in the governance, operational and risk management practices (Chavez, 2006). The study concluded that the prospect of change was better than the prospect of irrelevance and eventual closure.

- *A diminished role for social capital?*

The new incentive structure for credit cooperatives may affect the significance of associational features of social capital. In his social capital theory of cooperative organizations, Valentinov (2004) argues that the expansion of cooperative business prioritizes the expansion of economic capital over a corresponding expansion in social capital. He explains that the accumulation of

economic capital can readily be achieved through certain economic activities (e.g. lower interest rates on credit, wider range of services offered to members and the purchase of better operational equipment). Yet, a corresponding expansion in membership base may not necessarily yield proportionate increases in social capital due to the increased difficulties of ensuring consensus and maintaining the high levels of informal communication and exchange between the members that characterize social capital. Therefore, Valentinov (2004) posits that economic efficiency which usually accompanies growth in economic capital will be better obtained using hierarchical governance and technological solutions than with the deliberative processes of cooperative governance and reliance on guarantors associated with social capital.

I extend Valentinov's argument to the Kenyan cooperative scenario where a new emphasis on prudential requirements implies a stronger focus on business and economic efficiency. I therefore suggest that the reconfiguration of cooperative business models to comply with the new regulatory structure could result in the diminished role of the relational features that comprise social capital. For instance, an expansion in membership base is likely to be accompanied by advanced credit risk strategies and technological solutions that rely less on relational contracting. This may result in the partial loss of the cooperative's group identity. Thus, although social capital appears to play a role in the maintenance of collective economic resources, the introduction of prudential standards that emphasize economic efficiency may reduce the role of social capital in favour of financial procedures and technological solutions.

A similar shift away from reliance on social capital took place in the Desjardins network of financial cooperatives (*caisse populaires*) in Quebec Canada. In 1995, a 'business re-engineering' process was initiated within the Desjardins Group to simplify and modernize *caisse* operations. A subsequent review of the organizational and decision-making structure of the *caisse* resulted in the abolition of the credit committee structure. Prior to this move, the *caisse* had been governed by three committees: credit; administration; audit and ethics. Sriram (1999) infers that the role of the credit committee was rendered irrelevant as a result of the adoption of information technology. Thus, the credit history of the borrower was readily available via

computer-generated records and did not have to rely on the personal knowledge of credit committee members. Furthermore, the increased sophistication of loan products meant that credit committee members, who were drawn from the local community, were considered not to possess the necessary banking experience or training to assess credit risk.

Economic rationalization processes, implied in the adoption of prudential standards and financial best practice, may therefore result in a reduced role for social capital in Kenyan credit cooperatives.

7.4 A REVISED CONCEPTUAL MODEL OF ECONOMIC COOPERATION

The preceding discussion of the study findings necessitates a revision of the conceptual model of economic cooperation that was developed for the study (see Figure 2.2). The revised conceptual model clarifies the nature of interaction between individual actors (members), their cooperatives and the institutional realm. The model maintains three interrelated levels representing the macro-level institutional realm; meso-level organizations (cooperatives); and micro-level actors (members of the cooperatives). The conceptual model also recognizes the dual identity of cooperatives as formal economic entities and social organizations representing specific groupings in society.

The institutional realm is conceptualized as a socially constructed arena for the articulation and pursuit of interests. It is defined as a space in which formal and informal rules facilitate, motivate and govern economic organizations and individual actors as they pursue their interests. The formal institutional realm represents the economy in which credit cooperatives function as economic organizations. The formal rules define the incentive structure for economic exchange. The informal institutional realm encompasses the socio-political setting which governs relations between the state and the cooperatives as well as the societal macrostructure which governs relations between diverse groups in society.

The institutional realm is therefore depicted as the economy, state and society in the conceptual model to represent the economic, political and social systems operating at macro-level. These systems are distinct but not entirely independent of each other. In accordance with the assumptions of economic sociology, the economy is considered part of the social system, embedded in society (Zafirovski, 1999). The state may also be considered to be embedded in society because it shapes political outcomes (Block & Evans, 2005). The social system includes the underlying values, norms of behaviour and cultural traditions that regulate society (Kumssa & Mbeche, 2004). As microstructures in society, the cooperatives are subject to the influence of informal norms, values and culture at the individual member level and through the joint action of members.

The revised conceptual model of economic cooperation is illustrated in Figure 7.4 below. In the formal institutional realm or the economy, the formal rules consist of state regulation and macroeconomic policies that shape the market conditions for the credit cooperatives. State regulation comprises the new legislation that prescribes prudential standards and supervisory mechanisms for the credit cooperatives. Prudential regulation and supervision aims to improve the financial condition and reliability of credit cooperatives. The formal rules are depicted by a downward arrow to the credit cooperatives in the conceptual model. Informal rules refer to the norms and patterns of behaviour displayed in cooperative-state and cooperative-society relations. The influence of informal norms, values and culture is depicted as dashed lines to both the individual members and the credit cooperatives.

The cooperatives respond to the defined incentive structure in three ways: first, by ensuring compliance with the new regulation. Second, the cooperatives may engage in lobbying action to protect their common interests through their national unions. Third, the cooperatives are likely to adjust to competitive pressures by creative adaptation. Adaptation, compliance and lobbying action are depicted by an upward arrow toward the economy.

Credit cooperatives represent an avenue for collective action by organizing and facilitating the economic interests of their members. The cooperatives monitor the economic action of their members and enforce their agreements. As regulated financial institutions, credit cooperatives will now engage in risk management which involves monitoring business, operational and financial risk. Business risk is associated with changes in the macroeconomic environment which include interest rate fluctuations, competition in the financial sector, taxation changes and regulatory threats. Operational risk involves assessing capital adequacy, liquidity management and operating costs. Financial risk refers to risks associated with deposit-taking institutions and involves measures to protect member shares and deposits. Enforcement and risk management are depicted by a downward arrow toward the individual members.

Individual members of credit cooperatives engage in collective action with the help of the associational features of social capital. Cooperatives are member-owned organizations and governance is the joint responsibility of all members. Collective action and governance are depicted by an upward arrow from the members to the cooperatives. In the context of prudential regulation, general members will need a greater awareness of what is required to ensure a sustainable and viable enterprise. Some of these requirements include building institutional capital from retained earnings; providing accountable and competent leadership; and approving entrepreneurial strategies for innovative products and services that meet the needs and aspirations of members.

The conceptual model depicting the revised relationships between the institutional realm, credit cooperatives and individual members is illustrated in Figure 7.4.

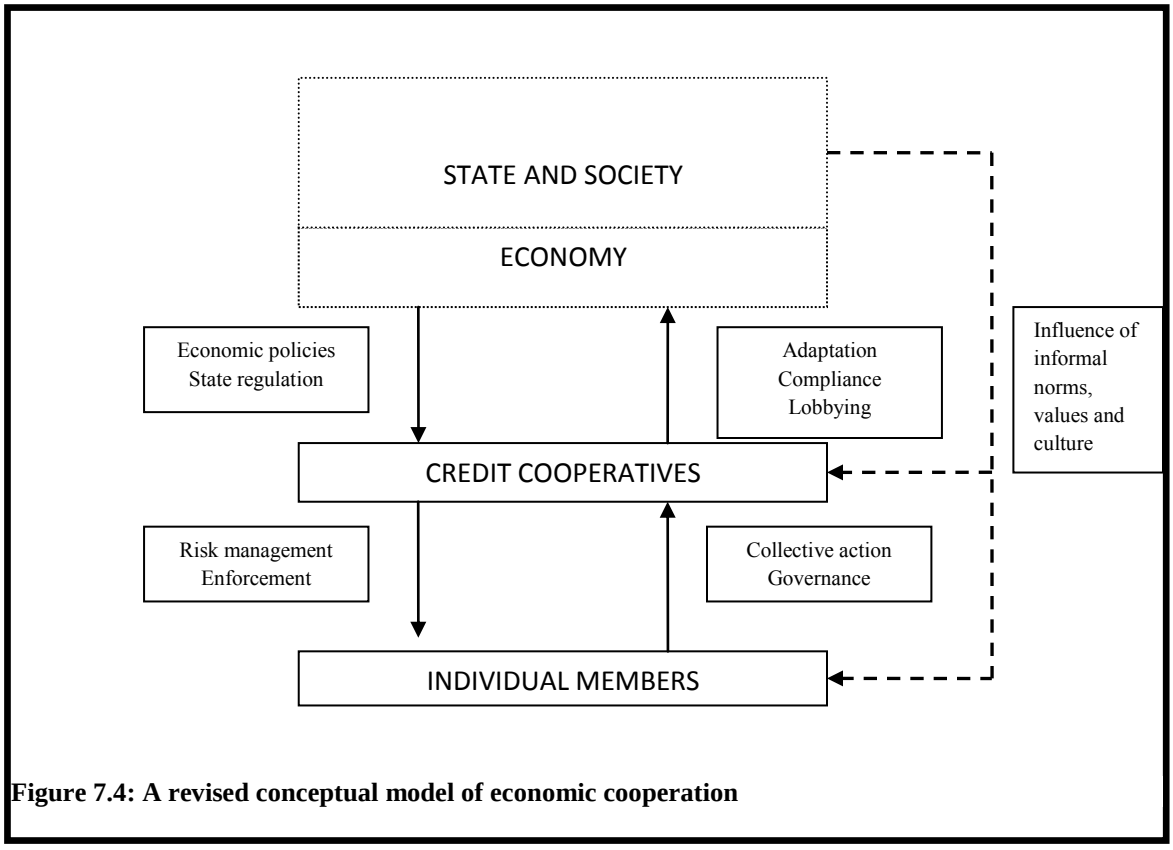

Figure 7.4: A revised conceptual model of economic cooperation

7.5 LESSONS IN COOPERATIVE DEVELOPMENT

Four cooperative examples are provided in Appendix III to illustrate the potential of cooperative development. They are included in the thesis to strengthen the confirmability of the findings by providing a source of comparison. Simmons and Birchall (2008) observe that it is quite difficult to evaluate experiences in cooperative development because of differences in cooperative types, country contexts and time periods. Nonetheless, I present a few lessons drawn from the Kenyan experience that are corroborated by the selected cooperative examples.

7.5.1 An underlying values foundation

The social foundation of cooperatives appears to depend on the presence of shared values. For example, it has been argued in this thesis that the Harambee ethic, which prioritized collective effort and enterprise, played a unique role in popularizing the cooperative model of self-help. The presence of a national self-help ideology in Kenya therefore served to seamlessly blend common societal values with similar cooperative values of self-help and self-reliance.

Likewise, the founding of the Mondragon group of cooperatives was influenced by faith-based values that were championed by the Spanish Catholic priest Don Jose Maria Arizmendiarietta. In particular, Mondragon adopted four basic concepts of Catholic Social Thought: social justice, economic justice, the dignity of persons and their work, and solidarity (Herrera, 2004: 2). Its business philosophy therefore affirms the central role of people over other forms of capital and is reflected in its four corporate values of cooperation, participation, social responsibility and innovation. As a result, the Mondragon group of cooperatives represents a unique form of cooperative enterprise based on worker solidarity (Birchall, 1997; Freundlich, 1998; Thomas & Logan, 1982; Whyte, 1999).

The role of religion as a source of shared values also played a part in the establishment of the Desjardins movement of financial cooperatives (*caisse populaires*) in Quebec Canada. Its founder, Alphonse Desjardins, relied on the Catholic clergy to promote the establishment of a network of *caisses* across the territory of Quebec. Levasseur and Rousseau (2001) attribute the rapid growth of the Desjardins movement in the early 20th century to the influence of Social Catholism as well as a strong sense of Quebec nationalism.

A strong solidarity network rather than an explicit appeal of shared values appears to explain the success of Amul India and the Danish cooperative dairies. In Denmark, a social class of small independent farmers established a dense network of agricultural cooperatives in the Danish economy that was described as a "cooperative commonwealth" (Birchall, 1997: 20). In India,

the establishment of milk cooperatives encouraged solidarity and inclusivity which proved to be beneficial to socially and economically marginalized groups (Chawla, 2007). As a result, the Indian dairy cooperative movement acted as a 'social equalizer' in society because any milk producer "irrespective of caste, religion or gender" was entitled to join and participate in a milk cooperative (Patel, 1993: 363). The influence of communal values arising from relatively homogenous populations in both cases should not, however, be discounted.

7.5.2 Compatibility of the cooperative model with member needs

A second lesson from the Kenyan experience is that the growth of a cooperative movement can only be sustained if the cooperative model matches the members' need for individual and collective economic empowerment. These needs may be triggered by external circumstances that are disadvantageous to the members' economic and social well-being. For example, Wakulima members were galvanized to action by incidents of financial exploitation while Uwezo members were motivated by a situation of financial exclusion. In a similar way, financial exploitation of the Indian dairy farmers through monopolistic and unfair trading practices led to the establishment of the Amul Dairy while Danish farmers formed cooperatives to improve their economic leverage against external capitalistic monopolies (Birchall, 1997; Chawla, 2007; Chloupkova, 2002). The dire effects of political marginalization served as the catalyst for the Mondragon group while usury and an anti-monopolist sentiment towards large commercial banks resulted in the growth of the Desjardins movement (Thomas & Logan, 1982; Levasseur & Rousseau, 2001).

The realization of individual and collective economic empowerment through the cooperative model emphasizes the fact that cooperatives are essentially self-help organizations. The cooperative model of enterprise is based on the collective pooling of resources in order to improve the economic leverage of members (Birchall, 2003). Cooperatives are therefore not synonymous with non-profit organizations that rely on donor funds or state subsidies. They are also unlikely to succeed in the long term if they do not generate an internal capital base to ensure self sufficiency (Guinnane, 1994). The collective pooling of resources must be accompanied by

effective monitoring and enforcement mechanisms to protect the efforts of members and ensure the sustainability of the resources.

7.5.3 The effect of economic rationalization on the social purpose of cooperatives

The third lesson is a potential consequence of the new incentive structure for Kenyan credit cooperatives in which a stronger focus on business and economic efficiency could result in the diminished role of the associational features that comprise social capital. The economic rationalization of cooperatives is usually promoted as a natural consequence of modernization. While this may be good for business, the denial or neglect of the social or associative purpose of a cooperative poses a danger to its existence. To illustrate, the rapid automation of the Desjardins network of *caisse populaires* and the need to maintain healthy balance sheets led to the closure of some *caisses*. Between 1970 and 2000, the number of *caisses* in Quebec fell from 1,400 to 984 (Levasseur & Rousseau, 2001). The *caisses* which were closed down were replaced by branch counters, financial centres and instant tellers. This trend has continued and resulted in the current number of 481 *caisses* (as of 2009)[173].

Levasseur and Rousseau (2001) argue that the modernization of the Desjardins movement shifted the power base from the local member-driven *caisses* to the affiliate bodies of the regional unions and the provincial federation. Whereas the manager of the *caisse* had previously been regarded as the community's representative in the administration of the cooperative, the professionalization of the movement meant that the manager was increasingly seen as the cooperative's representative in the community. In addition, the management style of the movement assumed more of a techno-bureaucratic nature that was characteristic of large capitalist firms. Birchall (2003) observes that cooperatives in developed economies are often characterized by professional management which implies distance from their members because they resemble conventional businesses.

[173] This information is available on the Desjardins website: http://www.desjardins.com

In extreme cases, the neglect of the associative purpose of cooperatives may lead to their demise. Svendsen and Svedsen (2004) argue that the decline of the Danish cooperative movement in the latter part of the 20th century was a consequence of the decrease in bridging networks of social capital which had emerged from regular association in the local cooperative dairies. After the Second World War, the Danish government initiated a trend towards large scale operations in agriculture when it endorsed a report on the economic rationalization of the dairy sector. The report recommended the establishment of large centralized dairies and the closure of smaller ones on the logic that large dairies were more capable of applying economies of scale that would ensure market dominance. It also advocated for a centralized national federation.

The report triggered an unprecedented wave of cooperative mergers and market centralization in Denmark. The number of cooperative dairies dropped from 1,127 in 1962 to 280 in 1971 (Svendsen & Svendsen, 2004). In 1995, there were 127 cooperatives down from 214 in 1991 and membership had dropped from 113,000 to 103,000 reflecting a drop in cooperative dairy production (Birchall, 1997). The demise of the cooperatives appears to have been related to a decline in their associative purpose. The Danish example suggests that the social foundation of cooperatives relies on a clear associative purpose among members inspired by shared values. It can be concluded that if the social foundation of cooperatives is ignored in the quest for economic efficiency, then their survival is at stake.

The cooperative examples of economic rationalization support Valentinov's (2004) claim that the expansion of cooperative business prioritizes the expansion of economic capital over a corresponding expansion in social capital. The examples draw attention to the fact that cooperatives are subject to market forces just like other economic organizations and their fortunes will be determined by the extent of competition, the quality of their management and their ability to satisfactorily meet the needs of their members (Simmons & Birchall, 2008). This lesson also means that the duality of the economic and social roles of cooperatives should not be separated or treated as if each were independent of the other (McKillop, 2005).

Conclusion

This chapter has presented a discussion of the findings in the light of the conceptual framework developed for the study. An analysis of power relations in the cooperative microstructures reveals that the Uwezo microstructure operated as an inverted pyramid in which the general assembly of members exerted its authority over the governing representatives. In contrast, the Wakulima microstructure appeared to operate as a normal pyramid in which the board and the management exerted considerable control over the general assembly of members. The discussion also reveals that the social nature of Kenyan cooperatives has been characterized by cronyism, non-technical considerations and populist choices of representatives which have tended to override a business mentality required for cooperatives as economic organizations. However, the introduction of prudential regulation implies a diminished role for the social nature of the cooperatives.

An analysis of the cooperative microstructures in relation to the societal macrostructure confirms that the cooperative microstructures were miniature representations of the larger macrostructure. Thus, income inequality between rural farmers and urban employees; gender inequality in income and employment opportunities; cultural biases against women leadership; and entrenched perceptions of ethnicity that characterize Kenyan society were reflected in the two cooperative microstructures.

Social capital, conceptualized as five associational features, was found to play a role in the creation and maintenance of collective economic resources. A time sequence in the application of these associational features was discovered in that a self-help ideology and solidarity bonds were important in establishing the collective resources while reciprocity exchanges, mechanisms of enforcement and democratic representation were important in maintaining the collective economic resources. The study therefore affirmed the presence of both economic and non-economic motivations for collective economic action. The study findings suggest that the efficacy of social capital is influenced by social position due to the differential access to resources. Despite this differential effect, the efficacy of social capital may still be enhanced by

a well-informed membership and competent leadership which implies continuous member education and relevant management training.

The relations between credit cooperatives and their institutions were discussed in two parts: cooperative-state linkages which describe the socio-political setting of the cooperatives and the incentive structure which describes the economic setting of the cooperatives. The discussion revealed that smallholder farmers (Wakulima members) generally possess low political leverage due to their latent lobby group status and lack of class consciousness. Uwezo members form part of public sector employees who enjoy a higher political leverage because the public sector is a key source of political patronage. The incentive structure for credit cooperatives involves new prudential regulation that implies a stronger focus on financial best practices and technological solutions and may result in a reduced role for social capital.

A revised conceptual model of economic cooperation was presented in which the spheres of state, economy and society were integrated to indicate their influence on cooperatives as economic and social organizations. In particular, the influence of informal norms, shared values and culture on the cooperatives was recognized. The revised model incorporates additional roles for the cooperatives such as risk management and creative adaptation that are implied in new prudential regulation and greater competition in the financial sector.

Lastly, three lessons in cooperative development based on the Kenyan experience and corroborated by some international experiences were proposed. These lessons were the important role of shared values in the emergence of cooperatives; the need for compatibility between the cooperative model and member needs and priorities; and the threat of economic rationalization processes on the associative purpose of cooperatives.

CHAPTER 8

CONCLUSIONS AND IMPLICATIONS

8.1 THE FOCUS OF THIS RESEARCH

The purpose of the study was to explore how members of Kenyan credit cooperatives achieve economic cooperation. Economic cooperation was conceptualized as collective economic action that enables individual actors to secure economic benefits through associational membership. A key argument of the study was that the presence of associational features may explain cooperative behaviour among members of a credit cooperative. The concept of social capital was used to explore how features of association facilitate collective action in credit cooperatives. A second argument was that collective action is likely to be shaped by the institutional context of a specific country. The institutional environment that governs Kenyan credit cooperatives thus formed the context of the study. The concept of institutions was used to investigate the influence of political, economic and social factors on collective action in the cooperatives.

An important theme of the study was to recognize the dual identity of cooperatives as economic and social organizations (McKillop, 2005; Valentinov, 2004). Cooperatives function as both voluntary associations and joint enterprises. Despite their dual identity, little research attention has been devoted to cooperatives as social organizations compared to their role as economic entities. This study therefore sought to fill this knowledge gap by examining cooperatives as economic and social organizations. An economic sociology perspective provided the theoretical basis for the combined analysis of economic interests with social relations (Smelser & Swedberg, 2005). This perspective implies the primary use of qualitative research methods. The study methodology therefore involved an interpretive case study design consisting of a rural (Wakulima) and an urban (Uwezo) credit cooperative as the two cases of the study.

The study findings suggest that the two credit cooperatives functioned as financial catalysts and societal mirrors with regard to their dual identity. Thus, the creation of collective capital due to situations of financial exclusion (Uwezo) and exploitation (Wakulima) enhanced the ability of Uwezo and Wakulima members to participate in the economic sphere. But the two cooperatives also acted as mirrors of Kenyan society by revealing the income inequalities between rural and urban residents; gender inequalities in cooperative membership and leadership; and entrenched perceptions about ethnicity. These findings affirm the observation of Birchall who noted that there was a greater probability for society to influence cooperatives than for cooperatives to be radical agents of societal reform:

> *"The relationship between cooperatives and communities is a complex one. A well-developed cooperative sector may be able to sustain a wider sense of community [beyond its members], but it is more likely that the sector will itself be influenced by the wider culture in which it is embedded" (Birchall, 1997: 71).*

Even so, the Kenyan cooperative movement possesses an untapped potential to contribute to societal integration. The movement consists of an inclusive network of cooperatives representing heterogeneous groups. This inclusivity should be promoted within society as a source of cohesion and solidarity to counter the existing societal tendency to view heterogeneity as a source of discord and fragmentation.

The next section provides concluding remarks about the role of social capital and institutions in facilitating economic cooperation.

8.2 CONTRIBUTIONS OF THE STUDY

The central research question was answered with the help of three subsidiary questions that are now discussed in turn. The conclusions to these questions formed the main contributions of the study.

8.2.1 The Conceptualization of Social Capital

The first question aimed to develop a theorized notion of the concept of social capital in credit cooperatives. Social capital was conceptualised as a set of interrelated associational features that are rooted in social interaction processes. These features were a common value set, bounded solidarity, reciprocity exchanges, enforcement ability and representation. I followed the approach of Coleman (1990) who defined social capital according to its function – to facilitate collective action among individuals who are within a specific social structure. In the study, the specific social structure was a credit cooperative. This meant that the social relationships among members in the selected cooperatives provided the relational context within which to examine the associational features of social capital in action.

The associational features of social capital are categorized according to their orientation to collective action and individual member motivations. Altruistic features of social capital consist of shared values and solidarity bonds that arise from common adverse circumstances. These two features convey principled or non-economic motivations for collective action that enable the formation of groups on a cooperative basis. Instrumental features of social capital comprise reciprocity exchanges, enforcement mechanisms and representation processes. These three features convey rational or economic motivations for collective action by enabling actors to secure individual benefits while ensuring compliance and participatory governance.

This conceptualisation of social capital allows me to separate the causes or sources of social capital from its effects and avoid some of the conceptual ambiguity associated with the term (Portes, 1998; Woolcock, 1998; Schuller, 2007). Thus, my conceptualisation strengthens the

internal logic of the concept by establishing the logical flow from the determinant (social interaction) to the effect of social capital (collective action). The conceptualisation of social capital as five associational features based on four sociological traditions also provides a holistic treatment of a multifaceted concept (Narayan & Cassidy, 2001).

- *Normative vs. resource conceptualizations of social capital*

Fulkerson and Thompson (2008) suggest that the contested definition of social capital has evolved into two competing camps in the major sociological traditions. The authors refer to the competing camps as "normative" and "resource" approaches to social capital. The normative camp defines social capital from a social norm perspective in which the presence and adherence of social norms provides the basis for the concept. This camp refers to the 'Durkheimian' notion of 'value introjection' which signifies a moral code that precedes economic behaviour and underlies contractual relationships. In contrast, the resource camp defines social capital in a largely instrumental way as a resource that results from investments that individuals make in their networks with the expectation of future benefits (Fulkerson & Thompson, 2008).

Normative approaches to social capital appear to be more popular than resource approaches to social capital based on the number of social capital articles appearing in major sociological journals (Fulkerson & Thompson, 2008). Even so, the authors call for greater integration of the two competing camps. They observe that normative approaches to the study of social capital have tended to rely heavily on empirical data in explaining the presence of norms of reciprocity, trust, cohesion and solidarity whilst neglecting the influence of historical context. Resource approaches to the study of social capital acknowledge the importance of context and offer it as an explanation for uneven patterns in the accumulation of power, prestige and other forms of social inequality. However, their individualistic approach within a rational-utilitarian perspective diminishes the role of shared values and cultural norms that may underlie individual behaviour.

My conceptualization of social capital indicates an attempt to integrate the two competing camps. For example, most social capital researchers have tended to use the collective-action analytical framework to frame their research problems (Ostrom & Ahn, 2007). I am no exception and I found the normative approach that examines social capital from a social organization perspective was useful in defining the concept as five associational features that facilitate collective action among members in a cooperative. Likewise, I found the resource approach to social capital which views the concept as an individual asset to secure mutual benefits for some aggregate of people to be useful in clarifying the comparative advantage of social capital and evaluating its effects. In addition, the choice of a case study design enabled a contextual analysis that was important in explaining the differential effects of social capital in the two credit cooperatives. The study has therefore provided an integrated approach to the concept.

The normative approach to social capital may offer a useful organizing tool for the development of second-generation collective action theories (Ostrom & Ahn, 2007). The authors observe that the first-generation theories of collective action advanced by Olson (1965/1971) and Garrett Hardin (1968) tended to focus on atomized, selfish and fully rational individuals. A normative approach to social capital can overcome this limitation by recognizing that many collective action problems occur in pre-existing networks, organizations and other ongoing relationships between individuals. Furthermore, individuals have been observed to be motivated by altruistic utility functions which suggest that economic modelling needs to accommodate multiple motivations among individuals and not just the selfish, rational individual. This observation corresponds with one of the core assumptions of the study in which actors are motivated by both formal (economic) and substantive (non-economic) rationality (Smelser & Swedberg, 2005).

Finally, the normative and resource approaches to social capital within sociology can be interpreted as two distinct sources of social capital rather than competing definitions. Thus, the normative camp represents altruistic sources of social capital in the form of moral codes and particularistic loyalties among individuals that are instilled during socialization processes while the resource camp represents instrumental sources of social capital that result from face-to-face

interactions between individuals. In the study, altruistic sources of social capital were important for creating collective economic resources while instrumental sources were important for the maintenance of the collective resources.

8.2.2 How Social Capital Facilitates Collective Economic Action

The second question aimed to investigate how the associational features of social capital facilitate collective economic action. Collective economic action in the cooperatives was conceptualized as the creation and the maintenance of collective economic resources. The creation of collective resources was found to involve a common set of values and bounded solidarity. The study identified a common set of values within Kenyan society that attached importance to cooperative activity. It was referred to as the *Harambee* ethic and motivated members to form groups on a cooperative basis. Members were also motivated to form cooperative groups by the presence of adverse circumstances that appealed to their sense of justice against financial exclusion and exploitation. The resultant 'bounded solidarity' promoted a strong sense of ownership and group loyalty among members of the cooperatives.

Reciprocal horizontal exchanges, enforcement mechanisms and representation processes played a role in the maintenance of the collective economic resources by facilitating the uptake of loans, ensuring compliance, and engendering trust and confidence among the members of the cooperatives in that order. These associational features involved the ongoing participation of members and were consequently critical to the maintenance of the collective economic resources. A time sequence was implied in the application of the associational features so that shared values and solidarity bonds were first necessary to establish a group that created the collective resources. Regular reciprocity exchanges, effective enforcement and transparent representation were then important to maintain the collective resources.

A common set of values appeared to mediate individual self-interest so that even though members joined the cooperatives primarily to help themselves, they chose to do so in a collective

enterprise. It also meant the acceptance of social roles and responsibilities among members such as monitoring loan applicants and participating in general meetings in order to elect governing representatives. The power of collective economic action was demonstrated by the creation of collective capital that enabled participation of formally excluded groups in the economic sphere. This explanation of the role of social capital in facilitating collective economic action represents one of the original contributions of the study.

8.2.3 The Influence of Institutions

The third question sought to describe and analyze the influence of formal and informal institutions on credit cooperatives. The institutional realm was conceptualized as a socially constructed space in which formal and informal rules facilitate, motivate and govern economic organizations and individual actors as they pursue their interests. The formal institutional realm represents the economy in which credit cooperatives function as economic organizations. The formal rules define the incentive structure for economic exchange. The informal institutional realm encompasses the socio-political setting which governs relations between the state and the cooperatives as well as the societal macrostructure which governs relations between diverse groups in society.

A conceptual model depicting the relationship between individual members, their cooperatives and the institutional realm was developed at the beginning of the study and revised on the basis of the study findings. The revised conceptual model depicts the economy, state and society as the institutional realm to represent the economic, political and social systems that influence credit cooperatives. These systems are distinct but not entirely independent of each other (Zafirovski, 1999). For example, the cooperatives are subject to the influence of informal norms, values and culture because they operate as microstructures in society. Thus, the presence of the *Harambee* ethic illustrated the influence of societal values on individual members. Similarly, the rural cooperative demonstrated cultural biases in property ownership that discriminated against women in its membership and leadership. Finally, informal organizational norms in Uwezo

urban cooperative provided a powerful deterrent against corrupt practices among elected representatives.

The revised conceptual model of economic cooperation (see Figure 7.4 on page 256) represents another original contribution of the study. According to Yin (1994), a refined conceptual framework provides the basis for analytical generalization that can be applied to other cases.

8.3 IMPLICATIONS FOR THEORY

The implications for theory are discussed in terms of the methodological considerations of measuring social capital.

8.3.1 *Measuring Social Capital*

This study has emphasized the theoretical basis of social capital in socialization processes and interactions that are explained by the classical sociology traditions. Woolcock (1998) has argued that the strongest theoretical premise of social capital draws on and extends the combined insights of Durkheim, Weber and Simmel on the different roles and types of social relationships. The relational context of the cooperatives provided the basis of investigating the role of the associational features of social capital. Thus, the presence of peer guarantors provided the analytical basis for examining the norm of reciprocity whereas shared values were explored in terms of specific Kenyan socialization processes that enhanced common beliefs in cooperation. Similarly, experiences of enforcement mechanisms were used to gauge compliance while member perceptions on electoral processes and voting practices were important in deriving a measure of trust and confidence in elected cooperative representatives.

My methodological contribution to the measurement of social capital has therefore been the identification of five associational features that can be empirically observed and tested within the

specific context of Kenyan credit cooperatives. These features were derived from the sociological literature and address the need for greater alignment between the theory and measurement of social capital. Portes (1998) asserts that the use of theoretically derived measures will avoid the use of questionable indicators in social capital research.

An implication for the conceptual development of social capital is a greater focus on its theory-building capacity. It suggests the deeper application of social capital within disciplines rather than its current wide application across disciplines (Akcomak, 2009). A deeper application of social capital in empirical research calls for a "sharper" definition of constructs that can enhance the concept's theory-building ability. According to Eisenhardt (1989), the tests of good theory or concept development are parsimony (simplicity in explaining relationships); testability; and logical coherence. Van Oorschot, Arts and Gelissen (2006) have noted that the literature on social capital contains insufficient theorization between indicators at the individual and aggregate levels which makes empirical studies prone to ecological fallacies. This observation strengthens the case for a greater focus on the theory-building ability of social capital.

8.4 IMPLICATIONS FOR POLICY AND PRACTICE

Should the development of cooperatives be a government policy agenda or a people-driven affair? Develtere (1994) has argued that the introduction of cooperatives in most African countries by colonial and newly-independent governments led to the creation of a government-controlled cooperative sector in sharp contrast to the emergence of a self-propelled and member-defined cooperative movement that occurred in 19th century Europe.

The early phase of cooperative development in Kenya appears to indeed fit the description of a cooperative sector rather than a cooperative movement. In particular, the paternalistic-interventionist phase imposed bureaucratic practices on the organizational development of the cooperatives which limited their autonomy and business capabilities. The resultant failures described in terms of member apathy, low business efficiency and weak management structures

led Hyden (1973) to conclude that modern economic cooperation (representing European ideals) could not succeed in the Kenyan environment because it relied on bureaucratic norms and an occupational solidarity that were "alien" to the local communities.

The credit cooperative segment, however, was not subject to excessive state control like the agricultural cooperatives. It could even have qualified as a movement as the emergence of credit cooperatives was largely driven by member needs and circumstances (Orora & Spiegel, 1980). Narrative accounts contained in Chapter Five describe the circumstances of financial exclusion (Uwezo) and exploitation (Wakulima) that led to the establishment of the two credit cooperatives in the study. Furthermore, the subsequent growth of the credit cooperative segment during the liberalization era suggests that credit cooperatives were better prepared than the agricultural cooperatives to adapt to competitive market forces.

Credit cooperatives are reported to be the fastest growing type of cooperative in Africa (DFID, 2010). Thus, despite the mechanical origin of cooperatives in several African countries, including Kenya, and pessimistic predictions of their future, the cooperative model has survived and been adapted to suit the diverse financial needs of members. The emerging success of these cooperatives has been attributed to three reasons: they mainly rely on locally mobilized resources which make them self-sustaining; they provide financial services in places where financial access is still limited; their open membership principle creates an inclusive network of diverse groups which broadens their appeal and outreach (Wanyama, Develtere & Pollet, 2009). The liberalized economic environment has also contributed to their formal recognition as autonomous, member-based organizations.

I conclude that the development of cooperatives requires both governments and citizens. Governments need to provide enabling policies and legislation while the belief and enthusiasm of citizens is necessary to sustain a self-help movement of cooperatives. The Kenyan experience suggests that policy makers need to formally recognize the capacity of member organizations to

mobilize local resources for economic and social development. This recognition means that paternalistic government policies are unsuitable for the organizational development of cooperatives when they foster an unhealthy dependence on the state.

The growth of the credit cooperative movement in Kenya was largely driven by low and middle-income groups such as smallholder farmers and urban employees. The fact that urban credit cooperatives hold the bulk of total savings in the cooperative movement compared to rural credit cooperatives suggests that it is more beneficial to broaden the target audience for cooperatives than to confine it to low-income segments of society. Ward and McKillop (2005) support this claim in their analysis of success factors for a cross-section of credit unions in the United Kingdom. The analysis revealed that credit unions which mobilized their resources from a wide cross-section of people from local communities were likely to be more financially stable than credit unions that solely targeted low-income groups or the financially excluded. In addition, credit unions located in relatively affluent areas tended to be more successful.

A related policy implication is that cooperatives should not only be promoted as empowerment vehicles for the poor. Instead, governments and development agencies should foster a broad social appeal of cooperatives by disseminating information about cooperatives to all sections of society. A diversified membership base for cooperatives is also likely to ensure that the management of cooperatives benefits from the diverse skills-set of their members. A final policy implication is the need to create favourable underlying conditions that can spur the performance of cooperatives (Birchall, 2003). The analysis of the tea sector showed how inadequate market access and value-addition has had a direct impact on farmer earnings. Lele (1981) notes that the effective performance of agricultural marketing cooperatives is influenced by external factors such as agricultural commodity pricing, input distribution, technology and infrastructure development. Therefore policy considerations for cooperative development need to incorporate an adequate appreciation of external factors and adopt a coordinated approach to address them.

8.4.1 Some Practical Implications

Some practical implications for Kenyan cooperatives are provided in Table 8.1 below based on the roles identified in the conceptual model of economic cooperation.

Table 8.1: Practical implications for members and cooperatives

ROLE	PRACTICAL IMPLICATIONS
1. Compliance 2. Lobbying	• Fulfil requirements of prudential regulation • Sustain linking networks with national credit cooperative unions
3.Competitive adaptation	• Develop innovative and value-adding products informed by market research • Constantly monitor and improve service delivery channels
4. Risk management 5. Enforcement	• Build institutional capital that ensures sustainability of operations • Invest in advanced risk management techniques
6. Governance	• Consider succession-planning for boards • Ongoing member education to enhance loyalty and ownership • Communication strategies to build ownership of collective decisions • Invest in relevant board and management training
7. Collective action	• AGM assessment of the associative purpose vis-à-vis the economic purpose of the cooperative

8.5 DIRECTIONS FOR FUTURE RESEARCH

This study highlights some interesting issues that could form the subject of further research. For example, the dual roles of democracy and efficiency in cooperatives constantly pose dilemmas when the business realities conflict with the cooperative philosophy. How are such dilemmas resolved? The introduction of prudential regulation suggests the need for evaluative studies that can assess the regulatory impact on cooperative performance. The role of cooperatives in contributing to societal integration; reducing gender and income inequality; and deepening democratic practice are possible considerations for future research. Finally, the economic

contribution of cooperatives in comparison to other economic organizations within various business sectors is another possibility for further research.

The interpretive findings of this qualitative study may also be supplemented by positivist research in order to provide a basis for generalization. In conclusion, it is hoped that this study has contributed to a clearer picture of how cooperatives work by recognizing the dual identity of cooperatives as economic and social organizations.

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APPENDIX I: RESEARCH PARTICIPANT CONSENT FORM

I, (full names) _____
hereby agree to participate in the 'Savings and Credit Cooperatives in Kenya' research project.

I understand that my participation will include being interviewed (with the possibility of being recorded) and/or being observed during my routine work in the office. I hereby consent to this involvement and to the use of my responses in the project.

I understand that my responses will be treated confidentially and I will not be identified in any way in any of the published results of the study. I understand that the data collected during the project will be treated confidentially and will be stored by the researcher either electronically protected by passwords or physically in a locked cabinet.

I further understand that I may withdraw from the project at any time by informing the researcher and that there is no penalty for not participating. My participation is voluntary and I have not been coerced or pressured into signing this consent form.

Signature: _____ Date: _____

APPENDIX II - INTERVIEW SCHEDULES

Informants: SACCO MEMBERS

Interview Questions

1. What made you join the SACCO?
2. What personal benefits have you received as a member?
3. Do you have a current SACCO loan?
4. Have you encountered any difficulties in getting assistance from the SACCO?
5. Please tell me about any opportunities you have to interact with other SACCO members.
6. Based on your own experience, do you think it is important to cooperate with others to achieve your financial goals?
7. Have you ever considered resigning / opting out of the SACCO? If yes, why?
8. When you think about your SACCO, what do you feel about it? *(E.g. makes you happy, proud, sad, angry)*
9. Do you wish to see any changes in the SACCO?
10. Do you attend AGMs? If yes, how important is it for you to vote in the AGM?
11. What do you consider when voting for the Management Committee?
12. Do you think the voting system meets the needs of all members? If Y/N, why?
13. Have you ever served in the Committee? If no, would you consider it? (If not, why not?)
14. What do you consider to be the qualities of a good leader?
15. How would you describe your overall satisfaction with the SACCO?
16. What do you think can be improved in the SACCO?
17. This brings me to the end of the interview. Is there anything you would like to clarify, comment or ask me?

Informants: SACCO MANAGEMENT & BOARD

Interview Questions

1. What do you do for the Board / SACCO management?
2. Please tell me about a typical day in the SACCO. (Management only)
    a. How much time in a week/month do you devote to SACCO matters? (Board)
3. What is important for you working here/serving on the Board?
4. The Board is the chief decision-making structure of the SACCO, could you tell me some of the things you consider when making decisions?
5. How would you describe your working relationships with the Management/ Board?
6. Please tell me about some of your achievements. What factors, in your opinion, have contributed to these achievements?
7. On the other hand, what challenges are you facing? (*E.g. in the light of increasing competition, how have you maintained member loyalty?*)
8. In the course of your work, do you participate in forums where you collaborate or learn from other SACCOs?
9. Do you receive or actively seek any form of government support (e.g. tax interpretation, technical advice)?
10. What challenges, if any, do you face in complying with government regulations?
11. In your opinion, how important do you think the SACCO sector is?
12. In your view, is there anything that the government can do better for the SACCO sector?
13. Looking ahead, what are your short-term (1-2 years) and long-term (>3 years) plans for the SACCO?
14. This brings me to the end of the interview. Is there anything you would like to clarify, comment or ask me?

APPENDIX III: COOPERATIVE EXAMPLES

INTRODUCTION

The following vignettes of cooperatives from Denmark, India, Canada and Spain illustrate the different types and origins of cooperatives and their socio-economic impact. The vignettes are mainly descriptive as they are not intended to provide a critical evaluation of cooperative development. Instead, they aim to show how people are motivated to engage in collective action through cooperatives.

1.0 Denmark: The Creation of an Agricultural Cooperative Economy

Denmark developed a highly successful agricultural cooperative economy in the 19th and early 20th century (Birchall, 1997; Alboek & Schultz, 1997; Svendsen & Svendsen, 2004; Henriksen & O'Rourke, 2005). The incentive for cooperation for Danish farmers began with their shift from grain production to dairy farming and pig-rearing (Chloupkova, 2002). The growth of capitalism in Europe meant that individual farmers had to devise ways of protecting themselves from the exploitation of large companies that were involved in the sale of goods to the farmers as well as purchase of their produce. From 1866, local campaigners promoted the idea that cooperatives were a response to capitalist monopolies and upper class privileges. By forming cooperative groups, farmers could increase their bargaining power with both buyers and suppliers as one farmer could not be played off against another (Svendsen & Svendsen, 2004).

In 1882, the first cooperative dairy was founded in Hjedding. Its founding principles emulated those of Rochdale: each member had one vote irrespective of the number of cows owned; the distribution of surpluses was proportionate to the amount of milk delivered; and membership was open and voluntary (Chloupkova, 2002). In addition, members were jointly responsible for any debts incurred by the cooperative society. This condition reflected the principle of unlimited

liability that was originally introduced by Friedrich-Wilhelm Raiffeisen in the establishment of rural credit cooperatives in Germany (Prinz, 2002).

The cooperative movement grew rapidly: 300 dairies were founded between 1887 and 1888. By 1900, there were more than 1,000 cooperative dairies receiving about 80% of the total milk produced (Birchall, 1997). As cooperative profits rose, a portion was used to invest in scientific innovations that improved the quality and quantity of the butter. Direct advantages of farmer cooperation included efficient milk transportation to the dairies; improved packaging for the butter which was essential in preserving the quality of the butter; standardized output which meant regular payments to the farmers; and better prices due to the high quality of the product (Chloupkova, 2002; Svendsen & Svendsen, 2004).

The economic strength of the cooperative dairies inspired the formation of cooperative enterprises in other agricultural sectors such as cooperative fodder purchase associations (from 1883) and cooperative pig slaughterhouses (from 1887) which were organized in a similar manner to the dairies. There were also cooperative fertilizer plants and canning factories as well as cooperative societies for accident insurance against hailstorms, fire and for the insurance of livestock. A special type of cooperative society, known as a Central, was established to improve the breeding and output of farm animals such as cattle, horses, swine and sheep. The first Central society was established in 1895 and there were 592 Central societies by 1913 (Svendsen & Svendsen, 2004).

By the turn of the century, the Danish cooperative movement, which had grown without any direct government support, was making a significant economic contribution. Danish butter exports accounted for over 40% of the value of total goods exports between 1895 and 1909 while bacon exports averaged between 18 and 22% of total exports over the same period. Danish butter products controlled a third of the British butter-import market and established a reputation for consistent quality that was reflected in their high sale prices (Henriksen & O'Rourke, 2005).

Agricultural cooperatives became the dominant form of organization among the Danish rural population. By 1914, about 86% of all cattle herds were registered to a dairy cooperative and almost 50% of all pigs were contracted to a bacon cooperative. Meanwhile, almost half of all rural households were members of a consumer cooperative. In effect, Danish farmers appeared to have created an agricultural "cooperative commonwealth" (Birchall, 1997: 20).

2.0 Amul –India: A Dairy Cooperative Federation

Amul is the brand name of an apex dairy cooperative, the Gujarat Cooperative Milk Marketing Federation Ltd (GCMMF) based in Anand, Gujarat, India. It is one of the best examples of cooperative achievement in the developing world (Prahalad, 2006). Its origins date back to 1929 when a small private dairy (known as the Polson dairy) was established in Anand. The dairy facilitated the creation of a network of milk collecting centres for the manufacture of butter. The main market for the milk and butter was the city of Bombay (Mumbai) located about 400km from Anand. During World War II, the Polson dairy was granted exclusive rights by the colonial government to collect milk and supply it to Bombay under the Bombay Milk Scheme (Chawla, 2007).

At that time, individual milk producers had to travel long distances to deliver milk to the various collection centres. Especially in the summer season, some of the milk went sour as the producers had to physically carry the milk in individual containers. The dairy employed arbitrary methods to determine the fat content and the milk quality for the purposes of payment. Consequently, the milk producers would often be paid less for the milk on the basis that it was sour upon arrival to the dairy. They also received fluctuating prices for their milk depending on the season. Angered by these unfair and manipulative trade practices, the farmers of Kaira District sought help from a well-known national leader who advised them to form a dairy cooperative and sell their milk directly to Bombay. Under the leadership of another charismatic social worker, the farmers organized a 15-day boycott during which no milk was supplied to the Polson Dairy. The

colonial government succumbed to the pressure and withdrew their executive order guaranteeing monopolistic rights to the Polson dairy (Chawla, 2007).

The Kaira District Cooperative Milk Producers Union Limited was registered in 1946. The local organizers worked hard to convince individual milk producers of the need to organize themselves into village cooperatives. Slowly, the cooperative movement gained strength as more and more village cooperatives were established. By 1955, the cooperative union had 64 village cooperatives representing 22,828 members and the annual quantity of milk collected was 11 million litres (Patel, 1993).

In 1955, the Kaira Union built a modern dairy at Anand which came to be popularly known as Amul Dairy after its brand name. The Amul Dairy diversified into the production of ghee, butter and milk powder under the professional leadership of Dr. Verghese Kurien and the technical expertise of H.M. Dalaya (a dairy technologist). In 1961, the dairy was expanded to manufacture products like baby food and cheese. An expansion in capacity and the product diversification strategy enabled the Kaira cooperative union to absorb new village cooperatives. By 1962, there were 219 village cooperatives representing 46,400 members and producing 25 million litres of milk annually (Patel, 1993). In 1965, the Union established a cattle-feed manufacturing plant to meet the requirements of all the affiliated milk producers. The Union also provided mobile veterinary services to the farmers at a nominal fee.

Within twenty years of its establishment, the Kaira cooperative union had attained national prominence and recognition for its dairy development programme in Gujarat. In 1964, the Indian government formed the National Dairy Development Board with a view to replicate the Amul model all over India. In 1971, the Operation Flood Programme was launched with donor funds and one of its objectives was the national replication of the Amul Model. Over the course of twenty five years, the Operation Flood Programme was implemented in three phases and contributed significantly to the growth in India's milk production. In 2003, India was the largest

producer of milk worldwide. The per capita milk consumption in India also doubled from 111 grams per day in 1973 to 222 grams per day in 2000 (Chawla, 2007).

SOCIO-ECONOMIC IMPACT

Since its launch in 1946, the dairy cooperative movement in Gujarat has achieved significant socio-economic change to the rural people. By vertically integrating milk production, the Amul Dairy created incentives for the producers to increase the quantity and quality of milk production. According to Chawla (2007), the development of the Amul model combined the collective power of individual milk producers, visionary leadership and professional management in an integrated cooperative structure.

The village dairy cooperatives have played an important role in the improvement of the socio-economic status of women. For example, Chawla (2007) records the story of a village, about 72km from Anand, which did not have a cooperative society of its own. Women were responsible for delivering milk twice a day to the collection centre two kilometres away, often against the wishes of their husbands. When a woman was elected as the head of the village community, she organized the women to form a cooperative society in their village. Within a year, the women generated annual revenue of Indian Rupees 150,000 which was one and a half times the earnings of the entire village through farming. As the women continued to head the cooperative effort, schools were established in the village, better homes were constructed, electricity was installed and other rural developments were observed. Education was also prioritized, particularly for the girl child (Chawla, 2007).

In 2004/5, GCMMF was India's largest food products marketing organization with an annual turnover of US$ 672 million. The average daily milk collection was six million kilograms of milk per day. The Amul cooperative structure consisted of twelve district cooperative unions, 11,615 village cooperatives and 2.4 million producer-members (Chawla, 2007). According to

Prahalad (2006), the Amul cooperative linked the poor farmer who had two dairy buffaloes with world-class processing facilities and a marketing distribution system with a national and increasingly global reach. The GCMMF represents not only a successful business enterprise but a social development enterprise in which profits from value addition are reinvested in the primary shareholders, the farmers, and contribute to the development of the village communities.

3.0 The Desjardins Movement: A People's Movement in Quebec, Canada

The Desjardins Group (or Mouvement des Caisses Desjardin) is the largest financial cooperative group in Canada with overall assets of over $173 billion[174]. It comprises a network of financial service cooperatives – *caisses populaires* and credit unions – and a network of twenty subsidiary companies in life and general insurance, securities brokerage, venture capital and asset management. As at December 31, 2009, the Desjardins Group consisted of 481 *caisses* and 903 service centres which served a total of 5.8 million members. There were 6,258 elected officers and 42,273 employees. Social investment in the community by the Group amounted to $72.3 million in the form of sponsorships, donations and bursaries. The Desjardins Group also has an international development agency, Development International Desjardins, which is active in several developing countries through technical support and investment programmes.

The founder of the Desjardins movement was Alphonse Desjardins who established the first *caisse populaire* in Levis, Quebec in 1900 after he had spent several years studying the European cooperative experience (Levasseur & Rousseau, 2001). His aim was to fight usury, which was prevalent at the time, and provide the local community with a means of decentralized credit drawn from a pool of small contributions or savings from the members[175]. In 1906, the Quebec legislature enacted a law on cooperative unions thereby giving the *caisse* a legal status (Sriram, 1999). From 1900 to 1920, with the support of the clergy, Alphonse Desjardins helped establish

[174] This information is available on its website: http://www.desjardins.com

[175] The historical account of the founding and development of the Desjardins movement is on their website. This section draws heavily on this account.

187 local *caisses* across the territory of Quebec which enjoyed a reasonable degree of autonomy (Levasseur & Rousseau, 2001).

The *caisses* were affiliated to regional unions and eventually a provincial federation was established in 1932. The role of inspection of the individual *caisses*, which had been performed by the unions, was then shifted to the Federation. In a striking example of self regulation, the representatives of the Desjardins movement negotiated an agreement with the Quebec State in which the state government agreed to pay the inspection costs but entrusted the responsibility of obligatory inspection to the movement itself (Levasseur & Rousseau, 2001). The Desjardins movement, which was initially established in the rural areas, gradually spread to the towns and cities. By 1944, there were 877 *caisses* with over 300,000 members and an asset base of $ 88 million.

In the post-war period, the Desjardins movement continued to enjoy growth, consolidation and diversification through the acquisition or establishment of subsidiary companies. As a result, the movement grew to embody two networks: a network of *caisses* and a network of subsidiary corporations. It was now referred to as a consolidated financial group. In 1964, the Group's consolidated assets broke the $1 billion threshold.

Levasseur and Rousseau (2001) observe that an interesting shift occurred in the partnership between the Desjardins movement and the Quebec state. The movement invested heavily in state bonds during the post-war period which contributed significantly to the financing of the Quebec government including the establishment of Hydro-Quebec, a state-owned corporation. In the 1960s, the Group was also active in setting up a financing company that was used by the state government to stimulate industrial development in Quebec. These investments strengthened the relations between the Desjardins movement and the Quebec state. It also demonstrated the power of a community-owned banking system in promoting regional economic development (Birchall, 1997).

In the 1970s and 1980s, the Desjardins movement attained the status of a major national financial institution. In Quebec alone, the Desjardins Group controlled almost half of the traditional savings market and dominated the residential mortgage market. It also dominated various segments of the financial market such as agricultural loans, consumer credit, commercial and industrial credit, fiduciary activities, and personal insurance (Levasseur & Rousseau, 2001).

SOCIO-ECONOMIC IMPACT

The Desjardins movement demonstrates the ability of the savings and credit cooperative model to overcome a financial exploitation problem (usury) by harnessing the collective economic power of a community. The growth of the movement from one *caisse* into a major national financial institution was achieved by diversifying its activities and establishing a corporate arm made up of a network of subsidiary companies. An important contribution has been its direct involvement in developing Quebec's economy by investing in public institutions and state bonds.

A central feature of the Desjardins movement has been the development of a robust system of self-regulation. Sriram (1999) observes that self-regulation within the Desjardins movement has allowed the Desjardins movement to pioneer prudential standards for the financial cooperative industry in such a way that law-makers are inspired to frame enabling legislation for the industry. The movement has also pioneered best practices in cooperative accounting and loan-provisioning systems which have been shared internationally through its international development agency.

4.0 The Mondragon Experience: Worker cooperation in Northern Spain

The Mondragon Corporation is a federation of worker cooperatives based in the Basque region of Spain. It is the unique embodiment of a cooperative movement that began in 1956 with the

creation of the first industrial cooperative firm in Mondragon in the province of Gipuzkoa. In 2009, it was the seventh largest Spanish company in terms of turnover and the leading business group in the Basque Country. It was providing employment for 85,066 people working in 256 firms in four areas of activity: industry, finance, retail and knowledge[176].

The history of the Mondragon Corporation is closely associated with the Catholic priest, Don Jose Maria Arizmendiarrieta. He arrived in the Basque town of Mondragon in 1941 when the Basque region was experiencing widespread poverty, hunger and political marginalization in the aftermath of the Spanish Civil War (Thomas & Logan, 1982; Freundlich, 1998). Don Jose Maria committed himself to improving the lot of the working-class people first through education and then through enterprise based on solidarity. In 1943, he established a Technical Training School with the help of the community.

Several of Don Jose Maria's students were deeply influenced by his teachings on the values of participation and worker solidarity and aspired to set up their own firm where they could apply these principles. In 1954, five engineering graduates, guided by Don Jose Maria, founded a limited liability company called ULGOR which was an acronym of the initial letters of their surnames (Thomas & Logan, 1982). In April 1956, ULGOR began construction of their first factory in Mondragon[177]. It was financed by members of the local community who raised 11 million pesetas of loan capital to set them up (Birchall, 1997).

During this time, Don Jose Maria crafted a model set of enterprise statutes with the help of two independent law experts that would enable a viable form of cooperative enterprise. ULGOR converted from its limited liability company status into an industrial cooperative in 1959 (Thomas & Logan, 1982). Shortly after, two other industrial cooperatives were formed. As the

[176] This information is available on its website http://www.mondragon-corporation.com/

[177] The historical account of the Mondragon Cooperative Experience, 1956-2008 is available on its website. This section draws on this account in conjunction with other sources.

Spanish economy recovered from the Second World War, the industrial cooperatives found a ready and growing market for their manufactured goods (Freundlich, 1998).

In 1959, the Caja Laboral Popular (CLP) was founded as a local savings bank to support the growth and development of the cooperative firms. The Caja Laboral Popular relied on the savings of the local community members and the income of the associated cooperatives to provide investment capital. As a result, the CLP had to ensure that investments in new cooperatives were sound and that it maintained a high degree of managerial integrity and expertise. Associate cooperatives had to formally sign a Contract of Association with the CLP in which they surrendered some degree of autonomy by allowing the transfer of equity to a common pool and financial monitoring by the bank (Birchall, 1997; Whyte, 1999).

A government directive that defined cooperative members as self-employed meant that the majority of Mondragon members were excluded from the national social security and health care systems. A social welfare service was incorporated in the CLP and funded from workers' monthly payslip deductions. In 1973, a separate legal entity, Lagun Aro, was registered as a secondary cooperative to provide a comprehensive system of social welfare and health care in line with national developments in the social security arena (Freundlich, 1998).

SOCIO-ECONOMIC IMPACT

From the beginning, the founders of Mondragon wanted their cooperatives to contribute to job creation, education and technical expertise, greater equity between management and workers, and regional economic development in the Basque region. The Mondragon Corporation has managed to achieve these objectives and attributes its success to seven factors: the visionary leadership of Don Jose Maria Arizmendiarietta; the principle of the sovereignty of labour which has led to high levels of worker involvement and commitment; an unambiguous business approach characterized by profitability and management efficiency; economic re-investment of

almost all resources generated; ongoing adaptation to external changes in the environment; creation of support institutions in the financial, social welfare and innovation areas; co-ordinated job management and conflict resolution mechanisms; and the importance attached to both formal and lifelong training. Several writers affirm these factors (Birchall, 1997; Freundlich, 1998; Herrera, 2004; Whyte, 1999).