

SPECIALIZED FARMERS COOPERATIVES IN CHINA AND THE LEADERSHIP ISSUE

35132323-8 DENG YIJUN

GLOBAL BUSINESS MANAGEMENT

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Summary

Due to the land policy and historical reasons, most Chinese farmers are small-scale producers that lease a tiny plot of the collective land and do farming on their own. In the market economy, they have little bargaining power to negotiate with suppliers and buyers. Growing customer demands on product quality and variety are posing new requirements on farmers. Considering the gap between a competitive national market and the limited capability of Chinese farmers, the Chinese government has been promoting farmers cooperatives as a promising way to fuel agricultural development and improve farmers' quality of life. Cooperatives that are democratically set up and controlled by a group of farmers enable them to pool resources, reduce transaction costs, increase bargaining power in the market and achieve economies of scale. Furthermore, the collective power of cooperatives can integrate more profitable links of the value chain to satisfy sophisticated customer demands. Therefore, farmers are likely to receive benefits of lower costs and more income.

Comparing with the international principles, the Chinese farmers cooperatives differ from the international practices in multiple ways in order to suit the unique Chinese situation. The Chinese model demonstrates some flexibility in terms of membership, voting right and distribution of surplus to stimulate the initial development of cooperatives. Besides institutional variations, the co-existence of heterogeneous types of cooperative leadership is also noteworthy at the moment. It is found that leadership will, to a great extent, influence the efficiency and sustainability of a

cooperative. While these forces in leadership have supported the emergence of cooperatives across China, farmers, who are supposed to be the leading forces and primary beneficiaries, are often deprived of decision making rights and find their interests secondary to those of the advantageous group.

With a hope to realize the fundamental values of cooperatives, which are “user-control, user-own and user-benefit”, this thesis studies different types of cooperative leadership and arrives at a three-stage approach as a progressive but systematic way to transform cooperatives. The three-stage approach starts with company-led cooperatives, to rural elites-led cooperatives as a transitional stage and finally approaches the last stage of farmers-led cooperatives. Proceeding from the first stage to the last, power and benefits for farmer members are supposed to be enhanced along with increasing demands on their capabilities to run a cooperative democratically. To complement rural elites’ leadership in the transitional stage, the author suggests the employment of college-graduate rural officials who are well-educated and capable of bringing new resources and innovative solutions to strengthen cooperative development and serve the demands of farmer members.

Now that the cooperative is one form of organization and its management resembles that of a corporation, this thesis employs management tools and frameworks taught in the business school to examine the proper management of cooperatives.

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CHAPTER 1. INTRODUCTION

While the stunning growth of the Chinese economy has attracted worldwide attention, the laggard rural economy has been overlooked by many. For a long time, urbanization has been the priority of the nation while farmers and agriculture are secondary in importance. In the 60s and 70s, the People's Commune was the highest administrative body in rural areas that exercised absolute control over resources and labor. Production was done collectively and allocation of products was planned centrally, in favor of urban residents. Farmers, who were working hard all year long, found themselves sacrificed for that their productions were collected to feed cities, leaving less than enough for them to survive, while industrial products were sold to farmers at higher prices. Situation has improved after the People's Commune and the planned economy were abolished, but the income gap between rural and urban residents is widening. Higher income and employment opportunities have drawn millions of farmers into cities, which resulted in a severe brain drain and labor issue in the countryside. For most people, rural China stands for poverty and failure.

Facing the rural issues, the central government has come to attach importance to the development of the rural economy and industrialization of agriculture by calling on the industrial sector to nurture agriculture. Yet, due to the land policy, most Chinese farmers are small-scale producers that lease a piece of collective land and do farming on their own. In the market economy, they have little bargaining power to negotiate with suppliers and buyers. Growing customer demands on product quality and variety add another layer of pressure on farmers. Considering the competitive national market and limited capability of Chinese farmers, there has been the consensus that establishing farmers cooperatives is a promising way to fuel agricultural development and improve farmers' quality of life. Cooperatives that are democratically set up and controlled by a group of farmers enable them to pool resources, reduce transaction costs, increase bargaining power in the market and achieve economies of scale. Furthermore, the collective power of cooperatives can integrate more profitable links of the value chain to satisfy sophisticated customer demands. Therefore, farmers are likely to receive benefits of lower costs and more income.

Born in a rural family and having spent the childhood in the countryside, the author is strongly attached to farmers and the rural life. After receiving education in a small city, a provincial capital city, the Chinese capital Beijing and later in one of the most developed cities in the world -Tokyo, the author has felt in person the striking contrast of living quality between advanced cities and impoverished rural villages. With the motive of finding out effective ways to improve farmers' livelihoods, the author sets out to research on the question and realized that Chinese specialized farmers cooperatives are promising instruments to realize the goal. Therefore, upon graduation from business school, the author would like to continue to study farmers cooperatives in China, which involve various industrial and business issues. It is expected that this thesis would help deepen the knowledge of cooperative mechanisms and work out a solution to solve the critical issues of the cooperative development.

Due to time limitation and the complexity of gaining first hand data of small cooperatives that is enough to represent the situation of the whole country, this study is done using survey results of other scholars as well as extensive reference to relevant literatures. Business frameworks and tools will also be utilized to analyze management and structural issues of cooperatives.

Since the concept of specialized farmers cooperatives was put forward only eight years ago in the year of 2007, the author assumes that the topic is new to many readers, therefore thorough explanation of cooperative mechanisms is one major part of the thesis. Following the first chapter of introduction, the second chapter is an introduction of the agricultural background in China, introducing agricultural conditions, history of rural development and current concerns. This chapter concludes with the point that agricultural cooperatives will improve the situation. Chapter two moves on to the topic of cooperatives in the world, and examines the history, basic values and fundamental mechanisms. A comparison between corporations and cooperatives is done using the Transaction-Cost Theory, the Principal-Agent Theory and the Stakeholder Theory, demonstrating the similarities and differences from other organizations, so as to assess roles of cooperatives and their governance.

Chapter three discusses specialized farmers cooperatives in China, explaining the basic

principles that are different from the international ones, four development stages of cooperatives and analyzing the current situation in China. To study the driving force, the author uses the Five Forces Analysis to reveal the necessity of horizontal integration of farmers to increase scale and enhance bargaining power. Besides, value chains of the agricultural industry and a farmers' cooperative as well as the smiling curve of agriculture are introduced to illustrate the value of vertically integrated links of the chain. After that, achievements and problems are studied, giving an overview of cooperative development in China. It is found that there is a co-existence of several types of cooperatives that are led by initiators with various backgrounds, most of whom are not farmers. The leadership and management issue is discovered to be the key factor influencing efficiency and farmers' well-being in a cooperative. Therefore, the author reviews four most important types of cooperatives in China that are led by different initiators such as agriculture-related companies, NGOs and rural elites. Effectiveness and sustainability vary from type to type.

While these forces in leadership have greatly boosted the emergence of cooperatives across China, farmers, who are supposed to be the leading force and primary beneficiaries, find their voices barely heard. In consistent with the fundamental values of cooperatives that are "user-control, user-own and user-benefit", in chapter five, the author proposes a three-stage approach as a progressive but systematic way to transform cooperatives. It begins with a first stage that features the initiation of agricultural companies and transitions through the second stage of rural elites-led cooperatives. Finally it arrives at the ideal model of cooperatives controlled by farmers that reflects democracy, transparency and fairness in the last stage. Proceeding from the first stage to the last, power and benefits for farmer members are supposed to be enhanced along with increasing demands on their capabilities to run a cooperative democratically. Furthermore, special attention is given to the human resource issue in the transitional second stage. To complement the inherent deficiencies of rural elites, the author suggests using college graduate village officials who are educated and capable. Feasibility, problems and concerns of using those officials are elaborated in the middle part of chapter five. The last part wraps up with further

analysis of the three-staged proposal, explaining major objectives, key success factors and outcomes of each stage.

CHAPTER 2. DEVELOPMENT AND CONCERNS OF THE CHINESE AGRICULTURE AND THE RURAL ECONOMY

Section 1. AGRICULTURAL CONDITIONS AND RESOURCES

China has a vast territory of 960 million hectares stretching from tropics to cold-temperate zones. It descends from the west to the east, creating a three-step-staircase topography. On the first and the highest staircase, with an average high altitude of over 4,000 meters, lies the Tibetan Plateau known as the rooftop of the world. Mountains, plateaus and basins make up the second staircase running across the Midwest China. The third and the lowest staircase in the east is mostly constituted by hilly areas and plains. Major plains such as the Northeast China Plain, the North China Plain, the Middle-Lower Yangtze Plain and the Pearl River Delta Plain locate in this staircase and feature arable lands, fertile soil, good irrigation as well as large population, thus making it the most important and productive agricultural area in China. Such climate and topographical factors have brought about highly diversified natural conditions in different regions. While China has expansive land area, only 121.7 million hectares, in other words 12.8%, is arable land. Divided by the large national population of 1.36 billion, arable land per capita is below 0.09 hectare, only 45% of the world average of 0.2 (World Bank 2015a). It also means with only less than 8% of the world arable land, China has to feed about 19% of the world population.

Section 2. HISTORY OF AGRICULTURAL AND RURAL DEVELOPMENT

In the past decade, agriculture in China achieved rapid development. According to the National Bureau of Statistics of China (2013), Gross output value of agriculture reached 9,699.5 billion Yuan in 2013, over three times of the output value in 2002. Agro-added value has also more than tripled, growing from 1,653.4 billion Yuan in 2002 to 5,696.6 billion Yuan in 2013. However, the percentage of Agro-added value to GDP has dropped from almost 13% to less than 10% in 2013, with years from 2002 to 2006 seeing the most drastic decline. Total grain yield has improved from 457 million tons to 602 million tons, which has significant meaning in food security since a

decreasing amount of arable land has to feed an ever-increasing population in China. At the same time, grain yield per worker also enhanced from 1,419 kilograms in 2002 to 2,168 in ten years, indicating an improving productivity per worker.

Such progress won't be achieved without the profound agricultural reform. In 1978, the Household Contract Responsibility System was put into use and in 1983 the People's Commune system was abolished. Before that, People's Commune was the highest administrative body that controlled resources and labor in rural areas. Land was collectively owned and all agricultural activities were centrally planned and assigned to members. Collective farming provided little incentive for farmers to work harder since everything was owned by the Commune and food produced was unevenly distributed by the government in favor of urban citizens. During those times, productivity was low and frustrated farmers were suffering from hunger and poverty. After the agricultural reform, although land is still owned by the public, it has granted rural households the right to contract some land and manage farming activities on their own, which re-ignited their individual intelligence as well as enthusiasm to improve productivity. In 1992, the agricultural reform was brought to a higher stage as the policy of State Monopoly of Purchasing and Marketing was terminated and a national food market came into being. Farmers were enabled to sell their products freely to the market under the market price. Since then, Chinese farmers start to make their production and marketing decisions individually.

Section 3. CURRENT CONCERNS

In spite of the good changes that have taken place, there are still a number of problems concerning agricultural and rural development to be dealt with.

According to National Bureau of Statistics of China (2013), in 2013 the rural population was 0.63 billion, taking up 47% of the total population. As indicated in Exhibit 2.3, the rural population has been on a continuous decline and such trend is expected to carry on. At the same time, the percentage of labor participating in agriculture has decreased by 8.4 percent to 35.2% in 2012. The percentage decline can be partly explained by the influence of rapid urbanization as well

as the income gap between urban and rural households. As can be seen in Exhibit 2.3, while urban residents on average have been earning 3 times of what rural residents are earning, what rural residents earned from agricultural activities to net income dropped from 45.8% to 34.4%, indicating that farmers have to turn to more non-farming work to sustain life. As more farmers are going to cities in search of higher income jobs as migrant workers, lands are left to be farmed by much fewer farmers, who are usually women and the elderly. Rural residents who have received higher education are also attracted to cities for better job opportunities and life quality. Agricultural efficiency and rural vitality therefore suffer all the more. If the situation continues, China will face a serious drain of young and educated workforce in the rural labor pool which will impair the sustainability and stability of the rural economy.

Along with the quick urbanization that is taking place in suburban areas, the total size of farmland is shrinking. Under the condition that land and farming labor have been decreasing, in order to meet national food demands, it is crucial to increase productivity. However, according to World bank, in terms of agricultural productivity that is defined as agricultural value added per worker in constant 2005 U.S. dollars., despite the fact that China improved from \$447 in 2000 to \$785 in 2013, the latest result is still less than the East Asia & Pacific region (excluding high income economies) average of \$822 and is far less than the world's average of \$1,193 (World Bank 2015b). On the other hand, Japan is a high number of \$46,045 and U.S. \$63,269. It is obvious to conclude that agriculture in China is still confronted with the problem of low productivity.

To improve productivity and outputs, the Chinese government has been making strong policy and financial efforts to help industrialize agriculture. Nevertheless, agricultural industrialization remains at a low level where land is fragmented into tiny pieces that are leased by individual households who do farming in a small scale and with little mechanization. Most goods produced by these farmers are primary commodities with neither processing nor packaging. The central government has realized that one effective way to industrialize agriculture is to promote agricultural cooperatives. In 2006, the national law on specialized farmers cooperatives was enacted and came into effect in 2007. The introduction of the law and other related supportive

government policies have reflected policy makers' belief in the strategic role that cooperatives can play. As written in the very first article of the law, the objective of the law is to support and regulate the development of farmers cooperatives and facilitate the overall growth of agriculture and the rural economy (Xinhua News Agency 2006). It is widely acknowledged that cooperatives serve the purpose of poverty reduction and job creation by offering higher income and new job opportunities for the rural population. Besides, some cooperatives will facilitate regional community development as a result of coordinated planning and implementation. (ZHAO & Yuan 2014) Despite vigorous state support and the beneficial outcomes, this concept is still new to many Chinese people.

To fully understand how cooperatives function, the next chapter will elaborate on the history, basic values and mechanisms of cooperatives.

CHAPTER 3. INTRODUCTION OF COOPERATIVES

Section 1. HISTORY OF COOPERATIVES

The concept of cooperatives has its source in Europe. During 1750 to 1850, while the Industrial Revolution had enhanced productivity tremendously, lower-class workers felt so exploited that they organized themselves against the suppression of capitalists, which was reflected in a wave of working-class movements. Witnessing the drawbacks of capitalism and the misery of deprived workers, Robert Owen and Charles Fourier proposed their idea of Utopia Socialism as a way to reform capitalism. According to their design, assets should be collectively owned, work collectively done, and members have equal rights. Putting forward these fundamental principles, they were regarded as pioneers of cooperatives.

The Rochdale Society of Equitable Pioneers established in 1844 was recognized as the prototype of modern cooperatives. It was located in a town called Rochdale near Manchester and founded by 28 people, of whom more than half were workers in the textile industry. In 1840s, which was known as the “Hungry Forties”, workers were suffering from unemployment and low wages. Their poor livelihoods were further exacerbated by unethical retailers who sold food neither at a fair price nor with honest weights. Food adulteration was also not rare. The Rochdale Society of Equitable Pioneers were created in this context with the “idealism and vision of a better social order” (The Cooperative n.d.). The pioneers also formulated the well-known Rochdale Principles of Cooperation, whose influence has been significant till this day. Following the Rochdale Pioneers, the movement of cooperation sprang up in Europe and the rest of the world. The basic principles of Rochdale were adopted by the international society, updated later, and have been serving as guidelines for all cooperatives.

The movement today has become more organized on a global scale. The International Cooperative Alliance (ICA) is an international non-governmental organization that unites and promotes cooperatives worldwide, covering various sectors such as agriculture, retailing and insurance. It was founded in 1895 by representatives of cooperatives from a number of countries.

At present, there are 284 member organizations from 94 countries on behalf of nearly 1 billion people (Cooperatives of the Americas 2015). It has been the most influential organization supporting the development of cooperatives in the world.

Section 2. DEFINITION AND PRINCIPLES OF COOPERATIVES

By definition from ICA, a co-operative is “an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically-controlled enterprise” (International Co-operatives Alliance n.d.).

There are seven cooperative principles set by ICA to guide establishment and management of cooperatives. They are voluntary and open membership, democratic member control, member economic participation, autonomy and independence, education, training and information, and lastly, concern for community. Referring to the definition and principles above, key to cooperatives is that members can make voluntary decisions to join or leave a cooperative and that cooperatives are jointly managed in a democratic manner by members with equal voting rights (one person, one vote).

Section 3. BASIC MECHANISMS AND COOPERATIVE GOVERNANCE

Cooperatives, as one form of business organizations, share structural similarities with other organization forms like corporations, the kind that most people are familiar with. On the other hand, cooperatives have unique features in contrast with corporations. Wu Bin (2014) in his book *Government Structure of Farmer Specialized Cooperatives Theoretic and Empirical Study* employed an approach to study corporate governance theories as a reference for cooperatives. He referred to Mallin's (as cited in Wu 2014) view that the three theories that have the most significant influence on corporate management are the Transaction Costs Theory, the Principal-Agent Theory and the Stakeholder Theory.

To study essential features and mechanisms of cooperatives, this thesis adopts Wu's approach to start with the case of corporations, observe similarities and distinctions, and try to

come to the core of cooperative governance.

3.3.1. The Transaction Costs Theory

The Transaction Cost Theory developed by the Nobel Prize winner Ronald Coase defines transaction costs as costs that derive from market transactions such as search of appropriate partners, negotiation over contracts, contract enforcement and inspection (Watkins n.d.). Compared to costs paying for goods and services themselves, transaction costs are additional costs accompanying the market transaction process in order to acquire goods or services. It means when transactions take place in the marketplace instead of from within an organization, additional transaction costs are created. Because of the costs and inconveniences to do external market transactions, companies are formed to internalize such transactions and thus lower costs.

Transaction costs are attributable to two driving factors. First of all, it is assumed that individuals and companies participate in transactions with bounded rationality, meaning that their personal and cognitive constraints limit them to make rational decisions. Secondly, individuals and firms are “self-interest seeking with guile” (Mikami 2011) and therefore behave opportunistically. They tend to manipulate information to serve personal interests.

According to Williamson (1979, p. 239), three characteristics critical to transactions are transaction-specific investments, uncertainty and frequency of transactions. Transaction-specific investments are assets for specific use of certain transactions and have much less or no value if transferred to other transactions. Once invested, those assets become sunk costs that can hardly be retrieved. Investors will therefore face unfavorable situations if the other party takes advantage to renegotiate terms out of personal interests. In order to constrain the hazards of opportunism when assets specificity is high, transactions tend to be internalized and more formal governance structures are often created.

Uncertainties of various kinds such as market demands, future trends and individual credibility will increase transaction costs since risks of uncertain happenings are taken into account and more efforts have to be made regarding contract enforcement.

Frequency of transactions also influences transaction costs to a great degree. It is widely

held that the more frequent transactions are with a certain partner, the less uncertainties there will be since familiarity and previous transactions with the other partner help both sides to predict things such as behaviors, quality and price. In contrast to one-shot transactions where trust is low and short-term private gain prevails, in a repeated game individuals and firms are less likely to take opportunistic actions for the sake of future transactions and long-term gains. The threat of opportunism is therefore contained and mutual trust is cultivated. As a result, transaction costs are lowered because information search costs, negotiation costs as well as enforcement costs can be reduced. Weesen, Hobbs & Kerr (2014) also pointed out that high frequency allows the internalization of transaction-specific assets and that the mutual trust developed during transactions sets the base for more formal governance structures with closer coordination.

In the case of agriculture, small-scale farmers face high transaction costs. Compared with large firms, they lack access to assets and markets. Due to the asymmetry in information and knowledge, they pay high costs to search for the appropriate trading partners and ensure their credibility. When a farmer finds or is reached by a buying company, he has little negotiation power to negotiate better terms and protect his personal interests. Costs also include time and money to monitor whether a contract is fulfilled as agreed.

Moreover, farmers are subject to high market uncertainties. The nature of agriculture causes seasonal variation of most agricultural products in both production and consumption. Changes in weather, market demands, demographics and other factors aggravate the fluctuations in price. Small-scale farmers are very vulnerable to prices since their limited access to information and scarce market knowledge often lead to blindness or time lag in production that are out of step with price change. Moreover, short-term unstable transactions with different partners will also increase the level of uncertainty in market exchanges.

As a result, short-term contracts are not satisfactory because of the high transaction costs and uncertainties farmers face. While Coase argued that a firm is a system of long-term contracts (Watkins n.d.), this view holds for cooperatives likewise. By forming a cooperative, farmers engage in long-term contracts to share risks and arrange production activities according to the

cooperative's direction. Meanwhile, the cooperative is obliged to provide services, oversee operation and negotiate with external parties. A cooperative allows farmers to internalize some transactions such as purchasing supplies, distribution and marketing. With larger scale, more bargaining power, better access to asset, information, technology and markets, it serves as an effective proxy to help farmers reduce costs and achieve scale economy.

3.3.2. The Principal-Agent Theory

The principal-agent theory, or often referred to as the principal-agent problem, is concerned with situations when a principal delegates his responsibility and entrusts an agent to finish a task. The agent is expected to serve the best interests of the principal. However, the agent's personal interests may not be consistent with the principal's goal. Therefore, driven by self interests, the agent is motivated to deviate from the principal's objectives and withhold information. Worse still, it is not easy for the principal to learn what really happened because of information asymmetry. In order to regulate the agent's behaviors and align interests, the principal has to devise and implement proper regulations, which will lead to agency costs.

According to the most-cited scholars on this topic, Jensen and Meckling (1976) proposed that the principal can restrict the agent by creating incentive systems and monitoring the activities of the agent which will incur what they call "monitoring costs". There are also bonding costs that agents spend to assure principals that they will commit to the interests of principals. Furthermore, losses are incurred when the agent's decisions diverge from decisions that will bring the best welfare to the principal, and such loss is termed as "residual loss". Therefore, by their definition, agency costs include monitoring costs by the principal, bonding costs by the agent and the residual loss.

To get the agent to accomplish the objective with efficiency and low costs, information transparency should be enhanced to reduce the information asymmetry problem while a binding contract and optimal regulation system should be created to minimize costs (Wu 2014).

For cooperatives, it is not economically effective or possible for the General Assembly of members to make every decision and supervise the implementation. It is necessary to bring in

management to manage daily operation and make decisions on behalf of members. When this happens, the “separation of ownership and control” issue takes place and becomes a source of the principal-agent problem.

Yet, the principal-agent relationship is even more pronounced in cooperatives. In corporations the management acts as the agent for investors, while in cooperatives a two-way principal-agent relationship exists. Sigismundo, Marcelo & Amaury (n.d.) illustrates the relationship in the figure below.

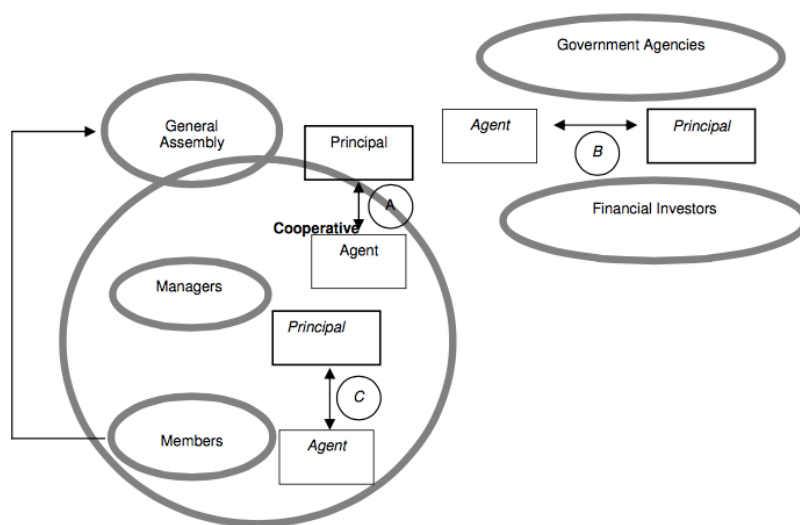


Figure 3.3.2 Source: Sigismundo, Marcelo & Amaury (n.d.)

The general assembly, which is constituted and controlled by members, delegates management responsibilities as the principal to managers. On the other hand, in actual operation such as production of milk, managers serve as the principal with a collective target and assign the production tasks to individual members. In this case, members become agents who are obliged to fulfill the principal’s goal. Because of the two-way attribute, the principal-agent relationship is more sophisticated in cooperatives.

The principal-agent relationship gives rise to agency costs because interests of the principal and those of the agent are not consistent, and sometimes in conflict with each other. Agents may act in their personal interests at the expense of principal’ s benefits. Such problem is further complicated when external managers are not allowed the right to own shares since cooperatives are,

by definition, owned by members (Hailu et al. n.d.). Therefore, effective incentive systems, control systems as well as transparency should be in place to reduce agency costs.

In addition, Sigismundo, Marcelo & Amaury (n.d.) argued that the degree of risk aversion of agents and principals should be taken into account when designing such systems so as to balance interests. If the agent is risk neutral, he might be motivated by incentives based on equity, which will enhance efficiency and help to align his interests with the principal's. If not, fixed remuneration might be preferred. In principal's case, if the principal is risk neutral, he might risk more expecting better returns on equity. When he is risk-averse, immediate benefits such as cheaper prices of supplies might be more appropriate. After all, design of incentive systems needs to consider agents' and principals' stances towards risk.

In agricultural cooperatives, particularly when members are not fully informed or educated to monitor the management's conducts and performances, importance should be attached to improve information transparency and establish a sound control system such as hiring accountants, auditors and setting up a board of supervisors.

3.3.3. The Stakeholder Theory

The concept of stakeholders was introduced into corporate management by R. Edward Freeman. He (1993, p. 41) argued against the traditional shareholder viewpoint that shareholders own the company and therefore the objective of the management is to maximize value for shareholders. His stakeholder concept defines stakeholders as "groups and individuals who benefit from or are harmed by, and whose rights are violated or respected by, corporate actions". In other words, stakeholders have a stake in the activities and performance of a company and will in turn affect its existence. Freeman and Reed (1983, p. 42) also divided definition of stakeholders into a narrow and a wide one. The narrow one is concerned with groups who have critical roles in a corporation's existence and success. The figure below is a model of a large corporation's stakeholders given by Freeman in a narrow sense. The wide one is enlarged to any group who has an influence or is influenced by corporate activities.

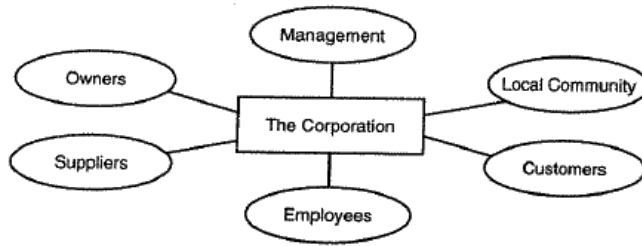


Figure 3.3.3 Source: Freeman and Reed (1983)

Therefore, stakeholders cover a wide range of parties from shareholders, employees, customers to the local community and political groups, whose interests are different and sometimes conflicting. Under the guidance of this theory, management is responsible to serve and balance out the various needs of all stakeholders. Besides the monetary return that shareholders demand, management should care for claims such as employees' demand for higher wage and customers' demand for better quality. Handling power struggle and giving considerations to divergent interests among stakeholders for the sake of common benefits is therefore a key role of management.

In principal, cooperatives are designed to have only one category of members, that is, farmers make the single category of membership of farmers' cooperatives. To serve the demands of farmers is the fundamental reason why a farmers' cooperative exists, thus granting farmers status as the pivotal stakeholders. Tirole (2001, p. 24) divided stakeholders in organizations into two groups. "Natural stakeholders" are the ones who are intrinsically related to an organization such as customers and suppliers, while "stakeholder by design" refers to stakeholders as a result of the organizational structure such as shareholders. In the case of farmers' cooperatives, farmers are users and shareholders at the same time. With respect to ownership, they are "stakeholders by design". Meanwhile, they are "natural stakeholders" by right of their user properties, utilizing cooperative services.

Nowadays, there is a trend of a broadening membership to include heterogenous members into the conventional single-category member group. Cooperatives having two or more types of member categories are called multi-stakeholder cooperatives, meaning that control power is likely to be transferred from a single member group to be re-distributed among multiple interest groups. The heterogenous stakeholderhood will create a larger pool of resources and by resorting to the

collective intelligence coming from groups with diverse backgrounds and viewpoints, a cooperative can thus strengthen its value creation.

Nevertheless, it also raises the difficulty to govern multiple controlling stakeholders in a single entity. One group of stakeholders may gradually prevail over others and dominate an organization to steer strategies towards their best interests at the cost of other groups. A group with the strongest voice or the manager category is likely to be the dominator. (Lindsay & Hems, 2004)

In addition, costs of engaging different constituent actors in decision making are high. Whereas cooperatives are designed to internalize market transactions to lower costs and enhance efficiency, slower decision making process and high costs of participation will in turn push up internal costs in multi-stakeholder cooperatives. Two reasons cause inefficiencies of management. To start with, different interests groups have the same inclination to prioritize their own benefits, rather than aiming for the well-being of the cooperative as a whole. Costs are boosted when the cooperative's overall interests are not maximized. Secondly, the process to understand the preferences and standpoints of other stakeholders, and arrive at a consensus through communication is also cost-adding to make a decision (Leviten-Reid & Fairbairn 2011).

After all, to resolve conflicts and direct multiple stakeholders towards a common goal is no easy task. Special governing mechanism is necessary to maximize benefits of a multi-stakeholder cooperative.

Section 4. THE LEGAL STRUCTURE OF COOPERATIVES

The legal structure of all business organizations, whether a for-profit corporation or a non-profit organization, defines ownership, control as well as distribution of surplus. (UWCC 2015) A cooperative, as a business organization, has its own distinct legal structure.

In a firm, investors who hold shares, or what we call "shareholders", possess the ownership and the number of shares decides the decision making power each shareholder has. When there is a surplus of profit, it is returned to shareholders according to the number of shares they hold. A cooperative, on the other hand, is owned by its members, therefore the ownership of a farmers'

cooperative belongs to all farmer members. It is democratically controlled by members who have equal basic voting rights (one person, one vote) regardless of the number of shares. Decisions are jointly made while surplus is distributed in proportion to each member's patronage.

Table 3.4 (a) further identifies differences among cooperatives, corporations and nonprofit organizations in detail.

Table 3.4 (a) Comparison of Co-ops, Corporations and NGOs

	Cooperatives	Corporations	NGOs
Purpose	Meet members' needs; profits from the market; other social welfare	Profit maximization from market; return on investments	To provide services or information
Ownership	Members	Shareholders	Nobody
Governance	General assembly and Board of directors elected by members; managers	Shareholder meeting and board of directors elected by shareholders as well as hired managers	Board of directors
Voting right	One person, one vote (in theory); Democratic control by all members	In proportion to capital investment	/
Entry/exit	One share/fee for a membership	Purchase/sell stocks	Membership fee
Financing	Shares to members; retained profits	Sale of stock; retained profits	Grants, contributions/donations, fees
Distribution of surplus	Members in proportion to their patronage	Shareholders in proportion to capital investment	Retained within the organization

Source: UWCC (2015), Smith (n.d.)

While the above table mainly addresses differences among organizations, it is notable that cooperatives, at the core, resemble the internal structure of corporations. Table 3.4 (b) illustrates the basic structures of cooperatives and corporations. Members who are entitled to rights of ownership, voting and obtaining profits, are counterparts to shareholders enjoying similar rights in corporations.

They act as the principal and delegate the day-to-day operation to the management with the hope that the management can serve their best interests. In reverse order, the management act as the agent and assume the responsibility of reconciling divergent interests among different constituents of the larger principal group. Staffs in both organizations take the same role of performing tasks according to the management's commands.

Table 3.4 (b) Internal Structure of Co-ops and Corporations

	<u>Co-ops</u>	<u>Corporations</u>
<u>The Principal</u> (Enjoy ownership, voting rights, profits)	Members	Shareholders
<u>The Agent</u>	Management	Management
<u>Staff</u>	Staff	Staff

Source: Created by the author

In all, the basic mechanisms such as transaction costs and the principal-agent relationship as well as the internal structure of a cooperative are more or less identical to that of a corporation, which implies that cooperatives could draw on experiences of corporations as references to deal with various issues.

Section 5. BENEFITS OF COOPERATIVES IN AGRICULTURE

By collaborating in cooperatives, famers bring themselves together to increase overall competitiveness in the market. In most cases, especially in developing countries, farmers do not have much access to market information, advanced technology or capital. Therefore, they can hardly differentiate their products and are usually very vulnerable against market changes. Moreover, they have poor bargaining power both when buying supplies and selling products, which often result in higher prices of supplies but smaller profits for farmers.

Agricultural cooperatives help farmers to pool fragmented resources together to achieve

scale economies. In this way, their bargaining power is enhanced and transaction costs are lowered as mentioned in the earlier chapter. With more market information, technical assistance, capital and marketing capabilities, cooperatives are able to introduce new products according to customer demands and build brands. Since a cooperative is managed democratically by all members, farmers also gain a channel to express their interest demands and make their voices heard.

Ortmann and King (2007) give an all-encompassing summary of the main reasons of formation of agricultural cooperatives. They are: poverty reduction, redressing market failure as a result of high information costs and transaction costs, promotion of self-help, wish for income increase, reduction of transaction costs with traders, improvement of bargaining power, assuring stable supplies and/or markets for products, good coordination of supply chain, support of government, strength of leadership, motivation and enthusiasm for cooperatives, community development, achieving scale economies and lastly reducing opportunistic behavior.

Moreover, the UN Food and Agriculture Organization (FAO) highly recognizes the importance of cooperatives in rural development and sustainable employment. According to FAO (2012, p. 1), cooperatives “empower their members economically, socially and create sustainable rural employment through business models that are resilient to economic and environmental shocks”. By joining and organizing cooperatives, farmers are also able to fully exercise decision making rights and claim for larger rights such as land rights, which is otherwise impossible to achieve by an individual farmer.

Because of the various benefits small-scale and marginalized farmers can enjoy as well as the significance to the society, agricultural cooperatives have found wide application in the world. According to the 2013 World Cooperative Monitor (ICA 2013, p. 17), cooperatives take about 32% of the world market share in agriculture and food industries. The largest cooperative by turnover in the sector in 2011 was Zen-Noh in Japan achieving a turnover of 62.44 billion USD. The largest cooperative in the sector by turnover on GDP per capita was Indian Farmers Fertilizer Cooperative Ltd.. Such gigantic cooperatives have exerted significant influence on a national and even global scale. However, there is no functioning cooperative in China at present that can be mentioned in the

same breath. It was not until 2007 that farmers cooperatives in China for the first time obtained legal status and since then started to rapidly develop across the country. Yet, a number of unique features and challenges emerged along the way.

Section 6. PROBLEMS AND CONCERNS

Scholars argued that while cooperatives provide a number of benefits, they also have some inherent risks. Common problems include the horizon problem that members tend to focus on short-term investments since they can't benefit from a cooperative once their membership terminated; the monitoring problem that decision making is controlled by professional managers who are not necessarily members and therefore have to be supervised; the influence cost problem that different interest subgroups are likely to engage in expensive lobbying activities so as to influence decision making; as well as the decision problem that it is difficult and costly for a large or heterogeneous membership to negotiate towards a consensus (Valentinov 2007). The table below gives a good summary of common inherent risks of conventional cooperatives.

Inherent weaknesses of conventional cooperatives

Inherent Weakness	Comments
Free-rider (common property) problem	Conventional cooperatives usually have a large amount of collective capital (common property) derived mainly from retained earnings accumulated over time. Initial membership fees (equity shares) at the establishment of a cooperative will likely be the same for all members, and these equity shares (property rights) are usually not tradable. However, since rights to residual claims (net profit) are linked to patronage instead of investment, new members joining later receive the same benefits as existing members although they are not required to make initial investments proportionate to their use of the cooperative; i.e. new members get immediate access to all the assets of the cooperative.
Horizon problem	The benefits members receive from their investments in the cooperative are limited to the time period over which they expect to patronize the cooperative. As young and older members have different planning horizons, the cooperative will not make the best investments; e.g. it will tend to under-invest in assets with long-term payoffs, and managers and directors will be under pressure to increase equity redemptions at the expense of

Inherent weaknesses of conventional cooperatives

	retained earnings (which could have been used to invest in additional assets).
Portfolio problem	Equity shares in a conventional cooperative cannot generally be freely traded so that members are unable to diversify their individual investment portfolios according to their personal wealth and risk preferences. It is, therefore, impossible for cooperative managers and directors to make investments in the interests of all members.
Control problem	A divergence of interests between cooperative members (principals) and managers (agents) gives rise to control problems. The challenge is to establish incentive mechanisms for managers that will align their interests with those of the members. This may not be a major problem in small cooperatives with a relatively homogeneous membership (in terms of members' interests) and focused (specialized) activities (e.g. sale of vegetables), which may apply to the case study example.
Influence cost problem	This problem can arise in a cooperative with a wide range of activities and thus diverse objectives of its members. Members may try to influence managers' decisions, which could result in costly misallocations of resources. This problem may not apply to the case study farmers whose objectives and interests may not be very diverse, at least initially .

Source: Ortmann & King (2007)

CHAPTER 4. OVERVIEW OF SPECIALIZED FARMERS COOPERATIVES IN CHINA

Witnessing the benefits of cooperation in agriculture, the public and the private sectors in China have been encouraging and involved in the creation of agricultural cooperatives. Similar to cooperatives around the world, the core of agricultural cooperatives in China is in line with the basic principles, mechanism and governance structure defined by International Association of Cooperatives. Yet, factors including the land policy, agricultural history, political environment as well as notable regional disparities in China aggregate to form a special type of agricultural cooperatives with strong Chinese characteristics. The Chinese government officially termed it as specialized farmers cooperative.

Section 1. DEFINITION AND BASIC PRINCIPLES

In 2007, the Law of the People's Republic of China on Specialized Farmers Cooperatives was adopted, finally granting Chinese agricultural cooperatives legal recognition. According to the law (Xinhua News Agency 2006), specialized farmers cooperatives are established on the basis of the Household Contract Responsibility System, which allows farmers to contract a piece of collectively-owned land and manage on their own. This feature derives from the unique Chinese situation and is different from the international practice. The word “specialized” means that the organization is constituted by members dealing with the same type of agricultural products or services. Farmers cooperatives serve the needs of members by providing services such as collective purchase of supplies, sales and marketing of products, processing, transportation and storage as well as technical assistance and market information.

Consistent with ICA, the Chinese law regulates that cooperatives should be voluntarily established and democratically controlled by members. There are also five basic principles to be observed.

Firstly, the majority of members should be farmers. Secondly, the purpose is to serve

members well and strive for the common interests of all members. Thirdly, members have the right to join and leave a cooperative in accordance with their own will. Fourthly, members are equal and cooperatives should be managed in a democratic manner. Fifthly, surplus should be mainly distributed proportionally to members' volume (amount) of transactions with cooperatives (Xinhua News Agency 2006).

Companies and organizations, which are engaged in agricultural production and management activities directly related to what a cooperative does, are allowed to join the cooperative but it is required that farmer members should take up at least 80% of the total membership. For cooperatives with less than 20 members, one company/organization is allowed to join. Cooperatives with more than 20 members can take no more than 5 percent of company or organization members.

A cooperative should establish the general assembly and elect a chairman who is the legal representative of the cooperative. The general assembly consists of all members and executes the governing power over the cooperative. Its rights and responsibilities include election and removal of board members, resolution on major issues, approval of annual reports, distribution of surplus, decisions on employment of managers and others. If necessary, the general assembly can elect its board of directors, executive supervisor and board of supervisors. For cooperatives with more than 150 members, representative assembly can be arranged to execute partial or full function of the general assembly.

Each member of farmers cooperatives has equal basic voting right of one person one vote, protecting the basic right and interests of each individual member. On top of that, it is also allowed to distribute additional voting right to members with large contributions (either in terms of transaction volume or capital investment). Yet, the total number of additional votes is restricted to be less than 20 percent of total basic votes by all members. Members can also exercise rights to attend membership meetings, utilize all services provided as well as the right to supervise the board.

Regarding the distribution of surplus, the law displays some flexibility. Although in

principal, surplus should be distributed proportionally to transaction volume (amount), it permits distribution of additional surplus according to members' capital contributions and shares of common reserve funds as long as no less than 60% of total surplus has been distributed based on the first rule.

As indicated above, the Chinese law on specialized farmers cooperatives modifies the classic cooperative principles and tolerates more diversity in terms of membership, voting rights and distribution of surplus. An explicit comparison between the classic model and the Chinese model is made in table 4.1. The introduction of non-farmer members is expected to strengthen ties between farmers and other market players so as to accelerate the integration of agribusiness supply chains.

Table 4.1 Comparison of the Classic Co-op Model and the Chinese Model

	Classic Cooperative Model	Chinese Specialized Farmers Cooperatives
Purpose	Meet members' needs; profits from the market; other social welfare	Meet members' needs; profits from the market; rural development; Increase job opportunities
Ownership	A single category of members	Farmer members as well as members of other categories
Governance	General assembly and Board of directors elected by members; managers	General assembly and director. (Board of directors, executive supervisor, board of supervisors if necessary)
Voting rights	One person, one vote (in theory); Democratic control by all members	One person one vote, plus additional voting right to members with large transaction volume or capital contributions
Entry/exit	One share/fee for a membership	One share/fee for a membership

Table 4.1 Comparison of the Classic Co-op Model and the Chinese Model

Financing	Shares to members; retained profits	Shares to members; retained profits; government subsidies
Distribution of surplus	In proportion to members' patronage	At least 60% of surplus should be distributed in proportion to transaction volume; the rest could be distributed according to capital contributions

Source: Created by the author

Section 2. DEVELOPMENT OF SPECIALIZED FARMERS COOPERATIVES IN CHINA

The emergence of agricultural cooperatives in China can be traced back to even before the founding of People's Republic of China in 1949. Due to distinct historical, economic and political features in different periods, the development path can be categorized into four stages.

4.2.1. Four Development Stages

Before the founding of P.R. China, the National Government ruled by the Kuo Min Tang (KMT) party had made attempts to promote agricultural cooperatives. However, without restructuring the land and local governing systems, KMT's top-down attempts could not raise much incentive among farmers. On the other hand, the Communist Party of China (CPC)'s bottom up approach received active response and participation from farmers. Through land reform, the feudal land ownership and the oppression of landlords on poor farmers were removed. The successful policy therefore won huge support from the grassroots for CPC (Garnevska, Liu & Shadbolt 2011, p. 71).

The second stage is featured with ups and downs. After the establishment of P.R. China in 1949, an earth-shaking nationwide revolution in land system took place in rural areas. Under the new land policy, poor Chinese farmers obtained the ownership right of land. The pervious loosely controlled rural areas were also placed under the governance of basic level government. Thanks to

highly motivated farmers as well as government support to integrate resources, productivity was improved greatly. However, such progress was snuffed out when the Chinese government rushed to urge the set-up of highly collective cooperatives on a national scale. The rash and top-down government decision was pushed forward regardless of farmers' wills, the level of productivity or other objective factors. Under the political pressure, farmers had to join the People's Commune which took absolute control over land, labor, resources and exercised the highest power in the rural areas. Farmers were deprived of the ownership of land, as well as the freedom and rights to manage production, surplus and use of labor. Although the People's Commune was intended to reflect the cooperation spirit, it ran counter to every aspect of basic principles and purpose of cooperatives. It went against ICA's core ideas of democratic control and member rights. As a consequence, farmers became de-motivated the outcome was disastrous. Productivity dropped drastically and agricultural development stagnated (Wang 2010).

Learning from the expensive lessons in the last stage, starting from 1980, the Chinese government refocused on agricultural and rural development, and showed vigorous support to stimulate farmers' enthusiasm. People's Commune and collective production was replaced by Household Contract Responsibility System and farmers started to make their own farming decisions. At the same time, State Monopoly of Purchasing and Marketing of agricultural products was abolished and changed to a market economy allowing farmers to directly participate in the market. Most farmers began to sell products to customers on farmers market or to small traders and wholesalers. While farmers were highly motivated by the new policies to work individually in the first few years, as market economy advanced, small-scale farmers started to feel pressured by the intensifying market competition and demanding customers. With so scarce resources and so little strength, individual farmers were unable to keep up with the market changes that they again resorted to cooperatives. Due to a lack of official recognition and guidance, those grassroots cooperatives came into existence in different forms, usually strongly influenced by the initiators. Although development of cooperatives at this stage started to take off, they were not yet regulated.

The latest stage began with the promulgation of the Law of the People's Republic of China

on Specialized Farmers Cooperatives in 2006 when the development of cooperatives finally came back to a regulated fast track with strong institutional backing. The central government has iterated the role of cooperatives as a critical instrument to fuel rural development. Farmers cooperatives can now register with Administrative Bureau for Industry and Commerce and obtain legal status. Hence, farmers cooperatives started to spring up nationwide. Note that farmers specialized cooperatives are by no means equivalent to cooperatives that were prevalent in the 1960s and 1970s featuring collective farming and undifferentiated distribution of products. Whereas those cooperatives were out of sync with the economic reality, farmers specialized cooperatives are the product of highly specialized division of labor as well as the market-oriented economy (Chai & Ye 2006).

Throughout the four development stages of cooperatives in China, government has played a significantly important role. However, such role is double edged. While government support can help to create an enabling environment that nurtures the growth of cooperatives, too much top-down government intervention is not in line with the democratic nature of cooperatives and will therefore dampen farmers' enthusiasm.

4.2.2. Current Situation: Driving Forces, Achievements and Problems

4.2.2.1. Driving Forces for Cooperatives

While the central government has explicitly stated the significance of cooperatives in rural development and farmers' livelihood improvement, this chapter will look into the driving forces of farmers cooperatives from a business perspective. Five forces analysis is utilized to analyze small scale farmers' market position against other players and therefore explain the necessity of horizontal integration of farmers to gain competitiveness. Furthermore, the value chain analysis is employed to show how cooperatives contribute to the vertical integration of the value chain and thus lead to value creation for customers, farmers, and the industry as a whole.

Horizontal Integration of Farmers

Market changes that are taking place in the agricultural product market challenge the ability and adaptability of small-scale farmers and provide impetus for them to change. The five forces analysis gives a clear illustration of small-scale farmers' position in the market.

Buyers' Bargaining Power

Buyers here refer to both end consumers as well as trading partners who buy from farmers. Consumers nowadays are becoming more sophisticated. They demand wider choices of products, better availability and accessibility as well as higher product quality (Bijman & Hu 2011, p. 1). Restricted by a limited number of products, the perishable and seasonal nature of fresh products, poor transportation and storage, individual small-scale farmers face difficulties to keep pace with customer expectations. Moreover, the outbreak of food scandals has raised Chinese customers' awareness of food safety. A decreasing level of trust on food quality has put farmers in an unfavorable position since their ability to preserve and track quality of fresh produce is lower than large companies. Differences of unprocessed agricultural products among competitors are minor. Hence, the switching cost is low for consumers since plenty of similar choices exist both in farmers market and in supermarkets. Trading partners including traders, wholesalers and retailers have larger bargaining power than farmers and can switch to other farmers easily. As supermarkets mushroom in Chinese cities, they become major food outlets for urban residents and have large transaction volumes. For this reason, supermarkets possess large bargaining power when negotiating with suppliers. Compared with larger suppliers like agricultural companies, it is difficult for small-scale farmers to fulfill large orders or to comply with the stricter quality requirements imposed by supermarkets (Bijman & Hu 2011, p. 1). Therefore, small-scale farmers are weak in power when dealing with buyers.

Suppliers' Bargaining Power

Suppliers are providers of production supplies such as fertilizers, seeds and pesticides. Most of the supplies are produced by companies and sold through retailers. Since individual farmers buy in very small quantity, there is little space of negotiation. Suppliers are price setters who leave not much bargaining power on farmers' hands.

Competitors

Small-scale farmers are likely to find themselves competing with competitors of various kinds. They have to compete with large-scale farming households, farms and other producers so as

to sell to players in the next link of the supply chain. Meanwhile, they also compete with retailers to sell to consumers. A large number of players are flooding the market with products of little differentiation. Worse still, competitors of larger scale have better access to capital, market information, technology as well as other resources that help them improve product varieties, quality and marketing activities. Thus, farmers are often overtook by large-scale competitors and find it hard to keep a firm foothold in the rivalry.

Threat of New Entrants and Substitutes

Barriers to entry are extremely low in China because initial investment is low. Anyone who contracts a plot of farm land can start farming. Substitutes are not common in this industry now that people have to live on fresh agricultural products.

All in all, according to the five forces analysis, small-scale farmers have very weak position in the market and are vulnerable against market changes. The situation is therefore driving farmers to form organizations with collective capabilities to meet customer demands and compete in the evolving value chain. Together with reasons of high transaction costs and market uncertainties mentioned previously, horizontal integration with other farmers into a farmers cooperative is an effective tool to share risks and achieve scale.

Vertical Integration of Value Chains

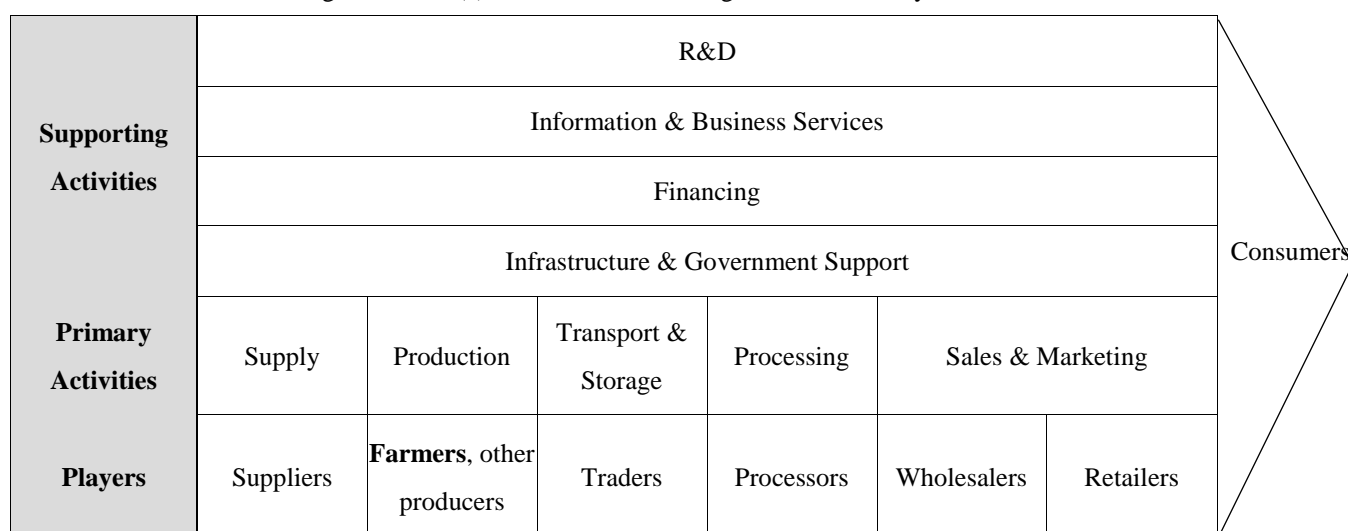
While the horizontal integration aspect looks at the unification of isolated households to enhance bargaining power and reduce costs, the vertical integration of value chain aspect focuses on how value and profits are created by cooperatives. The two types of integrations work out the ultimate formula of benefits for farmers, which is costs down and profits up.

The value chain is a chain of sequential activities that start from production and link together to deliver value to end consumers. In agriculture, Miller and Jones (2010) regarded it as the “farm to fork set of processes and flows”.

In Figure 4.2.2.1 (a), the author puts together a value chain of the agricultural industry. This chain starts from production supplies and flows through production, transportation/storage, processing, sales and marketing and finally ends up on consumers’ table. Participants carrying out

these activities include suppliers, farmers, traders, processors, wholesalers and retailers, yet some participants are able to play several roles in a coordinated manner. For example, large agricultural companies may lease some land, do farming and marketing on their own. Apart from primary activities, supportive activities such as R&D, financing, information, business services, infrastructure and government support are instrumental to smooth out the whole process. Instead of considering these activities as cost drivers, the value chain perspective views them as steps that add incremental value to the finished product or service. (HBS n.d.). In each step, value can be made through either simple transportation of the product from point A to point B or complex product enhancement such as processing and packaging (Miller & Jones 2010, p. 9).

Figure 4.2.2.1 (a) Value Chain of the Agricultural Industry



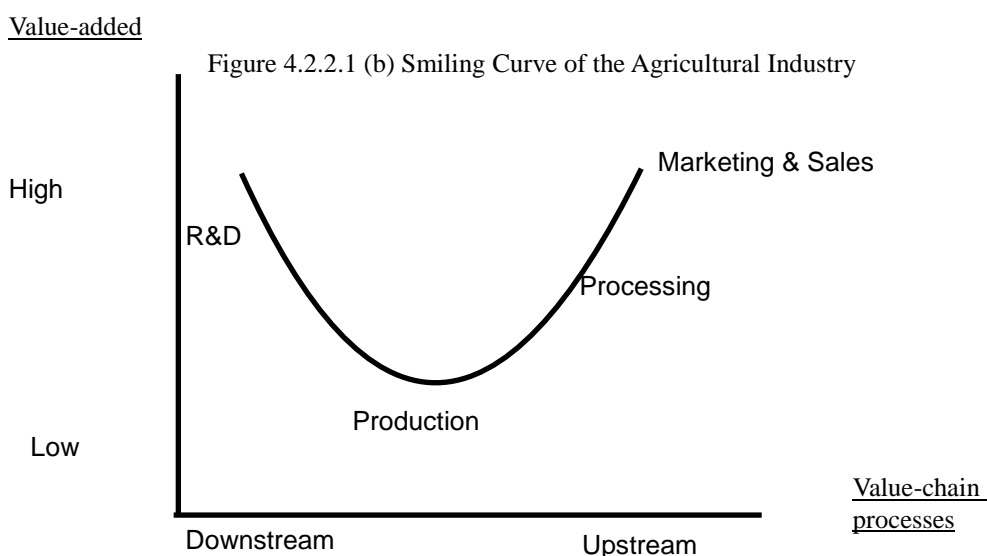
Source: created by the author

The vertical integration of upstream and downstream links of the value chain can bring benefits of efficiency improvement, freshness preservation and quality traceability which are critical competitive advantages when customer demands and sophistication are ever-increasing. Furthermore, it can reduce wastes and lower consumer prices. Value-chain integration is also recognized by the Chinese government as a method to industrialize the overall agricultural industry. It provides a source of competitive advantage in export when Chinese firms have to compete with highly integrated and professional international players.

In contrast with the overall value chain, in most cases, farmers only participate in the

production link and are squeezed between forward suppliers and backward traders. A smiling curve of the agricultural industry can further illustrate their deplorable situation. According to the curve in figure 4.2.2.1.(b), whereas activities like processing, marketing and sales are standing at the upper edges of the curve, production falls to the bottom of the curve adding the least value to products. Because of the intense competition mentioned previously, farmers have not yet enjoyed fruits of the upgrading value chain, but are rather deprived of profits.

Source: Adapted from Fan (2014, p. 398)



In order to turn things around, farmers have to perform other activities closer to the two profitable ends, now that they can't move away from production work. By forming cooperatives, such goal becomes viable. The cooperative role fits in well with the objective of vertical coordination. A cooperative's value chain usually occupies a part of the overall agricultural chain that is preceded by upstream suppliers and/or followed by downstream distributors. In figure 4.2.2.1 (c), the author illustrated the value chain of a cooperative. While the actual farming work is assigned to and done by farmer members, supporting activities such as planning, quality control, technical assistance, and HR management are performed collectively by cooperatives that have more capabilities and resources than individuals. Supplies are purchased together and marketing is unified at the cooperative level. By eliminating intermediaries and incorporating higher value

activities such as processing and marketing, cooperatives help farmers to climb up the value chain towards higher profitability. In the meantime, customers can benefit from lower prices, higher product quality and varieties, as well as brand credibility.

Figure 4.2.2.1 (c) Value Chain of A Cooperative

Supporting Activities	Cooperative Infrastructure (Financing, Planning)				Value to Customers
	HR Management				
	Technical Assistance & Information Service				
	Quality Control				
Primary Activities	Procurement (Seeds, pesticides, ect.)	Production	Processing & Warehousing	Marketing & Sales	
Value Creation	Lower price; Higher quality	Quality control; Product standardization	Variety increase & Quality improvement;	Better accessibility; Brand credibility	

Source: created by the author

Although a cooperative may not perform all the activities mentioned above at the moment, cooperatives do help vertically integrate some parts of the value chain. Moreover, since the Chinese law allows for non-farmer membership in cooperatives, farmers, traders, processors, wholesalers and retailers engaging in the same business entity can join hands and construct a value chain at a much integrated level. After all, “a chain is only as strong as its weakest link” (Miller & Jones 2010, p. 9), cooperatives’ ability to strengthen the production link and create synergy with other links or participants will have significant meaning to agricultural industrialization in China as a whole.

4.2.2.2. Current Achievements

With years of development, farmers cooperatives in China have increased in number, improved in operational quality and enlarged in scale. By the end of March 2013, more than 730,000 farmers cooperatives have been registered, involving 54 million or one fifth of total households in rural China. Every month, around 10,000 cooperatives are newly created (Zhang 2013, p. 19). From the year of 2008 to 2012, the total number of registered farmers cooperatives

grew six-fold over the five years and totaled 689,000 as of the end of 2012. During the same period, share capital surged by twelve times from 0.09 in 2008 to 1.1 trillion Chinese yuan. Moreover, The average number of members in cooperatives has increased from thirteen to eighty (Zhao & Yuan 2014, p. 33).

Table 4.2.2.2 The Development of Registered Farmers Specialized Cooperatives					
	2008	2009	2010	2011	2012
Number (thousand)	110.9	246.4	379.1	521.7	689
Share Capital (trillion RMB)	0.09	0.25	0.45	0.72	1.1

Source: Zhao & Yuan (2014).

By joining cooperatives, farmers do enjoy better prices than before. According to a 2009 data about 198 farmers cooperatives in a Chinese province called Hubei, it was found that members could sell to their cooperatives at such favorable price as 7% higher than selling to other parties. Statistics also show that farmers in cooperatives have benefited from higher income. According to the Ministry of Agriculture, farmers joining cooperatives earn on average 10% to 20% higher income than those who are not members of any cooperative. Moreover, the difference increases to 30 percent for members in a “model cooperative” (Zhao & Yuan 2014, p. 33).

Such results can't be achieved without the firm support from government at all levels. After the issuance of the national law, thirty provincial-level governments released relevant policies and sixteen of them also promulgated local regulations on the development of cooperatives by the end of 2011. Besides policy support, financial assistance offered by governments totaled 4.24 billion RMB among which 3.24 billion came from provincial level governments.(Zhao & Yuan 2014, p. 33).

4.2.2.3. Problems and Concerns

Despite the achievements mentioned above, farmers cooperatives are still in the initial stage

with a number of problems to be solved.

First of all, comparing with large cooperatives in other countries, cooperatives in China have much smaller scale on average. Only a small percentage of farmers are members of cooperatives (Fock & Zachernuk 2006). In addition, the influence of a cooperative is often restricted at the village level.

Secondly, the quality of service provided by cooperatives remains at the primary level and needs to be further improved. Services that members can obtain from cooperatives are mainly technical and information service, unified agriculture supplies purchase, unified sales and marketing of products as well as credit service. Research conducted by Deng, Xu and Liu (2010) with a sampling of 160 cooperatives in seven provinces showed that while 92.5% of the cooperatives provided technical and information service, the percentage dropped to 60% when it came to unified supply and marketing services. Only 3.1% of cooperatives managed to offer credits to members. The majority of cooperatives offered one to two service items and there were 4.4% of registered cooperatives not functioning at all. The more and more advanced services a cooperative provides often means the more organizational capabilities it has. For instance, unified purchase of supplies demands sufficient amount of fund reserve or the organizational ability to source fund in a short period of time. Marketing functions of a cooperative were often constrained by inadequate marketing expertise.

Awareness of the benefits of farmers cooperatives is not high among Chinese farmers, since farmers cooperative is a brand new concept introduced only a few years ago. Farmers who already joined cooperatives also have inadequate knowledge about values and mechanisms of cooperatives as well as the basic rights they deserve. Wu's (2013) study of 440 household members of cooperatives in two provinces showed that members' understanding about their cooperative's surplus distribution system and charter were all below 3 on a scale of 1 to 5, with 5 meaning full understanding. Most farmers were not clear that the purpose of cooperatives is different from companies' profit-oriented purpose.

Besides, internal management does not follow basic cooperative principles. In terms of

control, it is often the case that cooperatives are controlled by few influential figures or companies and that decision is not made in a democratic manner. Hu and Bijman's findings (2011) of cooperatives in Hubei province revealed that shares were distributed unevenly among members. Surprisingly, over 60% of shares were concentrated in founding members and chairman alone held 28% of all shares on average, leaving minor shares to other members.

Moreover, there is a human resource shortage of well-educated entrepreneurs who have sufficient knowledge and skills to manage cooperatives. In general, education level in rural areas is lower than that in cities. Due to prominent gap in income, educated rural students often choose to move to cities to work. According to a survey (Wu 2013) of 440 household members of cooperatives in Guangdong and Anhui provinces, the average educational level of members was primary school. Even in Guangdong province, which has the highest GDP in China, average education at the cooperative management level was junior high school. The Anhui province average was below junior high school.

Financing also remains a big obstacle for most of the cooperatives. Fund sources include retained earnings, share capital, membership fee, fund raised from members, donations and government support. However, Deng et al.'s (2010) research found out that 36% of cooperatives had no source of fund. The issue is most severe in small cooperatives since government support usually goes to large and standardized cooperatives. There are also difficulties for those small cooperatives to get loans from banks. It has thus become the biggest limiting factor of growth for most cooperatives.

Lastly, too much government intervention at the basic level poses big concern in the long run. Some village cadres take initiatives to establish cooperatives for the purpose of polishing political performance since the upper-level governments are attaching great importance to the development of cooperatives. To increase the number of membership, some may use political pressure or other methods to push farmers to join cooperatives. Research (Xu et.al 2011) showed that 69% of sample cooperatives were created as a result of town government and village cadres' initiation. Yet, those cooperatives are found to have provided less service than the ones initiated by

farmers voluntarily. Without democratic basis, they often fail to motivate farmers and eventually become phantom organizations of no real value.

The chart below gives a good summary of internal obstacles that are affecting the sustainability of farmers cooperatives. Respondents of leaders, members, non-members and government officials ranked the severity of obstacles. Results from all four groups identified that lack of capital was the number-one issue for cooperatives. Besides capital, issue of management and leadership were highlighted since both existing leaders and members ranked poor management as the number-three problem while government officials regarded poor management and unqualified leaders as two biggest obstacles.

Table 4.2.2.3 Primary Internal Obstacles to Sustainability of Farmer Associations

Obstacles Identified (Internal Factors)	FPA Leaders		FPA Members		Non-members		Government Officials	
	#	Rank	#	Rank	#	Rank	#	Rank
Lack of capital	39	1	95	1	14	1	17	1
Scale of operations scale too small	21	2	48	2	7	4	10	6
Poor FPA management	20	3	43	3	6	5	15	2
Inadequate market information	19	4	33	6	6	5	8	7
Lack of service from FPA	15	5	38	4	8	3	11	4
Lack of technical ability and service	15	5	35	5	6	5	11	4
Unqualified FPA leaders	9	7	12	10	5	9	12	3
Lack of training	9	7	17	8	4	10	7	8
Discrepancy between FPA members	9	7	11	11	6	5	4	9
Poor quality achieved	7	10	8	12	2	11	4	9
Land scale is too small	7	10	16	9	2	11	3	11
Never thought about	19	7	9	2

Source: Fock & Zachernuk (2006)

At present, there is the co-existence of several types of cooperatives with distinctive features. The type of a cooperative is usually determined by the nature of the initiator or the leader. Many studies made clear that different types of cooperatives vary in operational efficiency. A big contributing factor to this result is the initiator's relationship with members as well the initiator's resources and capabilities. Therefore, the author considers the leadership issue and management issue as highly related. Considering the relative importance, the two issues are the focus of discussion in the next chapter.

4.2.3. Analysis of Common Types of Cooperatives in China

In China, huge discrepancies in local development level together with grassroots explorations in farmer cooperation before formal regulation was in place have resulted in the heterogenous feature of cooperatives. Initiators of cooperatives range from farmers to processors, village cadres, NGOs and agriculture-related companies. While farmers' initiation is the most consistent with the value and purpose of cooperatives, non-farmer parties are more active to take initiatives because of Chinese farmers' limited resources and ability at the moment. These initiators, although with diverse backgrounds, are often core leaders who exert big influence on the development of cooperatives (Garnevska, Liu & Shadbolt 2011).

A study found (Garnevska et al. 2011) that an initiator took multiple roles of the board member, manager, and member of the cooperative. The role of a board member requires an initiator's vision to chart a proper direction of future development; the role of a manager requires the initiator's ability to deploy resources and execute goals; the role of a member has totally different demands on the initiator's ability to fulfill the contract, to commit to the goal, and to supervise the board and the management.

There is the consensus that good leadership is an essential success factor for cooperatives (Fock & Zachernuk 2006). A qualified leader is expected to have access to financial, human and social capital (Bijman & Hu 2011). Scholars describe attributes of successful leaders as: management capability, expertise in production and marketing, respect from members as well as motivation to contribute (Fock & Zachernuk 2006). In addition, broad vision, open-mindedness, communication skills and good education are also identified to be critical (Garnevska et al. 2011).

The nature of cooperatives leads to complicated roles a leader should take. The leader's capability is even more critical when Chinese farmers have low level of education and show insufficient knowledge about cooperatives. This chapter will therefore analyze common types of cooperatives established by different initiators and compare their performances.

4.2.3.1. Cooperatives Led by Government-Related Institutions

Government-related institutions refer to government agriculture departments at the basic

level and quasi-governmental associations that are affiliated to government departments. Different institutions leverage on their unique advantages to lead the establishment and management of cooperatives. Low-level government institutions summon farmers and set up cooperatives using authoritative power and are in a good position to pass on government policy and financial support. Agro-technology promotion centers that are common in villages and towns help transform technology achievements into agricultural productivity by leading cooperatives and working closely with farmers. These centers can also make advantage of existing assets such as buildings and facilities to use for cooperative activities. Besides, agriculture industry associations can utilize their network of human resources to provide expertise and market information to cooperatives they establish.

These institutions are able to bring in the assets, information, technology and knowhow that farmers have little access to. However, the top-down approach causes a major problem that farmer members are not motivated enough to participate in the cooperative affairs and therefore these cooperatives tend to lose vitality in the long run. There is also the risk that cooperatives end up becoming an actual affiliate of government institutions or an instrument to acquire political resources (Guo & Zhang 2010). In the present situation, this model is easier to succeed in the initial period, yet its future growth is constrained by a lack of closely linked interests between institutions and farmers. It is therefore a makeshift model, whereas the ultimate goal is to transfer leadership to farmers (Hu 2009).

4.2.3.2. Cooperatives Led by Non-Governmental Organizations

NGOs also take initiatives to lead cooperatives out of passion and good-will for public welfare. A particular feature of this type is that these cooperatives are set up in firm accordance with the classic cooperative principles. Hence, these cooperatives are usually well structured and operated in a standardized way. An emphasis is also placed on member education and the cultivation of cooperative culture (Hu 2009).

The drawbacks of this type include interests conflict between the non-profit nature of NGOs and the for-profit objective of cooperatives in the market; the discrepancy between an advanced

organizational structure and the laggard state of business; and the gap between high requirements on managers versus their true capabilities to achieve effective management (Hu 2009). In view of the drawbacks, in particular the contradiction in interests, the author is not optimistic about NGOs' ability to lead cooperatives to compete for profits. But on the other hand, NGOs can function as consultants to cooperatives on issues of structure standardization and human resource management. Furthermore, the nature of NGOs justifies them as candid supervisors for the purpose of promoting fairness and common welfare.

4.2.3.3. Cooperatives Led by Agriculture-Related Companies

In this model, companies in the agriculture industry participating in value-adding activities such as processing or sales, will take the lead to form farmers cooperatives and absorb membership from farmers. By connecting with a large number of small-scale farmers through the intermediate cooperatives, companies can secure stable source of raw materials which are primary products produced by farmers. It is also easier to implement quality control and increase overall quality traceability using the organizational capability of the cooperative. Moreover and very importantly, transaction costs can be significantly lowered. Before this model comes into being, companies used to deal with individual farmers through a model which is often referred to as the “companies plus individual farmers” model. Because of the Household Contract Responsibility System, farming activities are usually performed by individual farmers in very small scale. To secure enough raw materials, companies have to sign contract with numerous farmers beforehand, negotiate terms one by one, collect products and make small payments, which inevitably lead to high transaction costs. It is also hard to control product quality from numerous sources. Moreover, the default rate is commonly high at the negotiated time of delivery. When supply is short and market is offering a better price, farmers tend to default and sell directly to the market. Since it may cost companies more to initiate legal proceedings with a small farmer whose transaction volume is tiny, companies tend to let things drift. On the other hand, when market price is low, companies see incentive to default and try to decline products from contracted farmers. Now that small farmers have neither money nor power to go for a lawsuit, they often choose to endure it.

The cooperative therefore offers a good platform to resolve the default and transaction costs issue by bringing the two sides into one entity with common interests. Instead of dealing with numerous farmers, companies can deal with the cooperative to sign a single contract and impose quality standards. After receiving the contract from companies, a cooperative will implement the contract by planning for production, purchasing supplies, providing technical assistance, collecting products from members, supervising product quality and distributing profits in proportion to profit contribution. Despite the benefits cooperatives bring, there are few existing and functioning cooperatives that satisfy companies' needs. In this case, companies will take the lead to invest assets and establish cooperatives.

However, companies usually control the management of cooperatives leaving little power to farmers. Managers come from companies and make decisions with little involvement of farmer members. They take the majority of shares and have a tendency to distribute profits unevenly. In all, in the company-led cooperative model, farmers can lower market risks, gain more profits and more importantly they get to cultivate a sense of cooperation, yet they usually have limited rights and voices.

4.2.3.4. Cooperatives Led by Rural Elites

Comparing with the three types mentioned above, the rural elites-led cooperative is the closest to the ideal farmers cooperative since rural elites are part of the farmer group and have high appeal to other farmers. It has been recognized by scholars as an effective way to operate cooperatives under the current Chinese conditions. Rural elites are large producers, farmers with large sales, village cadres as well as rural residents with capital, technology background or prestige. They use their personal capabilities and charisma to attract membership to form cooperatives. In this way, their individual resources like sales channel and marketing expertise are utilized for the common interests.

Local farmers are familiar with these rural elites, trust their abilities and usually respond to their appeals. In an organization where trust is one of the cornerstones, rural elites' strong network plays an important role. It is also in line with the original intention of cooperatives to improve

people's livelihoods through mutual help.

In contrast with the top-down approach initiated by the government institutions, this model is bottom up and therefore has more participation from farmers. Sustainability is therefore enhanced. It is worth noting that rural elites often take dominant roles in cooperatives and in most cases farmers are ruled out from decision-making. Advantages of the model include fast decision making, lower management costs and operational efficiency (Hu 2009).

At the same time, the rural elites-led model often causes problems that they dominate the management without regard to the organizational rules. Therefore, the organizational structure and operation are often not standardized. In addition, the personal influence and network of rural elites may restrict the future development of a cooperative to a large scale. The cooperative may also be troubled by the ambiguity in property rights, which makes it hard to differentiate the elites' personal properties from common properties (Guo & Zhang 2010). When losses incur, farmer members may not be willing to share responsibility of operational losses and initiators will have to assume excessive responsibilities. Result like this will in turn hurt rural elites' motivation. Hu (2009) listed three reasons to explain the happening of this situation. Firstly, farmers are not fully aware of the necessity to follow proper procedures of production, which thus results in substandard products. Secondly, members' understanding about the cooperative charter is inadequate. Lastly, leaders tend to overlook the importance of member training and education.

In all, against the current backdrop of low education and insufficient management capabilities among farmers, it is an effective transitional model to leverage on rural elites' resources and prepare farmers for future leadership.

The farmer producers-led cooperative model is the ideal type of farmers cooperatives since cooperatives are owned, controlled by farmers and all benefits go to farmer members. However, most farmers at the current stage are not able to initiate or successfully manage a cooperative and hence demand external support.

CHAPTER 5. THE THREE-STAGE APPROACH TO COOPERATIVE DEVELOPMENT

Considering the imbalanced situation of regional development in China as well as the social and cultural diversities, it is reasonable to believe that cooperative will not develop at the same pace. On the contrary, a mix of different types will continue to co-exist across the country. While this chapter is not aimed at promoting a single solution, it is intended to propose a reasonable three-stage approach that addresses problems and demands at different stages.

Section 1. THE THREE-STAGE APPROACH

The three-stage approach starts with company-led cooperatives, to rural elites-led cooperatives as a transitional stage and finally approaches the last stage of farmers-led cooperatives. The criteria for selection is the fundamental cooperative philosophy of “owned by, controlled by and benefits for the farmers” as well as the degree of feasibility against the socioeconomic backdrop.

Proceeding from the first stage to the last, power and benefits for farmer members are supposed to be enhanced along with increasing demands on their capabilities to run a cooperative democratically. In essence, the international movement of cooperation is indeed a movement of culture that transforms traditional farmers into a new generation of farmers with the ability and vision to effectively cooperate with others (Hu 2009). This transformation of farmers can not be realized overnight, since most Chinese farmers’ cooperation spirit, entrepreneurial courage and overall market capabilities are so far from enough to effectively and democratically lead cooperatives that any bold change may give rise to utter chaos. Taking account of the difficulty, the author believes that it is inevitably a time consuming process to gradually guide and cultivate farmers to become qualified decision makers and that this transformation should be carried out in a staged and progressive fashion.

In the first stage, agriculture-related companies engaging in processing, sales and relevant

services of agricultural products take the lead to form cooperatives while farmers join as members and produce products. Comparing with other organizations such as NGOs and governmental institutions, companies are most familiar with the competitive market and they demonstrate a high degree of vitality and flexibility in economic activities, which can't be matched by non-profit organizations or governmental institutions. Moreover, companies engaging in various agriculture-related activities and of different scales can be found throughout China to be paired with cooperatives that feature similar diversity in demands. It is considered by the author as, by far, the most feasible and economical way to facilitate cooperatives' participation in the Chinese market.

In this cooperation, both sides can be better off. By working and trading with cooperatives, companies are able to secure steady supply and lower transaction costs since they no longer have to deal with small farmers one by one. Cooperatives serve as the intermediary that on one hand negotiate purchasing contract with companies and on the other, implement the contract by organizing, supporting and supervising productions that are carried out by farmers. Farmers receive assignment from cooperatives and produce according to the quantity and quality requirements. To facilitate farmers' compliance with the contract and quality standards, companies may provide additional services such as extending technical assistance and securing supplies. After contracts are successfully fulfilled, retained earnings are distributed in proportion to each member's patronage as well as capital investment, after part of the surplus is devoted to cooperative reserve.

When transactions between farmers and companies are internalized, single shot transactions become repetitive games where farmers and companies trade with each other frequently. The higher the frequency becomes, the less the uncertainties of trustworthiness, behaviors, quality and prices become. Moreover, both sides have incentives to refrain from opportunistic actions so as to build credibility and gain long-term benefits. Enforcement costs may therefore be reduced thanks to higher mutual trust and the intermediary role of cooperatives. In general, transaction costs to search and verify trading partners, to negotiate contract terms as well as to enforce a contract will be cut down. As a result, cooperatives provide a mechanism to mitigate market risks and lower transaction

costs for both companies and farmers.

While farmers can benefit from agriculture company-led cooperatives, it is also mentioned in the last chapter that as members of a cooperative, farmers' rights may be infringed by companies holding much greater power. In addition, driven by self-interests, the companies, controlling decision making in reality, are likely to squeeze out profits from farmers to feather their own nests. To make sure the cooperative is managed with fairness, effective supervision mechanisms should be in place.

In the second stage, rural elites rather than companies take a leading role in cooperatives. They take over power by either initiating a new cooperative or getting elected by members as the dominant force that manages to recapture leadership from agriculture companies in existing cooperatives. While in stage one companies as profit-oriented entities are likely to infringe upon farmers' decision making rights in order to maximize their own profits, rural elites belong to the same farmer category and are concerned with similar interests and issues as ordinary farmers. In this stage, conflicts of interest are expected to be mitigated to some extent.

Rural elites have close connections with farmers and share common interests to strengthen bargaining power on the market. Comparing with ordinary farmers, they possess greater economic, political or social status that enables them to drum up membership and play the leading role. However, as mentioned in the previous chapter, rural elites have low level of education in general and their understanding about basic principles, mechanism and democratic governance of cooperatives are limited. In rural elites-led cooperatives, organizational structure and management are not as standardized as those initiated by NGOs that are clear about cooperative theories and comply with the fundamentals. However, there is no doubt that the rural elites model is the closest to the ideal farmers cooperative model and that it is an effective transitional stage to finally hand over the leadership power to small scale farmers.

In view of the common constraints of rural elites, the author suggests the utilization of the national talent pool of 'college graduate village officials', who are educated, ambitious, open-minded and therefore can complement the shortcomings of rural elites. Since the 'college

graduate village official program' has very unique Chinese characteristics, the author will elaborate on the leadership of young college graduates in cooperatives in another section later.

Following the second stage that is led by rural elites, the third stage finally features the leadership of ordinary farmers, who have familiarized themselves with how cooperatives work and have developed their overall capabilities while participating in cooperatives. Farmers get to exercise decision making and control power directly and democratically, thus they can prioritize their ultimate demands as the cooperative goal. This is the ideal model according to the cooperative principals. Yet, to govern cooperatives with efficiency, continuous institutional support is needed.

Section 2. LEADERSHIP IN THE TRANSITIONAL STAGE

5.2.1. College-Graduate Village Officials

College graduate village officials, as the name suggests, are college graduates who are recruited as officials in under-developed rural villages. This program was started in 2008 by the central government in an effort to provide well-educated human resources to support the rural development as well as to alleviate the employment difficulties in cities.

On April the 10th, 2008, an official document was released jointly by the Organization Department of the CPC, Ministry of Education, Ministry of Finance as well as the Ministry of Human Resources and Social Security of the People's Republic of China. According to the document (Organization Department of the CPC 2009), the program is intended to select 20,000 qualified college graduates annually for five years in a row with a target total number of 100,000 students to be sent to villages. Applicants will be evaluated based on their overall competitiveness but CPC party members are preferred. These Party member graduates will normally be assigned as assistants to the village Party secretary, while non-Party member graduates will assist the head of the village committee. These young graduates are expected to improve rural governance since they "are often from cosmopolitan, urban backgrounds, and may act as counterweights to local officials, who tend to be undereducated and provincial in outlook"(Tedesco 2012). Once their work is recognized by the locals, they are entitled to run in the election of Party secretary and other village

positions. Salaries and allowances are decided according to the level of income received by newly graduated officials employed at the township government. Extra allowances are paid to those working at remote and poverty-stricken areas.

The employment contract is two to three years. After the contract expires, they can choose either to renew the contract if performance appraisal is passed or to seek job on their own. In honor of their special contributions, they enjoy favorable policies such as bonus points in national civil servant exams and graduate school exams (Organization Department of the CPC 2009).

In the year of 2010, under the impact of global financial crisis, government support for the program strengthened by resetting the target to recruit 200,000 college graduate village officials by 2012. The new policy was welcomed by college students who were under heightened employment pressure at the time. It was reported (‘Total target’ 2014) that about 2 million students in total had applied for the program by 2011. In July, 2012, when the first five-year-plan came to an end, the central government released a new policy document to further facilitate the program. According to the new policy (Organization Department of the CPC 2012), half of the villages in China should have one college graduate officials by 2015, which means a total number of 300,000 students should be recruited. In three to five years’ time, every town should on average have two college graduate village officials taking chief positions of the village committee and the village Party. By the end of 2013, the number of college graduate village officials surged to 220,000 people (‘Total target’ 2014).

However the onrushing momentum took a sudden turn when the central government, for the first time, cut down the target number from 300,000 to 150,000. Experts (‘Total target’ 2014) analyzed that the intensifying employment issue after contract expiration was the main cause of the downsizing. Although student officials receive favorable treatments when applying for civil servant or graduate school, the real advantage is not apparent since the surge in the total number of college graduate officials has greatly aggravated the internal competition. Moreover, their two to three years’ devotion to rural affairs at the grassroots level may alienate them from their original college majors, office work or exam preparation.

Therefore, future career of college graduate village officials has become an urgent problem to be solved if the program is to be well sustained. Regarding this issue, the central government has been proposing various ways to help these young officials settle down in a new career. They are encouraged to start their own businesses or set up organizations of technical promotion, social service as well as farmer cooperatives. Government will provide financial backing such as lending and subsidies to support their activities.

5.2.2. College-Graduate Village Officials' Leadership in Cooperatives

According to a report ('Three million' 2014) of the college graduate village official program released in 2014, over 30,000 young officials started their own business after the tenure, creating 266,000 new jobs for farmers. They have initiated over 20,000 start-up projects, among which 5,204 are farmers cooperatives.

When starting cooperatives, these college graduates have clear advantages. First of all, they have received four years of college education in cities which often means they have the best educational background in a village. Four years of higher education have equipped them with broader knowledge, wider vision and a skill set including information search and analytical skills, computer skills, learning ability and language skills. Comparing with local farmers, their city experiences have also enabled them to gain insights into city life and adapt to the city market. As a college graduate official wrote (He 2012), experience of organizing events and managing student societies help some students obtain managerial capabilities, communication skills as well as problem solving skills that are essential to cooperative management. In addition to that, their major in college such as law, agriculture, marketing allow them to bring in extra expertise to assist the operation of cooperatives.

Secondly, the village official position itself gives them favorable conditions to take a leadership role in the future. According to the latest official document (Organization Department of the CPC 2012), in the second year of service, qualified and capable college graduate officials are suggested to assume chief positions of the village committee or the village Party. Their responsibilities include promoting projects to increase farmers' income as well as leading or jointly

leading farmers cooperatives. Their first year in village helps them keep in close contact with government officials, engage with farmers, learn about agriculture and the local situation as well as take on village administrative work as a village leader. Such intensive on-job training will facilitate them to adapt to the local community and work out how things get done in the local way. As a result, those experiences will complement their disadvantages of being unsophisticated newly graduated outsiders and prepare them for management positions in cooperatives. In general, they have more hands-on experiences, credibility, political power and policy support in villages than other urban entrepreneurs. Meanwhile they are more educated than rural elites to understand cooperative theories and introduce standardized structure.

Thirdly, college graduate officials serve as a channel connecting government support and farmer demands. The Chinese government has been providing various kinds of support to encourage these officials to set up cooperatives. As the official document stated (Organization Department of the CPC 2012), government will innovate financial services to offer lending, credit guarantee and subsidies to assist fund-raising. Furthermore, government will integrate resources from agriculture, technology, poverty-alleviation and other relevant departments as well as intelligence from research and education institutions to provide services including project assessment, technical assistance and market information for their projects. In addition, government efforts have also extended to guiding and encouraging enterprises and NGOs to give support to college graduate officials' initiations. With government backing, young officials are able to acquire and apply various resources to develop cooperatives, which is otherwise hard to realize by farmers. On the other hand, working and living at the grassroots will enable officials to get a deeper understanding about farmers' worries and demands. The program is therefore a good platform to reflect farmers' demands and try to match them with institutional support.

Lastly, being a much-talked-about topic of the public, college graduate officials' involvement often draws media attention. Media exposures and public attention are advantageous and free vehicles of marketing that should not be neglected, especially for cooperatives with limited budget but are eager to expand marketing channels.

With such advantages, college graduate officials' educational background, current position and policy support together offer them favorable conditions to engage in cooperatives. Very importantly, their salaries are paid by the government, therefore there is no economic pressure on the cooperative side to employ them. Leveraging on this opportunity, some outstanding young officials have initiated cooperatives during their tenure and achieved remarkable results of improving farmers' income. For those who are not capable of leading cooperatives during their term, their firsthand experience of learning and working in existing cooperatives will prepare them for future entrepreneurial endeavors.

Young officials gain valuable assets by participating in cooperatives. Through hands-on involvement, they put theories into practices and acquire workable knowledge about the operation of cooperatives which is more valuable than book knowledge. In addition, comparing with their daily administrative work as a village official, experience in a cooperative is more business-oriented and is therefore a precious opportunity to build up business and marketing skills. Moreover, guiding cooperative production and effectively communicating with farmers demand understanding about agriculture, which in turn stimulates young officials to master some production techniques. Furthermore, while efforts paid in village administrative work including a good number of paperwork may not demonstrate quick results or visible influence on the rural economy, economic benefits of cooperatives are straightforward. Farmers' active response to the success of a cooperative can greatly motivate young officials' and increase their confidence. Apart from mental fulfillment, revenue from cooperatives also rewards extra income to young officials whose fixed salary could barely make ends meet.

The leading function that college graduates play brings about additional meaning in rural development for that it is transforming Chinese students' perspective on working in the countryside. The long-standing view among college graduates is that going to the village is a step-back towards poverty and failure, while cities stand for opportunities and success. This viewpoint has started to change since young officials are taking critical roles and have truly contributed to overall welfare of the rural society. It demonstrates that there are precious opportunities in China's villages for young

talents (Tedesco 2012).

5.2.3. Problems and Concerns

Meanwhile, quite a number of problems and concerns are noteworthy. First of all, most of the college-graduate officials work in cooperatives in a part-time rather than full-time manner. Their major responsibilities lie in village administration. Yet, organizing cooperatives demands a lot of efforts. Secondly, it is hard to communicate with farmers who have their own way of thinking and expression (Ma & Yang 2010). It takes young officials, who are born and raised in cities, tremendous efforts to understand the differences, speak the same language and finally persuade local farmers. To fit in with the local community means a lot of preliminary work to get a grasp on farmers' values and true concerns. Thirdly, young officials have expressed concerns about their insufficient personal capabilities. For one thing, because the concept of farmers specialized cooperative has just emerged since 2006, young officials have little knowledge or training before joining a cooperative. Even for people who have already started a cooperative, how to effectively manage the organization remains an issue. According to a survey conducted by Agricultural Management Institute of Ministry of Agriculture (Wei 2011), 84% of college graduate official respondents from eight provinces and municipalities admitted a lack of professional knowledge. 74% of them responded that they hadn't had any training concerning cooperative knowledge. For another, few of the officials majored in agriculture back in college which creates a mismatch between what they can offer and what farmers demand. Farmers hope that young officials can do more than simply managing administrative work in cooperatives, since local experienced officials may do a better job in this aspect. They expect young officials to leverage on their professional background and bring in external resources to solve problems in an innovative and efficient way (Wu 2010). Yet, due to strong government push and relatively loose selection process, the background, personal capability and original intention of young officials vary widely.

The harsh working conditions and low salary are also recognized as major concerns for young officials. The problem is even intensified by the increasing gap between rural areas and cities. Those born in cities may find it difficult to adapt to the way of living in rural areas, which is

not only impoverished in material life but also deficient in spiritual life. Infrastructure and facilities such as convenient transportation, internet, library, cinema are rarely found in villages. Furthermore, they constantly feel the pressure from college peers who are working in cities and gaining far better salary. After all, in China, most students study extremely hard to excel in fierce competition so as to get a good job and improve life quality. Therefore, working in rural areas requires extraordinary determination and mental toughness.

A related issue of this is the insecure future career prospect. Anxiety is felt by many young officials since those who could not make it to the position of either head of village committee or secretary of the village Party generally can not renew the contract but have to leave the position after the term terminated. According to a survey (Liu 2010), results showed that 59% of college graduate officials would like to attend the civil servant examination after their tenure, while 23% of them intended to stay and 17% would like to start their own business. The clear priority of being a civil servant reflects young officials' demand for a stable job in the government and a higher social status. According to Liu (2010), being a village official is more of a short-term and voluntary choice to college graduates, rather than a life-time career. Because of the future instability, some young officials who have successfully started a business or led a cooperative expressed that if they could not stabilize their career as official government cadres, they would rather quit and leave. The stability problem of leadership is an obstacle for cooperatives to develop under consistent management. Besides, the venture of initiating a cooperative demands certain risk resistance capacity. However, the slender income they receive does not allow them to take high risks.

Lastly, since most young labors have gone to cities, the remaining farmers are the seniors, women and children, who tend to be conservative and less willing to take risks. To explain the basic principles and benefits of cooperatives as well as to appeal to them to join a cooperative takes more efforts than usual.

5.2.4. Solutions

To deal with problems and concerns mentioned above, this thesis proposes the following solutions. Considering the lack of necessary knowledge among college graduate officials,

government ought to provide more systematic training such as incorporating contents of cooperative management as part of the college graduate official training courses. Relevant institutions' advocacy and media publicity are critical to raise awareness among farmers towards farmers specialized cooperatives. Higher awareness will help reduce hurdle of indifference or resistance and thus evoke grassroots participation. Similarly, member training should be strengthened so as to facilitate comprehension of cooperative strategy, effective implementation of tasks as well as succession of leadership in the future. To supplement internal training done by cooperatives, training sessions organized by basic level governments are also necessary. As Ma and Yang (2010) pointed out, member training builds up farmers' understanding and hence improves young officials' working environment as well as their performances.

Besides efforts on training, financial assistance is needed to sustain young officials' undertaking. Currently, these young officials possess low risk tolerance due to low salary, small initial capital, as well as difficulties to acquire external capital. Financial assistance should come in various forms such as subsidies, interest-free credit and monetary rewards that are easily accessible to young officials.

Additionally, the author suggests institutional modification of the College Graduate Village Official program to include farmers cooperatives as places of service. College graduates holding cooperative positions will enjoy equal salary and policy treatment as village officials do. Qualified young officials who could not make it to the village head or secretary of the village Party still have the opportunity to stay as a manager of cooperatives. It provides a stable job opportunity for capable officials and motivates them to devote to work since future instability is reduced to some extent.

Section 3. FURTHER EXPLANATION ON THE THREE-STAGE APPROACH

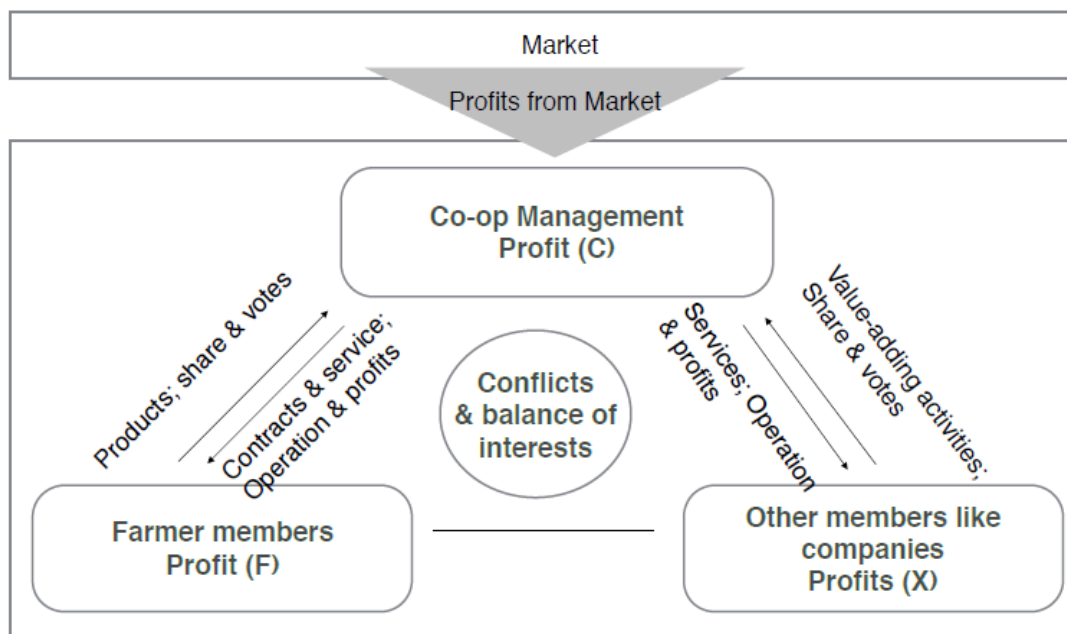


Figure 5.2.4 (A) Profit Distribution in Cooperatives

Source: created by the author

The three-step approach is designed to propel growth of cooperatives as well as to strengthen farmer members' democratic control over the cooperative and increase their proportion of income from the cooperative pool over time. This proposal is consistent with the very core of farmers cooperatives, that are equal member status, democratic control, common interests of all members, and fair distribution of surplus. It can be translated into a goal to realize cooperative governance on the basis of fairness, transparency and democracy.

In terms of fairness, the author basically refers it to the fair distribution of profits inside the cooperative. A simple formula can be used to explain how profits are distributed internally. Total profits gained from the market is written as Profit, while farmers gain Profit (F), other member categories such as agriculture-related companies gain Profit (X) and cooperative management retain Profit (C). Profit (C) includes reserve funds and development funds at the cooperative level as well as private earnings that the management captures. The formula goes as: Profit = Profit (F)+Profit (X)+Profit (C). When total profit is stable, any increase in profit of one party will inevitably hurt profits that other parties could access to. If all parties have high morality and are

willing to fairly distribute income according to the cooperative charter, then fight for profit allocation will not be an issue. However, in reality, these parties are driven by their own interests and therefore are motivated to prioritize their gains over others. Fair distribution is indeed not an easy task. In the Chinese farmers cooperatives case, since membership can include non-farmer constituents, these cooperatives with heterogeneous members are multi-stakeholder cooperatives. Conflicts of interests are likely to be aggravated to a higher level in multi-stakeholder cooperatives because one group of stakeholders often plays the dominant role and may allocate profits lopsidedly in favor of themselves.

In the three-stage model, the author is not attempting to fulfill the unrealistic goal of eradicating the uneven allocation issue overnight, but instead, would tolerate its existence with the purpose that economic gains could stimulate competitive parties' entrepreneurial spirit to the greatest extent. Note that this is, in no circumstances, freewheeling without any constraint. Supervision and control systems from both inside and outside are indispensable to safeguard the basic rights of the disadvantaged groups. This perspective draws lessons from a national development policy by Deng Xiaoping, a great leader and the "architect" of the Chinese modernization construction, who proposed a new way of thinking to integrate market economy with the socialist ideology into a "socialist market economy". The socialist market economy method is intended to reconcile the tension between the socialist goal of common prosperity and the demand for economic development to compete globally. This pragmatic approach is proven to have reshaped people's perspective towards socialism and have greatly supported the Chinese economy.

Quoting from Deng Xiaoping (Whiteley 2007), "According to Marxism, communist society is based on material abundance. Only when there is material abundance can the principle of a communist society be applied. The principles of socialism are: first, development of production and second, common prosperity. We permit some people and some regions to become prosperous first, for the purpose of achieving common prosperity faster." The author considers this viewpoint to be applicable to cooperatives since the fundamental question is the same for both cases, that is to

balance the market-oriented development goal with the pursuit of common interests. Specialized farmers cooperative is, in itself, a product as well as a means of the socialist market economy. Therefore, permitting some groups of members to become prosperous first so as to maximize profits from the market is not in conflict with the purpose of achieving common interests and fair distribution later. In fact, it may accelerate the process.

With this view point, the author regards agriculture-related companies as proper leadership candidates for the initial stage in the hope that these profit-driven market veterans can capitalize on their resources and market experiences to enhance competitiveness of cooperatives, and therefore maximize total profits gained from the market. To enlarge the cake of total profits, how the cake is cut is likely to sacrifice fairness to some extent. In the profit formula, Profit (X) is expected to be large, but Profit (F) is relatively small, although still larger than farmers who are not cooperative members. The main objective at this stage is to enhance market competitiveness, reduce transaction costs and achieve scale economies. United small-scale farmers will benefit from increased income and enhanced bargaining power than before, although such benefits are anticipated to be limited. Another critical task at this stage is to familiarize members with the concept of farmers cooperatives which is new to most people. Since companies play the leading role, human resources of the management mainly come from dominant companies. To protect the basic right of farmer members, internal supervision by supervisors, the supervisory board, accountants and member themselves are indispensable. However, more importantly, external supervision should be particularly strengthened, taking into account the fact that farmer members have little internal power to constrain the dominant stakeholders. External auditors and relevant governmental bureaus are feasible supervisors to check on conducts of those companies. Trust is key to success among farmers, the management and company members so as to maintain a working relationship and get internal contracts fulfilled, otherwise transaction costs reduction could not be realized. Besides trusts and ethics, supervision is also a key success factor, because if farmers' basic rights are not secured, a cooperative is doomed to fail. Table 5.2.4 (B) is a summary of the three-stage approach, recapitulating the main points of objectives, key success factors and criteria of each stage.

In the second stage, leadership of companies is replaced by rural elites, who are part of the larger farmer group, thus transferring power from companies to the farmer group. Rural elites refer to large farming households, village cadres, villagers with capital, technical advantages or high prestige. Conflicts of interest are supposed to be mitigated because rural elites and farmers share more essential similarities in interests, though rural elites are apt to abuse their power in cooperatives for personal economic or political gains. Being the influential figures among farmers, they have strong networks and enjoy a high level of trust from members, so the trust issue in the previous stage is not prominent now. Main objectives at this stage include further empowerment of farmers, cultivation of cooperative leaders at the grassroots and more profits distributed to the farmer group. The profit formula in this case will see a large Profit (C), noting that rural elites as the management are separated from ordinary members here. Profit (F) of the farmer group will be improved, while Profit (X) will decrease as a result of relatively weakened position of other member categories like agriculture-related companies. Although rural elites are expected to show more care for the larger farmer group due to homogeneity in backgrounds, sympathy as well as the pressure of public opinions from the rural community, support and supervision are necessary to regulate their conducts since they are not familiar with standardized business organizations and tend to act arbitrarily, in addition to the abuse of authority to pursue personal benefits.

Marketing capabilities and financing are key success factors at this stage, especially for cooperatives without other member categories and should resort to internal resources for self reliance. Moreover, it is important to avoid too much intervention from government bodies at the basic level since some rural elites, village cadres in particular, have strong political backgrounds. The top-down government approach is proved to be detrimental to cooperatives that should be set up and managed in a bottom up fashion. On the other hand, rural elites should actively seek policy and financial support provided by the government that could become crucial resources for small-scale cooperatives.

In the final stage, ordinary farmers who become educated and informed in previous stages turn into the dominating force. The general assembly and a board constituted mostly by farmer

members come into power and help farmers gain full control of cooperatives. Although differences in interests also exist in the farmer group, when subgroups' demands and voices are heard, they will act as counterbalances to each other to ensure that decision is made with considerations to different factors and can reflect the collective interests of the cooperative. The objective at this stage is to realize democratic control and fair distribution of profits. The profit formula will see a large Profit (F) that farmers deserve according to the distribution principles. Key to success at this stage is HR management. Since leadership comes internally from farmer members, cultivating qualified leaders with management capabilities is critical. Besides, democratic control also puts requirements on every farmer member to be concerned and informed. Member training and education programs should be routinized to further their growth to keep up with development of the cooperative. Transparency is another key success factor to facilitate decision making and supervision of the business in order to serve the interests of members. This ideal model reflects the essential principals of cooperatives, yet at the moment there is sure to be a tough way ahead towards actualization.

Table 5.2.4 (B) The Three Stage Approach Source: Created by the author

		Stage 1	Stage 2	Stage 3
Objective		Enhance market competitiveness and achieve economies of scale; Increase member income and enhance farmers' bargaining power; Familiarize members with cooperatives;	Further empowering farmers to exercise control right; Cultivate leadership from the grassroots; More benefits towards farmers	Democratic control by farmers; Fair distribution of profits; Transparency
Factors to Consider	Governance	Company-led	Rural elites-led	Farmers-led
	Human Resource	Managers from company members	Rural elites as managers	Farmers as managers / external managers employed
	Dominant	Company members	The management	Farmer members

Table 5.2.4 (B) The Three Stage Approach Source: Created by the author

Key Success Factors Criteria owned by users ; controlled by users (decision making, voices heard);benefits for users (fair distribution of profits; lower costs and higher income)	Stakeholders			
	Supervision	Importance attached to external supervision: auditors, government bureau to complement weak internal control (supervisors, board of supervisors; accountants; members)	Internal and external supervision, while external supervision still demands special attention	Internal and external supervision
		Trust; supervision Balance interests; Supervision to safeguard farmers' interests; fulfillment of contract	Marketing Capabilities; Financing; Avoid too much government intervention and bureaucracy;	HR Management; Transparency Leadership capability; training and education (informed and educated members); financing; scale
	owned by users	Yes	Yes	Yes
	controlled by users	Little	More	Most
	benefits for users	Little	More	Most

CHAPTER 6. CONCLUSION

To industrialize the Chinese agricultural industry and enhance farmers' income, farmers cooperatives should be strongly promoted and supported. The Chinese specialized farmers cooperatives differ from the international standards in multiple ways in order to suit the unique Chinese situation. The Chinese model allows some flexibility than international standards in terms of membership, voting rights and profit distribution. While the classic international model features homogenous membership, Chinese farmers cooperatives permit heterogenous groups of members such as agriculture-related companies and non-profit organizations. Compared with the one person one vote international rule, cooperatives in China are allowed to allocate additional voting rights to members with big contributions. Moreover, the distribution of profits could be made to reward capital investment, as long as at least 60% of total profits are distributed in proportion to transaction volume.

Besides institutional variations, the co-existence of heterogeneous types of cooperative leadership is noteworthy in China. To a great extent, initiators' capabilities and control over decision making and profit distribution influence efficiency and farmers' well-being in different types. In most cases, farmers are weak in power and therefore their interests are not prioritized by the dominant member group. With the purpose of transforming cooperatives to really serve the collective interests of farmers, after examining the pros and cons of different types, a three-stage model is proposed. In the first stage, company initiators are expected to enhance market competitiveness of the cooperative by leveraging on the company's resources and marketing expertise. In the second stage, leadership is expected to transfer from companies to rural elites who have high influence among farmers. Now that most rural elites have low education level and their vision tends to be constrained by their rural background, the author suggests that cooperatives should employ college graduate village officials who are educated and capable. After the transitional second stage, farmers will be able to capture leadership and make decisions to maximize their own needs in the last stage. The last stage is in line with the fundamental

cooperative principles of democratic control, serving the interests of farmers and fair distribution of profits.

The three-stage process is intended to cultivate and empower farmers in a progressive manner so that the transformation can be carried out smoothly and effectively. However, it is not by any means the only solution to cooperative development in China where social, economic and natural conditions vary considerably from place to place. Decisions regarding the leadership and control issues in a cooperative should be made on the basis of actual situations, while in this process the three-stage proposal can be used as a reference. A cooperative can choose to start with the second stage or substitute leaders in a certain stage for another as needed, which does not necessarily have to follow the proposed sequence from the first to the last. Nevertheless, the kernel of the proposal that farmers cooperatives should be managed in a fair, transparent and democratic way for the common interest of all members is supposed to be universal to all solutions.

Limitation of this thesis includes a lack of primary data because of the time constraint and the complexity to obtain good samples to represent cooperatives in the whole country. This paper and the three-stage proposal are results of analysis and deductions based on literatures and secondary data, therefore further research to support the proposal with quantitative evidence is needed. Furthermore, this thesis is limited to the Chinese agricultural industry that is not as advanced as agriculture in developed countries. Chinese farmers cooperatives, at the initial stage of development, are not able to compare with agricultural cooperatives in those countries that are large in scale, advanced in technology and professional in marketing. To compete on the global stage in the future, it is necessary to study advanced cooperative models as in Japan, North America, Europe, and Australia. Each of the regions has distinct cooperative business model that suits the particular socioeconomic situation of that region. While some cooperative models have greatly promoted agricultural development and farmers' welfare in the past, the changing global and regional environments of the agricultural industry demand a re-examination of the cooperative models to see if they are able to adapt to ecological and economic changes as well as the evolving demands of all stakeholders. In addition, the global requirements on freer trade, natural resource conservation and

environmental protection are setting new tasks for cooperative management and activities. To comply with these requirements, cooperatives need to transform their usual way of doing business. Hence, further research on the topic needs to be done to deal with the new business context and explore appropriate cooperative models that can be applied in China in the future.

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Appendix- Exhibit 2.3

YEAR	POPULATION AT YEAR-END (10,000 PERSONS)	RURAL POPULATION AT YEAR-END (10,000 PERSONS)	RURAL LABORS (10,000 PERSONS)	LABORS IN AGRICULTURE TO NATIONAL TOTAL EMPLOYMENT	PER CAPITA NET INCOME OF RURAL RESIDENTS (RMB)	THE RURAL-URBAN INCOME GAP	NET INCOME FROM AGRICULTURE TO TOTAL NET INCOME OF RURAL RESIDENTS %
2002	128,453	78,241	48,121.0	43.7%	2,475.6	3.1	45.8%
2003	129,227	76,851	47,506.0	42.4%	2,622.2	3.2	45.6%
2004	129,988	75,705	46,971.0	41.2%	2,936.4	3.2	47.6%
2005	130,756	74,544	46,258.0	40.2%	3,254.9	3.2	45.2%
2006	131,448	73,160	45,348.0	39.2%	3,587.0	3.3	42.4%
2007	132,129	71,496	44,368.0	38.0%	4,140.4	3.3	42.2%
2008	132,802	70,399	43,461.0	37.5%	4,760.6	3.3	40.9%
2009	133,450	68,938	42,506.0	37.0%	5,153.2	3.3	38.6%
2010	134,091	67,113	41,418.0	36.4%	5,919.0	3.2	37.7%
2011	134,735	65,656	40,506.0	35.8%	6,977.3	3.1	36.1%
2012	135,404	64,222	39,602.0	35.2%	7,916.6	3.1	34.4%
2013	136,072	62,961	38,737.0	/	8,895.9	/	/

