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CAPITAL FORMATION IN NEW COOPERATIVES IN CHINA: POLICY AND PRACTICE

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CAPITAL FORMATION IN NEW CO-OPERATIVES IN CHINA: POLICY AND PRACTICE[1]

Li Zhao[2]

Abstract

This paper aims to fill one knowledge gap on understanding the issue of capital formation in new co-operatives in developing countries. By doing so, it presents the main findings of capital formation and investment in a small sample of horticulture shareholding co-operatives in rural China, because shareholding co-operatives, as one best example of new multi-stakeholder co-operatives in China, have become a vehicle to mobilize additional resources. To better understand shareholder co-operatives' stakeholder heterogeneity, two main groups of stakeholders are identified, namely, member stakeholders (investor-members and patron-members) and non-member stakeholders (non-member investors and non-member donors/grant-givers). Following a brief theoretical overview concerning co-operative multi-stakeholdership and capital acquisition and constraints, I then analyze both the rules-in-form and rules-in-use with respect to the co-operative stakeholders' capital involvement in China.

Cases observed indicate a hybridization feature of the co-operative capital base, including member contributions, public subsidies, income from the market sale, institutional capital and social capital. There exist at least four ways to raise equity capital from co-operative members. External capital comes mostly from direct government support in the form of grants and project funding, and indirect financial support through preferential treatment and policies. Different from the situation in the West, debt capital does not appear to be a widely-used traditional financing source. New co-operatives in China have difficulty even in borrowing short-term debt, not to mention receiving long-term loans. Also specialized/non-traditional external capital sources such as those provided by co-operative banks do not suffice. Co-operative banks are not always ready to provide micro-credit to co-operatives. Only when the government plays an active role, this lending process is facilitated. Many innovative financial systems are also observed in the field, which facilitate the mobilization of more external capital for co-operatives.

Key Words: Capital Formation; Co-operative; Multi-stakeholder; China

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1. Introduction

Previous research indicates the emergence of multi-stakeholder co-operatives (MSCs) in the West (a.o. Pestoff, 1995; Borzaga and Mittone, 1997; Münkner, 2004; Borzaga and Defourny, 2001; Defourny and Nyssens, 2008; Gijselinckx and Develtere, 2008; Gijselinckx, 2009; Girard, 2009), and its importance to economic participation and social cohesion (Galera, 2004; MacPherson, 2004; Thomas, 2004). In recent years, the rise of MSCs has also been witnessed in China (a.o. Xu, 2005; Xu and Huang, 2009; Zhao *et al.*, 2009; Zhao and Develtere, 2010a).

As member-driven business organizations, traditional co-operatives primarily rely on member contributions in terms of shares, fees and business transactions. But in today's competitive market, finding capital is still one of the most prominent challenges they face (Von Pischke, 1993; Harris *et al.*, 1996). Therefore, they need to mobilize both more member contributions and outsider finance to fund their growth without threatening their co-operative character. Both in the West and China, external capital nowadays has a more prominent role than two decades ago (van Dijk *et al.*, 1997; Kyriakopoulos, 2000; Côté, 2001; Gijselinckx and Develtere, 2008; Zhao *et al.*, 2009). In the West various innovative financial instruments, such as those adopted in US new generation co-operatives and European co-operative holding systems have been developed to realize the same goal (Cook, 1995; Van Dijk, 1997; Lang *et al.*, 2001; Chaddad and Cook, 2002; Iliopoulos, 2002). In China, the shareholding co-operatives (SHCs), as one best example of these new multi-stakeholder co-operatives, have been a vehicle to mobilize additional resources.

However, while the reality of mobilizing co-operative capital investment in the West has been studied extensively, little attention has been paid to the situation in developing countries. Almost two decades ago, motivated by the financial crisis faced by farmer co-operatives in many developing countries, FAO in collaboration with the COPAC[3], launched a research program on examining agricultural co-operative capital formation in three developing countries (Guatemala, India and Kenya). But nowadays, less effort has been made. Internationally, the new co-operative development in China is widely unknown, not to mention the situation concerning capital formation in agricultural co-operatives of China. The peculiar historical development of co-operatives in China may explain this knowledge gap.

Against this background, this research aims to fill this gap by providing empirical evidence from China. To focus my research, the MSCs examined in this study are the SHCs existing in rural China. The SHCs refer to agricultural co-operatives in the form of farmers' specialized co-operatives (FSCs) and land-based co-operatives that have emerged in some of the most developed coastal areas as well as in peri-urban rural areas with rapid urbanization and industrialization in China (Zhao and Develtere, 2010a). Stakeholders in the SHCs in China include member groups such as big-scale and small-scale farmer members and local enterprises, as well as non-member groups like government agencies, financial institutions, local communities, etc.

Through this analysis, the study aims to answer the following questions: (1) What kind of policies and legal requirements exist concerning co-operative capital acquisition in China (*i.e.* rules-in-form)? (2) What can we witness in agricultural co-operatives in practice (*i.e.* rules-in-use)? (3) To what extent have new co-operatives

[3] Committee for the Promotion and Advancement of Co-operatives.

indeed opened their doors to different forms of member capital investments and non-member capital participation? And what are the consequences?

The paper is organized as follows. In the next section, a brief overview of theoretical insights is presented concerning co-operative multi-stakeholdership, capital acquisition and constraints. Afterwards I analyze the legal context specifying co-operative stakeholders' capital involvement in China. Empirical evidence will be presented in section IV based on data gathered from 20 cases in the SHCs in rural areas of Zhejiang Province in China. The last section draws conclusions by looking for explanations for this important modification of co-operative practices and the consequences for their capital base.

2. Theoretical reviews

2.1 Co-operative multi-stakeholdership

Nowadays, it is widely observed that global changes in the business environments have significantly influenced co-operatives and require new types of co-operative organizations. Numerous cases show that the classic co-operative model with an inward-economic orientation has gradually transformed into a new model with a more outward-community orientation thus forming the emergence and development of multi-stakeholder co-operatives (Pestoff, 1995; Turnbull, 1997; Levi, 1998; Gijselinckx and Develtere, 2008; Girard, 2009). Internationally, these new multi-stakeholder organizations have been labeled as social enterprises (a.o. Borzaga and Defourny, 2001; Nyssens, 2006; Defourny and Nyssens, 2008). According to Borzaga and Mittone (1997), these new hybrid organizational forms are the outcome of a mix of associative and co-operative models. With the law adopted in Italy creating a specific legal form for "social co-operatives", the co-operative movement has engendered the first appearance of the concept of social enterprises.

Theoretically it finds its potential power thirty years ago in Laidlaw's idea of building co-operative communities (1980)[4]. MacPherson's social dimension of co-operatives is well inspiring with its emphasis of "common capital" system instead of regarding co-operatives as mere agglomerations of members (2004). Empirically, it is widely proved in several countries in the West, such as those identified by Borzaga and Spear on co-operative movement orienting to the direction of revitalizing the communitarian tradition (2004). Several countries have adopted or revised laws recognizing multi-stakeholder co-operatives. Girard (2009) proposes that some of these laws characterize the field of activities of multi-stakeholder co-operatives and others simply focus on the notion of multi-stakeholdership. The cases examined by Gijselinckx and Develtere (2008) in Europe also prove this trend of co-operative renewal. In China, the new co-operative movements and the emergence of the SHCs are regarded as best evidence of new multi-stakeholder co-operatives (Zhao and Develtere, 2010a).
These numerous eminent observations make one believe that this phenomenon has become common enough to deserve more profound theoretical consideration. However, in contrast with countless discussions about multi-stakeholder theories in analyzing mainstream corporations (See, for example, Donaldson and Preston for an excellent overall review of the three aspects of the theory; cf. Donaldson and Preston, 1995; Barry, 2002; Jensen, 2002; Phillips, 2003), there exist less theoretical

[4] It is worth noting that afterwards, ICA adopts the principle of "Concern for Community" and adds it as a seventh co-operative principle in 1995.

underpinnings (especially in English-written literature) for the newly emergent multi-stakeholder co-operatives[5]. With co-operatives involving more upstream and downstream activities, the phenomenon of stakeholders' heterogeneity has become more obvious. Furthermore, this has recently changed from the heterogeneity among new and old members, active and inactive members, as well as non-member shareholders, to the even more complexity adding by processing enterprises, and small-scale and big-scale farmers as well. They contribute different amount of capital investment according to their diverse objectives. These multiply objectives from different groups can be conflicting, in which a compromise decision should be reached as a result of bargaining processes. At this point, collective-choice-and-action studies in a co-operative organization facing groups of heterogeneous members have been conducted by several agricultural economists. They view co-operatives either as a coalition of utility maximizing subgroups (Zusman, 1992; Albaek and Schultz, 1997; Hendrikse, 1998; *etc.*), or as a "nexus of contracts" in which business relationships among co-operative stakeholders are regarded as contractual relationships (cf. Cook *et al.*, 2004). According to Cook, Chaddad and Iliopoulos (2004), this latter approach is really a loose coordination of agency theory (Eilers and Hanf, 1999), transaction cost economics (Hendrikse and Veerman, 2001), and property rights-incomplete contract theory (Hendrikse and Bijman, 2002). And their commonality is contractual in nature. For the purpose of this paper, I do not plan to examine those economic modelers further but focus my discussion on the stakeholder theory justifications *per se*. Nonetheless, for a multi-stakeholder co-operative with multiply objectives, these theoretical approaches mentioned above enrich one's understanding on the existence of various problems traditional co-operatives face (Sexton and Iskow, 1993; Cook, 1995; Sykuta and Cook, 2001; Xu, 2005), and thus advance one's thinking on how new co-operative structures/alternative co-operative models can best deal with these problems (Chaddad and Cook, 2002).

Gijselinckx (2009) has once made the attempt to examine the way co-operatives' stakeholders can be conceived by virtue of the inspiration of the stakeholder theory[6]. Based upon it she presents a distinction between four models of stakeholder management in co-operatives, a continuum from the classical single-member model to a strong multi-stakeholdership. The division of weak and strong multi-stakeholdership is somewhat similar to Vidal's argument (2009), stating that working as a partnership among different stakeholders has two forms, *i.e.* multi-stakeholder dialogue (every stakeholder gets a voice) and multi-stakeholder governance (every stakeholder gets a voice and vote). However, back to my discussion on stakeholder theory dealing with co-operative stakeholder heterogeneity, I need to nevertheless address the question of how to balance the various or even conflicting interests of co-operative stakeholders. One opinion holds that stakeholder theory implies all stakeholders must be treated equally irrespective of the fact that some obviously contribute more than others to the organization. This is regarded by Robert Phillips as one of several "straw-person objections" posed by critics of the theory (Phillips, 2003). In response, Phillips, also inspired by "Clarkson Principles" (1999), holds the principle of meritocracy as the interpretation of this balance which can also be regarded as the principle of stakeholder fairness[7]. Not coincidently, moreover, this

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[5] With regard to this, there exist several outstanding insights of the theory in non-profit studies, such as Ben-Ner and Van Hoomissen (1993), Krashinsky (2003), Anheier (2005), *etc.*.

[6] Also before, Leys *et al.*(2009) have examined the differences of the investor-owned corporations and co-operatively-structured corporations with respect to the position of at least one stakeholder group, whether it is consumers, employees or producers.

[7] It means that, according to Phillips, stakeholders should have a slice of the organizational outputs and a voice in

principle resonates with the principle of "financing in proportion to patronage" when discussing the democratic control and proportional voting issues in co-operative studies (Robotka, 1947; Phillips, 1953, Schaars, 1957). Although co-operative governance issue is not the focus of the paper, it is highly relevant to the co-operative stakeholders' capital involvement issue, as well as the question on what kind of conditions should exist in order to motivate more member capital investment, which turns out well to be the focus of the paper. Furthermore, it should be noted that financing in proportion to patronage is based on the "concept of proportionality", which is rooted in the work of Phillips (1953; cf. Royer, 1992). However, there exist various difficulties in reality pointed out by Abrahamsen (1976) when putting this principle into practice.

Another crucial question under hot debate concerns with the distinction of stakeholders. Based on the attributes of power, legitimacy and urgency Mitchell *et al.* (1997) have identified eight types of stakeholders. A more general division constitutes two main groups: "primary" and "secondary" stakeholders, or "inside" and "outside" stakeholders (Jones, 1995), or "supply-side" and "demand-side" stakeholders (Ben-Ner and Gui, 1993), or "normative" and "derivative" stakeholders (Phillips, 2003) which follows the taxonomy of Donaldson and Preston (1995). This distinction is surely also varied as a result of a broad or narrow interpretation of the stakeholders. Some prefer the former[8], while others prefer the latter, and even pragmatically suggest not using "stakeholder" whenever it can be replaced by the other more concrete term (Leys *et al.*, 2009)[9]. Concerning the paper's topic, I propose that a basic division in a co-operative organization should constitute member and non-member stakeholders. Following the discussions on a heterogeneous membership within this new co-operatives (Xu, 2005; Huang, 2008), I tend to expand this debate to a multi-stakeholdership model identified by both member stakeholders including investor-members and patron-members[10], and non-member stakeholders involving non-member investors and non-member donors/grant-givers. Understanding the relationships between these various stakeholders and the way they cooperate and have a say in the decision making, appears very important if one tries to understand this new co-operative organizations as an indigenous model of social enterprises in China (Zhao and Develtere, 2010b).

2.2 Co-operative capital acquisition and constraints

Capital acquisition has long been cited as a problem for co-operatives (Helmberger, 1966). The difficulties co-operatives face in raising funds is receiving increasing attention as co-operatives diversify their operations to include further processing activities (Harris, 1995; cf. Harris *et al.*, 1996; Cook and Iliopoulos, 2000). International agencies (like FAO, COPAC, ILO, the World Bank) have also observed that capital formation is at times a major challenge for co-operatives, which often

how value is added that is consistent with their contributions to the organization. In other words, balance does not imply equality of voice or share of outputs. Voice and share—and therefore a sort of priority—should be based on contribution to the organization. The more a stakeholder group contributes to the organization, the greater their voice and share of value created should be (Phillips, 2003: 162).

[8] Townsley, in a report examining fisheries systems, proposes that the term "stakeholder" needs to be interpreted in the broadest possible sense, at least initially (Townsley, 1998).

[9] They argue that the stakeholder-notion by itself is "empty and often used in vain", and "there is in fact no such thing as 'stakeholder theory'".

[10] It should be noted that patron-members also provide basic shares, similar to investor-members (who contribute investment shares too). These basic shares can be qualification shares/common shares, or can be just in the form of membership fees.

appear to be undercapitalized (cf. Von Pischke, 1993). According to Cook (1995), this problem of being undercapitalized is due to the co-operative property rights structure. Facing capital constraints, a new institutional arrangement has been designed and introduced in the US co-operatives, and this new generation co-operatives have been hereof studied extensively (Cook, 1995; Harris *et al.*, 1996; Van Dijk, 1997). In order to mobilize more capital sources, co-operative holding systems have been also developed in many European co-operatives (Van Dijk, 1997; Harte, 1997). Some scholars also compare these institutional innovations in US and European co-operatives aiming to overcome the capital constraints faced by traditional co-operatives (Lang *et al.*, 2001; Iliopoulos, 2002). It is claimed that organizational restructuring is necessary to create a clearly defined property rights structure thus complementing innovative financial instruments such as investment shares and delivery and earnings rights, because "financial instruments alone may not suffice" (Iliopoulos, 2002). Also the membership policies should be rethought in favor of long-term financing methods European co-operatives adopt.

Generally speaking, co-operative capital comes in two forms: equity and debt. Equity capital is the internal sources provided by the members who invest in the co-operative to get needed services. It is also referred to as ownership capital, member's share, patient capital, member funds, net worth or risk capital. Equity capital includes initial capital investment (membership fee or share, common stock, preferred share/stock or investment share, *etc*.), and capital obtained through operation (for example, retained patronage refunds). Correspondingly, there exist patron-members and investor-members in co-operatives. Debt capital means borrowing funds from external sources including non-member investors and the investing public (who may invest capital in the co-operative to earn dividends), and loans from such lending agencies as a co-operative bank or a commercial bank. They are therefore non-member investors or creditors. In most cases, a successful co-operative adapts a judicious mix of equity and debt capital which will make it possible for the co-operative to meet its present goals and objectives and those that might be anticipated (McBride, 1986, p. 169). Yet in pursuing the initial capital for a newly organized co-operative, share capital from the members is considered as the most important financial source for starting its operation. Moreover, some studies show that co-operatives raise new debt mainly in the form of short-term borrowing, and co-operatives may have difficulty borrowing long-term debt due to the fact that commercial banks are uncomfortable with the "unorthodox" ownership structure (Lerman and Parliament, 1993), and the dynamic nature of co-operative equity associated with various retention and redemption plans (Cobia and Brewer, 1989).

Capital formation is regarded as a means of increasing member participation and control (COPAC, 1995). Consequently, co-operative capital has a qualitative dimension, which is based on the proposition that different types and sources of capital have different degrees of what might be called "co-operative power". The quality of co-operative capital is defined by the intensity of member commitment demanded by the terms and conditions attached to the various forms of capital used by co-operatives (Von Pischke, 1993, p. 44). Some types and sources of funds do a better job of promoting cooperation and empowering co-operative societies to achieve that mix of ideals, democratic processes and commercial performance that constitutes the promise of cooperation and that creates the epic of member-controlled self-help activities. It is proposed that institutional capital, which is collectively-owned non-refundable capital, is designated as the highest quality capital (Von Pischke, 1993, p. 20). These unallocated retained earnings is also the main source of capital accumulation (McBride, 1986, p. 161), and plays more and more roles in co-operatives' financial structures, according to the data study provided by Royer, Wissman and Kraenzle (1990). Yet too much institutional capital may also result in perverse incentives (Murray, 1983), which conflicts with the co-operative service-at-cost principle (Schrader, 1989, p. 119-120; cf. Royer, 1992)[11]. Also, in the developing countries, public funding is mostly made available to co-operatives in terms of loans or shares, or even grants or project funding. While government grants are considered as the lowest quality co-operative capital, it is suggested that public agencies should provide financial support in the form of loans or shares, because the incentive and constraint mechanism existing in these forms make sure that the funds would be used more effectively.

When a co-operative needs more capital due to enlargement of operation, for example, it can appeal to non-member investors or creditors for loans or investment shares. This non-member equity can take various forms, like non-member patrons in USA, local parties in France, institutional investors in the Netherlands, and public-listed shares in Ireland (Kyriakopoulos, 2000, p. 46). Yet, more capital from the members-users should always be encouraged, which is in accordance with the co-operative principles of "user-owner, user-control and user-benefits" (Dunn, 1988). It can be done either by collecting additional share capital from the existing members, or attracting new members to accumulate more members' shares. Co-operative lawmakers try to solve the problem of how to satisfy the need for flexible methods of capital formation without departing from co-operative principles. In several countries (*e.g.* Germany, Italy, South Africa and partly in France), the "one member one vote" principle has been softened up or simply abandoned to facilitate capital mobilization. However, unlike the scholars who support for the idea of proportional voting aforementioned (Robotka, 1947; Phillips, 1953, Schaars, 1957), that reality is being actively opposed by many other co-operative researchers (cf. ILO, 2001, p. 82).

Nonetheless, a distinction is still made between the cooperatives in the standard business sense and those with the common goal of fostering social harmony. It is prescribed that in the former case "equity" is most appropriate/dominant principle as a distributive value, which would otherwise be "equality" in the latter case (Deutsch, 1975, 1985; Greenberg, 1990). In a co-operative, when there exists no big difference in members' capital contribution, member equity is generally not required to be in accordance with the principle of financing in proportion to patronage. Therefore, it also leads to "equality" both in patronage distribution and voting right. While for a co-operative with highly heterogeneous members, the principle of financing in proportion to patronage has been more and more adopted. Empirical studies from China presented in the following also provide evidence to this phenomenon.

Finally, It is worth noting that social capital can be widely seen as another co-operative resource in reality. According to Evers (2001), social capital-building may be an aspect of the social embeddedness and of the manifold and diffuse side effects of such types of action and/or it can become an explicit goal and purpose of the organization. Among various social capital forms, in most cases, donations (in cash, in kind or in time) and volunteerism are thought to be most widely observed types.

[11] These perverse incentives, it is said, refer to reducing the interest and authority of members, who thus tend to be motivated to dissolve the co-operative organization for personal gain.

3. Rules-in-form: regulations and legal context in China

Multi-stakeholder co-operatives have been witnessed as the most dynamic social enterprise organizations nowadays in rural China. This dynamics is a combining result of both the effect of a creative vibrant civil society in rural China, and the influences from various national policies in the 2000s, especially the issuance of seven *Number One Documents* annually concerning the "three rural issues" since 2004, and the implementation of a first National Co-operative Law after China's reform and opening-up[12], influenced by the international co-operative experiences and principles. In what follows I will examine these rules-in-form concerning co-operative capital formation.

- Capital involvement concerning members

According to the *Administrative Regulation on the Registration of FSCs* (the State Council, No.498), members may make financial contributions either in cash or non-monetary yet transferable property that can be converted into cash, like physical objects and intellectual property[13]. Before the promulgation of the national regulation, the *Regulation on FSCs of Zhejiang Province* (the NPC of Zhejiang, 01 January 2005) requires that every member *shall* subscribe shares, and members can unite together to subscribe shares on a voluntary basis. Shares subscribed by members engaged in production should be more than 50% of the total share capital (Article 13, emphasis added). However, the national Regulation which has been promulgated two years later does not contain such requirement on share subscription, in order to encourage more co-operatives to be established in economically less-developed areas in China[14]. Moreover, the Regulation of Zhejiang also sets a limitation on the number of shares every member or a group of united members may own (no more than 20% of the total shares), in order to avoid that invested capital would become the basis of control. Members' share capital in most cases equals to co-operative registered capital. And the Regulation of Zhejiang states that the registered capital shall be more than 50,000 rmb in order for a co-operative to be registered (Article 6). There is no such requirement in the national Law[15]. An additional requirement in the national Law states that "farmers should account for at least 80% of the membership of a co-operative (Article 15)[16].

Concerning patronage refunds to members, the national Law stipulates that the total amount returned shall be no less than 60% of the distributable profits (Article 37). It

[12]The *Law of the People's Republic of China on Farmers' Specialized Co-operatives* (the National People's Congress, 01 July 2007). Hereafter FSCs is short for Farmers' Specialized Co-operatives. It is a "mutual-aid economic organization, which is voluntarily formed by production and business operators of *similar* agricultural products or by providers or users of *similar* agricultural production and business operation services on the basis of rural household contractual management and which is subject to democratic management" (Article 2, emphasis added).

[13]The value of the non-monetary property shall be determined by all members through evaluation. No member may contribute with labor service, credit, name of a natural person, business reputation, franchise right or property on which there is a guarantee, *etc*. (Article 8).

[14]Therefore it gives a great amount of flexibility to each co-operative, who can stipulate it in its own Charter (according to Article 18).

[15]Another difference is that the number of members involved in a co-operative should be more than seven, according to the Regulation of Zhejiang, while this number should be more than five according to the national Law. It is obvious that the requirement set by the national government is lower than those by local government.

[16]It further regulates that if the total number of members is 20 or less, there may be one enterprise, public institution or organization as its member; if the number exceeds 20, the number of enterprises, public institutions or organizations shall not exceed 5% of the total number (Article 15).

means that there is a specific limit on the dividend rate a co-operative can pay in proportion to the capital contribution (at no more than 40% of the total allocated profits). Apparently it is much higher than that established by most statutes around the world[17]. This fact is said to be appropriate for the current capital-scarce yet labor-abundant reality in rural China. This may create more incentives for a co-operative to accumulate member's equity capital. Another incentive shown in the national Law is the allowance of additional votes. However, the total number of additional votes shall not exceed 20% of the total number of the members' basic votes (Article 17).

According to the national Law, every co-operative *may* draw common reserve funds (public accumulation funds) from the profits of the year (emphasis added, which means it is not compulsory but optional). The common reserve funds shall be used for making up for losses, expanding production and operation or be converted into members' capital contributions. The common reserve funds drawn every year shall be quantified as shares of each member according to the stipulations of each co-operative Charter (Article 35). This quantification method is suggested to be in accordance with the amount of services used by the members, therefore in proportion to the patronage (Ministry of Agriculture, 2008, p. 78). It is nevertheless not specified in the Law.

At the termination of the membership, the member can get back the amount of the capital contribution as well as personal shares of the common reserve funds recorded in his/her account in the co-operative (Article 21).

- Non-members capital involvement

Non-members capital involvement includes loans a co-operative borrows from the financial agencies and subsidies and grant directly given by the government, and social donations it receives sometimes. The Law makes clear that the state "shall promote the development of FSCs through fiscal support, tax preferential treatments, support in finance, science, technology and talents, as well as through industrial policies" (Article 8). More supportive policies are also formulated in Chapter 7 of the Law. Article 50 states clearly that the central and local governments shall respectively allocate funds to support the FSCs[18]. While Article 49, through supporting the government to assign or entrust with FSCs the construction projects related, also indicates the financial support from the government in the way of project funding[19]. Moreover, FSCs also enjoy some preferential treatment in taxation prescribed by the *Notice concerning the Relevant Tax Policies for the FSCs* (No. 81 of the Ministry of Finance and the State Administration of Taxation, 01 July 2008). According to Article 51, the state also encourages the commercial financial institutions to provide financial services to the FSCs by diversified means. However, it does not provide more regulations in detail dealing with the difficulty in accessing micro-credits, which has been long obsessed by the farmers in China. The *Number One document of 2009* encourages FSCs to carry out credit mutual-aid. In the same year, an *Opinion concerning Supporting Financial Services to FSCs* (No. 13 of China Banking Regulatory

[17]Which is usually 8% or less in the United States, according to Baarda (1986), for example.

[18]These financial supports shall help FSCs in providing services in respect of information and training, quality standards for agricultural production and their authentication, construction of infrastructure for agricultural production, marketing and technology dissemination, *etc*. Article 50 also states that "priority shall be given to the FSCs in ethnic areas, outlying areas and poverty-stricken areas and to the ones engaging in the production of major farm products which are urgently needed by the State and the society".

[19]Very recently, a further *Opinion on Supporting Qualified FSCs to undertake Public Projects concerning Agriculture* (No. 6, 04 May 2010) has been promulgated.

Commission, 05 February 2009) has been issued, fostering pilot program of establishing credit mutual-aid co-operatives based upon FSCs through capital financing from commercial banks. Furthermore, the *Number One document of 2010* also emphasizes to encourage the establishment of village banks and loan companies along with credit mutual-aid co-operatives. Actually, supporting policies concerning fostering farmers to establish mutual-aid organizations can be found earlier in the *Number One document of 2006*.

Before examining what is happening in practice, I should conclude my discussion on these rules-in-forms by emphasizing one fact that, under the national Law (as its name demonstrates), only one sort of agricultural co-operatives called the FSCs can register. This indicates that all sorts of other forms including associative co-operatives or co-operatives providing comprehensive services are actually "out of legal"[20]. It means currently many innovations are perplexed with "a legal mix", which may potentially inhibit the practices conducted by co-operatives in order to motivate members and non-members to contribute more capital.

4. Rules-in-use: observations in the field

Royer (2002), in a paper analyzing co-operative principles and equity financing, claims "despite the fervor with which specific principles are advanced, co-operative practices often appear to be influenced as much by individual self-interests, economic considerations, and statutory restrictions". It seems to show that co-operative practices do not necessarily follow what have been required by those rules-in-form. Indeed, as our previous research on the development of the SHCs in China indicates, both institutional and ideological legacies from the past and resources and environments in the present have led to the formation of a heterogeneous yet innovative new co-operative form that deviates from the dominant paradigm prevailing in orthodox co-operatives (Zhao and Develtere, 2010a). When examining the capital base of this new co-operative sector, I therefore also tend to ask how co-operative stakeholders capital are involved in reality and what kind of conditions needed for them to invest in the co-operative.

In my research, case studies have been used to obtain information and insights. This is because, similar to situations in many other countries around the world, one major challenge for doing empirical research on co-operative capital formation in China is in gathering large sample yet credible data. Therefore, case studies are regarded as one best alternative means. Through my initial research, I am informed that although a substantial diversity concerning agricultural co-operative development level can be witnessed from Province to Province, most of agricultural co-operatives in Zhejiang Province have adopted the shareholder ownership structure. That is why I tend to focus my case studies to this Province in China. As aforementioned, Zhejiang has had its local co-operative law as the first one in China even before the promulgation of the national law. It demonstrates that the co-operative development in Zhejiang is well advanced comparing that in the other areas in China. For the reason of data's comparability, all the co-operative cases chosen are horticulture co-operatives. In 2006, a large sample survey has been conducted organized by Provincial Agriculture Department in collaboration with several eminent scholars in co-operative studies from Zhejiang University. Before case discussion and analysis, , the main findings

[20]Yet, interestingly enough, a Co-operative Law of PRC was once formulated in 1950, in which the regulations are more comprehensive than those in the current Law. Under that law of 1950, various kinds of co-operatives, like consumer co-operatives or handicraft co-operatives can register. Unfortunately, that law did not come into being due to political reasons later on.

concerning capital formation from this survey are presented first, in order to provide a macro-perspective on capital arrangement in this region[21].

The survey has distributed 600 questionnaires to co-operatives in different areas in the Province; 500 have been sent back, among which 372 are regarded to be valid. The result shows that the average number of co-operative members is 140, while the average amount of total share capital reaches 694,000 rmb. However, it is also not surprising that there exists a great variety with respect to the amount of total share capital (min 5,000 rmb till max 80 million rmb). This amount is mostly small, with the result showing that 19.8% of co-operatives investigated have the total share capital of less than 50,000 rmb, and 50% of them have less than 100,000 rmb. While less than 9% of the co-operatives examined have the total share capital of more than 500,000 rmb (Table 1).

Table 1 Total Share Capital of FSCs in Zhejiang (2005)

10,000 rmb	0.5-5	6-10	11-30	31-50	51-100	101-8000
Frequency (number)	69	97	102	49	18	13
Frequency (%)	19.8	27.9	29.3	14.1	5.2	3.7

Concerning the percentage of shares owned by the largest shareholder in the co-operative, the figures in Table 2 show that this percentage ranges from min 0.9% to max 80%, with the average percentage of 15.24%. In 65.6% of the co-operatives investigated, the percentage is below 20% (while 30.4% of co-operatives with the percentage of 20%). More than 4% of the co-operatives under the survey allow their largest shareholder to hold more than 20% of the total shares.

Table 2 The percentage of shares owned by the largest shareholder of FSCs (2005)

%	0.9-5.0	5.1-10.0	10.1-15.0	15.1-19.9	20	20.1-80.0
Frequency (number)	40	81	44	79	113	15
Frequency (%)	10.8	21.8	11.8	21.2	30.4	4.0

Table 3 presents some interesting phenomena. The percentage of shares owned by the top ten largest shareholders ranges from 4.5% to 100% of co-operative total shares (there are 57 co-operatives in which the top ten largest shareholders hold 100% of total shares in their co-operatives). In merely 5.4% of the co-operatives investigated (20 co-operatives out of 372) the top ten largest shareholders hold less than 20% of the total shares, while we should keep in mind that the average number of members is 140 according to the survey. This indicates that in most co-operatives, there co-exist a small number of big shareholders (as core members) and a great number of small shareholders (as common members). This reality of member's heterogeneity coincides with the fact that most co-operatives in the region have been initiated by a small group with the ability to invest plenty of capital. They attract then many farmer-producers as patron-members who provide in most cases only a small amount of qualified/basic shares, or membership fees.

Table 3 The percentage of shares owned by the top ten largest shareholders (2005)

%	4.5-20.0	20.1-40.0	40.1-60.0	60.1-80.0	80.1-100.0
Frequency (number)	20	52	91	80	129
Frequency (%)	5.4	14.0	24.5	21.5	34.7

[21]The result of the survey can be found from Xu and Huang (2009). For more information concerning co-operative capital formation in Zhejiang, please consult Xu and Huang (2009, p. 102-103).

Data from the cases help one understand in detail what kind of capital formation patterns investor-members and patron-members exactly shape from the micro-perspective, and what kinds of other capital resources exist in reality for co-operatives. As aforementioned, before the promulgation of the national co-operative Law in 2007, Zhejiang Province had already established a regional co-operative Law in 2004. Under the regional Law all co-operatives had registered just as co-operatives (as a special business entity/enterprise legal person). After the issuance of the national Law, co-operatives in Zhejiang have undergone a registration change from "co-operatives as a special business entity" to "specialized co-operatives", and thus obtaining business license of farmer specialized co-operatives from the local Administration for Industry and Commerce. I use this registration change opportunity to look for any change in capital formation, because many co-operatives, for the reason of efficiency, have used this opportunity to enlarge their capital base, or formalize any share capital change that happened already before the registration change. During the fieldwork conducted in November and December of 2009 in several regions of Zhejiang, I have thoroughly investigated 20 cases of horticulture SHCs. Data is gathered through a combination of semi-structural interviews with key figures in the field, as well as documentary analysis. After analysis and synthesis I find out that co-operative fund-raising comes mainly from two sources: members and non-member grant-givers (*i.e.* the government and similar public agencies).

Co-operative fund-raising from members can be increased through the following various ways:

- No new members are involved, existing members provide more capital as shares;
  It is a relatively simple situation of capital formation. The co-operatives under this situation are found out to be relatively small-scale in terms of membership. Another feature is that there exists no big difference in members' capital contribution. One case of HYX co-operative shows that eight members add more capital from 20,500 rmb to 50,000 rmb (each holds 10% of total shares decreasing slightly from 10.25% per person before), while the contribution of the director changes to 100,000 rmb (increasing from 18% to 20% of total shares). Therefore, the percentage of shares every member holds does not change much. In 2007, this co-operative draws 12.3% of the surplus as public accumulation funds. The rest of the surplus is distributed according to patronage (40%) and according to shares (59%)[22].

- No new members are involved, existing members offer more funds as loans;
  In small-scale co-operatives internal financing is another popular way to raise capital, when micro-credits from the banking system is not always easy to get, and there is no enough time or no interest to enlist more members. From the meeting notes of DWF co-operative it can be seen how the difficulty in capital turnover was solved when the co-operative needed more capital to reseed the fruit plants. Three members from the Board of Director had a meeting first and prepared a plan, proposing every member provide extra 10,000 rmb as circulating capital. Four days later, the general meeting with all 30 members was held. During that meeting, a different solution was yet agreed, namely, the co-operative would borrow 50,000 rmb from two members from the Board of Director instead of raising funds by everyone, "considering the actual economic strength of the members in general" (from the meeting note). From this one

[22] It needs to be repeated that, according to the national Law, the total amount of patronage refunds shall be no less than 60% of the distributable profits (Article 37).

can see that due to the limited economic capability, most farmer-members face the difficulty to contribute more capital. Most members contribute share capital initially in order to use various services the co-operative provides rather than for investment. Considering the principle of equality, the co-operative is originally composed of 30 members, each contributing 1/30 of the total shares. This "borrowing" more capital from the members does not change the original capital contribution pattern.

- New members are involved, they contribute more capital as shares; It is a typical situation for those co-operatives which are initiated by several core members first, and absorb more common members later for various reasons. In some cases this is because they need to change the shareholding arrangement in accordance with the regulations in the newly published Law; and in some other cases this is due to the fact that more farmers in the local area are willing to join in the co-operatives because they have observed that members of the co-operatives have finally earned more incomes than themselves; and also in some cases this member increase is finalized because the director of the co-operative wishes to help more producers with financial difficulties. Three co-operatives can represent each of the situations aforementioned.

In the first case of HLF co-operative, there were originally six members (two of them holding 25% of total shares per person, two holding 18.75% per person, and two holding 6.25% per person). Although the Regulation of Zhejiang stipulates that the number of shares every member or a group of united members may own should be no more than 20% of the total shares, it is obvious that two big shareholders hold shares more than required. Interestingly enough, they use the opportunity of the issuance of the national law to mend up their shareholding arrangement by absorbing more members, although there is no such requirement in the national law. Currently, there are 36 members, 26 of which hold less than 1% (including 1%) of total shares per person. And the two big shareholders hold 20% of total shares per person.

In the second case of ZDM co-operative, the membership has added from seven to 150 at one time. The director held 20% of total shares before, but now only 5%, diluted by more capital added by new members. The director does not wish to contribute more capital. More than 90% of members hold less than 1% (including 1%) per person of total shares. In 2007, the average income of a member is 60% higher (or 13,000 rmb more) than that of a non-member farmer producing the same fruit in the local area. This is partly due to the fact that this co-operative chooses to distribute all the distributable profit in proportion to the volume/amount of the transactions members made with the co-operative (after deducting 20% as public accumulation funds and 20% as public benefit funds). This means no distributable profit is returned according to the amount of share contributions. For a great number of farmer-producers who need the co-operative service but who are too poor to contribute more capital, this profit distribution method is without doubt the best way to maximize their incomes.

The capital change in the third case of XQG co-operative is also very interesting because similar to the case of ZDM, it is also a case which can illustrate the transformation of traditional co-operatives from mutual aids to become more oriented to the whole community and strive for social finality. In 2008, after three years of its establishment, the membership involved has reached 103. 90 members hold less than 1% of total shares per person, most of whom are destitute households or household with the disabled. The co-operative teaches them how to plant vegetables thus helping those who might otherwise become marginalized in the employment market.

There is another prominent situation revealed in the survey. It appears in several cases that new members are not directly registered members according to the member lists that co-operatives should provide to the local Administration for Industry and Commerce. But in fact, the capital they provide is indeed regarded as shares. Accordingly, shareholding rights and responsibilities are demonstrated through a share right consignment agreement made individually between the co-operative registered members and new members as non-registered members. The local official who facilitates my research confirms that those non-registered members are indeed members of the co-operative, and this practice is meant to avoid lots of troubles that might arise every time when the co-operative capital base changes and the co-operative is required to inform the local Administration for Industry and Commerce of the changes. It works in this way: through this consignment agreement a non-registered member provides capital shares to the cooperative via a registered member, thus accounting for a certain percentage of capital shares of the registered member.

- New members are involved, they provide capital only as membership fees but not as shares;

This way of capital acquisition happens when the initiator of the co-operative is mostly a co-operative entrepreneur who regards the co-operative both as a for-profit enterprise in front of outsiders (*i.e.* businessmen outside the community), and as a not-for-profit organization for local farmers and co-operative members. I come across two cases from different places in the field that exemplify this situation.

According to the membership arrangement in one case of BHB co-operative, 328 members are composed of three types: core members (28 persons); tight-knit members (100) and associative members (200). Members of the first two types are those who provide share capital. Among them, members of the second type should provide 2,000 rmb/person as shares, whereas members of the first type contribute 5,000 rmb/person or more (the capital contribution of the director reaches 75,000 rmb, or 15% of total shares). Members of the third type provide only membership fees of 50 rmb/person[23]. Accordingly, members of the first two types bear the business risks and thus enjoy, besides patronage refunds, the surplus dividend in proportion to the capital contribution, while associative members only receive patronage refunds. Similarly, in the other case of DKB co-operative, there are 13 principal members and 90 associative members. Capital contributions of the principal members vary also greatly, from the director contributing 19.93% of total shares, to the thirteenth largest shareholder contributing less than 0.05% of total shares. However, they all receive surplus dividend in proportion to the capital contribution. While the rest 90 members who provide membership fees of 200 rmb/person only receive patronage refunds. But when asked if they would like to absorb more members, the directors of both co-operatives answered "no", because "it would be too costly" (interviews in the field). Those additional costs could come from more costs for providing training courses and extra costs for administration. On average the co-operative pays 500 rmb for one member (including training costs, risk costs for providing protection price to members selling products to the co-operative, and "social cohesion" costs for buying moon cakes during the Mid-Autumn festival and seasonal

[23]Before 2006, it was 20 rmb/person.

gifts during the Chinese New Year, just to name a few). Therefore, "the members are very willing to pay 50 rmb membership fees, because they actually receive far more benefits" (interviews in the field). Mentioning the motivation for this capital acquisition practice, it is a mix of feelings. On the one hand, they are proud of contributing to the promotion of local economic and social development by absorbing more farmers with little capital as members and thus helping them gain more incomes. On the other hand, however, they are "forced" to choose it in order to make the co-operatives' shareholding arrangement in accordance with the Regulation. Through enlisting more members, the percentage of the shares they hold would then become less than 20%. But as they have contributed a great amount of energy and time to the co-operatives' establishment and operation, they feel that the Regulation decreases their enthusiasm to further service for the co-operative, since their investment return becomes limited and less than before.

All of the scenarios abovementioned concern co-operative capital acquisition through member contributions. As aforementioned, another main capital source for co-operative fund-raising is the grants and project funding provided by local governments. Concerning government grants, local governments generally have various policies to encourage the establishment of co-operatives and the standardization/normalization of co-operatives[24]. For example, in one municipality, local government provides 20,000 rmb as grants to the co-operatives who reach the criteria of standardization of the municipal-level, and grants 10,000 rmb to newly established co-operatives[25]. These criteria generally concern with the number of members a co-operative involves, the amount of total share capital it has, the times of trainings it organizes per year, the number of households it helps in gaining incomes and employment (an indicator showing its capability in local crop-farming driving), and whether a democratic management system exists, *etc*.. Actually it is not hard to understand why the government would award those co-operatives who take the social finality into consideration and promote employment for more farmer householders, because they facilitate the local government in achieving its goal of local economic development and thus social stability. Besides, all co-operatives can apply for various local governments' projects in order to gain more capital. But this capital is not regarded as shares from the government. It is the government's funding to support the co-operative development or "new rural development". This source of fund-raising can be expected every two years. It means that co-operatives who get the public funding this year are not qualified to obtain another funding from the government next year. The cases demonstrate that many well-developed co-operatives (*i.e.* those who reach the criteria of normalization or standardization) have received various project funding, with the total amount reaching from more than 80,000 rmb to more than one million rmb.

Direct financial support from the government is also complemented by the indirect type. For example, it is interesting to mention that, both directors from the BHB and DKB co-operatives are local NPC members (National People's Congress). Therefore, they both have the connections with the local government and the ability to make proposals or have a say concerning local co-operative development. In January of 2010, one director has submitted a proposal at the provincial NPC Meeting concerning stimulating the undergraduates to work in co-operatives. This proposal suggests

[24]It happens when there are a lot of co-operatives established, but the government concerns that the quality of co-operatives should be increased.

[25]In 2009 when the fieldwork was conducted, the local official mentioned that this grant of 10,000 rmb is abolished, because the goal to encourage the establishment and development of co-operatives is already achieved. The next step should be to promote the quality of co-operative operation.

granting preferential treatment to the undergraduates wishing to work for a certain period of years in the co-operative if they later take the examination aiming to work as a civil servant for the government. With respect to it I asked this director if the co-operative would then have to bear the opportunity cost when the undergraduates decide to leave for employment in the government while the co-operative has already invested much energy and time in cultivating the undergraduates (to teach them plantation skills for example). The director proposes correspondingly that the local agricultural bureau can organize trainings for them and the local government can provide salaries to them. Correspondingly, the co-operative can give some premium if they work well. Therefore, this innovative system would not require the cost from the co-operative but be purely beneficial to its development. Later on the proposal was put into practice, which can be regarded as a way of indirect financial support from the government to the co-operative (in accordance with the Article 8 of the national Law).

Incomes through doing business with non-members outside the local community are served as another external capital source. In this situation, the co-operative entrepreneurs always make a clear distinction between transaction with the local residents and with those from outside of the community. For instance, the BHB co-operative has contracted two vegetable markets. In the market it is free for all local farmer growers (not only for co-operative members) to sell vegetables. But the businessmen from outside are charged market service fees. For the DKB co-operative, the director has invented a special packaging system, which can prolong the freshness period of waxberries. Therefore, the co-operative came to earn more income from selling competitive products packed in gift boxes that can be transported even to Europe. And thanks to this new packaging design, the co-operative has enlarged its market and the supply is since then always far from meeting the crying demand. The co-operative is open to all local farmer growers that raise high-quality waxberries, thus helping them in earning more incomes (while the members get an extra patronage refunds). While at the same time, the co-operative itself is able to accumulate more capital through operation.

As another external source, loans from lending agencies are really scarce as shown from my cases comparing with government funding. Co-operative banks in rural areas that have been transformed from formerly rural credit co-operatives can still fail to meet the co-operatives' demand for credit, not to mention the other commercial banks. It is partly because the co-operative itself does not have much fixed capital assets that can be used as collateral. The factory buildings established in rural areas, for example, cannot be granted with property ownership certificate. Besides, the office building belongs sometimes to the processing company affiliated to the co-operative, sometimes to the local public agencies that lend some office space to the co-operative, and sometimes to the member personally (mostly the initiator of the co-operative). Moreover, the production land is owned by the rural collective, although farmer members have the land use right. Although according to the central government's *Number One Document* and other documents related, many tangible assets can be used as collateral, such as farming machines, agricultural greenhouses and warehouses, in reality, many banks are actually not willing to accept them as collateral[26]. Short-term loans or micro-credits that most co-operatives in my cases have successfully gained are actually in the name of the director or of the other large shareholders. In other words, personal assets or creditworthiness from the core

[26]Chen Xiwen, "Three Problems concerning Rural Reform", from *First Financial Daily*, see http://www.chinareform.net/2010/0531/17397.html (accessed 31 May 2010).

members are popularly used as collateral for the co-operative in order to gain loans from the banks.

Consequently, in order to alleviate the problem of micro-loan shortage co-operatives and farmers face, policy banks and guarantee companies have in some places emerged. This financial innovation is the result of the collaboration among the local government, the co-operative bank and the co-operatives. To give one example, in one municipality, a guarantee company with the registration capital of ten million rmb has been established, with the financial contribution from the local government of five million rmb and from the municipal supply and marketing co-operative of five million. The guarantee company has further signed an agreement with the municipal co-operative bank, who grants the credit extension attaining 80 million rmb (1: 8 ratio). The guarantee company provides "guarantee" to the co-operative bank in favour of the co-operatives that need capital. The co-operatives then need to provide a counter-guarantee to the guarantee company. The existence of the guarantee provided by the guarantee company decrease the lending risks for the bank, thus making the bank more willing to lend capital to the co-operatives. Through this innovative system the local government has played a positive role in activating and circulating the potential capital in rural areas, such as trustworthiness and credit (through credit rating and assessment), the land use rights (through estimating and pricing land tenure), *etc*. Those co-operatives that are regarded to reach the criteria of normalization or standardization, for example, can be awarded with higher credit rating, and thus enjoy preferential treatment when applying for loans. In some other places, the local government also facilitates the cooperation between the co-operatives and the financial agencies by way of establishing a rural co-operative union. Because it is regarded that financial institutions themselves cannot solve the capital constraints the co-operatives face. Only when they work together with the co-operative can they collect better information concerning co-operative need and creditworthiness the members have. This co-operative union is actually a sort of comprehensive co-operative or associative co-operative organization. But since under the current law, only specialized co-operative can be granted with co-operative legal personality, this organization has to be registered as social organization under the administration of Ministry of Civil Affairs.

Finally, the cases also indicate the role social capital plays concerning resource dimensions of the co-operatives studied. The most significant phenomenon observed is a high level of voluntary work conducted by college graduate village officials and local CPC (Communist Party of China) members.

Voluntary work in co-operatives by college graduate village officials is indirectly mobilized by public policy. It is because, recently, finding work for new graduates has become one of the country's top priorities. Correspondingly, the central government has launched a recruitment campaign since the beginning of 2008. Until now a total of 1.3 million college graduates have voluntarily applied for jobs and 159,000 have been recruited[27]. They were working in the local villages in 1381 counties in 31 provinces, autonomous regions and province-level municipalities. The villages I visited are no exception. In many cases I am informed that the village officials also provide extra working hours in co-operatives because "there is not always work to do in the committee" (interviews in the field). This voluntary work happens especially when the director of the co-operative is also engaged in the village committee or village party

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[27] China plans to recruit 36,000 college graduate village officials in 2010, http://english.cpc.people.com.cn/66102/6977428.html (accessed 07 May 2010).

branch as village head or village party secretary.

While at the same time, voluntary engagement by the local CPC members is directly motivated by public policy. The CPC rural grassroots organizations are regarded as the basis for the CPC rural work which is to promote "scientific development in rural areas and to lead farmers to get rich" (stressed by The Fourth Plenary Session of the 17th CPC Central Committee). The CPC members are taught to fully play a pioneering and model role in local areas in "promoting development and serving and uniting the people". Therefore, co-operatives party branch and Party member's employment promotion service centre have in several cases also been witnessed. One best example illustrating their voluntary work is "first-aid repair and rebuilding of the co-operatives' greenhouse after snow storm or typhoon disaster" (interviews in the field). Not surprisingly, many college graduate village officials are also CPC members. In one case of a newly-established co-operative by ten college graduate village officials from nearby villages in one county, five of them are Party members.

Besides, although the law mentions social donations in cash and regards it as one type of non-members capital involvement in co-operatives, in reality, they are rarely observed. Therefore, donations in time constitute the main common form of voluntary resources.

5. Conclusions

In this paper I have investigated the capital base of new agricultural co-operatives in China. Cases studied indicate a hybridization feature of the co-operative capital base, including members' contributions, public subsidies, income from the market sale, institutional capital and social capital in the form of donations over time. In these multi-stakeholder co-operatives, two stakeholder groups, namely, core members and government agencies as non-member stakeholders appear to be the main contributors to co-operative capital formation.

Different from the situation in the West, debt capital does not appear to be a widely-used traditional financing source. New co-operatives in China have difficulty even in borrowing short-term debt, not to mention borrowing long-term loans. Also specialized/non-traditional external sources of capital such as those provided by co-operative banks do not suffice. Co-operative banks are also not always ready to provide micro-credit to co-operatives. It is not only due to the fact that lending agencies are uncomfortable with the co-operatives' unorthodox ownership structure, but also because co-operatives in China are regarded to have little capital assets on their own which can be used as collateral. Only when the government plays an active role does this lending process facilitate. Moreover, many innovative financial systems are observed in the field, which facilitate the mobilization of more external debt capital for co-operatives. Furthermore, since it is believed that those policy supports and indirect financial supports have better quality than government grants, the local government has gradually abolished grants for newly-established co-operatives, as the numbers of co-operatives are increasing.

Through comparing the co-operative rules-in-form and its practice, I discover that (1) although the Regulation allows financial contributions either in cash or non-monetary property, in reality it is always in the form of cash in FSCs[28]; (2) although the

[28]It should be noted that although in land-based SHCs, land tenure right is also used as share capital. For more information, see Zhao and Develtere (2010b).

Regulation sets a limitation on the number of shares every member may own (no more than 20% of the total shares), in reality it is not always achieved initially. When a co-operative is required to change its shareholding arrangement later in accordance with the Regulation, in some cases its initiator (as core member) feels that his motivation and enthusiasm to work in the co-operative have decreased; (3) a specific limit on the dividend rate a co-operative can pay in proportion to the patronage is specified as no less than 60% of the total net earnings, and in reality many co-operatives choose to increase this percentage in order to motivate the small-scale members with little capital assets to join in the co-operatives; (4) all co-operatives choose to draw common reserve funds in practice, although it is not a prerequisite but only suggested by the Law; (5) the Law has displayed a strong government preferential policy towards co-operative development, and it happens also in reality, through direct and indirect ways of government financial support. Through this way however, different from what happened in some other developing countries where co-operatives have become more government-oriented, the cases studied prove that co-operatives remain as member-controlled self-managed organizations. After all, the main capital contribution still comes from members.

Now I need to answer the last research question raised in Section I, namely, to what extent new co-operatives have indeed opened their doors to different forms of member capital investments and non-member capital participation. The evidence shows that three customary forms of member capitalization exist in co-operatives in China, namely, member shares, membership fees, and surplus retention as the creation of institutional capital. When co-operatives enlarge their capital base, it is always the co-operative entrepreneurs (as one initiator or a group of initiators) that decide by which way co-operative fund-raising would be done, through mobilizing more capital shares by the existing members or involving new members. Accordingly different practices are also observed in the field. If the co-operative entrepreneurs are a small group of big-scale farmers who together invest in the establishment of the co-operative, it comes out mostly that they would not prefer to open the door to new members who are incapable of contributing as much capital as they do. Facing the same difficulty in borrowing loans from the banks, internal financing is another mostly-used way to raise capital inside the co-operative. In this situation the members tend to be more homogeneous with respect to capital and patronage contributions. Whereas in the situation when the establishment of the co-operative is mostly influenced by one co-operative entrepreneur who regards the co-operative as a social enterprise and promotes the "social finality" of the co-operative, the co-operative appears to be more open to new members. And a new membership design is conducted dividing all the members into different categories. Different from new co-operatives in the West (in which there exists a division of voting stocks and nonvoting stocks), the SHCs in China grant all the shareholders a vote. In order to protect the motivation of big shareholders, some co-operatives adopt a specific policy in their Charter to make investor members enjoy additional voting rights (yet still with a maximum limitation). Also except from the fact that all the members enjoy the patronage refunds (because in China, the investor members are generally also growers and sell their products to the co-operative), the investor members receive extra dividends. Through adopting this proportional voting and distributing system, the SHCs take the contributions different members provide into consideration, and allocate surplus share and voice accordingly, thus trying to balance the various interests of co-operative stakeholders. This in turn helps the co-operative in mobilizing additional resources, not only from new members' capital contribution but also from the government awards as well (because the co-operative strives for social finality and promotes prosperity and employment for more farmer householders).

However, non-member investors are not yet witnessed in the study. All farmers that provide capital are designated as members. This can be also achieved through the consignment agreement design in the co-operative.

The main consequence for the capital base in the cases lies in the fact that there co-exist a small number of big shareholders and a great number of small shareholders. This reality of member heterogeneity coincides with the evidence that most co-operatives in the region have been initiated by co-operative entrepreneurs with the ability to invest. Some of them attract afterwards other farmer-producers as patron-members who provide mostly only a small amount of qualified/basic shares, or membership fees. Share capital from the members appears always to be the most important financial source, especially for the newly organized co-operative, which is good for co-operative sustainability because it helps the co-operative to remain as a member-controlled organization. However, in order to get government project funding and grants, some co-operatives need to mend up their shareholding arrangement which should meet the requirements of the co-operative standardization. It means the percentage of shares owned by the initiator should decrease (to less than 20% of the total shares). This may de-motivate the co-operative entrepreneurs who have invested a lot in the establishment and operation of the co-operatives, since it impedes them to gain more economic opportunities.

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