

# CO-OPERATIVES IN THE FREE STATE PROVINCE (Report 3):



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## 1. BACKGROUND

In March 2014 the Department of Economic Development, Tourism and Environmental Affairs (DETEA) requested a study on all the co-operatives in the Free State Province. The International Labour Organisation (ILO) then requested the SME Observatory of South Africa based at the Centre for Development Support (CDS) of the University of the Free State (UFS) to develop a proposal responding to the DETEA request. Over several meetings the scope of the study was developed and a proposal was submitted that was endorsed by DETEA and that forms part of the agreement between the UFS and the ILO for the execution of the study.

The time available for the study was extremely tight. The first report<sup>1</sup> completed at the end June dealt with:

- The enterprise category of co-operatives as defined in the legislation
- A short overview of the literature on co-operative studies.
- The scope of the study and an overview of the data sets obtained for the analyses.
- An overview of the occurrence of co-operatives per economic sector.
- An overview of the occurrence of co-operatives at Provincial, Metro and District municipal level, and Local Municipal levels to indicate the geographic spread.
- A comparison of the Co-operative profiles of some Local Municipalities and towns with the Enterprise Architecture of those municipalities and towns
- A focus on the specific economic activities of co-operatives within some sectors, and
- Listing issues for reflection to be work-shopped with DETEA.

This second report was based on telephonic interviews with 215 co-operatives to determine what the situation is pertaining to the economic activities and employment creation by the co-operatives. It dealt with aspects relating to the membership of co-operatives, the dominance of women in co-operatives, the perceived importance of various business skills and a self-assessment of the co-operative members about their competency levels, as well as information about their markets.

The last report will highlight the findings from:

- The 42 *in situ* interviews with Co-operatives

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<sup>1</sup> Wessels J & Nel W 2014: **Co-operatives in the Free State Province: an Explosion of Firms**. SME Observatory of South Africa, Centre for Development Support, University of the Free State

- A focus group session in Thabo Mofutsanyana with district based officials from DETEA, the Department of Agriculture and Local Economic Development officials to discuss and reflect on the findings of Report 1 and Report 2.
- Recommendations based on the findings.

Whilst this report should preferably be read together with the first report, the definition of co-operatives as well as the preliminary findings of the first report will be summarised before dealing with the essence of the second report.

## **2. DEFINITION OF CO-OPERATIVES**

The Co-operatives Act (No 14 of 2005) defines a co-operative as “*an autonomous association of persons united voluntarily to meet their common economic and social needs and aspirations through a jointly owned and democratically controlled enterprise organised and operated on co-operative principles.*” The formulation of the “co-operative principles” in the Act is important. The key aspects of these are:

- Open membership: “*a co-operative is open to persons who can use the services of that co-operative and who are able to accept the responsibilities of membership*” [Section 3 (1) (a) of Act 14 of 2005].
- Democratic control: In the case of a primary co-operative that has to have at least 5 natural persons as members, each member will have only one vote. In the case of a secondary co-operative (formed by two or more primary co-operatives) no member can have more than 15% of the total vote.<sup>2</sup> [Section 3(1) (b) and Section 3(3) of Act 14 of 2005].
- Financial interest by members: “To the extent feasible...” members will provide the capital of the co-operative. [Section 3 (1) (c) of Act 14 of 2005].
- Limited returns: The return on equity is limited to the percentage determined by the constitution of the co-operative. [Section 3(1) (d) of Act 14 of 2005].
- Capitalising the enterprise: At least 5% of the annual surplus remains non-divisible to members and should be set aside as a reserve fund. [Section 3(1) (e) of Act 14 of 2005].

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<sup>2</sup> Since the members of a secondary co-operative are the primary co-operatives, the 15% maximum vote by a member (a primary co-operative) in fact requires that a secondary co-operative should comprise of at least 7 primary co-operatives. This anomaly was only corrected by The Co-operatives Amendment Act (Act 6 of 2013).

Section 10 of the Co-operatives Amendment Act (No 6 of 2013) also makes it unlawful for a person or an entity to utilise the term co-op or co-operative for any association or entity that is not registered in terms of Act 14 of 2005 as amended.

### **3. SUMMARY OF KEY FINDINGS FROM THE FIRST TWO REPORT**

#### **3.1 Key issues emanating from the literature survey<sup>3</sup>**

There are clearly commendable objectives for supporting and establishing co-operatives. These include worker control and empowerment, better access to finance, informal learning, and collective marketing. Despite this, the literature consulted pointed to the following:

- Earnings can be low or negligible;
- Access to supermarkets or non-local markets is a challenge;
- Co-operative structures can lead to internal conflict;
- Grant dependency can undermine sustainability and delink reward from productivity and quality;
- Consideration of suitable support advisors and models that encourages SME to link into higher marketing opportunities would be advantageous;
- User co-operatives should also be considered; and
- Alternative enterprise forms may be more suitable than co-operatives in some instances.

#### **3.2 Findings based on analyses of the co-operative data base of the Free State**

The following findings were documented in the first report:

- 3.1.1 It appears highly unlikely that the birth explosion of co-operatives is the result of members in communities freely and voluntarily and spontaneously deciding that they wanted to formalise their entrepreneurial efforts through forming co-operatives.
- 3.1.2 It appears far more likely that the explosion of firms was the result of a public sector driven campaign to create co-operatives. It could possibly have been driven by consultants who had received an incentive for each co-operative registered. As the literature argues there is a need to be sensitive to the very real financial, skills and marketing challenges co-operatives face and when establishing them, focussing on their potential markets and user needs is critical as supply does not necessarily create demand (Philips 2003; Borda Rodriguez and Vicari, 2014).

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<sup>3</sup> Sources consulted are listed in report 1

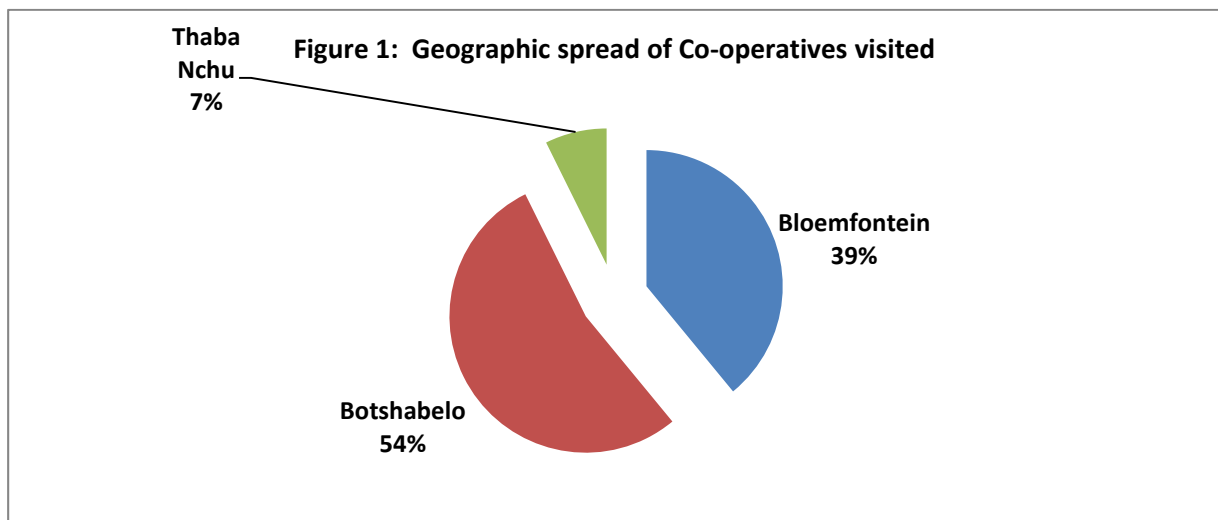
- 3.1.3 If the conclusions in (a) and (b) are correct, it can be predicted that successful enterprise growth is fairly low and that a high failure rate of co-operatives as formal enterprises, could, unfortunately be anticipated.
- 3.1.4 Philips (2003) notes that institutional support must be appropriate and consider key variables which impact on success. The State serving as an enterprise incubator could ignore the very basic dynamics of local economic drivers and value chains and further enhance the prospects of the enterprise failure of co-operatives.
- 3.1.5 The creation of the enterprises appears in many instances as an exercise in formal enterprise creation without real economic activity supporting it. These impacts cannot be assessed purely from a database and has to be pursued by research assessing outputs and impact on GVA and employment opportunities.
- 3.1.6 The Enterprise Architecture approach of the SME Observatory proves that **formal entrepreneurial space is in many sectors already fully occupied**. Enterprise formation through forming co-operatives in trade will therefore either set such co-operatives up for failure or push existing trading entities into oblivion.
- 3.1.7 A large percentage of enterprises are mainly aimed at local, community consumption expenditure, e.g. catering services and in some cases even to the expenditure of the members of the co-operative. Given the socio-economic conditions of such local communities, **these attempts boil largely down to a recycling of poverty since it fails to bring in money from outside the community**. Poverty cannot be addressed in this way. A broader vision for what co-operatives can undertake and the niche that they can fill is clearly needed (Philips, 2005; Hartley and Johnston, 2014).
- 3.1.8 A substantial number of co-operatives appear to be established to gain income from public sector expenditure. Apart from a number that were blunt enough to state that “tendering” is their activity, a large number are aimed at feeding schemes (schools) and cleaning services (public sector buildings). This can be considered as a redistributive approach rather than growing of the economy since it is tax income (derived from private sector surplus and, in the face of a budget deficit, from loans Government has to take on) that is used for the food parcels, feeding schemes and such cleaning and security services.
- 3.1.9 The overwhelming majority of co-operatives are aimed at production of commodities (vegetables / poultry / crops) or undifferentiated products (catering services for community gatherings). This large scale failure to grasp opportunities to embark on differentiated products will not provide the leverage that could be obtained by a targeted intervention to create conduits for products or services that will bring in money from outside the local communities (export-led enterprises). In addition, as

the literature argues there is scope to also encourage the establishment of 'user co-operatives' which are regarded as poorly developed in the country (Philips, 2003).

3.1.10 It is unlikely that there has been a rapid change in the entrepreneurial climate in the Free State. This is due to the fact that many of the new co-operative enterprises probably do not have entrepreneurs with adequate business skills in them. Any intervention with the thousands of co-operatives will have to be carefully thought through and assessed. There clearly is a need to learn from succeeding and failing co-operatives what the key catalytic variables are.

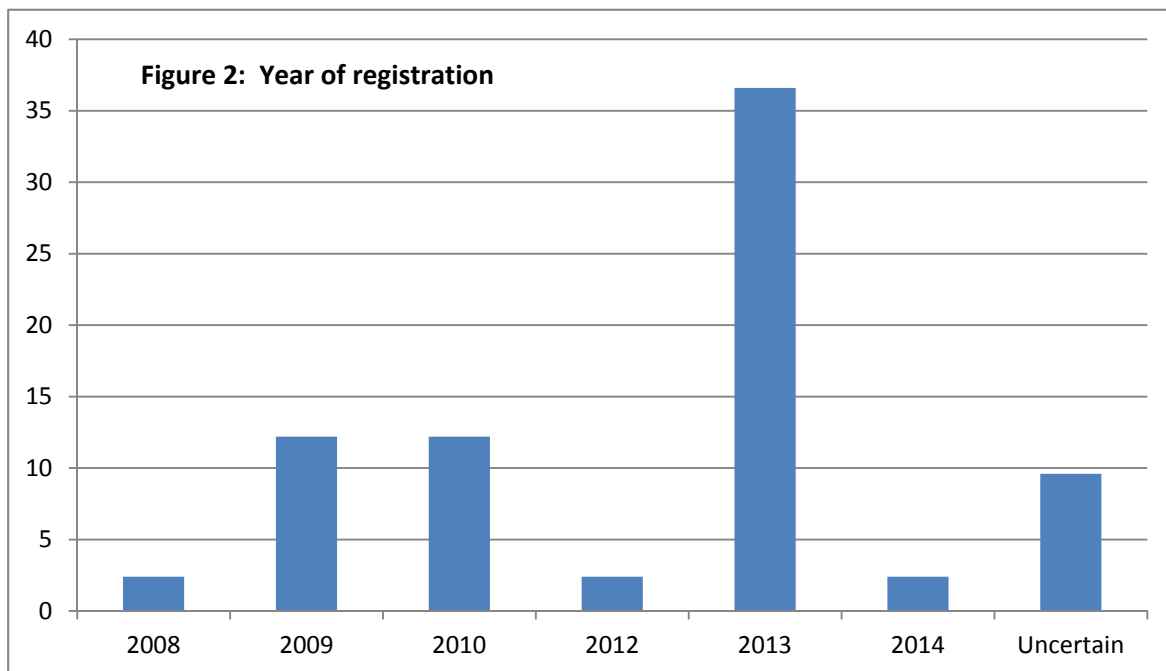
#### 4. **KEY ISSUES EMERGING FROM *IN SITU* INTERVIEWS WITH 42 FREE STATE CO-OPERATIVES:**

To increase the in situ interviews with co-operatives from the contracted 30, and since all the contactable co-operatives with telephone numbers in Thabo Mofutsanyana area were already contacted for the telephone interviews, a group of 42 co-operatives in the Mangaung Metropolitan area were contacted. More interviews could be arranged since it now involved no travel costs. Of the 42 co-operatives the data of one is excluded from the analysis in this section, since its data (being a very successful co-operative) skews the picture. This section will therefore concentrate on the data obtained from 41 co-operatives. Just over 54% of the interviews took place in Botshabelo, 39% in Bloemfontein and 7% in Thaba Nchu.



The 41 co-operatives are all younger than 10 years and the year of registration is reflected in Figure 2.





#### 4.1 Membership

The 41 co-operatives jointly had members when they were established. That gives an average membership of 19.32 members per co-operative. Since a few co-operatives boasted very large numbers (more than 100), it is important to look at the mean as well. The mean co-operative had 6 members at founding. The quintile (20%) with the largest membership had 594 members at an average of 74.3 members. The quintile with the least members had 38 members at an average of 4.75.

By the time of the interviews, the total membership had increased to 847 members or an average of 20.66. The mean remains at 6. Looking at the quintiles again the largest 20% had 662 members for an average of 82.75 per co-operative. The quintile with least members had a total of 35 members and an average of 4.38 per co-operative. As pointed out in Report 2, membership of co-operatives should not be confused with people that are being employed.

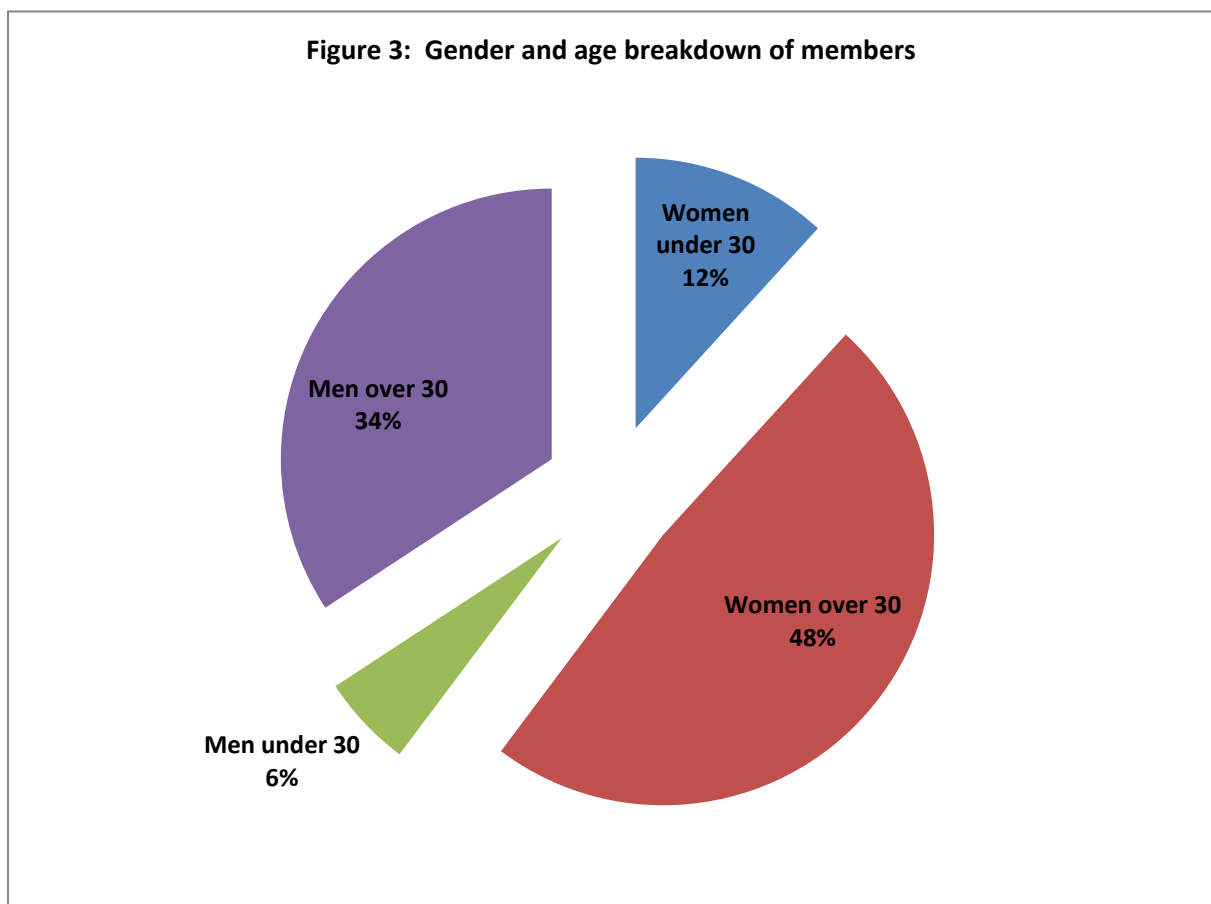
It should be further stressed that the growth in membership occurred overwhelmingly in one co-operative.

The gender and age of members is also interesting, whilst in a country that struggles to provide formal job opportunities to the youth, members 30 years and younger comprise only 18% of membership (Figure 3). That corresponds with the findings in Report 2 based on the

220 telephonic interviews: members 30 years and younger comprised just under 28% of membership.

The dominance of women is also striking when 60% of the members are women compared to 63% in the sample of telephone interviews (Report 2). This raises several questions:

- Why is the youth not enthusiastic about co-operatives?
- Why is it that especially young males are disinterested? In the case of the 220 co-operatives males 30 years and younger formed a mere 10% of the members and in the 41 co-operatives in Mangaung a mere 6%.



## 4.2 Employment

The employment in the 41 co-operatives is 148 or 3.6 employed people per co-operative. Given the fact that the co-operatives have not indicated a real increase in turnover or profit since formalisation, the question arises to which extent this amounts to full-time paid employment.

The employment impact of the co-operatives therefore does not seem to make a meaningful contribution to the triple challenge of unemployment, poverty and inequality.

### 4.3 Sectors

The undifferentiated nature of the co-operatives is (see both Reports 1 & 2) manifested itself with 60% of the 41 co-operatives being multi-sector entities (See Figure 4). There is again little evidence of special entrepreneurship coming through with manufacturing and processing being minimal.

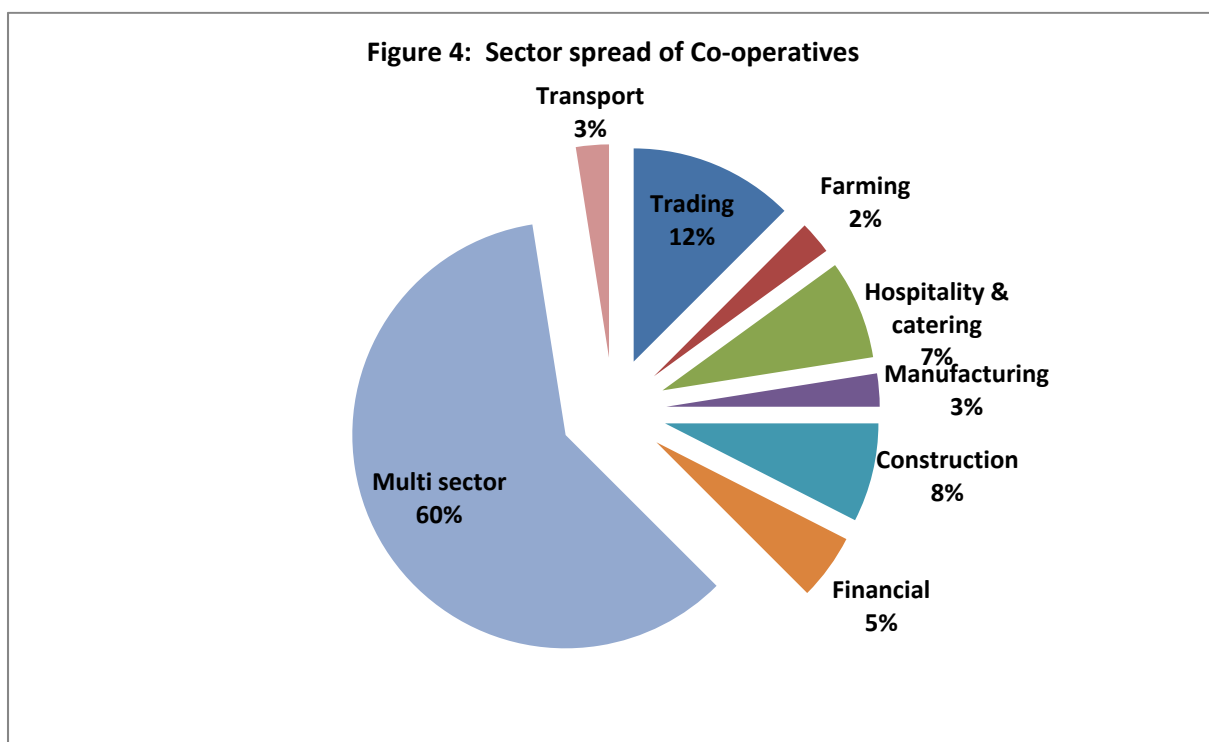
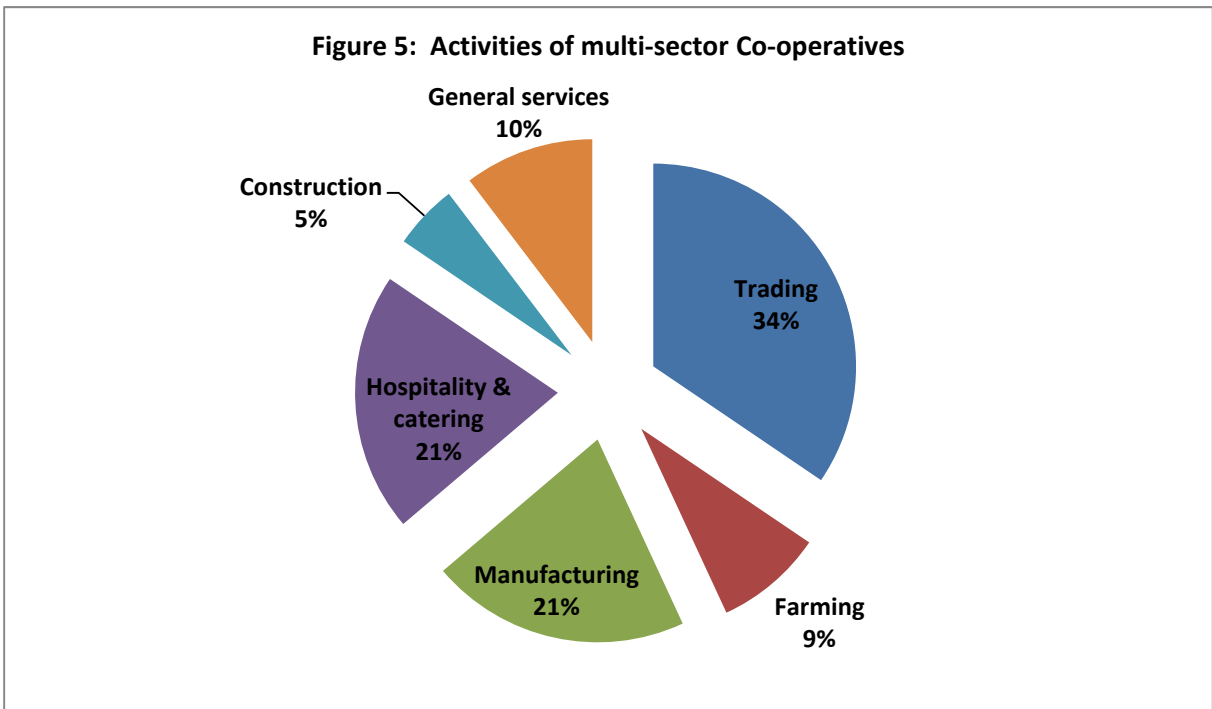


Figure 5 gives an overview of activities of the multi-sector co-operatives.



The impression of co-operatives that try to generate income by being all things to all people with little if any specialisation, is confirmed by this information. It recalls a comment from Report 1 that the multi-sector approach by co-operatives is a signal of all the co-operatives trying to be a little of everything to be able to obtain any kind of funding that is available.

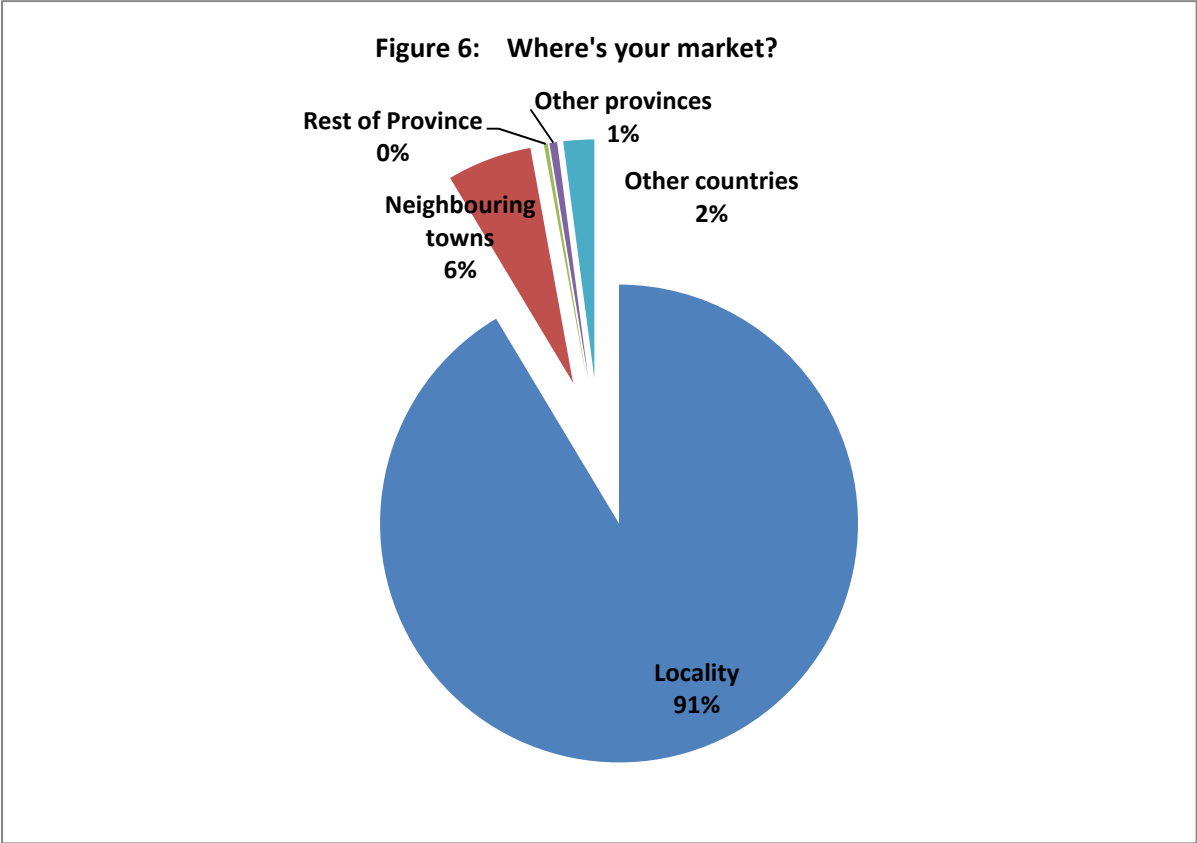
This is an approach that resembles casual / informal workers and not an enterprise that pursues a business idea in accordance with a specific business strategy.

#### 4.4 Procurement & Markets

In this section four figures will be utilised to depict:

- the locality of markets for goods and services (Figure 6)
- the locality where goods and inputs are procured (Figure 7)
- Who constitutes the market in the locality (Figure 8)
- Who are the supply chains in the locality (Figure 9)

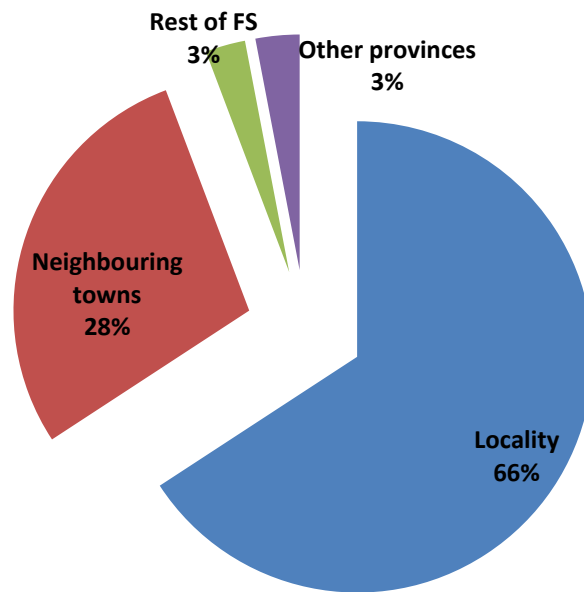
It is evident that the 41 co-operatives operate predominantly in the locality with 91% and neighbouring towns constituting 6%. There are from a market perspective no significant linkages beyond the locality boundaries. This inward looking picture suggests activities that are run-of-the-mill (survivalist) enterprise activities.



This picture varies substantially in one aspect from the data obtained from the 220 telephone interviews. In the 220 cases 69% of sales took place in the locality or neighbouring towns with 28% in the remainder of the Free State. The co-operatives interviewed by telephone (Report 2) were compelled to look further afield than what is the case with the co-operatives in the Mangaung area.

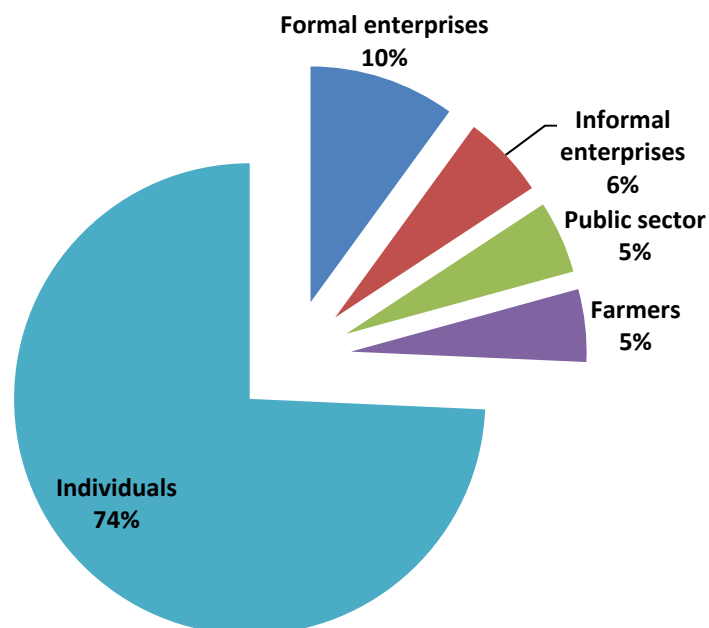
Co-operatives in the Mangaung area are also very inward looking when considering the input and supply lines: 66% procure in the locality with 28% from neighbouring towns.

**Figure 7: Where do you procure inputs?**

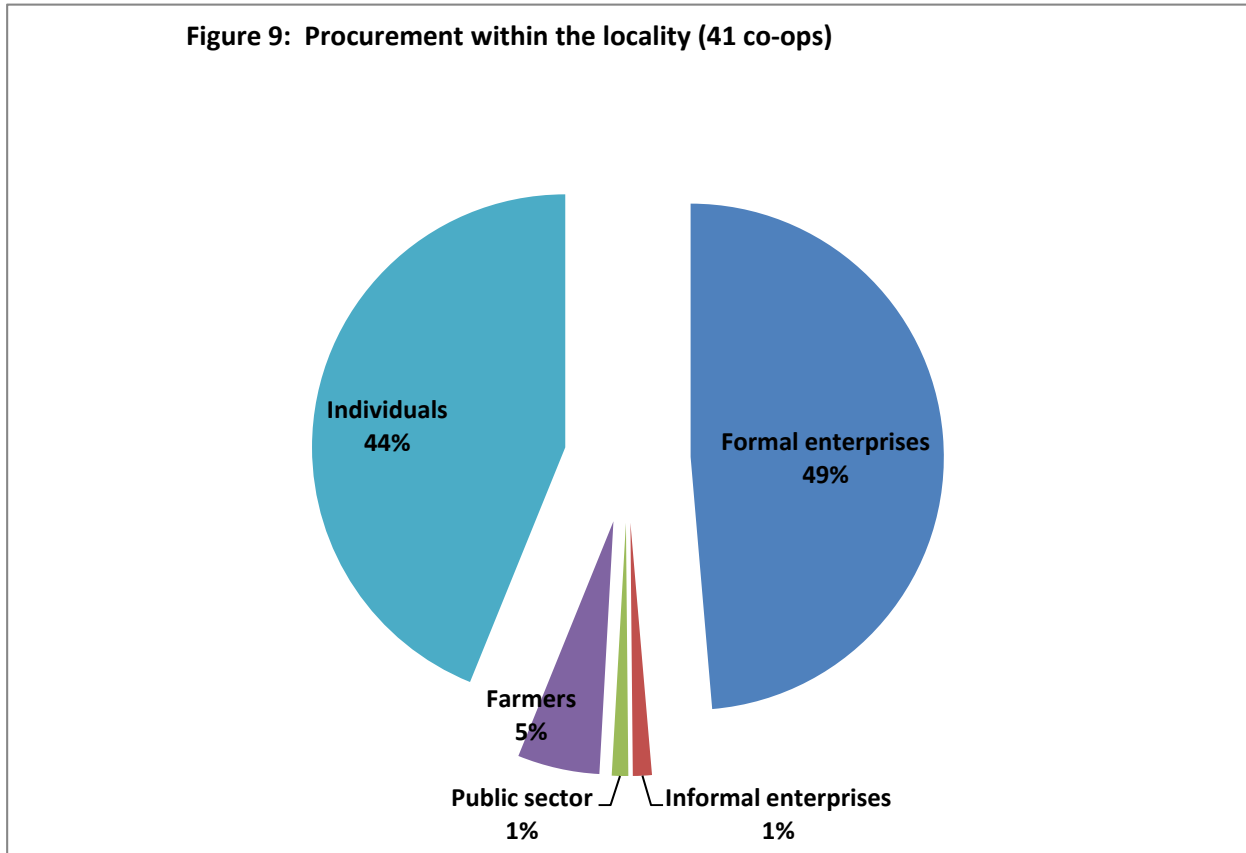


When the market within the locality is analysed, 74% comprise individual sales with other formal enterprises making up 10%. It reflects the incidence of trade (probably a large percentage township trade) and services within even suburban communities (catering and renting out equipment for funerals).

**Figure 8: Market in town**

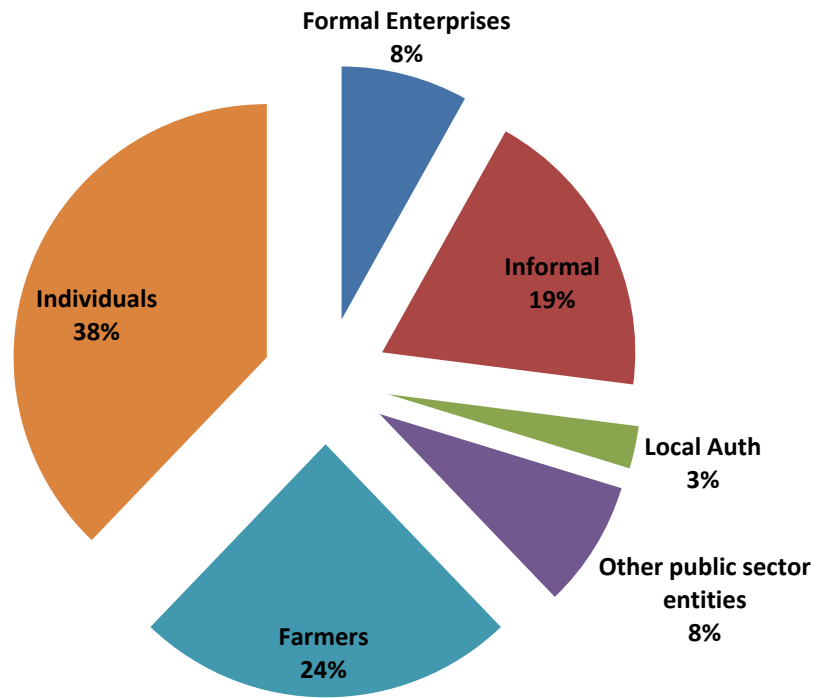


The supply line story of the 41 co-operatives (Figure 10) is very interesting when compared to Figure 11 based on the 220 telephone interviews:



The link with farmers as well as the public sector is substantially less significant in the Mangaung sample than in the 220 telephone interview sample, whilst procurement from formal enterprises is significantly more important. The reason for this difference is probably rooted in the locality circumstances with the majority of the 220 interviews in the Thaba Mofutsanyana area with far more small towns included (towns where the link between farming and town is still closer than in the Mangaung metro area). In addition, formal enterprises in the metro can provide most of the co-operative requirements and needs whilst that is not necessarily the case in the smaller towns.

**Figure 10: Co-operative supply lines within localities (220 co-ops)**



#### 4.5 Skills

If one would take 50% as an acceptable level of skills, the members of the co-operatives rated their capacities as follows:

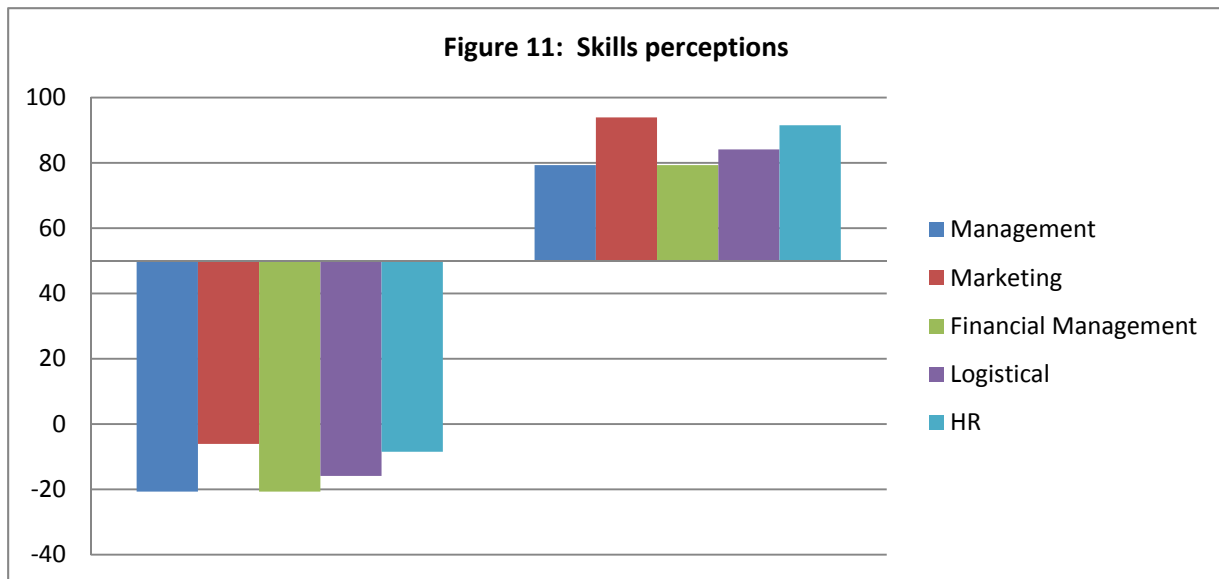
**Table 1: Rating of own skills levels of co-operatives**

<b>Skill</b>	<b>Above 50%</b>	<b>Under 50%</b>
Management	29.3%	70.7%
Marketing	43.9%	56.1%
Financial Management	29.3%	70.7%
Logistical	34.1%	65.9%
HR	41.5%	58.5%

The situation is also conveyed in Figure 11. The self-perception amongst the co-operatives is therefore that they do not have the required skills base to make a success. This reinforces the perception that the formation of thousands of formal co-operatives is more the outcome of a public sector campaign than groups of entrepreneurs coming by themselves and on a voluntary basis to the conclusion that they should embark on establishing a



business. The failure of co-operatives is therefore, given these situations, a systemic given that should have been foreseen by the advocates for co-operatives at national, provincial and local levels.



## 5. FOCUS GROUP SESSIONS IN THABO MOFUTSANYANA

Two focus group sessions were arranged in Qwa Qwa on Wednesday 1 October 2014. The first focus group took place at the Free State Development Corporation (FDC) with 12 co-operatives. The main aim of this focus group was to confirm the findings of the 220 interviews and probe for more detail. There are a few factors that should be taken note of that confirms these findings. The co-operatives reported the following:

- *“We gave up our (survivalist) business because they were struggling and the government was supporting co-operatives and providing funding for co-operatives”<sup>4</sup>*
- *“We are hungry and desperate for work and to get money no matter how little the client offers we take it”*
- *“Those co-operatives that are willing to bribe from officials takes for tenders get more opportunities to do work”*
- *“Marketability of product is difficult without funds”*
- *“Big contractors like Spar need quality as well as quantity”*
- *“We cannot use this money to improve our co-operative in terms of buying new material for the co-operatives our family needs to eat and go to school”*
- *“Budgeting is not useful because our finances fluctuate each and every month or even worse each and every day”*

<sup>4</sup> All the words in “ “ and *italics* are exactly the words that was reported by the participants

- *“Our success rate is very low we rate it at level 1 or 2 due to the fact that we feel there is more to be done for us as co-operatives to succeed”.*
- *“It is for the first time we see each other here because we know co-operatives are many but maybe if we can get together and start working together we can even get government to support us and listen to our needs”.*
- *“Most of us buy material or products within our own towns because we avoid paying too much money for transport”*
- *“We have not done the market research. We only formed co-operatives according to the vocational skills that we have”*
- *“Members of co-operatives losing hope because of lack of funds”*
- *“Ha hona motho ya batlang ho sebetsa a sa kgole (No one wants to work for nothing)”*
- *“We do not have business skills – government should help us”*

The second focus group was represented by many of the Local Economic Development officials from the Thabo Mofutsanyana District as well as the Local Municipalities that form part of the district. An Extension Officer from the Department of Agriculture, a representative from DETEA as well as a representative from FDC, working with co-operatives in the district formed part of the discussion. It was a very constructive dialogue and it was decided to start with the positive aspects of the co-operative system.

- *“Passion “*
- *“Have excellent vocational skills “often just need little support and markets”*
- *“Those committed are eager to see results”*
- *“Those that are not registered and not receiving funding are successful”*
- *“Teamwork”*
- *“Flexible”*

Challenges and concerns were also mentioned.

- **Training** is essential for both the officials as well as the co-operatives themselves (even on Co-op Act). The main reason for this is that *“Co-ops not working according to their constitution (do not even understand it)”*. Specific mention was made to the fact that business and management skills were lacking in the co-operatives. The officials also noted that no market research is done before the registration of the co-operative activities.

- Activities of the co-operatives should be **co-ordinated**. This could be in the form of a forum because the “*co-operatives are often double-dipping on funding*”. Consultants are now playing this role (Maluti co-op forum) and registering co-operatives to make a profit. It is important to identify the successful cases and learn best practice for the future. It was suggested that a district forum should link with the province.
- A sense of **dependency** has developed from the co-operatives because they “*have no desire to grow and want to remain in incubation forever*”. This could be caused by the fact that the co-operatives are not business minded
- It was realised that there is very little **support** for these co-operatives once they have been registered. “*Exposure of their products*” is needed like a website promoting all products available in each district. The DETEA support centres could be an answer to this because they are available in the districts.

### FREE STATE SUCCESS STORY: SAMBA



The picture concerning co-operatives in the Free State is not only doom and gloom. The province houses one of the most successful co-operatives in the history of South Africa. Samba Co-operative:

- exists for almost eighty years;
- has 23 500 members;
- an annual turnover exceeding R830 million;
- gave birth to a bank that was merged into the banking giant that is now known as Barclays Africa (ABSA);
- rewards its members with an annual bonus.

Without any Government support, a group of 32 people met on 18 March 1938 in Bloemfontein to discuss how combined consumer power could be utilised to the advantage of consumers and thereby improve their living standards. In addition, the founding group of 32 realised from the beginning the need for expert management and proper administration. Starting with the 32 members Samba Co-operative was formed and in the first year a group of 14 dealers in Bloemfontein were persuaded to give a discount via the co-operative to its members. This discount is repaid every year in the beginning of December to the members. In return for this discount Samba took over the billing and guaranteed the dealers payment.

This approach can only work on the basis of stringent credit assessment of the members and efficient administration. That remains the core success factors till today, according to the Chairman of the Samba Board of Directors, Mr Gerhard van Graan. He indicated that in this period of African Bank and its furniture company Ellerines, as well as the JD furniture group struggling because of bad debt, Samba manages to keep its non-performing accounts within 1.5% of turnover.

At this stage Samba has 23 500 members and since several members have more than one card (husband and wife) they operate with 34 000 Samba credit cards. Amongst the enterprises that acknowledge the Samba credit card are 40 national chains and a further 1 500 regional and local enterprises. In the 2013 financial year the turnover of Samba was R834 million and it reimbursed its members with a bonus totalling R26 million.

The members are all effective shareholders in the co-operative and therefore have an interest in the retained surplus and assets of the co-operative as well. Apart from the credit card with a bonus, Samba also offers its members:

- Insurance at well-known national insurance companies at a discount;
- A funeral group insurance benefit;
- Loan facilities including hire-purchase facilities.

Samba grew from the modest beginning to an entity that at one stage had its own store in Bloemfontein: Floreat. Samba realised however that operating a co-operative store, diluted the focus on maximising the consumer power of its members. The store was sold. Samba also initiated Bankovs (the Bank of the Orange Free State) that was later taken over by Volkskas just before the merger with other financial institutions into ABSA.

Concentrating on serving the interests of its consumers, Samba utilised some of its surpluses to take over two buy-aid societies in Kimberley and Port Elizabeth. That laid the foundation also for tapping into national chain stores that enables its members to buy its groceries or medicine whether in its hometown or when on holiday.

## **6. MAIN FINDINGS – PREVIOUS REPORTS**

In the main the in-situ visits and interviews did not yield a more promising story line emanating from co-operatives created through a public sector drive. The field exercise largely confirmed the key conclusions based on:

- (i) Ignored the basic verifiable truth that enterprise space in a range of sectors (especially trade) is not readily available, since that space has been occupied already. Trading co-operatives that are formalised are therefore established either to fail or to push other existing traders into oblivion.
- (ii) Ignored proper market research and business plans as fundamentals for sustainable enterprise creation.
- (iii) Ignored the need for a diversified range of enterprise management skills and did nothing to test the readiness of co-operative members to run a business.

## **7. RECOMMENDATIONS FROM FINDINGS**

As previously mentioned, all the approaches that were used to be able to obtain the information about the co-operatives came to very similar conclusions.

Co-operatives do not only need to be registered but should avail more support from all avenues possible. This could possibly be achieved in three ways:

- Co-operatives should be assisted to do proper market research so that they link to the main economic drivers in the Free State and value chains are created. By taking this approach markets are not only developed locally.
- Secondary co-operatives can assist the primary co-operatives with management and marketing avenues. This also enables the co-operatives to work together to be able to procure greater opportunities together.
- The development of skills is essential. Co-operatives have been established due to vocational skills that they already have. There is no coordinated training for the co-operatives in the Free State. Business and management skills are lacking. An action plan from all stakeholders should be initiated to bring parties like SETAs, SEDA, FET Colleges and universities together to empower co-operatives in the Free State. Mentorship programmes should also be included in this initiative so that small co-operatives could learn from best practices.

## **8. WAY FORWARD**

It is proposed that the reports should be distributed to all the stakeholders and directorates so that all those involved in working with the co-operatives are on the same page with similar

information. It is envisaged that an in-depth study should be initiated to highlight the experiences of all the successful co-operatives. This will establish a best practice scenario. The above-mentioned recommendations should also be discussed and implemented by all stakeholders and role-players that work with the co-operatives.

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