



The Co-operative Regulatory Framework in a Small State: Reviewing the Alternatives

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Abstract

The objectives of this research are to identify the major areas needing reform in the co-operative regulatory framework of the small state of Malta and to evaluate possible alternatives. Objectives were achieved by the analysis of the legal framework and the conduct of semi-structured interviews. Findings indicate a general yearning for co-operative regulation to be less paternalistic and to allow greater financial and operational autonomy to co-operatives and their institutions. However, results highlight the importance of upholding the distinct co-operative identity encompassed by the co-operative values and principles. The article concludes that it is the areas of co-operative financing, the distribution of returns and the role of co-operative institutions needing most addressing. Recommendations include amending the provisions relating to the redemption of capital upon member exit, removing the asset lock on ploughed-back surpluses, and updating regulations regarding representative co-operative organisations and the Maltese co-operative funding entity, the Central Co-operative Fund.

Background to the Study

The International Co-operative Alliance (“ICA”) defines a co-operative society as:

“An autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically-controlled enterprise.” (ICA, 1995, p.1)

Essentially, a co-operative society is a collection of individuals who opt to join forces and work collectively to achieve a common goal (Lund, 2011).

The ICA definition highlights that the aim of the co-operative structure goes beyond that of solely carrying out business and making a profit, in that it also gives regard to the wider needs for the fulfilment of social and cultural desires of its members. Particularly, co-operatives engage in ‘member-promotion’ by placing a higher value on the betterment of the co-operative’s members’ situations, than they do on profit-making (Henrÿ, 2012b). The balancing of economic and social values by co-operative societies, termed the ‘co-operative identity’ is encapsulated in the co-operative values and co-operative principles (“Principles”) whose roots date back to the nineteenth century (ICA, 1995; MacPherson, 2012).

In an effort to popularise the co-operative model of doing business, and to promote the establishment and growth of co-operatives, the United Nations (“UN”) have recognised 2012 as the International Year of Co-operatives (UN, 2011).

Co-operative societies still strive for recognition as an alternative business vehicle to the limited liability company in Malta (Burlo' and Baldacchino, 2014). Studies by Maltese authors and stakeholders alike have suggested that this may be due, in part, to certain barriers impeding the legal vehicle’s development (Koperattivi Malta (“KM”), 2010; Tabone, 2013; Malta Co-operative Federation (“MCF”), 2014). The underdeveloped or outdated state of certain aspects of Maltese co-operative law was cited in these studies as one existing barrier.

This barrier is not unique to Malta, with the ICA having asserted that few jurisdictions have appropriate legislation for co-operatives in place (ICA, 2013). This often leads to the co-operative structure being viewed as a marginal form; one which is isolated and discouraged (Henrÿ, 2012a). Although the co-operative form has been a huge success in certain countries, it is often regarded as the preferred choice only for disadvantaged individuals (Henrÿ, 2012a), and one that is fragile when compared to the limited liability

company structure (Ortega, 2010). These perceptions shroud the co-operative form in uncertainty, thus posing serious problems to the thriving of co-operative societies.

As such, one of the goals of the ICA's Vision 2020 is to entice governments into developing more co-operative-friendly legislation, prioritising the need to preserve their distinct co-operative identity and ultimately to provide this form of enterprise with a level playing field, and not preferential treatment, to co-exist *vis-a-vis* other business forms (ICA, 2013).

There have been various attempts by Maltese stakeholders to determine and address possible deficiencies in the legal framework regulating Maltese co-operatives, that is, in the Co-operative Societies Act ("CSA") and related subsidiary legislations (KM, 2010). At the date of writing, no substantial changes have materialised. The need to reform the law was also addressed in Malta's 2014 Budget Speech, which identified the government's intention to re-visit the intricacies of the law regulating Maltese co-operatives (Ministry for Finance, 2013).

On this basis, the objectives of this study are:

- a. to identify the major areas needing reform in the Maltese co-operative regulatory framework; and
- b. to evaluate various proposals for reform in the areas identified in (a) and select the ones, if any, to be recommended.

The study is not an exhaustive analysis of Maltese co-operative law, with focus being attributed solely to particular problem areas in need of reform. Particularly, the liquidation process, taxation issues and the lack of legislation for the setting-up of co-operative banks were specifically excluded as these merit a dedicated study. Additionally, while the study does provide recommendations for change, it is beyond its scope to propose the actual legal wording. The study is based on and limited to information available up to 31st December, 2016.

Methodology

The pragmatic approach guided the entire research process as the study aims at determining how behaviour in the Maltese co-operatives is affected by existent law with the purpose of working out how it may be revised, further envisaging the changes in behaviour any such revisions may bring about. The research involved the use of the abductive approach, with the intention of applying iterative progression to enable the achievement of the research objectives. For this purpose, a cross-sectional qualitative

research design involving the carrying out of semi-structured interviews was considered most appropriate.

The main themes and target questions for the interview sessions were established by reference to current and preceding relevant Maltese legislation, as well as current foreign legislative instruments and reports on the matter. In developing these main interview topics, reference was also made to proposals for change made by representatives of the Maltese co-operative associations. The resulting interview skeleton consisted of two general questions holding multiple close-ended statements to which a dichotomous scale was utilised, these being followed by five open-ended questions, requesting interviewees to put forward opinions on proposed amendments and/or inviting them to make additional suggestions for improvements.

The choice of interview respondents was made through purposive sampling with the aim to target co-operative experts having diverse proficiencies and experiences in relation to Maltese co-operatives. Interviews continued being held until it was considered that data saturation had been reached. A total of 20 interviews were held in the period between October 2015 and February 2016.

The data analysis process involved the categorisation and unitisation of data so as to enable its clearer presentation, thus allowing for the emergence of any patterns or relationships among the provided responses and with analysed secondary data. The researcher's focus in the analysis was directed both at the items which emerged in multiple interviews, and also at particular points of view which, although not necessarily repeated by the majority of interviewees, proved to be insightful based on prior research.

Findings and Discussion

Setting the Scene: What is the CSA to look like?

Hansmann and Kraakman (2000) have determined that organisational law, of which co-operative law is a subset, is fundamental in that it codifies the defining features of the legal entity, which are essential for an entity's establishment and operation as such.

In this respect, Fici (2013) considered that the defining feature of co-operative societies is their co-operative identity, while Henry (2012b) identified the Principle of member promotion, as opposed to profit maximisation, as the other defining feature of the legal form. Consequently, if the CSA, as the main body of law governing co-operatives in Malta, is to encourage and enable the establishment and flourishing of co-operatives, it should primarily aim not at profit maximisation but at highlighting and safeguarding the distinct

co-operative identity encompassed in the co-operative values and Principles, particularly the Principle of member promotion as the ultimate endeavour.

While keeping the aforementioned aspects in mind, the legislator is also to look at the bigger picture and to recognise the importance of economic efficiency, which is imperative if co-operative societies are to survive. Interviewees suggested that the legislator should also seek to create a law which is “*wide enough*” to face not only the realities of co-operatives at the time of the drafting of the law, but also new circumstances as these become realities. Additionally, as expressed by interview respondents on numerous occasions, the elimination of the paternalistic approach towards co-operative societies is also to be considered.

Building the Foundations: Definition and Principles

A One-Size-Fits-All Definition?

What constitutes a co-operative society will vary from one jurisdiction to the next, depending on the culture and legislation of the country. As such, in determining which definition is most appropriate, the legislator has first to decide about the nature of the co-operative movement.

The existent definition of co-operative societies in the CSA is an almost word-by-word replica of the ICA’s 1995 definition. The use of such a definition has been endorsed by the United Nations (2001b). The majority of interviewees have determined that the current definition is satisfactory since it wholly encapsulates the particular characteristics of the co-operative form. Contrastingly, a minority of respondents asserted that a home-grown definition would be more appropriate.

Given, however, that a good number of interviewees have voiced their desire to further widening the perceived possible uses of the co-operative form, the idea of introducing a home-grown definition in the law does not appear to be a better alternative. This is because while appropriate for the current co-operative movement, a home-grown definition may not remain as suitable as this changes to accommodate new forms. Additionally, retaining the ICA wording should ensure that the definition at law reflects the vehicle’s distinct identity.

Should Co-operative Principles be in the Law?

The CSA (Art 21) includes a list of the Principles, although it acknowledges that they are not directly enforceable in a court of law. Most respondents saw the inclusion of the Principles in the law as adequate as this emphasises their pivotal role for co-operatives.

This is because their inclusion signifies that *“being in breach of them adds up to being non-compliant with the law”* and therefore it was stated that it is pertinent to have them *“entrenched”* within legislation.

Notwithstanding the above, the inclusion of the Principles in the main legislative instrument might not be the most practicable solution. This is because any modifications to the Principles as put forward by the ICA would necessitate amending the CSA in Parliament. As such, it would be easier to have the Principles only referred to in the CSA and then outlined fully in *‘regulations made under the Act’* that can be amended by the responsible Ministry.

As for Principles’ unenforceability, one may introduce a ‘comply or explain’ approach, wherein the co-operative prepares a report which outlines its compliance to the Principles and explains any shortfalls. However, an issue in this case would be the extent to which the explanations being provided would be satisfactory.

The Members

Eligibility Criteria: Who is Suitable to be a Member?

The CSA (Art 55) states that one cannot be a member of another co-operative having the same or similar objective. The aim of the legislator in introducing this provision seems to have been that of limiting any conflicts of interests (Fabri, 2006). However, this provision has given rise to multiple controversies and its amendment has been called for in the literature (KM, 2010; MCF, 2014) and also by the interview participants, with the majority calling for a stricter rules and a minority commenting that co-operatives could do without such an imposition.

The law is likely to be clearer if the provision is replaced with one limiting the co-operative member from engaging in any competing activities which could give rise to conflicts of interest, whether through another co-operative, any other legal vehicle or even as a sole trader. Caution would need to be exercised in the implementation of this change to ensure that any such provision does not result to be unacceptable in terms of competition legislation.

The question of whether a limited liability company is to be permitted as a member of a co-operative society, as is currently allowed by virtue of Art 53(2) in the CSA is also somewhat contentious. However, the argument that such membership reduces the community spirit, as pointed out by a number of interviewees, is in itself questionable, especially given the popularity of the legal structure in the Maltese economy. On the

contrary, such inclusion may be rather perceived as further widening the community spirit to include the legal structure which is by far the most popular (Ganado, 2009). A corporate member may also be a valuable source of financing. Furthermore, eliminating the restriction of including as members only companies having '*wholly or mainly similar or equivalent ... operations*' could help expand co-operative operations since it would allow, for example, for synergies amongst entities having complementary products or services.

Minimum Number of Members: A Storm in a Teacup?

Over the years, the minimum member requirement in Maltese legislation has been consistently reduced. These reductions were intended to assist the establishment of additional co-operatives (Fabri, 2006).

While one representative co-operative organisation ("Rep Organisation") (MCF,2014) has argued that this number, now standing at five, should now be further reduced to three members, the other (KM,2012) has attested that this should remain so to protect the co-operative movement from sham co-operatives. Even the interview participants held opposing views in this regard.

As would be expected, some participants contend that further reducing the allowable minimum would increase the propensity of "*fake*" or "*sham*" co-operatives. Contrastingly others assert that retaining the minimum at five gives rise to "*fake*" members who do not actually participate in the co-operative society's activities, whether economic, social or cultural, but are part of it solely to meet the legal minimum. Yet, the significance of the issue seems to be overstated. In fact, neither option should be an issue provided that the body responsible for registration carries out satisfactory due diligence upon being presented with an application to set up a new co-operative society. Indeed, the above arguments seem at odds with the call made by respondents for the co-operative registration process to be simplified and quickened. In light of their above concerns, it would probably make more sense for the Registrar not only to retain its registration process but also to make more frequent use of the rights extended to him by the CSA (Art 28), in relation to provisional registration.

Co-operative Governance

What may be Improved in Co-operative Governance?

Member Level

The Principles state that a co-operative should be self-sufficient and self-directed by its members in a democratic manner. The centrality of this member-controlled notion is recognised in all assessed legislative instruments or guidelines.

The CSA embodies these notions by requiring member voting to be made on a 'one member, one vote' basis. However, other forms of voting are allowed by the CSA, subject to them being permitted by the society's constitutive documents. This possible deviation from the 'one member, one vote' basis of voting has been identified as a positive step leading to co-operative societies balancing their social and entrepreneurial aspects (Delia, 2006). However, Rizzo (2010), predicted that Maltese co-operatives would likely not opt for another form of voting. Indeed, in line with Rizzo's (2010) expectations, the majority of interviewees asserted that the law is not to permit the possibility of moving away from the 'one member, one vote' regime since this concept is considered "*fundamental*" in "*differentiating*" the co-operative structure from the company set-up.

Governance Structures

Although member control is of paramount importance in a co-operative structure, it might be impracticable to require the involvement of all members for every decision, especially as the number of members in the society increases (Henrÿ, 2012b). As such, governance may need to be delegated to representatives (SGECOL, 2015).

Accordingly, the CSA requires all co-operatives to have a Committee of Management ("COM") consisting of society members elected by a majority at a general meeting. The COM is responsible for the "*conduct and management of the affairs and business of the society*" {CSA, 2001 (Art 74)} and has, overall, a role which is very similar to that of a Board of Directors within a limited liability company (Zammit, 2013). Various authors have commented on the need to alter the governance structure of Maltese co-operative societies (Kummissjoni għat-Tishih tal-Koperattivi ("KTK"), 2009; KM, 2010; Baldacchino and Bugeja, 2012; Abela, 2013; Zammit, 2013; MCF; 2014).

Out of the proposed amendments aimed at what was identified by interviewees as "*a much needed improvement*" of the governance of co-operatives, respondents generally preferred removing the current eligibility criterion which restricts possible COM members to the existing members of the co-operative. It was stated that such a change

would render the co-operatives' COM more comparable to the Board of Directors of a limited liability company. It would therefore enable co-operatives to elect non-members on the COM, thereby enabling persons having particular knowledge or expertise to join the governance board.

Those disagreeing with this option stated that having persons on the COM which are not members of the co-operative would lead to a reduction of member sovereignty. However, this argument may not be so relevant given that members would retain the right to elect or dismiss COM members. Such a change in legislation would likely need to be accompanied with provisions providing the members with proper controls to monitor the behaviour and actions of the COM members. Respondents provided numerous suggestions in this respect, the most relevant of which relates to including a requirement of mandatory induction training for new COM members. This would also facilitate the upholding of the fifth Principle, which relates to education, training and information.

A relevant consideration to be made before proceeding to amend the law to allow externals to sit on the COM is whether this is in fact necessary. As pointed out by a few respondents, the required mix of COM members could already be achieved with the current legislation by having the necessary external persons become members of the co-operative. For this to be effected, the co-operative might need to amend its statute, if it currently applies any type of restriction to membership provided by CSA {Art 53(1)(b)}. However, given the high utilisation of this provision, particularly with respect to restrictions by trade or profession, respondents suggested that one could consider whether the statutory introduction of the notion of a non-trading member would help ameliorate the situation.

Is there a Need for a Dual Governance Structure?

A further issue relates as to whether the supervisory board provisions in the CSA (Arts 83-86) are to be removed. A two-tier corporate governance set-up, consisting of a supervisory board ("SB") supervising the work of the COM, was required in the original law (Münkner, 1975). However, such a structure was rendered optional in the 2001 revision of the CSA (Fabri, 2006). Respondents confirmed that following that law upheaval, existing SBs were not retained, this resulting in none of the current registered societies having a SB. While this might seem at odds with the interviewees' call for more controls on the COMs to be introduced in the law, the lack of uptake of the SB voluntary provision is probably due to the SB concept remaining alien in the Maltese corporate

culture. In fact, no other Maltese legal vehicle employs such a dual governance structure and the Anglo-Saxon one-tier corporate governance system is applied without exception. Therefore, the voluntary SB provision might now seem to be redundant.

A disadvantage of having the possibility of setting-up a two-tier structure is that the CSA refrains from directly identifying the COM as the structure having directional and strategic responsibilities. Instead, the CSA (Art 74) provides the COM with the responsibility for the “*conduct and management of (the cooperative's) affairs*”, which seems secondary to the responsibility for “*general good governance*” as is attributed to directors by the Companies Act (Art 136A). These articles could be revised to remove the provision allowing the establishment of the SB and instead elevate the COM as the primary governing structure. In deciding which functions are to be introduced, altered or deleted care needs to be taken to preserve those arising from the Principles or which support them. In particular the functions relating to the approval of new members and to encouragement of member involvement should be maintained.

Financing, Distributions and Reserves

The fourth Principle advocates the nature of co-operative societies as autonomous and independent. As such, co-operatives must be able to generate the necessary economic independence (Henrý, 2012b) to become truly financially self-reliant (UN, 2001b).

Limited Liability with No Liability?

While the majority of legal systems require share capital to set up a co-operative (SGECOL, 2015), Maltese law enables the constitution of co-operatives without share capital (CSA, Item 6, 2nd Schedule).

The lack of a statutory minimum level of share capital was identified as indispensable by almost half of the interview participants given that it protects the notion of open membership put forward by the third Principle and allows the entity to set any minimum in accordance with its particular needs.

However, other participants were in favour of introducing a mandatory minimum share capital since this would increase the legal structure’s “*credibility*” and ensure that the enterprises have some “*much needed*” additional capital. In addition, one must consider what the lack of a statutory minimum means in the context of an entity with members having limited liability, as is established for co-operatives in the CSA (Art 59). At present, this essentially means that it is possible for members to have no liability whatsoever in respect to the co-operative’s affairs. This in turn puts forward a situation of uncertainty

for those trading or intending to trade with the co-operative. The legislator would better consider the introduction of a minimum level of share capital, albeit a low one, to partly alleviate this uncertainty and improve the legal vehicle's credibility in the eyes of actual and potential creditors.

New Members with Increased Share Capital/Admission Fee Requirements?

The Principle of open membership requires that entry to the co-operative is not unduly restricted. Accordingly, Maltese law determines that co-operatives have variable share capital. Literature (Baldacchino and Camilleri, 2013) and respondents alike have called for a specific inclusion in the law to the effect that the minimum share capital and/or admission fees allotted to or collected from members upon joining the co-operative would be increased for members joining at a later date. It is worth noting that the existent CSA does not prohibit any such requirements for increases.

However, increases in the requested payments upon entry should be made with caution, since these could be a deterrent to the concept of open membership with the cost for new joiners becoming prohibitive. One possible solution aimed at balancing fairness to the original members with the concept of open membership could be introducing an addition in the law providing that upon entry, all members will subscribe to or pay the original amounts, with any additional amounts as established by the co-operative being paid in a deferred manner by having withheld a maximum proportion of later surplus distributions or interest payable to such members.

Is the Reserve Fund Justifiable?

Undistributed surpluses have been identified as the major source of financing both for Maltese co-operatives (Buttigieg, 2004; Camilleri, 2012) and abroad, with various scholars labelling reserves as "*the financial resource of best quality*" (SGECOL, 2015, p.79) for the co-operative.

It is common for legislations to require the establishment of certain indivisible reserves, also referred to as undistributable reserves, in line with the Principles (Henrj, 2012a). Accordingly, the CSA provides for the establishment of the Reserve Fund within Art 90. The co-operative society is required to transfer at least 20% of its surplus to this fund every financial year end, until the fund becomes equal to the total of the paid-up share capital plus an additional 20% of the borrowed capital of the society. The monies held in the Reserve Fund are required to be in liquid form. As with the general international

trend with respect to mandatory reserves (SGECOL, 2015), monies allocated to this reserve are non-distributable, even upon the liquidation of the entity (Camilleri, 2012). Both MCF (2014) and KM (2010) have recommended the re-think of this Reserve Fund's requirement. Some respondents have gone further and called for the elimination of the concept of the Reserve Fund, claiming that this is a burdensome imposition over the co-operative's remit with respect to financial management. In this context, there seems to be a common misunderstanding that the funds, once allocated to the Reserve Fund, are rendered completely unusable. However, Art 90 details that they are to be used to offset "*past or future losses*", meaning that such funds still have their possible uses.

Notwithstanding this, one may consider the need to update the reserve's calculation mechanism, which was also widely called for by the interviewees. This is especially true in the light of the uncertainty cast by the lack of a definition of "borrowed capital". Additionally, the article {Art 90(2)} which states that the Reserve is to be backed by "*liquid assets*" needs to be addressed since it was commonly hailed as a factor limiting co-operative growth. It would probably be more adequate if legislation permitted wider utilisation of the funds backing the Reserve, perhaps prohibiting only the funds' investment in highly illiquid or speculative assets. This would enable more benefits to be derived from the funds in question, while at the same time retain them sufficiently liquid to ensure that these could be called for when needed.

A major justification for the existing provision regulating the indivisibility of a portion of the co-operative's surpluses is the notion of variable share capital. This implies that the co-operative may be requested at any time to repay the shares of an exiting member. To alleviate the possible financial stresses placed on the co-operative in such cases without compromising the usability of existing co-operative monies, the legislator may introduce the possibility of a deferral period for repayment of the shares as was suggested by MCF (2014).

Are Ploughed-Back Surpluses Really Asset Locked?

The CSA, in line with PECOL (SGECOL, 2015), allows for the establishment of other reserves in which the co-operative may retain its net surpluses when its members choose not to distribute them wholly.

A point of contention with respect to these voluntary reserves is their future indivisibility (Tabone, 2013). Once undistributed in the year in which they are earned, surpluses are assumed to become asset locked given that there exists no provision pointing to the

possibility of later distribution of retained surpluses. The CSA (Art 92) refers exclusively to the application of surpluses earned during that "*accounting period*". This disincentives members from choosing to retain profits within the entity (Tabone, 2013).

Notwithstanding that the law does not specifically determine that funds held in reserves other than the Reserve Fund are indivisible, the response indicated that this interpretation is being widely inferred. However, it is doubtful whether such complete asset lock limiting later distribution of ploughed-back profits would hold if challenged in court. Therefore, if such interpretation is to be retained, although opposed by most respondents, then this needs to be clarified in the law.

Some of the arguments put forward by respondents with respect of these provisions refer to these provisions being a deterrent to ploughing back profits, which in turn contributes to co-operatives facing cash flow problems and having limited funds for reinvestment and growth. Respondents also commented that the asset lock does not arise from the Principles and so it has "*no use*" except to render the co-operative "*disadvantageous*" to other legal vehicles.

Others asserted that while they recognised that irrevocably retaining profits within the entity might easily induce members to distribute each year's profits, the absence of such asset lock could be unfair in that new members would be in a position to receive surpluses generated by retired members. Therefore, an important precondition to removing the asset lock is that this would be tied up with the introduction of due provisions aimed at properly compensating members upon terminating their membership.

A few respondents echoed Münkner (2010) and acknowledged the alternative solution of enabling the co-operative to retain surpluses while simultaneously not prohibiting later distributions by distributing bonus shares or certificates as per provided by the CSA. (Art 94) These instruments effectively lead to a delayed distribution. This, however, could be regarded as a stopgap solution, in that the funds would no longer be locked but would still need to be redeemed by members at a later date, whether five or ten years, thus merely delaying the asset lock disadvantages, which will resurface at a later stage.

A Phased Redemption upon Member Exit?

Respondents acknowledged that the elimination of the asset lock on its own would have limited effects on the willingness of members to retain surpluses in the entity. This is because the general practice has been that, upon member exit, only the nominal value of

shares is remitted to the them, and they have up to now not derived any personal benefits from the undistributed surpluses. Therefore, if surplus retention is to be encouraged in the absence of an asset lock on ploughed back profits, the law must also cater for the proportionate compensation of retiring members.

Such reasoning may seem to be at odds with the Principles which are meant to encourage co-operative members to attach significance to the continuation of the co-operative for future members. However, it is reasonable for members to expect some compensation for the success of their co-operative during their tenure. Therefore, claims for some type of fair compensation are to be given due consideration.

In this context, the legislator has various options to consider. One suggested solution to ensure appropriate compensation would be to release the past undistributed surpluses held in distributable reserves. Yet care would need to be exercised to tackle the potential problem of possibly landing the co-operative in financial woes.

Another suggested solution forwarded by respondents would be to change the status retiring member to that of non-trading ones, with their portion of undistributed surpluses being converted to *“irredeemable preference shares having fixed annual returns”*. However, such a course of action would likely be detrimental to the Principle of autonomy given that, as more members retire and become non-trading members, the co-operative would possibly tend to move towards a structure whereby the capital is predominantly provided by past participants rather than active trading members.

The suggestion for share redemption to be made at fair value was made by a minority but was dismissed by a sizeable proportion of respondents. However, outright dismissal may not be the best way forward. For example, the legislator could consider introducing a system whereby the fair value of the shares would be paid in instalments to the retiring members or their family over a number of years, perhaps with the amounts being paid also varying with the surpluses being generated. Such a system would probably not be detrimental to the co-operative's liquidity, particularly if the system is accompanied with the aforementioned offsetting one of deferred pay-ins upon entry by new members.

Main Co-operative Institutions

Is the Regulatory Arm Satisfactory?

The regulatory body, the Co-operatives Board (“the Board”), is established by the CSA (Art 3). It fulfils the registration, monitoring and supervisory functions of Maltese co-

operatives. It also carries the responsibilities to support and assist the establishment of Maltese co-operative societies and to promote co-operative set-ups.

A portion of interviewees emphasised that the Board is under-utilising its powers and thus not meeting co-operative expectations. This was held to be particularly true in the case of a *"much needed cleansing exercise"* aimed at *"identifying and removing fake co-operatives"* from the Register. Conversely, others again pointed to the law itself, emphasising that more extensive powers need to be allotted to the regulator. Others still commented that the root of this problem was neither the Board nor the legislation, but attributed it instead to politics.

A few respondents called for the legal revision of the co-operative registration process, claiming that it is too slow and inefficient. This is in line with KM's (2010) and Burlo's (2013) comments. However, others stated that the slow pace of registration is justified as it is due to the need to ensure the viability of the prospective co-operatives.

The CSA (Art 4) states that all Board members are appointed by the Minister responsible for co-operatives and remain on the Board for a period of at least two years and a maximum of five years unless they choose to resign. In this respect, a good number of interviewees referred to the need for change in the rules governing the composition and constitution of the Board. Given that the necessary technical expertise are lacking in the Maltese co-operative movement, it is particularly relevant for Board members to be required to be experts in this particular field. Furthermore, others contended that Board reconstitutions should take into account continuity and as such these would best be carried out on a periodic rotational basis. Another important factor is that the minimum two-year period of Board tenure is too short to enable long-term strategic planning. This was also noted by KTK in their 2009 report (KTK, 2009).

A Future for the Central Cooperative Fund?

It is not uncommon for co-operative legislation to mandate the establishment of reserves aimed for education through which the co-operative would be able to address the aspirations of the fifth Principle (SGECOL, 2015). The CSA does not require each individual co-operative to establish such internal reserve. Instead, the CSA (Art 91) mandates transfers of 5% of the annual surplus of each Maltese registered co-operative to the Central Co-operative Fund ("the Fund"). The same article also states that the main aim of the Fund is the furtherance of education, training, research and the general development of co-operatives in Malta.

The Fund is administered by a Committee which is established via the Central Co-operative Fund Regulations, 2016 (Art 3) ("Regulations"). In theory, the Fund was meant to unite the various co-operatives, it being based on the community concept, with the stronger helping the weaker. However, the reality is bleaker, with the fund being labelled by interviewees as the main cause for major disagreements in the movement. These in fact opined that further legal amendments relating to this Fund were required since, although well-intentioned, it was "*generally failing*" to achieve its stated purposes.

The main criticism put forward by literature and interviewees alike seems to relate to who should administer the Fund and who should have access to its resources (KM, 2010; MCF, 2014). With respect to the first contention, one may forward the argument that it is best for the Fund to be largely administered by the representatives of the co-operatives themselves, as the Fund's resources are raised by them. Yet, a moot point arises: would the co-operatives on their own be capable of appointing a Fund Committee members with sufficient extensive knowledge, skills and independence to make optimal utilisation of the available resources and at the same time avoiding possible conflicts of interest? Unfortunately, experience to date does not point to this. Probably, as a result, and in an attempt to ensure an appropriate Fund Committee, the stance taken by the recently introduced Fund Regulations (Art 4) is that of assigning a more active role than previously to Government in the composition and control of the Committee members. However, such a stance may clearly raise new issues. For instance, the *de facto* Government control may be easily perceived by the co-operatives themselves as being a retrograde step to the autonomy of the co-operative movement. Clearly, the viability of these Regulations has yet to be subject to severe testing in practice.

The second controversy arises in view of the fact that the Regulations (Art 12) now no longer restrict access to the Fund's resources to one Rep Organisation having the majority of member co-operatives but permit such access to more Rep Organisations - in fact, to any such organisation with either thirty-five percent of all the eligible co-operatives or with member co-operatives contributing at least thirty-five percent of the annual contributions to the Fund. Given the relatively recent set-up of a second Rep Organisation {The Malta Co-operative Federation (MCF)}, it may understandably be difficult for the Fund to continue to restrict the application of its resources to that Rep Organisation having the majority of co-operatives as its members. Yet, with two or

possibly more Rep Organisations in the future, the situation may easily give rise to the inefficient duplication of facilities and increased administrative overheads

However, it might be the case that even if the above issues were to be resolved, the intrinsic structural problems of the Fund would still not be tackled. One alternative proposal by respondents relates to the division of the Fund through the establishment of sub-funds, while another involves the elimination of the Fund as the middleman, with the statutory contributions being automatically passed on to the relative Rep Organisation/s. In essence, both proposals would diminish the extent to which the concept would embody the community Principle, but would retain a safety net of guaranteed income for the Rep Organisations.

At this point one may question whether the law should cater at all for the financing of the Rep Organisations (Regulations Art 16), and whether the Rep Organisations are sufficiently motivated to seek efficiency in the utilisation of the funds since they have comfort of a specified amount of guaranteed financial support.

In the light of such realities, it might seem useless to continue to put forward an image of the Fund as the embodiment of the Principles. Instead, it might be appropriate to come to terms with its practical function in the movement and to think as to how such function may be improved for its benefit. Given this new mindset, the reasoning of those calling for the complete elimination of the 5% Fund contribution starts to make more sense. Upon eliminating the Fund, the existent Rep Organisations would then be free to charge membership fees to their members. This, in turn, would create a direct line of accountability and healthy competition among the Rep Organisations which would have to prove that the fee is worth its value. It would also give the movement some much needed independence boost in that it would be able to shape itself in the manner most suitable for the members within it, rather than that dictated by legislation. To safeguard the application of Principles, the legislator may then consider the introduction of a provision to individual co-operatives similar to that utilised by European counterparts (SGECOL, 2015).

Are More Representative Organisations to be Recognised in the Law?

Although, as already stated, the Regulations (Art 12) now no longer restrict access to the Fund's resources to one Rep Organisation having the majority of member co-operatives but permit such access to more Rep Organisations, the CSA still recognises one Rep Organisation as such, which is termed Apex organisation (CSA, Part X, Art 106). Such an

organisation must represent more than half of all registered primary co-operative societies as its members and its ultimate aim has to be defined within its statute as that of *"facilitating the operations of all...co-operative societies in Malta"* (Art 106, CSA). Registration with the Apex organisation or any other Rep Organisation is not compulsory (Baldacchino and Bugeja, 2012).

Koperattivi Malta (KM) is the Maltese "recognised" and "registered" Apex organisation, representing close to 6,000 co-operative societies' members (KM, n.d). Yet, the prerogatives pertaining to KM which may emanate from such sole recognition are not laid out in the CSA and these therefore remain ambiguous. MCF is another recently founded Rep Organisation for around 100 co-operative societies' members (MCF, n.d). As a result, the existence of two active Rep Organisations results in a current split in the movement and may therefore be regarded as a limiting factor impinging on its ability to becoming a truly co-operative environment in line with the Constitution of Malta (Art 42.(Brincat, 2014).

The majority of the interviewees called for the CSA to recognise all present and future Rep Organisations, stating that, however ideal the concept of a single recognised Rep Organisation is, this is *"not realistically achievable"* owing to irreconcilable differences on the direction of the movement. However, if the provision mandating the 5% Fund contribution from co-operatives is to be repealed, thus paving the way for Rep Organisations to being funded exclusively from their members through membership fees, then the notion of Apex as the operational institution would clearly become obsolete. This is because in the event of such occurrence, all existent Rep Organisations would be aiming at safeguarding the interests of their paying members and not those of the movement as a whole. As such, no one Rep Organisation would qualify as Apex since none would have as their principal object the required *"facilitation of operations"* of all co-operative societies. The same reasoning would also apply should the Fund be divided into sub-funds or else be eliminated, with the statutory payments being made directly to the rep organisations.

The value of Part X of the CSA relating to an Apex organisation therefore remains doubtful, irrespective of the decision to be taken with respect to Fund structure. This is particularly so given the freedom of association that is afforded by the Constitution of Malta and that co-operativeness in other countries have not refrained from establishing their respective Rep Organisations notwithstanding the lack of dedicated provisions in

their respective regulations. Accordingly, Part X of the CSA relating to an Apex organisation calls for urgent review, and this has become even more clearly so in the light of the new Regulations, which, as stated refer to financing access to multiple Rep Organisations.

Other Possible Adjustments

Financial Accounting and Auditing

The CSA places a requirement for co-operative societies registered in Malta to maintain proper accounts and file a set of financial statements prepared in line with International Accounting Standards with the Board. The Third Schedule to the CSA provides a template set of financial statements for co-operatives to use as a guidance in preparing their own statements. The majority of respondents questioned the usefulness of the Third Schedule in the law, since, they argued, such a Schedule has become redundant in this day and age given the availability of other specifically dedicated legislations or standards. This is particularly true following the development and enactment in Malta of General Accounting Principles for Small and Medium Entities ("GAPSME") which should be applicable for most, if not all existent co-operatives given their small size. Notwithstanding this, co-operatives cannot as yet utilise GAPSME as this has not been transposed within their framework.

What about Social Auditing?

The inclusion in the law of a provision requiring the annual social audit of co-operative societies has been long debated, with those in favour claiming that this is crucial to help entities assess the extent to which their practices are in line with co-operative values and Principles. Those against its introduction often argue that this would be an additional cost burden. Taking both perspectives into account, one suggestion could be to introduce a self-evaluation exercise involving a 'comply or explain' approach.

Conclusions

It is clear that a number of changes to the CSA are likely to benefit Maltese co-operatives. Particularly, it is the areas of co-operative financing, distribution of returns and co-operative institutions which need most addressing, with the remaining areas necessitating fine-tuning.

The common thread is the need for less paternalism and greater independence, both in terms of financing and operations. This would enable the individual co-operative to take financial and operational management decisions for itself and also enable the movement

to shape itself as it considers best, free from any structures mandated by legislation. Although it is a common perception that such greater financial and operational freedom causes the legal structure not to remain as true to its co-operative identity, one should not simply dismiss any suggestions made since it is not necessarily so, especially if the legislation in place manages to establish a balance between the two.

This study therefore makes the following recommendations:

- that the existent definition of a co-operative society be retained:

This general definition, which is based on the internationally recognised definition of the ICA, puts forward the defining features of the legal vehicle and is also wide enough to ensure that any type of business can be set up as a co-operative.

- that the Principles be extracted from the main Act, and transposed in Co-operative Rules with co-operatives being subject to 'comply or explain' with respect to the said Principles:

Once the Principles are extracted from the main Act, their amendment upon changes being put forward by the ICA would be simpler and easier. By introducing a 'comply or explain' approach, co-operatives would essentially be carrying out a self-evaluation exercise and would be made to reflect upon the extent to which their actions are upholding the co-operative identity. This could also serve as a cheaper alternative to social auditing. The success of such an alternative would be subject to having a responsible body assessing the provided explanations.

- that the law (Art 55) specifies that a co-operative member shall not partake into any competing exercise to avoid conflict of interest:

The law should be clear in prohibiting co-operative members from generally having any conflicts of interest, instead of trying to limit the opportunities as to when said conflicts may arise as is currently the case. Additionally, given that membership in the co-operative is a precondition to sitting on the COM, it then follows that the no-conflicts clause may not be waived for COM members, as allowed by Art 72, which therefore needs also to be amended.

- that the law extends co-operative membership to companies offering complementary products:

The amendment of Art 53(2)(a) extending membership to companies offering complementary products would cause greater co-operation with entities having such a popular commercial legal structure.

- that the minimum number of members to form a co-operative be reduced to three or two:

The reduction of the minimum threshold to at least three members would aid in further placing the co-operative model in line with its European counterparts and simultaneously on a level playing field with the company set-up since the structure would become a viable option for the establishment of micro-entities. This is subject to retaining, and ensuring the strict enforcement, of the present provisions with respect to the registration of co-operatives to enable proper monitoring of new societies.

- that the possibility of moving away from the 'one member, one vote' regime be removed from the law:

Given that the one member, one vote' regime is an integral characteristic of the legal vehicle, through which the value of democracy is protected, the law should not allow the option (as in Art 56) for a co-operative to be alternatively constituted and operated.

- that the precondition of membership to be eligible to sit on the COM be retained, but that there be a reference to non-trading members in the law:

The lack of persons having the necessary knowledge or expertise on the COM may be the result of a misunderstanding of the law rather than a limitation. This may be addressed by referring to a non-trading member in the law to help increase awareness of the available possibilities.

Furthermore, a provision necessitating induction training for new COM members should be included. This would ensure that COM members would be well aware of the intricacies of the co-operative form.

- that the notion of the supervisory board be eliminated from the CSA, and replaced with a requirement of an audit committee for larger co-operatives.

The SB is rarely, if at all, established in practice, making the relevant articles redundant. Removing its notion from the CSA would establish the COM as the primary governance structure having directional and strategic responsibilities. Art 74 of the CSA should be reworded to make this clear, while at the same time retaining the functions which are necessary to uphold co-operative identity.

The notion of an audit committee may be considered for the larger co-operatives to alleviate concerns of insufficient controls on COM members. While it would be ideal for this to be applied across the board, it is hard to justify the additional cost burden for

smaller co-operatives, especially since companies of comparable size are not burdened by it.

- that the law specifies a minimum amount of share capital, with settlement of entry fees and exit compensation being made over time.

The introduction of a minimum level of share capital would be beneficial since it would improve the vehicles' overall perceived creditworthiness. For the cost not to be prohibitive to the extent that it limits open membership, a system of deferred payment by instalments should be introduced and should be mirrored at exit to also allow for appropriate compensation of exiting members. The system of increasing admission fees should be made in such a manner so that the payment of later-joiners reflects the value of the shares at that point in time. However, upon entry, all members would pay the original amount, with the difference being paid in instalments over a predetermined number of years as a proportion of later surplus distributions or interest paid to such members.

Given this new admission system, the repayment upon member exit at nominal value would make no sense. The law should be amended so that a system is set which provides the exiting member with the fair value of the shares via instalments in a deferred manner, subject to surpluses being generated.

- that the Reserve Fund be retained, but the requirement for it to be backed by liquid funds be amended.

The importance of indivisible reserves should not be underestimated. As such, the Reserve Fund should be maintained. In light of the shares being valued at their fair value in accordance with the above suggestion, it would suffice if the Reserve Fund's ceiling is set at the total of its paid-up share capital, thus removing the notion of borrowed capital from Art 90. Legislation should allow the investment of the funds backing the Reserve, prohibiting only the funds' investment in highly illiquid assets or those of a speculative nature.

- that the law (Art 92) be amended to explicitly permit the later distribution of ploughed-back surpluses.

This would permit the co-operative to take the financial management decisions most suitable for it. Given the above suggested system for compensation upon member exit, allowing for said later distribution would cease to be perceived as unfair on exiting members.

- that financial accounting requirements be brought in line with generally accepted accounting principles.

The CSA should state that “*generally accepted accounting principles*” shall be designated in the same manner as in the Accountancy Profession Act. This would automatically make GAPSME applicable for co-operatives falling under the respective size thresholds and essentially render the Third Schedule redundant. It should thus be removed, retaining only provisions outlining differences which would be more suited for the financial reporting of co-operative societies.

- that the Co-operatives Board minimum tenure be increased, with members being replaced on a rotational basis; also that the law (Art 4) be amended to require appointment of fit and proper persons defined as professionals and/or persons having extensive experience in co-operatives.

These changes would ensure the proper management of the regulatory arm of the movement.

- that a professional Registrar reports to the Co-operatives Board, with the institution having powers of deregistration and to striking off defunct co-operatives.

This could result in a shorter and more diligent decision process with respect to prospective registrations, and also enable constant monitoring of the veracity of registered societies. The Registrar would be enabled to remove any “sham” co-operatives.

- that the Fund be phased out of Maltese legislation, being replaced with a provision mandating the retention by each co-operative of a portion of the profits as indivisible reserves to be utilised solely for education and training.

While this could possibly be perceived as non-adhering to the community Principle in the movement, in actual fact this could be the manner via which the community feel is renewed among the different co-operatives. This is so given that common divisions in the movement are predominantly the result the present contentious Fund system. A major determinant of the movement’s ability to overcome its differences is the proper determination of what is to be done with the existing Fund resources.

- that the notion of a central representative organisation in the law (Part X) should be revisited and possibly amended.

The issue of whether multiple Rep Organisations are all to be fully recognised is an important bone of contention for Maltese cooperatives. As stated earlier, a well-managed

single national Rep Organisation could contribute more towards unity, strength and possible synergies. However, multiple Rep Organisations do have the countervailing advantage of enabling more freedom of association and competition. Nonetheless, this study recommends more research study on possible alternative ways forward for co-operative to associate.

Before concluding, we note the limitations of the study. One such limitation is the possibility of the researchers having missed out on some differing expert perspectives on aspects of the law. This despite the fact that towards the conclusion of the interviewing stage, it was deemed as serving little purpose to carry out more interviews, as the indications were that new viewpoints had reached their saturation point. A further limitation is that since the interviews were predominantly carried out in Maltese, some of the context in the replies may have been slightly altered in their translation to English. A third limitation relates to the difficulty for the researchers to achieve total detachment from the subject matter, given the researchers' own role in the interviews.

A final word. For more progress to be achieved there is the ultimate need for more responsibility to be placed on the co-operatives themselves. As Winston Churchill put it *"The price of greatness is responsibility"* (Humes,1995,p.82).

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