The Member Owns His Cooperative: Two Israeli Case Studies

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1. Introduction

One feature of most cooperatives around the world is that the cooperative's assets – or, in other words, its immovable property – does not practically belong to its members. This feature is in fact supported by laws relating to cooperatives in most countries. It is further strengthened by the International Principles of Cooperatives of the International Cooperative Alliance (ICA), particularly by the third of the ICA's seven central principles (Galor, 1997a).

This article will identify the changes that have taken place since 1999 in two of the largest and most prominent cooperatives in Israel. We will first examine Tnuva, which is a second-degree marketing cooperative, and which is today the seventh largest financial body in Israel. Afterwards, we will study Coop – Blue Square, which is the largest consumer cooperative in Israel. Both of these cooperatives were established in the 1920's.

The evolving relationship between the member and his ownership in the cooperative are the subject of this article.

2. Defining the Cooperative

The cooperative has been considered for many years the most widespread form of organisation in the world, particularly in developing countries. And despite the changes that have taken place, the cooperative is viewed in most countries as an organisation whose time is past and whose outcome is failure and disappointment to those who put their faith in it.

It is important to emphasise that the cooperative is not a goal in itself, but a tool for implementing the goal. The cooperative is probably one of the only means by which poor individuals can escape their poverty and go on to better themselves, their families, and their countries.

An individual joins a cooperative when he realises that his lone efforts are insufficient to achieve his goal. At that point, he becomes ready to rise above his own individual concerns, to cooperate with others who have the same needs, and to establish a cooperative. The goal of people who have reached this understanding is single and exclusive: to get the best possible service at the best possible price from the cooperative they have established. In a consumer cooperative, members strive to buy at the best possible prices the best quality goods for themselves, their families, and their homes. In a producer cooperative, members strive to receive the highest consideration for their work in the cooperative. In a marketing cooperative, the desired outcome is the highest financial consideration for the marketed product.

The management of the cooperative consists of two major parts. Figuratively speaking, the cooperative stands on two legs, and these two legs help it serve its members in the best possible way.

The first leg is the member's full ownership of the cooperative that he has established or that he has joined. The member is the full owner of his own relative share in the cooperative's total value, and the total value of the members' shares is exactly equivalent to the total value of the assets of the cooperative. The ownership of each member is equivalent to the ownership of every other member: each member holds one share of the cooperative, no more and no less. He or she acquires this share through cash or through the credit provided to him by the cooperative. The number of shares in the cooperative is exactly equivalent to the number of the cooperative's members. The share always maintains real value, and this value can rise or fall from one day to the next, whether through its linkage to the total value of the fixed assets of the members or through a change in the number of members. At the time the cooperative is established, members buy their shares at a price that reflects the share's real value.

The second leg is the sum total of the necessary expenses for the smooth operation of the cooperative. It is essential for the cooperative's accounting department not to confuse the accounting of the two legs. The sum total of the cooperative's expenses are paid by the members in exchange for the services provided by the cooperative. A member purchases services from the cooperative according to his needs, which are not necessarily the same as those of other members. The cooperative therefore charges a member according to his own use of the services. The more a member uses the cooperative's services, the more that member will pay. The sum total of the members' payments for their use of the cooperative's services will be equal to the sum total of the cooperative's operating expenses.

3. The Cooperatives under Study in this Article

3.1 The Nature of Tnuva

Tnuva is a second-degree marketing cooperative. It was established in 1926 as a result of a decision by its membership, which consisted of *kibbutzim* and *moshavim* that existed in Israel at the time (Verlinsky, 1965). It began with the decision to share, according to its various functions, the central provider, which was a second-degree cooperative, established in 1916 for the purpose of providing agricultural input to various settlements – in other words, to its members. This provider continued to maintain its major function, the provision of input. Tnuva's purpose was to engage in the organised marketing of its members' produce.

The procedure for acceptance of members into Tnuva was simple. The *kibbutz* or *moshav* that joined the cooperative was responsible for one thing only: to market all it produced exclusively through the cooperative. It is important to note that membership was open only to firstdegree cooperatives – *kibbutzim* and *moshavim*. Only after many years did individual farmers join, but they had only the right of marketing, and these were unusual cases. Upon joining the cooperative, members obligated themselves to market all they produced exclusively through the cooperative; new members did not need to pay any amount whatsoever for membership. Despite this, during the period of membership, a small percentage of money was withheld from the member's sales in the cooperative. Tnuva called the amount withheld payment for "subscription to Tnuva" (Vitels, 1970).

Mr. Verlinsky, the first director of Tnuva and the individual who designed Tnuva from the beginning, points out that these payments were designated by the early heads of the cooperative to cover the monetary investments that Tnuva required in order to establish the different properties that comprised its marketing apparatus. In the difficult economic conditions of the 1920's and 30's in Israel, these payments were a critical source – and, at times, a nearly exclusive source – for financing these investments.

The result was a situation in which members of the cooperative contributed into the investment fund from the proceeds gained by the cooperative's marketing of their produce. Because members did not produce at equal levels, their contributions to this fund were not equal. But these contributed sums were invested in the cooperative's property, which, according to law, belonged equally to all members. In other words, what resulted was unequal financial participation for equal ownership. The consequence was a cumulative inequality that lasted almost eighty years, and the cumulative injustice assumed enormous proportions (Galor, 1989).

Whether through individual membership via the *moshav* or joint membership via the *kibbutz*, the amounts that each member paid to Tnuva – the subscription to Tnuva – were recorded in the cooperative's books according to their nominal value. This practice is shared by most cooperatives around the world, and this is also the procedure recommended by the ICA. But after a decade or two, because of the fall in the money's value, there was no longer any meaning to what had been recorded. Thus it happened that members owned subscriptions whose value was lower than the price of their registration recorded on paper.

Despite this, the cooperative's property – property of all kinds – rose in value. First, Tnuva continued to invest in real property, which was necessary for the advancement of the cooperative's business. Second, the cooperative's property in general went up in value during most years of the cooperative's existence. In the last few years, the cooperative's property has been unofficially valued at billions of American dollars. None of this property belonged to the members. It did not belong to them according to the cooperative's by-laws, according to the laws governing cooperatives, or according to the ICA.

3.2 The Nature of Coop – Blue Square

The consumer cooperative Coop – Blue Square was founded for all practical purposes in 1937 (Daniel, 1976; Raviv, 1999). The Coop was established through the unification of a large number of cooperative shops, which had been set up at the beginning of the 1920's in different cities as well as in different neighbourhoods within the same city. Each cooperative shop was, in effect, a small consumer cooperative which served a small number of members – from one hundred to five hundred families in a residential neighbourhood. Because these cooperative shops were too small to survive economically, the Histadrut decided after a few years to combine them with a number of larger consumer cooperatives, which would then include a larger number of branches – namely, the previously independent cooperative shops (Galor, 1986). The Histadrut decided to establish a number of even larger consumer cooperatives in Jerusalem, in Haifa, in Tel Aviv, and in other places. Over the course of time, the cooperative that was established in the Tel Aviv area – which was called "Coop" from the start, and only later added the words "Blue Square" to its name – expanded its scope and united with other similar cooperatives. The course of events was accelerated at the end of the 1950's, when private supermarket chains began to appear in Israel, especially the Supersol chain, and particularly in Tel Aviv. In reaction, the Coop established its own chain of supermarkets, which tried to respond to the needs of retail marketing and to changing consumer habits in Israel. At that point, the words "Blue Square" were added to the cooperative's name.

The process culminated at the beginning of the 1980's, when the Blue Square chain comprised more than one hundred supermarket branches in Israel, expanding from the Hadera region in the north down to Eilat in the south. During that period, the management of the system was in the hands of Benny Gaon, who made a profound mark on the impressive economic development of this chain of consumer supermarkets.

The cooperative's property has derived from two major sources. The first one relates to the historical establishment of the different cooperative shops: each member of the cooperative shop paid for a single membership share, whose value remained nominal. This value has changed on occasion during Coop's lifetime, but never with any link to the real value of the cooperative's property. To illustrate this point, through today the value of an individual membership has been 500 shekel, and the official number of members is 20,000. Based on this, the total value of membership subscriptions is 10,000,000 shekel. The cooperative's current property, however, is valued at 2.5 billion shekel. Given this situation – which does not contradict ICA doctrine and which occurs in other countries as well – the members are actually owners of less than 1% of the cooperative's total property. In the view of many people, as we will soon see, this situation is unacceptable.

The second way in which the cooperative's property has grown is through regular business management, in which the cooperative's managers have taken out loans for the development of the property. Over the course of time, through sound management, the cooperative has repaid the loans out of its profits on its business activities. Since this is the case, to whom does the property of the consumer cooperative belong, once all loans are repaid? The Coop management's response, which is based on the prevailing approach to cooperatives throughout the world, is that the property belongs to the cooperative. But the cooperative is thus an entity independent of its members, who are its owners, and therefore the total value of these fixed assets cannot be apportioned among them.

To clarify, other large and successful cooperatives exist in Israel, such as transport cooperatives and cooperatives for public transportation, in which all the property of the cooperative belongs completely to the members (Galor, 1998). This means that membership shares in these cooperatives – one share per member – have risen in their real value over the course of time, and that they are now identical in their collective value to the total value of the cooperative's current property.

4. Changes that Occurred in 1999 and 2000

In the past few years, a significant number of Israeli cooperatives have been undergoing a reassessment of the economic linkage between the member and the cooperative. The *moshav*, the multi-purpose cooperative that is the most complex of its type, has always maintained the parity between the total of members' property and the total of the cooperative's property, and in general, the index for maintaining the real value has been the market value of the property. The Israeli *kibbutz*, a unique organisation for rural cooperatives and communities, has also initiated a reassessment of this type. This article, however, will deal exclusively with the two cooperatives already under discussion.

4.1 Tnuva

On November 17, 1999, a general meeting of Tnuva convened in Kibbutz Yagur (Raveh & Lavi, 1999). Nine hundred thirty-eight delegates participated, representing the 607members of the association, all of which are *kibbutzim* and *moshavim* (Tnuva, 1999b).[1] At the meeting, a significant majority decided to change the cooperative's by-laws so that members would have full ownership of all the cooperative's fixed assets. Members would have the right to sell their membership at its real value. This general meeting was convened only after two years of preparation. The management of Tnuva had decided to establish a preparatory committee because it understood the difficulties in getting such a far-reaching decision passed, and it recalled the problems that had arisen at the previous general meeting, when attempts at reform had failed because of inadequate preparation of delegates. This committee understood that the prerequisite for passing such a bold measure lay in the precise definition of the relative share of each member in the association's property (Tnuva, 1999a). At the conference itself, the management prepared

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[1] The numbers given are based on the official protocol of the general meeting of Tnuva on November 17, 1999. In some other publications, the official number of members is recorded as 620. This difference in figures has no impact on our discussion.

an audio-visual display that explained different aspects of the desired changes to the delegates.

The following is the reason for the change, as presented in the words of Gedalia Gal, Chairman of Tnuva's management (personal communication, April 17, 2000):

> It is fitting to remember that a very long time ago, *all* the members [of Tnuva] were producers, and they sent their produce exclusively to Tnuva. Quite a number of years ago, the *majority* of them stopped dealing in agriculture, but they nonetheless continue to remain owners of the property – Tnuva. Tnuva for a good number of years has operated like a company in its relations with its producers – its members, but Tnuva has not been required to provide consideration to its owners, its members.

The management of Tnuva has continued to explain to delegates, through the audio-visual display, the reasons for the changes. The management points out that the by-laws of Tnuva that had existed previous to the general meeting were adopted decades ago. But there is no similarity between the reality back then, when the by-laws were written, to the reality at the end of 1999.

According to the management of Tnuva, three central reasons justify the reforms that were proposed:

- Tnuva changed from being a shared association in which all its members were involved in agriculture and marketed their produce exclusively through the association, to an association in which only some of the members are involved in agriculture.

- Only a portion of the members of the association market their produce through the association itself.
- Even more seriously, a portion of the members market their produce in competition with Tnuva.

Given these considerations, it became the responsibility of the management to convince the delegates to vote for the proposed changes.

There are two facets to the way in which Tnuva proposes to transfer ownership of its assets to its members.

Fifty percent of all Tnuva's assets will be divided equally among all the members – which are, as mentioned earlier, the primary associations of *kibbutzim* and *moshavim*. The remaining 50% will be divided among all members based on the total of "subscriptions to Tnuva" – in other words, the total of marketing amassed during all the years of membership by each member in the cooperative. These "subscriptions" will be revalued from their nominal value in the past to their real value today. Because the association's accounting books do not enable a reconstruction back to the date of the cooperative's establishment, it was decided to calculate the subscriptions' value according to the amount of marketing that each member conducted through the cooperative between the years 1952 and 1978 (Raveh & Lavi, 1999; Tnuva, 1999a, 1999b).

It is appropriate to note two additional points. First is the issue of consideration to the member in exchange for his participation in the association's financial activities. A great deal of deliberation has been devoted on a number of occasions to this complicated matter (Galor, 1994, 1995, 1997b). Over the course of many years, as already noted, Tnuva did not see itself as a cooperative of members. As a result, Tnuva was not particularly concerned about passing along to its members the highest possible consideration for their marketed agricultural product. At the general meeting, the management of Tnuva explained that the new policy would be, in fact, to distribute to members any possible surplus from the total financial consideration that Tnuva receives from product sales.

In April 2000, the management of Tnuva decided to apportion among members, as an additional consideration for the marketing of their product, a total of 25 million shekel from the profits of 1999 (G. Gal, personal communication, April 17, 2000; Haaretz, 2000) .

The second point, in the context of the ownership issue which we are discussing, is that the compensation for salaried workers of the association was raised. Tnuva extends throughout all of Israel, and it functions through thousands of salaried workers at different levels, including the level of management. The workers' committee of the association demanded, as an outcome of the process of distributing shares, that the salaried workers receive 10% of Tnuva's assets. It is not yet clear at the time of this writing whether this demand will in fact be met, despite the positive approach of Tnuva's management (Hayoun, 1999;

Tnuva, 1999a). A similar claim has been made in connection with the cooperative Coop – Blue Square, which we will deal with shortly.

In this way, Tnuva has completed the process of returning ownership of the cooperative to its members – a process that can be described as revolutionary.

4.2 Coop – Blue Square

The association Coop – Blue Square has undergone a huge shake-up in the past year. Large consumer cooperatives like this particular one exist in different Western European countries – such cooperatives extend over large sections of a specific country and include an extremely large number of branches. Such cooperatives also exist in Asia, where the most well-known example is the consumer cooperative Apna Bazaar in Bombay, India. Germany is another country in which there now exist – and where there used to exist – consumer cooperatives that served extremely large geographical regions. The example of the consumer cooperative Dortmud-Kassel, which is discussed in Munkner's article (1999/2000), is particularly interesting. Munkner describes a consumer cooperative that was established in 1902 and that was once the largest in Western Europe but that, as a result of various unsuccessful business decisions, went bankrupt and shut down in 1998. The article attempts to describe what occurred in that case, explaining that management policies, which attempted to distance the members from the control and supervision of their own association, resulted in the association's demise.

In the Israeli example, the end is different, even though certain characteristics are similar. Here, too, the management attempted to complete a process of detaching the association from its members, but this process was unsuccessful. In the Israeli case, the association did not go bankrupt, and it continues to survive economically.

4.2.1 Background to the Changes that Occurred in the Association

Benny Gaon began his work as manager of the association in 1982 and succeeded in moving the association forward as a financial business. He initiated operations of buying, selling, mergers, and offerings, which raised the total value of the association's assets.

In 1996, the association publicly issued shares of its subsidiary, Blue Square, in the New York Stock Exchange. This operation met with great success, both for the cooperative and for the group of individuals who occupied the most senior positions in the association's management, with Benny Gaon at their head. Each one of these individuals was in a position to receive figures in the millions of shekels, through the exercise of their options or as payment for the success of the offering (Raviv, 1999).

According to an article in the Israeli financial newspaper *Globes*, the Israeli branch of the company Dun & Bradstreet ranked Blue Square as the seventh largest company in Israel. Tnuva was ranked in fourth place in that same year (Koren, 1998). In that year, Benny Gaon began an operation that was ultimately meant to result in the sale of the Coop to private investors. Coop held 82% of ownership in Blue Square, and, as quoted by the same newspaper article, the monetary value of the company's assets approached $400 million (Yitzhak, 1998b). A *Globes* article dated May 11, 1999, already quoted above, notes that the value of Coop's assets approaches $550 million (Raviv, 1999).

The year 1999 also stands out for the association as a time of investment and expansion. The goal of the association was to reach 220 branches throughout Israel. In 1999, the association sought to establish 12 new branches with an investment of $100 million. In 1998, the association's profits reached 70 million shekel, and together with the profits of 1997, the sum reached 170 million shekel (Dovrat, 1999). It is important to note once again that the association's members did not actually benefit either from this accumulation of profits or from the increase in the value of the association's assets.

4.2.2 The Beginnings of Change

A number of the association's members, with the help of lawyers Herzl Caspi and Eliezer Levitt – the latter of whom is also a member – began to work against the control of Benny Gaon and his group. The process began after the public offering of Blue Square in the New York Stock Exchange, during the course of which fifteen senior administrators, including Benny Gaon, received a package of options that enriched each one of them by the millions of shekels (Veiner, 2000b). Benny Gaon initiated an effort in which he requested the Registrar of Cooperative Associations, Attorney Uri Zeligman, to locate the full list of the cooperative's members. This effort was intended to pave the way for a small group of associates to gain full control over the cooperative's assets and, in this way, to realise enormous personal profits. The Registrar of Cooperative Associations appointed a retired governmental legal advisor, retired Judge Michael Ben-Yair, to locate the cooperative's members or their heirs from all the years of its existence – a group that was estimated at 40,000. The decision was already issued in 1997, but it was not publicized to members until halfway through 1998 (Yitzhak, 1998a). It should be remembered that according to another source (Zitrin, 2000a), the association's current members number 185,000, with an additional 2000 who have passed away. There exist another 37,000 whose status is unclear. The task of Mr. Ben-Yair was to submit a final list of the association's members categorised by their different types. The report was prepared and was in fact submitted to the Registrar of Cooperative Associations on February 23, 1999. The report's findings presented clearer figures: 17,558 full, registered members; 2230 members who are no longer alive; and 38,159 individuals whose status is unclear.

The Registrar decided on May 28, 2000, to appoint a new investigator. He appointed accountant Yehuda Barlev as special investigator and gave him the task of completing the list of members. The special investigator opened an

Internet site that contained an appeal for the further location of members (www.coop-barlev.co.il).

An additional factor in the course of events was the committee of retired District Judge Eliyahu Winogard. The committee was established on the initiative of Benny Gaon as part of his strategy to sell the nucleus of control in Coop to a single investor, who would consolidate in his own hands the control of that economic giant and who would enable his own group of close associates to make huge fortunes. Benny Gaon presented the committee's establishment as a means of responding to members' complaints about the lack of negotiability, and particularly about the nominal value of the members' shares. The recommendation of Judge Winogard's committee was that members' shares receive their real market value and that they be negotiable. Practically speaking, this decision presented a reversal in the cooperative's approach and in the quality of member-cooperative ownership (Zitrin, 2000a; Tsuriel, 2000). In the lawsuit that Caspi filed in the district court of Tel Aviv on behalf of a group of members, he points out that the member's share is today worth 500 shekel. But given that the cooperative's assets are valued at more than $500 million, each member's share should actually be worth $24,000, which is approximately equivalent to 100,000 shekel (Danon, 1999).

4.2.3 The Big Change

General elections in Coop were held in November 1999. These elections took place in the various branches of the association; in each branch, registered members selected representatives who attended the association's general meeting and who, in turn, chose the association's management. The elections were conducted amidst the extremely bitter misgivings of members, and in a number of branches, the elections were disqualified. The result of the elections was the continuation of the existing management, with Benny Gaon at its head.

This result was not accepted quietly. A legal complaint against the elections, which was filed on behalf of a group of members by the two lawyers mentioned earlier, Herzl Caspi and Eliezer Levitt, resulted in the decision of the Registrar of Cooperative Associations to appoint two special investigators to the case. One of these investigators, a lawyer named Dinay, was appointed to investigate the propriety of the elections, while the second investigator, a lawyer named Indig, was given the job of investigating the distribution of options in the wake of the public offering of Blue Square in New York in 1996 (Veiner & Gross, 2000a).

Attorney Dinay recommended the disqualification of the elections. He noted that improper agreements had been made between Coop's management and representatives of the cooperative's salaried workers, some of whom were themselves members of the cooperative; these agreements ensured the workers' support of the management during the elections. Additionally, at the expense of the association, the management funded the election campaigns of candidates sympathetic to itself. The management also knew that the list of voters was flawed, but did nothing to correct or update it. The elections were contaminated by serious disorders and by significant departures from legal dictates and from the association's by-laws. The report recommended that the Registrar of Cooperative Associations appoint an administrative committee to the association (Gross, 2000).

The Registrar of Cooperative Associations appointed Attorney Indig to examine the propriety of options distributions in Blue Square, as well as the propriety of the transfer of assets from the cooperative to the company. Within the framework of the public offering, all of the cooperative's business activities and assets were transferred to Blue Square, a company owned by the cooperative. Within the framework of the prospectus, officers of the association were offered 1.5 million options out of the total capital that was raised. The identity of options holders was kept secret, as were the number of options that each holder received. The options were offered to officers of the association at a price of $10, while shares were offered to the general public at $11. In July of 1999, thirteen of the senior officers exercised the options in their possession, selling them at a price of $16 per option – in other words, a profit of $6 over 1.5 million options, meaning a total profit of about $8 million, or close to 30 million shekel. Attorney Indig examined this matter in a most thorough manner. He also examined the sales of storage supplies to the cooperative stores of the association – sales made by A.R.M.G, a company owned by Benny Gaon, the president of Coop (Veiner & Gross, 2000b).

Indig's report was published in July, 2000 (Veiner, 2000a). The report recommended that the existing management be dissolved, pointing out that Benny Gaon worked intentionally to conceal his involvement in the distribution of options. The report notes that the central motive of Benny Gaon's actions was his desire to change the structure of the association's structure so that he would gain complete control over it.

Once the previous committee was dissolved and Benny Gaon was forced to leave his position, the Registrar of Cooperative Associations appointed an external administrative committee, which was composed of thirty members (Zitrin, 2000b). One of the new committee's objectives is to bring membership shares in the association up to their real value.

5. Conclusion

The two cooperatives, Tnuva and Coop, underwent extremely important structural changes. Neither of the two cooperatives came to a financial end; in fact, the opposite occurred: they continue to function, and to do so successfully. The changes that they underwent occurred within the framework of a logical and appropriate process of returning the cooperative to the ownership of its members. In another study (Galor, 1998), we have shown that Israeli credit cooperatives have disappeared because they did not know how to adapt to current realities, and particularly because they did not belong to their members. Tnuva and Coop are currently in the process of returning complete ownership to the members, a process that will ultimately give members the real monetary value of their ownership. The lesson these cases provide to cooperatives throughout the world is critical. Most cooperatives in the world do not belong to their members. Even the cooperative principles of the ICA fail to support this approach. Nonetheless, this approach guarantees a better future to existing cooperatives and a more promising future to new cooperatives.

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