Toward a Team Production Theory of Cooperatives

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Commonplace conceptions: cooperatives are concentrated in agriculture; primarily in developing countries; elsewhere scarce, small, formed only when high unemployment, etc.

In reality:

- Largest cooperatives (turnover) to be found in **developed countries**: US, Japan, France, Germany, Korea, Switzerland, Spain, Italy
- Total turnover of top 300 cooperatives worldwide exceeds **US$ 2.2 trillion** in 2013, which is in terms of nominal GDP is comparable to Italy (ILO, 2015)
- In G20 countries around **12% of total employment**, indirect and induced employment excluded (ICA, 2015)
- **Many sectors**: agriculture, food processing, banking, insurance, construction, housing, energy, wholesale distribution, retail, creative industries, healthcare, social care, education, transport, sports
Following Hansmann (1996) cooperatives are firms

(a) formally owned by a subset of their patrons
   (ownership = residual income + control)
(b) members’ claims to the surplus are proportionate to patronage
(c) governed by member-elected board according to one-member-one-vote rule (or proportionate to patronage)

There are as many types of cooperatives as there are groups of patrons

consumer cooperative, producer cooperative, purchaser cooperative
worker cooperative, capital cooperative

⇒ All firms are cooperatives (Hansmann, 2013)
Intermediary cooperatives (consumer cooperative, producer cooperative, purchaser cooperative) have never been the focus of theory of the firm (ToF)

No one other than Hansmann has ever called the investor-owned firm a cooperative

**Worker cooperatives primarily in ToF literature**

**Historical reasons:** in late 1960s and early 1970s calls (market socialists, radicals, other critics of corporate power) for *industrial democracy* lead to comparative defences of capitalist firms

**Theoretical reasons:** as black box of $Y = f(K,L)$ replaced by *comparative institutional analysis* attention focuses naturally on relative merits of capital-owned vs labor-owned forms of organization

⇒ One of the origins of the contractual theory of the firm
1. Relatively small **old-school neoclassical literature** on **labor-managed firms** (Domar, Sen, Ward, Vanek, Meade)

2. Larger **radical literature** on **superiority of democratic firm** (Bowles & Gintis, Horvat, Clarke, Ellerman, Weisskopf, Braverman)

3. Large **NIE literature** on **unequivocal superiority of capitalist firms** (Alchian & Demsetz, Furubotn & Pejovich, Jensen & Meckling, Williamson, Holmström, De Alessi, Eggertsson, Hart & Moore)

4. Relatively small **NIE literature** on **potential relative efficiency of worker cooperatives** (MacLeod, Ben-Ner, Dow, Putterman, Aoki, Hansmann)

5. More recent small **NIE literature** on classification of **cooperatives as hybrids** (Ménard, Haddad, Cook, Hendrikse)

6. Lots of **empirical studies** (Jones, Berman & Berman, Oakeshott, Conte, etc.)
We want to assess the extent to which the standard ToF result that cooperatives are relatively scarce because they suffer from chronic under-investment (free-riding problem) and under-capitalization (horizon and non-transferability problems) is justified.

Argument: standard result no longer holds once consideration of legal form, specifically of cooperative law, is introduced.

Focus on ToF thread picked up in Blair & Stout’s (1999) team production theory of corporate law to show that cooperative law produces the exact same benefits and for the exact same reasons as corporate law.

Actually Blair & Stout argument works better for cooperatives.

(In later phase we want to examine relative success or failure of cooperatives using the logic of institutional complementarities à la Aoki, Pagano, etc.)
We are dealing with Coasean ToF, meaning that all models discussed share the following feature:

the contractual centralization of transactions, where several input owners make bilateral contracts with a central agent (as opposed to with each other) is an efficiency-enhancing, i.e. transaction-cost economizing, institutional arrangement

ToF differ in terms of

(a) who or what is identified as the central contractual agent
(b) what economic functions are performed by this agent
(c) which bundle of rights are assigned to this agent
(d) which groups of input owners are inside firm boundaries
Team production: several input owners, super-additive surplus, metering problem, potential for free-riding

It pays for one team member to monitor inputs, detect shirking, reward accordingly, etc.

Monitor’s incentives ensured if residual claimant, and role effective if sole central contractual party with right to alter unilaterally individual contracts without affecting team or other contracts, change the membership mix, etc.

Hobbesian solution with ownership and control together (entrepreneurial firm) but separate from labor

Clear/narrow boundaries: owner inside, all other inputs outside
Related point of departure: several input owners, super-additive surplus, noncontractible specific investments, potential for hold-up

Distributing residual claims to team members may exacerbate rent-seeking behaviour

Assigning residual claims to third party unrelated to team production process improves members’ incentives to make specific investments

Hobbesian solution with separation of ownership from control (managerial firm) and labor

Unclear/broad boundaries: any agent making specific investments, including suppliers and clients, is team member
Third party owner and central contractual agent is incorporated entity, i.e., legal person with capacity for property, contract and litigation assigned by law

Board of directors trustees not of any particular team members but of entity itself

Board mediates disputes among and interests of all team members, broadly viewed as any stakeholder, as ultimate court of appeals

Model applies primarily to public corporations and consistent with corporate law, viz. fiduciary duty, duty of care, duty of loyalty, business judgment rule, etc.

Unclear/broad boundaries: who is a member of the corporation?
We agree with interpretation of legal entity as third party owner and central contractual agent, i.e. nexus for contracts

Corporate law does stipulate that boards should act in the interests of the enterprise as a whole

Courts don’t intervene in internal disputes (Williamson’s forbearance) both because of business judgment rule and because as unified legal entity corporations appear in court as singular persons, i.e. divisions don’t have standing on their own

We are sceptical of Blair & Stout’s (and Rajan and Zingales’) claim that team comprises all specializing agents, including clients and suppliers

We don’t see the need to restrict the team production theory of corporate law to public corporation: it would work equally well for close corporations, LLCs, and cooperatives
Cooperatives are generally incorporated under either special statute or under other legal forms, e.g., under general corporation statutes, with very similar governance provisions.

Most recent cooperative statutes have made them look like corporations or LLCs in terms of organizational structure (e.g. board composition) and liability (most cooperatives have limited member liability).

Many cooperatives issue preferred (non-voting) shares to raise finance and have transferrable (in some form) shares.

With cooperatives it is easier to see who the members are.

Cooperatives have been adapting to changing competitive conditions, ICT revolution, financial revolution, human capital-intensive economy, and their prevalence may well grow in the future.