Toward a Team Production Theory of Cooperatives

David Gindis & Francesca Gagliardi

University of Hertfordshire

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Facts about cooperatives

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 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

Hansmann's definition

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

$\Rightarrow$ **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**

$\Rightarrow$ One of the **origins of the contractual theory of the firm**

ToF literature on cooperatives

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.)

Motivation & argument

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.)

Note on Coasean ToF narrative

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

Alchian & Demsetz (1972)

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

Rajan & Zingales (1998)

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

Blair & Stout (1999)

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?

Assessing Blair & Stout

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

Empirical relevance

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