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Co-operatives and Employee Ownership

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I Historical background and International perspectives

The first co-operatives appear to have been established in the eighteenth century. Early utopian writers, notably Owen, who saw co-operative communities as alternatives to competitive and individualistic capitalism, were a major stimulus to the establishment of these first co-operatives. Equally, practical necessities, such as the need to obtain unadulterated foods, played major roles in the formation of early co-ops such as the flour mills at Woolwich in the 1760's and the famous Rochdale store in 1844. Subsequently while the development of the co-op movement continued to be inspired by the writings and actions of individuals such as Fourier, Blanc, and Buchez, pragmatic considerations have always played prominent roles in the evolution of co-operatives.

Diverse forms of co-operatives exist. Hansmann (1996) and Birchall (1997) amongst others provide good descriptions of co-operatives around the globe. Empirically, the most important forms of primary co-operatives, both in the US and elsewhere, appear to be co-operatives in the agricultural sector (mainly in food production), in banking and finance (in the form of credit unions and co-operative banks), in insurance (either mutual or co-operative form), and in retailing, where co-operatives are either retailer- or consumer-owned (the latter is fairly uncommon in the US but is very popular in some European countries). Co-operatives are economically significant actors all around the globe, and the combined membership in co-operatives, according to the International Co-operative Alliance, is more than 800 million people (see www.ica.coop.) Moreover some co-operative forms, including co-operative banks, have been found to be of growing importance in their sectors (Fonteyne 2007). However, the importance of co-operatives does not derive solely from their economic significance, but also because of their democratic governance and their perceived ability to address market failures (see, e.g., Kalmi 2007). In part reflecting their social objectives, associations of co-operatives are a prominent feature of the co-operative landscape.

Compared to co-operatives, interest in and examples of employee ownership are much more recent phenomena. The oldest forms of employee ownership are stock purchase and stock option plans and have existed only for about 100 years. But even fifty years or so ago such schemes were often quite extensive—for example they are believed to have covered at least one million employees in several countries including Germany and the U.S. However interest in those schemes has often been limited since stock tended to be owned by highly compensated employees. By contrast the growth of employee stock ownership plans (ESOPs) has stimulated a reawakening of interest in employee ownership. By the mid 1980s it was estimated that the number of plans existing in the US was approaching 10, 000and that 10 million employees were covered (Rosen, Klein and Young, 1986.) Also employee ownership has grown rapidly elsewhere. Thus in Japan, in little more than a decade ESOPs (mochikabukai) grew to cover more than 90% of top listed companies (Jones and Kato, 1995). And in Europe the Pepper reports (e.g. Lowitzsch, 2006,) document the rapid dissemination of diverse forms of employee ownership especially in the last twenty years.

The reasons for the recent growth of employee ownership appear to be quite different from those forces behind the fluctuating fortunes of co-operatives. For many years it is believed that most actors were not enthusiastic about employee ownership—for example employees stressed problems flowing from income variability in firms in which they had an ownership stake. The attitude of governments around the world mirrored this lack of enthusiasm and few promoted ownership by employees. However in recent years this stance has changed and various fiscal incentives for companies and individuals often exist as governments seek to encourage productivity growth, stimulate capital formation, anchor jobs and ameliorate income differences. This has led to a parallel growth in institutions dedicated to promoting the spread of employee ownership, such as the National Centre for Employee ownership in the US or the European Federation of Employee Share Ownership. Also the collapse of the command economies and the move away from state ownership led to many "privatization surprises" (Uvalic and Vaughan-Whitehead, 1997) and the emergence of considerable employee ownership. However, in the main, employee ownership has not proved to be stable during economic transition (see, e.g., Jones and Mygind, 1999.)

II. Definitions and examples

For our purposes the essential features of co-operatives are given by enterprises that have the following characteristics: 1) Ownership is not determined solely by investment in shares, but the owners have another transaction relationship with the enterprise (as employees, suppliers, or customers); 2) Voting rights are not divided in relation to capital but equally between members. As such this definition de-emphasizes other Rochdale principles including open membership, limited interest on capital, religious neutrality, cash trading and the promotion of education (Bonner, 1961).

As already indicated a wide variety of firms can be listed under the co-operative umbrella, including agricultural, credit and consumer cooperatives. One form that has proved to be of particular interest to many is the producer or worker co-operative. In such firms the position of the worker is crucial so that membership is restricted to worker-members in the business who effectively own and control the firm. One of the best known examples today of worker co-operatives are the Mondragon co-operatives (see http://www.mcc.es/ing/) though there are other prominent examples in Italy and France.

Employee ownership also encompasses a wide variety of types, notably employee stock ownership plans, employee stock purchase plans and stock options. For some employee ownership is seen as part of "shared capitalism"—where employees participate in the rewards of the business, similar to other alternative methods of compensation including profit sharing and gain sharing (Kruse, Blasi and Park, 2008.) In the vast majority of instances of employee ownership, and unlike in co-operatives, voting rights reflect ownership of capital which are not equal either amongst employees or between employee and non-employee owners. In firms with employee ownership, capital owners sometimes do introduce arrangements that enable employees to have enhanced involvement in decision-making. While this often happens, it is also rarely to such a degree that firms with employee ownership and worker co-operatives are aligned in this respect. Instances in which this has happened, such as the Eroski retail chain in Spain or in some British consumer co-operatives where employee directors are present (Jones, 1987) are the exception rather than the rule.

III. Key Issues

While co-operatives and firms with employee ownership are often quite different animals, research by economists on these organizations often concentrates on similar issues. This is especially the case for the overlap between worker co-operatives and firms with employee ownership and in this section we first discuss the economics literature on worker co-operatives and employee ownership. Second, we discuss literature on other types of co-operatives. Much of this literature has been theoretically focused, and empirical literature has followed with a considerable lag. However, this has not been the case in the study of co-operatives within development economics. In that field, empirical observations have motivated theoretical models, but a unifying theoretical framework has been lacking.

Issues concerning employee-owned enterprises and worker co-operatives

One set of issues concerns the *comparative scarcity of worker co-operatives or firms with employee ownership.*[1] Why, apparently, are such firms rare (compared to conventional investor-owned firms)? In turn this leads to examination of issues relating to formation, survival, and life cycle. One might also classify the many studies that examine issues of the incidence of co-operatives and firms with employee ownership under this broad heading.

In investigating such matters, work on both producer co-operatives and firms with employee ownership has tended to have a mainly micro focus and to proceed by examining a set of such firms within one country. See for example studies of the entry and exit of French worker-coops (Perotin, 2006) or the investigation by Blair et al.(2000) of the stability of employee owned firms. This is also the case for studies of firm survival. Such studies tend to refute the prediction that firms with employee ownership, including producer coops, will have lower survival rates (e.g. Perotin, 2006). At the same time,

[1] For useful surveys summarizing the economics literature worker co-operatives and employee ownership, see Bonin, Jones and Putterman (1993) and Dow (2003).

beginning with the work of the Webbs and continuing with formal economic modeling by, amongst others, Ben-Ner (1984) researchers have analyzed the tendency of particular types of co-operatives (notably producer co-operatives) to transform themselves into organizations within which control rights are vested in a small number of worker-members.

There is also a growing literature that investigates the determinants of the incidence of firms with some degree of employee ownership. For representative studies see, for example Poutsma, Kalmi and Pendleton (2006) for listed firms in European countries.

A second area of inquiry revolves around issues of *employment and output*. For worker co-opertives a vast body of theoretical work was triggered by a seminal paper by Ward (1958) in which a worker co-operative was believed to maximise per capita income of worker-members rather than total profits, as in a capitalist firm. A key finding emerging from this early model is that, relative to a capitalist twin, the producer co-operative will tend to have smaller employment, a negatively sloped supply curve and that labour will be inefficiently allocated within an economy of producer co-operatives. Most subsequent theoretical work overturned the pessimistic conclusions that resulted from this simple Ward model and little or no empirical support was found for these key propositions. Indeed the better empirical inquires, including Craig and Pencavel (1992) find that producer co-operatives have more stable employment. No evidence has been found either of short run inefficiencies or of perverse supply curves. And work for firms with employee ownership also finds evidence of more stable employment (e.g. Blair et al. 2000).

A third area of investigation is *investment and finance*. The way in which capital requirements are financed and the resulting structure of ownership of the firm's assets are matters that have attracted the interest of many researchers, especially students of co-operatives. In co-operatives the issues are particularly interesting since assets may be owned by members individually or collectively as well as by non-member financiers. The non-transferability of ownership rights in many co-operatives has led some theorists to argue that some co-operatives, notably worker co-operatives, will face persistent underinvestment. However empirical support for such predictions is weak (e.g. Jones and Backus, 1977), a finding that many find unsurprising since many real world co-operatives have implemented specific institutional design to ameliorate potential problems that pure theorists have identified.

A fourth and final area is the matter of the role of *incentives and performance* in firms that are co-operatives or within which there is some degree of employee ownership. One issue of especial interest to theorists is whether employee ownership and/or co-operation will lead to employees supplying efficient effort. For example, will democratic firms suffer from shirking by employees? For both types of organization a vast empirical literature has emerged to examine not only the links between employee ownership and firm performance but also the roles of employee involvement in decision-making. To date the bulk of the evidence rejects the hypothesis that employees in firms with employee ownership supply lower levels of effort. Following Jones and Backus (1977) a commonly favored approach to test this and similar hypotheses has been to augment a standard production function by a vector of ownership and participation variables. The key result is that the null hypothesis that the various forms of participation taken together do not affect productivity is rejected.

Other types of co-operatives

Among the various types of co-operatives, worker co-operatives have received most of the attention in the economics literature, disproportionately so compared to the size of this sector. However, this was the case already in the economics literature of co-operatives in the early 20th Century (Kalmi, 2007). Financial co-operatives have been studied to some degree and there are attempts to model their specific characteristics such as whether members may have diverging preferences depending on whether they are net savers or net borrowers. Also the composition of the membership is likely to influence the setting of interest rates, as demonstrated in theoretical models by (e.g. Smith et al. (1981). More recently, Emmons and Schmid (2002) have extended this framework into a situation where co-operative banks can also distribute dividends. However, very little empirical work has been undertaken to date in this field. There is also a large empirical literature that uses data from co-operative banks, with much of this literature testing more general propositions using samples of co-operative banks.[2] Studies of interest that focus on issues of more specific co-operative issues include Angelini, Di Salvo and Ferri (1998), who find that co-operative banks provide better access to credit for small firms, and Hesse and Cihak (2007), who find that co-operative banks are more stable than commercial banks. There is also literature analyzing the determinants of membership rates in financial co-operatives including Emmons and Schmid (1999) and Kalmi, Jones and Jussila (2008), the latter attempting to explore the role of various motivations (in particular monetary versus social) in the membership decision.

[2] Fonteyne (2007) is an excellent guide to some of this literature.

There is a surprising dearth of research concerning consumer co-operatives, with. Ireland and Law (1983) constituting a notable exception. In contrast, research on farmer producer co-operatives has proven to be an enduring topic of interest in the field of agricultural economics in journals such as *American Journal of Agricultural Economics* (see e.g. Sexton 1986, and Torgerson, Reynolds and Gray 1998).

Perhaps the most lively area within the field of co-operatives might is that of development economics. Much of this research is motivated by the rise of microfinance and other grass-roots economic initiatives. In recent years, the research on co-operatives that has found its way into major economics journals has often come from development economics (e.g. Banerjee, Besley and Guinnane 1994; Pitt and Khandker 1998.)

Finally, there is literature that attempts to provide more general approaches to co-operatives. Hansmann (1996) presents an elaborate theory on optimal ownership structures, building especially upon the argument that different ownership structures have different implications on collective decision-making costs. Jones and Kalmi (2008) use the recent ICA Global 300 (see www.global300.coop) dataset on the largest co-operatives in the world and find that co-operative incidence is very strongly and positively related to the level of interpersonal trust in a society. They determine that trust is a much more robust predictor of co-operatives than is the case in large listed firms, although there is some evidence that the presence of large listed firms is also higher in the presence of higher trust.

IV. Future Directions

Commenting on the literature on worker co-operatives up to the early 1990s, Bonin et al.

(1993) noted that the literature had been theory-led and that empirical literature had lagged significantly behind. At the same time, it was apparent that theory building had often ignored many well-known stylized facts. Also, most of that early literature on labor-managed firms (worker co-ops) used a comparative static framework that appears somewhat dated by current standards (e.g. Vanek 1970). By contrast some of the leading figures in contract theory have developed models that are based on more modern approaches (e.g. Rey and Tirole 2007). While such models are still in their infancy and have not been subject to empirical testing potentially large dividends will accompany better modeling that is grounded in stylized facts.

Early empirical studies often contained results that contradicted the most basic propositions of the early theory. Reflecting the general rise in the of esteem of applied work in economics, in part because of improved access to data and the broader availability of more powerful statistical software, empirical research on co-operatives and firms with employee ownership has made great strides in the last thirty years or so. However, it is also clear that much remains to be done. Before many research questions can be addressed it is also clear that much more and better data are needed. And while much progress in assembling improved data sets continues to be made, it is also apparent that empirical research in particular will continue to suffer because of the demanding requirements imposed by the challenges posed by robust empirical design.

These points can perhaps be best illustrated by considering work on questions at the *macro* level -- for example, work which aims to understand the reasons for the varying importance of co-operatives or employee ownership across time and space as well as the impact of these phenomena on macro variables such as employment adjustment. In this respect most useful beginnings have been made by the ICA and its recent efforts to provide systematic data on the top 300 coops around the world. Equally the nature and quality of data on employee ownership has been much helped by the continuing efforts of those institutions that act to assist firms with employee ownership, such as the NCEO. One example of the potential that such macro data have to offer is the paper by Jones and Kalmi (2008) that was discussed earlier. Equally such work is necessarily still in its infancy since the available data are typically restricted in important ways, including the span of years or the less-than-comprehensive way in which the universe of co-ops or employee owned firms is covered. In turn these deficiencies often reflect the historical ways that data have been collected by national authorities (such as census data), with a continuing failure to, for example, distinguish alternative organizational forms such as co-ops from conventional firms.

It is also the case that better *micro* data is needed. Again the traditional ways that government agencies collect data is often quite limited –there is a tendency to give only cursory attention to what goes on inside the "black-box" that is the firm. Consequently there is little on-going and systematic data collection on phenomena such as the presence and extent of employee ownership. In this context it is unsurprising that many firm-level studies have suffered from several important shortcomings. For example, many studies operate with samples of convenience rather than samples that are representative of the underlying populations. Often the range of key variables that are able to be measured is limited—thus studies of firms with employee ownership may omit measures of other potentially important variables, such as the extent of employee involvement. And when key variables are measured sometimes this is done so in an oversimplified way—for example a dummy variable for a producer co-operative, which ignores differences among producer co-operatives in critical respects such as the extent of worker membership. However, we are also seeing research on co-operatives that uses empirical approaches that are close to the frontier of current applied work; for example the work of Pencavel et al. (2006) that creatively combines and matches organization-level with individual-level data.

Apart from these empirical issues, there are also theoretical issues that are underdeveloped in current economics research. One glaring example is the role of co-operative networks in the growth and survival co-operatives. All types of co-operatives are often organized into federations. Among the services these federations provide are collaboration in marketing, raising public awareness of co-operatives, often economic cross-insurance, training, liquidity management in the case of financial co-operatives, wholesale operations in the case of co-operative stores, and so on. Often these networks have a regional character (e.g. Mondragon co-operatives, Antigonish movement in Nova Scotia, Maharahstra co-operatives in India, Emilia-Romagna co-operatives in Italy). Despite the fact that the importance of such networks has been recognized in the co-operative literature from its early dawn, economists, in contrast to sociologists (e.g. Halary 2006), have not paid much attention to it. Moves in that direction include Joshi and Smith (2008.)

A second promising research field is the relationship between co-operatives and social capital. While much of the literature emphasizes how co-operatives can contribute to the building of social capital (e.g. Borgen 2001), there is much less literature that looks into social capital as a prerequisite of meaningful co-operatives or as a motivator to participate in co-operatives (e.g. Jones and Kalmi 2008; Heikkilä, Kalmi and Ruuskanen 2008). This research can potentially give important insights into whether it is the narrower, "bonding" type of social capital that is associated with the rise and sustainability of co-operatives, or the more general, inter-group "bridging" social capital that matters. It is also possible that the determinants of local co-operative formation and successful operations of large co-operative networks require different types of social capital. The importance of social capital can also give indications for general development plans for co-operatives in developing countries; for instance, it suggests that centralized attempts to promote co-operative either by large donor aid infusions or government decrees may not be appropriate.

See Also

CIRIEC
Community-based organization
Co-operatives, history and theory of
Credit unions
Fourier, C.
Gide, C.
International Cooperative Alliance
Raiffeisen Banks
Raiffeisen, Friedrich
Schulze-Delitzch, H.

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