

# **The extended governance of cooperative firms: inter-firm coordination and consistency of values**

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## **Abstract**

Cooperatives are characterised by mutual-benefit coordination mechanisms aimed at the fulfilment of members' welfare. The paper considers cooperative principles and suggests a layered framework that relates principles, governance choices, and related aims or values. The framework supports the interpretation of cooperative governance and can be extended to the interpretation of inter-firm relationships. To this end, we consider an extended notion of governance, whereby those who impact on strategic decision-making are not to be searched only within the internal governance bodies, typically the board of directors, the managers or the assembly, but also outside the cooperative, in the extended network of production relationships in which the organisation is embedded. We then analyse the features of production linkages and their potentials in the accomplishment of cooperative principles. We support our analysis with examples from European experiences.

**Keywords:** cooperatives; ownership; governance; production networks; cooperative principles; internationalisation.

**JEL:** L2 - Firm Objectives, Organization, and Behavior, L21 - Business Objectives of the Firm, L24 - Contracting Out; Joint Ventures; Technology Licensing, Firm Performance: Size, Diversification, and Scope, L31 - Nonprofit Institutions; NGOs.

## 1. Introduction

There are 4.7 million people employed by cooperatives in Europe (Roelants et al., 2012). Cooperation is a prominent phenomenon in France, Italy, Spain and it is growing up in the UK where medium to small cooperatives represent an important part of the cooperative economy. The cooperative basic idea is centred on the specific aim of membership welfare to be reached by means of democratic governance. Albeit much has been written on the dispositions, practices and outcomes affecting economic sustainability, member welfare and - through this - community welfare, conversations on the impact of cooperative strategies on other stakeholders (besides members) need to be developed further (Sacchetti, 2012). Specifically, in this paper we would like to take a stand on production coordination and its impacts across networked firms, albeit these identify only part of the welfare effects interested by a cooperative's strategy.

Over the past two decades the growth and internationalisation of cooperatives has posed a number of questions, which have triggered reflection on the consistency of growth strategies with cooperative principles. By addressing the specific aspect of production coordination across firms, we apply an extended notion of governance, whereby control over the allocation of resources is not to be searched only within internal governance bodies (typically the board of directors, the managers, or the assembly) and internal organisational practices, but also outside the cooperative, in the extended mesh of production relationships in which the firm is embedded (Sacchetti and Sugden, 2003).<sup>1</sup>

The question we set up to answer addresses the potential impacts of cooperatives on the industrial development of localities through other linked firms, their stakeholders and the communities where these are situated. To illustrate, consider recent debate about worker cooperatives in times of crisis. The European Confederation of Worker Cooperatives, Social Cooperatives and Social and Participative Enterprises (Cecop) highlights subcontracting as an alternative or complementary solution (amongst others) to the use of cooperative reserves in times of crisis (Cecop, 2012). A perspective on inter-firm governance would suggest a more careful approach, as the stability of employment in worker cooperatives needs to be weighed against the implications of its external strategies, controlling in particular for the distribution of the negative externalities on for-profit subcontractors and subsidiaries.<sup>2</sup> The idea is to reach beyond the internal organisation of production and its principles to understand how strategic choices about inter-firm coordination can impact on the welfare of connected actors, beside members. This problem assumes particular relevance in the context of cooperative principles, which explicitly recognise community welfare aims.

In 1995, the International Cooperative Alliance (ICA) emphasised concern for communities as a foundational element of the identity of cooperatives. Literature has addressed the relation between democratic governance and community welfare at different levels. Empirical findings suggest that by looking after the welfare of members, cooperatives support also the wellbeing in their communities. For example, community social and economic impacts have been argued to spread through membership, as members are as a norm part of the community where production activities are located (Borzaga and Tortia, 2009). Consistently with this interpretation, welfare and wellbeing (measured in terms of health and safety) have been shown to be higher where cooperation and, in particular, worker cooperatives are diffused (Erdal, 2011). Cooperatives contribute to the welfare of communities also because they take a long-term perspective on membership and on the use of resources. Their governance and working rules, in fact, require a stable membership. To this end, in times of economic expansion, cooperatives create reserves that have been shown to work as buffers when the economy contracts (Birchall, 2009; CECOP, 2012; Navarra, 2010). Empirically cooperatives have strived for the realisation of the community-care principle also by promoting a culture of self-help and mutual responsibility across communities, by supporting the creation of new cooperative ventures or, more generally, of social and economic activities which are explicitly aimed at the development of horizontal social initiatives, such as urban regeneration, cultural and educational activities or other welfare services.

Since inter-firm linkages typically span across communities, it would seem appropriate to elaborate an extended interpretation of the ICA community principle. We would therefore think in terms of *care for multiple communities through the democratic management of production linkages*. This enlarged focus becomes particularly relevant when the location of members (those empowered to make strategic decisions) does not coincide with the location of operational activities. Such activities may be undertaken by subsidiaries of various natures or by other legally independent cooperatives.

Here we introduce some elements of novelty. In the literature, conventional approaches have mostly focused on membership, that is on the “private” or internal dimension of cooperative governance, whilst disregarding the “public” domain, or the external impacts associated with every private choice (Dewey, 1927; Branston et al. 2006; Sacchetti, 2012). To address this point we consider the extent to which strategic choices made by cooperatives take into account the welfare of others beyond the rights defined by membership.<sup>iv</sup> Specifically, we enquire on whether the choice of external coordination mechanisms, aimed primarily at the achievement of member welfare, compromises or

benefits the welfare of other connected actors, therefore impacting on the welfare of communities.

In order to focus on external governance and its impacts we will assume that, internally, the cooperative is equipped with deliberation processes that ensure a shared understanding of cooperative values and aims<sup>iii</sup> and that internal governance and practices reflect the essential economic objective of promoting the welfare of members. Albeit this is a simplification of an evolving complex reality, it allows us to concentrate on the coherence of external governance. As a reflection, the principles help us to discriminate amongst inter-firm relationships and possible welfare outcomes. From considerations on the nature of inter-firm relations, we will also derive some implications for member welfare.

## **2. The economic nature of cooperatives**

Economic analysis has focused mainly on internal welfare effects, to be reached through democratic mutualistic principles. In these respects, cooperative firms are understood as mutual benefit organisations created by self-organised principals that operate through the "one member one vote" governance rule (Borzaga and Tortia, 2010; ICA, 1995). Their nature is given by the need to devise mutual-benefit coordination mechanisms for the fulfilment of social rights and needs pertaining non-investor stakeholders. Such needs would include, for example, the stability of employment and a fair wage for workers in worker cooperatives, access to financial support and advice for small producers and savers in credit cooperatives, adequate quality and product prices for customers in consumer cooperatives, re-investments of surplus in community projects for community cooperatives.

Cooperatives fundamentally differ from conventional firms. Economic analysis in particular has shown behavioural diversities not only in individual needs and aims but also in the choice of means, emphasising differences at the collective level between cooperative and for-profit firms (Bonin, Jones and Putterman, 1993). On the other hand, cooperatives are to be distinguished also from other non-profit organisations, since members' wellbeing is their primary objective, while traditional non-profits are defined by wider societal aims, which stem at least partly from broader socially inclusive preferences (Sacchetti, 2012). Given their non-profit nature, external financiers have limited incentives to invest and to organise production in cooperatives, both because private returns on investment on specific assets are lower than in for-profit firms, and because - in terms of conventional economic approaches to property rights - cooperative control rights increase the risks of losses and of morally hazardous behaviours by the

self-organised principals. The weak interest of external investors to financing cooperatives - an interest that regards mainly loans or to the purchase of cooperative bonds - places the obligation to fulfil economic, financial, and organisational requirements directly on the self-organised membership.

When cooperatives are able to withstand their financial needs, then behavioural differences become evident. Profit does not represent an objective in cooperatives as in conventional corporations. More specifically, the net residual in cooperatives is to be regarded as instrumental to the pursuit of other objectives that have to do with members' wellbeing, not as an end in itself informed by the pursuit of shareholder value. At the most fundamental level economic returns and surpluses are used by cooperatives to guarantee the long-term survival and expansion of the organisation. The sustainability of activities is to be pursued in a way that guarantees the long-term desired level of members' wellbeing both in material and non-material terms. Because of these reasons, cooperatives can be regarded as stable non-profit oriented firms that operate in the market.

Differently, in new institutionalism, cooperatives (as most other typologies of non-investor owned, non-profit oriented organizations, e.g. non-profits and social enterprises) are interpreted as transitional organizations (Hansmann, 1996). They are deemed as be useful and effective in certain specific circumstances, such as in emerging, non-competitive, and unregulated markets characterized by marked imperfections (in terms of market power and asymmetric information). However, as markets become more competitive and better regulated, new institutionalism suggests that cooperatives are bound to fade away and become marginal. Better performing and highly capitalized investor-owned, for-profit companies are predicted to take over as dominant organisations.

The main reason, from a new institutionalist perspective, is that cooperatives are regarded as cost-inflating and, therefore, inefficient entrepreneurial organisations. Democratic governance is depicted as a cost-generating solution, while its socio-economic potentials (in terms of innovation or of benefits for the members and the wider community) are not considered. By the same token, the value-laden nature of cooperative aims is downgraded when compared with the pure commercial rational of for-profit enterprises. New institutionalism presents therefore a limited understanding of cooperation, wherever it fails to encompass the specificities of membership rights as opposed to shareholding rights, the idea of mutuality and its implications for cooperative governance, or the wider implications for communities that democratic participation to economic activities can have.

### **3. The pragmatic nature of cooperatives**

Taking a broader stand than neo-institutionalism on the issue of democratic production governance, ICA's members agreed on the Statement on the Co-operative Identity at the 1995 Manchester Congress. The statement identified the values of cooperation in "self-help, self-responsibility, democracy, equality, equity, solidarity, justice, mutual help" as well as "social responsibility and caring for others" (ICA, 1995). The majority of these values are not, as a norm, emphasised across conventional business communities, but rather represent a niche culture defining the specificities cooperative movement.<sup>3</sup> The above values are implemented through seven cooperative principles, which emphasise: 1) voluntary and open membership; 2) democratic member control; 3) member economic participation; 4) autonomy and independence; 5) education, training and information; 6) cooperation among cooperatives; 7) concern for community (ICA, 1995; Appendix 1). The community care principle in particular was the last one to be introduced at the ICA congress of 1995, to reflect the value of "social responsibility and caring for others" (ICA, 1995).

Like for other cooperative values, the community welfare dispositions of cooperative behaviour emerged empirically, out of the identification of recognised common practices and concerns across cultures, industrial sectors and activities. Ian MacPherson, who led the process that eventually resulted in the definition of the ICA cooperative identity, notices how the principles represent benchmarks rather than stringent features of cooperatives. In particular, he observes how "democracy is always a work in progress ... a dimension of membership that should always be evolving" (MacPherson, 2012, p. 11). In fact, despite the identification of the principles, assuming their absolute implementation would lead to an unrealistic appreciation of the variety of governance settings, processes, behaviours, outcomes and opportunities for improvement which can be observed and conceived across cooperative organisations.

The common identity of cooperatives, therefore, may be better explained in behavioural terms rather than alongside new institutional economics, with its emphasis on the minimisation of governance costs (Hansmann, 1996). The points of contact between new institutionalism and the ICA's pragmatic approach are only in some respects straightforward. For example, ICA requires cooperatives to be economically sustainable and independent, finding compatibility with the neo-institutional criterion of cost minimization. However, ICA also requires cooperatives to be democratically run by their members, and this aspect is in contrast with the alleged inefficiency of democratic governance which, for neo-institutionalism, inflates decision-making costs as well as the risk of internal contrasts, and the more so when the membership is characterized by heterogeneous preferences. It follows that the economic efficiency principle represents

only a portion of the outcomes against which the fulfilment of the ICA principles is evaluated, the others being related to the seven principles (Novkovic et al. 2012).

The cooperative model faces many challenges in meeting its principles, not least because, as noticed, these are not typically emphasised or rewarded in the market place, where cooperatives operate. Evidence of the difficulties of implementing democratic governance, besides the criticism moved by new-institutionalism, are subsumed in particular by the three dimensions identified by Cornforth et al. (1988). These are: a) "constitutional degeneration," which occurs when decision-making power shifts from the members to a restricted group and turns into the exercise of power by an elite; b) "capitalist degeneration," when cooperatives adopt financial instruments and practices that are typical of investor-controlled firms; c) "internal pressures" when misbehaviour and opportunism increase managerial control at the expenses of democratic and deliberative processes (Cf. Varman and Chakrabarti, 2004). Consistently with the first degenerative element, literature has emphasised the dangers associated with the emulation of practices and strategies of conventional businesses, possibly inducing membership apathy and mining the sustainability of the cooperative organisation (DiMaggio and Powell, 1983; Spear, 2004). In line with the latter point and with Hansmann's transaction costs perspective, others have emphasised how internal governance failures can play against cooperatives' survival, and represent a serious threat to the possibility of enhancing welfare through self-management. Cases of fraud, in worst case scenarios, jeopardise trust between members and management, as well as the firm's reputation within the community (Hernandez, 2006; Cornforth, 2004; Spear, 2004; Birchall, 2002).<sup>4i</sup> In some of these contributions democratic governance is seen as weaker and more vulnerable to opportunistic behaviour than hierarchical governance.

The conclusion that can be drawn from this body of literature is that an equation between aims and principles on the one hand, and individual cooperative practices on the other, may not, in some cases, support the explanation of cooperative performance with respect to member and community welfare. There can be misalignment between principles and practices towards external stakeholders (community), or inside the cooperative. It follows that opportunities for improving performance with respect to the ICA guidelines can emerge through a critical appreciation of strategies, practices, and principles. Therefore, an understanding of outcomes and opportunities requires, in line with the pragmatic approach that qualifies ICA, a focus on strategic choices and outcomes as much as on underpinning values and principles.



#### 4. The governance of production linkages

Although cooperatives aim at being independent from other investor influences, we would suggest that in practice the representative function of cooperatives may be, to different degrees, casted also from the outside and, in particular, by the nature of inter-firm relationships. Similarly to what has been argued about traditional for-profit firms, cooperatives do not work in isolation. Extending Coase's warning, neither conventional firms, nor cooperatives can be considered as "islands of economic planning" (Coase, 1937). Cooperatives are businesses which operate in the market, interacting with its extent, structure and technologies, whilst being placed in a context often dominated by investor-owned firms, their for-profit nature and related incentives (Varman and Chakrabarti, 2004).<sup>5</sup> The need for linkages was earlier justified by Richardson (1972) in terms of complementarities of competences and assets that firms seek. More broadly, the position that the firm occupies in production networks, the characteristics of interaction and complementarities, have been argued to impact on firm performance (Jarillo, 1988, Gagliardi, 2010) as well as on governance, in terms of who determines strategic direction and how problems are addressed within the network (Helper, 1990; Markusen, 1996; Sacchetti and Sugden, 2003; Sako, 2004; Thorelli 1986).

Given the peculiarities of aims and principles of cooperatives, at a more fundamental level interconnectedness requires the difficult task of balancing the values applied internally to the pursuit of members' welfare with the values underpinning relations with other organisations, whether cooperatives or investor-owned companies. This aspect reinforces the need to specify the nature of coordination in terms of location of strategic decision-making power, rather than in terms of business functions, e.g. marketing, production, R&D, finance (Sacchetti and Sugden, 2003).

To make sense of the nature of linkages in terms of their welfare outcomes, we build on Cowling and Sugden (1998) and allow for strategic choice power to be located outside the cooperative, and consider, in particular, external influences stemming out of cooperatives as well as those affecting cooperatives (or other forms of businesses). For each of its linkages, then, a cooperative firm can be considered as:

- (a) An *inter-actor*, or an active participant which relates with another firm on a mutual and reciprocal basis;
- (b) The *recipient* of another organisation's strategic choices, or an organisation which is mostly subject to decisions taken elsewhere;
- (c) A *director*, that is an active participant which represents an external source of direction for another firm.

The first stylised relational form, mutual inter-action, is the one that best fit with cooperative ideals, as it emphasises heterarchical relations based on deliberation, reciprocity, and mutual dependence (Sacchetti and Sugden, 2009). Differently, in the second and third typologies the recipient firm and the director firm assume, in turn, a passive and an active role. The active role of the director carries the potential of being exerted at the expenses of the recipient, who is not included in the making of strategic decisions on which it has an interest. When the director is a cooperative firm, the exclusion of a relevant stakeholder is not in line with the general principle of cooperation among cooperatives. When the recipient firm is a cooperative, the passive role is not consistent with the principle of autonomy and independence. The exclusion from relevant production decisions depicted by the director-recipient relation detaches some of the cooperative principles from actual strategic behaviour, both for the director and for the recipient.

## **5. Internal and external cooperative institutions**

There is a complex puzzle emerging from the joint consideration of internal and external governance. To clarify, we now build on Williamson's analysis of institutional layers to provide an interpretative scheme of cooperative firms' practices. Table 1 systematises different levels where values represent the foundational layer shaping all subsequent institutional formalisations (Williamson, 2000). The foundational layer is the realm of evolving values, shaped by individual experience as they strive for the fulfilment of their needs and desires (Level 1). The cooperative values, as other values, are part of this process. Principles, such as the 7 ICA principles, reside at a subsequent level. They are the instruments that can objectify such values. Furthermore, legislation can support the actualisation of cooperative values by defining the nature of property rights. In particular, the designation of who owns and control resources, respond to principles of voluntary and open membership, joint ownership of members, and members' economic participation. The general aim is to increase members' welfare through self-help, self-responsibility, and mutuality (Level 2).

### **Table 1 about here**

Values are reflected also in principles that define how control over the use of resources has to be implemented. Within the cooperative model, the principles of democratic member control and participation in the allocation of surplus define the internal governance structure (Level 3). The purpose of these instruments, specifically, is to achieve procedural fairness, as per the values of equality and equity (Tyler and Blader, 2000; Borzaga and Tortia, 2006).

Further to this, the rules underpinning the actual allocation of resources are defined by an internal incentive system which emphasises limited remuneration of capital as well as the reinvestment of surplus for mutualistic and communitarian purposes (Level 4). These instruments are particularly oriented towards the pursuit of distributive fairness, long-term sustainability and the creation of societal value.

Having defined the association between values and the principles which characterise cooperative internal institutions, the next step is to define a correspondent set of external institutional levels. Given the initial set of values forming the cooperative business culture, the definition of formal institutions that regulate external linkages may be coherently reflected in the definition of second level cooperatives, for example consortia or cooperative groups, which take the form of cooperatives of cooperatives (Level 2). This form of collaboration would be consistent with the set of cooperative values as well as with the internal principle of joint member ownership at Level 2 and democratic member control at Level 3. Likewise other contracts (e.g. financial participation, partnerships, subcontracting) should be drafted so that the governance of the collaboration is heterarchical, participatory and democratic. At Level 4 the allocation of surplus should follow similar rules to those of first level cooperatives. In the case of second level cooperatives distribution of material and immaterial surplus is effected through participatory and non-exclusive mechanisms, which take into account the objectives and the needs of all involved constituencies. Likewise, incentives should be drafted to achieve mutual benefit with no parties exploiting their competitive advantages against others' interests.

## **6. Hub-led types of coordination**

The application of the institutional layers scheme to cooperatives can clarify the actual behaviour of the cooperative towards each and every firm or cluster of firms in its production network. We bring together financial participation and other contractual agreements and consider the consequences of inter-firm coordination in terms of consistency of values and behavioural predisposition to cooperate. We will also account for collective governance arrangements for the coordination of common activities (mutual-help networks and consortia). The underpinning idea is that financial participation and other contractual agreements represent different but converging modalities for achieving coordination in the formation of an extended network (Amin and Cohendet, 2000; Grandori, 2000; Nootemboon, 2000). In particular, financial

participation has to do with the exchange of ownership rights, while coordination by means of contracts represents a mechanism based on the governance of relations.

First consider coordination by means of financial integration. The tightening of coordination typically occurs through strategies that involve financial integration and, in the case of the largest cooperatives, the creation of groups where the core cooperative holds financial control in a number of other conventional firms (e.g. joint stock companies or limited by shares) thus internalising relations and activities.<sup>6</sup> For example, in construction or manufacturing (because of the technology, fixed costs and scale of activities) worker cooperatives tend to integrate conventional businesses through shareholding (an example is Coopsette in Italy).<sup>7</sup> The activities of controlled companies are in general functional to the activity of the leader firm, although they may not be directly related to it. Such strategy can support in particular capital accumulation, allowing cooperatives to raise capital through traditional for-profit companies (Cf. Menzani and Zamagni (2010) for a historical account of network features in the Italian context).

Secondly, consider coordination through contractual agreements, with the principal aim of increasing flexibility. In this case the core operates by means of subcontracting agreements, ventures and other collaborative forms such as consortia and network contracts. Consortia and network contracts are formal institutional tools that indicate how inter-firm cooperation treats common capital reserves and resource allocation across the cooperating organisations, and provide guidance on the governance and incentives operating across the network. In constructions for example the core may resort to temporary consortia for the delivery of specific projects, generally holding a substantive quota in each consortium. Cooperatives (as well as other firm types) can also create networks that hold legal responsibility through a 'network contract', as for example in Italy since 2009.<sup>8</sup>

Having anticipated that production relations may entail cooperation amongst inter-actors, but also more hierarchical ties between a director and a recipient, we use the multi-layered institutional scheme depicted in Table 1 to identify commonalities and diversities amongst the variety of inter-firm linkages described above, and their potential welfare effects. In particular, we set *exclusive hub-led coordination* and *cooperative hub-led coordination* as two rather extreme ideal-typical settings, against which to contrast the reality of coordination orchestrated by cooperatives. The first typology is based on the director-recipient relationship, whilst the second features inter-actors. For each type we focus on elements mediated from Table 1, specifically:

(a) Formal institutions: the positioning of each firm in the relation through property rights and contracts;

(b) Governance structure and strategic control: the distribution of control over production resources across firms;

(c) Contracts: constraints and incentives towards the achievement of relation-specific aims;

(d) Values in practice: the values infused in the practices of the cooperative when relating to other organisations or stakeholders.

### **Table 2 about here**

#### *6.1 Exclusive hub-led coordination*

We talk of *exclusive hub-led coordination*, when internal governance reflects, to some extent, the democratic principle on the one hand, whilst at the same time confining its underpinning values within the cooperative organisational borders. Relations with subsidiaries (through financial integration), complex governance (consortia and other mutual-help networks), and contract-based relationships (such as ventures or subcontracting arrangements), would be functional to the objectives of the core cooperative or particular groups within it, even despite the welfare of subsidiaries, partner companies or subcontractors. In line with the strategic governance approach (Cowling and Sugden, 1998), we suggest that when the hub cooperative uses its power advantage to take strategic decisions despite the desires of the 'recipients', consistency between mutualistic principles of cooperatives and the wider principles of cooperation is undermined.

As an illustration, consider a hub cooperative acting as the 'director' of the supply chain, the cooperative may manage relations in different ways. In fact, the greater the distance from the perfectly competitive market benchmark, the higher the relevance of firm behaviour and, therefore, of the choice of the governance and incentive structure through which coordination is implemented. It follows that, depending on the market structure and type of competition, and despite its non-for profit nature, the cooperative could, as a possibility, seek monopoly power or collusive agreements with other producers, or exert its market power against suppliers.<sup>9</sup> Where the competitive element is more incisive, strategy may focus further on permanent cost minimisation by stimulating arm's length market competition among substitutable producers, typically for low knowledge content production types. In summary, we talk about exclusive hub-led coordination when the modalities of the interaction resemble governance by exclusive direction, where relationships are administered strategically without coordination mechanisms that guarantee that the interests of other firms are properly taken into

account (Sacchetti and Sugden, 2003). In other words, this is a case of coordination without cooperation.

### *6.2 Cooperative hub-led coordination*

Conversely, we call *cooperative hub-led coordination* a production relation where the core organisation applies its core principles also to external governance, actively searching for mutually beneficial opportunities, for compatibility between the objectives of members and the interests of other stakeholders. The application of the cooperative principles to other firms would add consistency to the organisation also internally, although this may increase the tensions between those who perceive the cooperative as being essentially about the welfare of members and those who would regard behaviour towards others outside the cooperative as subject to similar principles. When the cooperative coordinates its different sets of relations on the ground of cooperative principles more generally, external coordination would endorse (through appropriate mixes of financial participation, contractual arrangements, networking and other substantive practices) participatory governance processes and mutually beneficial incentive structures (Sacchetti and Sugden, 2009).

### *6.3 The evolving nature of coordination and its institutions: The Mondragon Group*

In practice, cooperatives and those of large size in particular coordinate with other firms through a variety of mechanisms, and can resort to both exclusive hub-led or cooperative hub-led coordination. To illustrate, consider the expansion and internationalisation of the Mondragon Cooperative Corporation, the Basque cooperative group which since its foundation after WWII has, in many respects, pioneered the articulation of a system of inter-organisational rules alongside the principles of cooperation. In 2011 the group associated 258 organisations, including 109 cooperatives, 125 subsidiary companies and employing over 83,500 (Mondragon, 2011). Despite its shared values, internal and international growth has not occurred without tensions. In particular, the expansion of retailing in Spain (the Eroski retail chain employs 45,000) and manufacturing overseas involving 65 production plants and 14,601 employees in 2006 (Monasterio et al. 2009) has been shaped by a strategy of acquisitions and green-field investments for the creation of subsidiaries, without worker membership. In 2011, 82 per cent of the workforce employed in manufacturing activities was constituted by members. However within the retailing sector of the group membership was only 26.5 per cent,<sup>10</sup> the others being non-members or temporary workers in seasonal activities (Altuna, 2008). At the same time, overseas the Mondragon

group has been argued having adopted a strategy towards internationalisation similar, in some respects, to those of traditional transnational corporations (Errasti et al. 2003).

FDIs have reflected, in part, a strategy of cost minimisation, but also risk reduction in the face of diverse workers attitudes regarding employee ownership across countries, and different legal and juridical frameworks.<sup>11</sup> Overall, the growth strategy of Mondragon has raised an issue around their actual values, where the pursuit of members' welfare becomes a cost for other workers inside controlled or otherwise affiliated companies. Tensions between membership and management on such matters may run the risk of damaging, in particular, the trustworthiness of the cooperative as well as member motivations.

The challenges to the idea of membership presented by growth across sectors and regions, through internationalisation, are currently unresolved, but likely to change again the architecture of rules at Mondragon. In the attempt to improve the application of the principles of cooperation, in 2009 the retail chain Eroski has developed a plan to enhance participation by including workers in employee ownership schemes (Sánchez and Roelants, 2011; Jones and Kalmi, 2012). Overall there are also plans across the group to re-discuss and find mechanisms to support the extension of membership rights to workers overseas, gradually starting a process aimed at reducing control and direction beyond membership rights.<sup>12</sup> This is likely to be a complex process riddled with tensions. The governance of relations and, likewise, its impact on distributional outcomes across borders and institutional set-ups will require a careful balancing between the extension of empowering rules (e.g. unrestrained extension of membership rights) on the one hand and, on the other, the segmentation of the membership on the basis of contextual conditions (e.g. different wage levels based on parity of purchasing power). More generally, the historical evolution of the largest existing cooperative group suggests that the development of both internal and external democratic governance requires complex operations of social reconstruction that often take place in the institutional void, as far as cooperation is concerned. This aspect of cooperative development reinforces the need for a constant appraisal and elaboration of strategies, practices and values in a pragmatist fashion (Morrison, 1991; Stickers, 2011).

### ***7. Mutual-help networks of small and medium co-operatives (SMCs) as an answer to market power***

When interacting with suppliers or buyers, the cooperative, which is often created to overcome the presence of monopoly and monopsony power in upstream and downstream sectors (Hansmann, 1996, Borzaga and Tortia, 2010), can undergo

exploitative contractual relations by the private contractors. Small and medium size cooperatives (SMCs), on the other hand, are likely to be subject to dependence on their main contractors, whether those are conventional firms, larger cooperatives or public administrations. Consider for example the provision of social services, where cooperatives currently play a large role.<sup>13</sup> Typically the public sector would work as the main contractor of local social cooperatives. In this case cooperative objectives are mostly influenced by the welfare policy and standards set by policy makers.

Our framework suggests that a strong dependence of SMCs on an exclusive hub-led relation runs the risk of hollowing out the bond between management and members, whilst exacerbating the potential tension between member welfare and economic sustainability. Also in the case of state-anchored cooperatives, where the type of direction provided by the public sector may be expected to have a number of contact points with cooperative principles, consistency (and in particular the principle of cooperative autonomy and independence) need to be tested in practice, as dependence on the public sector is in general high and can expose the cooperative to the dangers of public failure. Consider, for example, inefficiencies in public administrations causing delays that make social cooperatives insolvent, eventually bankrupt, and service beneficiaries uncovered. Consider also the tendency of the public sector to prefer the delivery of low quality, but standardized and easily controllable set of services, to the experimentation of innovative, but more effective and creative solutions.

Again, where the decision-making power of the membership is subordinated to the strategies of third parties, the principles of the cooperative may be at risk, and likewise member rights. Also growth strategies aimed at developing monopolistic power as an answer to monopolistic power would not be aligned to the value principles of cooperation, which rely on free and independent entrepreneurial action.

Rather, beyond relying on regulation of exchanges, cooperatives could resort to mutual-help networking, such as consortia, as an instrument to achieve sufficient dimension and ability to contrast the monopoly power of a supplier or the monopsony power of the public sector or other private firms. These strategies may be absent or ineffective when the cooperative acts in isolation, or when it is confined to exclusive relations with the contractor. The recognition of the potential of peer networking to free small cooperatives from unfair constraints relies on both the cooperative ability to build effective relations and on the willingness of the public regulator to properly recognize in consortia and networks valid development tools for SMCs.

These types of coordination are grounded on peer-support and control, gathering groups of cooperatives that rely on socially-embedded governance mechanisms, such as shared values, trust and reciprocity. The mechanisms have also been considered as the basis for



local social capital formation (Sabatini et al., 2012) as they can lower the risk of opportunism within communities (Galassi, 2001). Relationships typically involve a plurality of inter-actors with diverse and evolving interests and do not allow for direct control over production activities, which are instead prominent in ownership and, to some extent, contract-based relations. Consortia and similar forms of networking can be interpreted as mutual-help networks, aimed at creating specific group identities and give voice to co-operators and their stakeholders. They are typically backed by network statutes, aims and values declarations, as well as discussion fora. Through mutual-help networks, cooperatives pair the creation of business opportunities with awareness of their values; they generate capacity building and scale economies. Examples of this type of network are, in Italy, CGM (Consorzio Gino Mattarelli), with 5,800 associate cooperatives with social aims<sup>14</sup>, or those in Scotland introduced to support the development of social enterprises, such as Sencot (established in 1999), Social Enterprise Networks (both thematic and geographical), Development Trusts Association Scotland, Scotland Unltd (established between 2002 and 2003).

## **8. Concluding remarks**

We have started this contribution by considering cooperative firms as entrepreneurial associations driven by self-organised action in which members are granted democratic and non-saleable control rights. We have also set the principles and objectives of cooperation as the benchmark for assessing inter-firm relations, as well as the impacts of coordination strategies on the welfare of linked firms.

Consistently, our question regarded the extent to which the nature of inter-firm coordination mechanisms could be deemed consistent with the nature of cooperation and its principles.

We have argued that unbalanced forms of control and direction, whether coming from outside the cooperative or effected by the cooperative itself, may emerge out of production relationships, in particular when the cooperative principles are not extended to the governance of inter-firm relations. Control achieved by the cooperative over linked companies may increase standard measures of economic performance in the core cooperative, at the potential price of eroding the welfare of stakeholders and demotivate members. For the recipient firms that are subject to external control, self-management is at risk of being hollowed out, leading to a decrease in the welfare of effected stakeholders, such as workers, producers, or users. On the other hand control power by external actors (a hub company or the public sector) is likely to depress and frustrate attempts to achieve democratic control and participation. These imbalances may be

reflected, for example, by a lower degree of members' satisfaction and welfare. Also, unequal decision-making power could back-up on the relations between the cooperative and its membership, for example exacerbating detachment between managers' and members' objectives.

The suggested answer to our question would be that with power unbalances amongst organisations, the consistency between organisational strategies and the principles of cooperation can be placed at risk and generate tensions across members and other stakeholders. To counteract these degenerative tendencies, inter-firm relations could prompt an extended notion of mutuality, as in acknowledging, through appropriate processes, multiple perspectives and interests in order to achieve solutions that do not compromise each other's fundamental values and needs. Inter-firm mutualistic coordination can be achieved through appropriate institutional arrangements involving, in different measures, the allocation of property rights, strategic choice power and incentives, all of which should be monitored against the principles of cooperation. Cooperative hub-led coordination and mutual-help networks can institutionalise peer-support and control, and democratic governance by means of formal or customary rules. Complementary, practices that acknowledge and support the use of improved means of communication and deliberation should be encouraged, not least to achieve an inter-subjective understanding, amongst members and organisations, of the meaning and value of cooperation, as well as of consistent practices.

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## Notes

<sup>1</sup> Also, a body of theoretical and empirical studies has accentuated cases of external constraints, as related to ill-suited legal frameworks, access to capital, production conditions and contractual requirements, bargaining and decision-making costs, or external controls of political nature (Russell, 1991; Ben-Ner, 1993; Book and Ilmonen 1989; Lima, 2007; Hernandez, 2006; Speckbacher, 2008; Wanyama et al. 2009; Birchall and Simmons, 2010).

<sup>2</sup> Such understanding is inter-subjective and context dependent. We can expect therefore different interpretations and implementations across localities and organisations, more or less in line with the seven ICA cooperative principles. A more general stakeholder perspective would allow a tailored application of our framework and further specifications regarding the nature of coordination and value consistency. For example, within producer cooperatives issues of worker welfare may be disregarded by a more standard focus on member welfare. An interesting sector, in these respects, is agro-food. If observing producer cooperatives we would need to consider also employees as a major stakeholder (besides linked firms).

<sup>3</sup> We use niche-culture rather than the more widespread term of sub-culture because the latter creates a hierarchy amongst values which fails to recognise equal dignity to different expressions of values.

<sup>4</sup> Overall, however, some authors have found that free-riding carries less weight in cooperatives than in other organisational forms (Craig and Pencavel, 1992, 1994; Bartlett et al., 1992).

<sup>5</sup> Besides links for trading and production purposes, cooperation typically regards finance (typically through solidarity funds), the creation of scale and scope economies on a variety of business functions, capacity building, education and training (Roelants et al. 2012).

<sup>6</sup> Workers cooperatives, for example, are required not to fall below a given member-employee ratio which can be discretionally set by the cooperative, consistently with legal prescriptions (the latter, in some countries like Italy, may include a “prevailing mutuality” principle, which is a necessary condition to obtain also some fiscal advantages).

<sup>7</sup> Although cooperatives are not controlled by investors, in some cooperative models (e.g. in the Italian system) cooperatives can issue shares. The modalities of shareholding have to be defined and approved by the members. The Italian law allow shareholders up to one third of the total votes in the assembly. Investors cannot choose more than one third of the board of directors.

<sup>8</sup> The ‘network contract’ has been introduced as part of the policy measures towards the economic downturn in 2009. An interesting example of its application by cooperatives is the Conesco cooperation network, a permanent collaborative network amongst energy service companies that develop renewable energy in Southern Italy. Cf. Roelants et al. (2012).

<sup>9</sup> Similarly, in the case of consumer cooperatives such behaviour would contrast with the economic aim of maximizing member welfare, which is typically created to prevent price increases and quality reduction associated with monopoly power.



<sup>10</sup> Own elaboration based on corporate data retrieved at <http://www.cecop.coop/Eroski-integrates-morethan-4-000> (accessed 23 October 2012).

<sup>11</sup> From the corporate website: “All our companies abroad are organised as Limited Companies. There are several reasons for this: most of the countries do not have the appropriate legislation of a cooperative nature that we have here; in many cases we incorporate these companies as a joint-venture with other partners and, thirdly, and this is perhaps the main reason, the setting-up of cooperatives requires cooperative members who are used to working within a cooperative culture, and this is a process that takes time.” <http://www.mondragon-corporation.com/language/en-US/ENG/Frequently-askedquestions/Business-Strategy.aspx> (accessed 23 October 2012).

<sup>12</sup> From the corporate website: “At our Congress held in May 2003, the decision was taken to drive the creation of formulas that allow for the participation in ownership and management by employed workers that pursue their activities in our non-cooperative companies.” <http://www.mondragoncorporation.com/language/en-US/ENG/Frequently-asked-questions/Business-Strategy.aspx> (accessed 23 October 2012).

<sup>13</sup> From the corporate website: “At our Congress held in May 2003, the decision was taken to drive the creation of formulas that allow for the participation in ownership and management by employed workers that pursue their activities in our non-cooperative companies.” <http://www.mondragoncorporation.com/language/en-US/ENG/Frequently-asked-questions/Business-Strategy.aspx> (accessed 23 October 2012).

<sup>14</sup> In 2005 the production costs of Italian social cooperatives nationally were 2.4 per cent below the level of total turnover and 63.2% of social cooperatives made a surplus (ISTAT, 2008).

## **Appendix 1**

### **“Cooperative identity, values and principles”**

**(from the ICA website)**

#### **Definition**

A co-operative is 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.

#### **Values**

Co-operatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity. In the tradition of their founders, co-operative members believe in the ethical values of honesty, openness, social responsibility and caring for others.

#### **Principles**

The co-operative principles are guidelines by which co-operatives put their values into practice.

##### **1. Voluntary and Open Membership**

Co-operatives are voluntary organisations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

##### **2. Democratic Member Control**

Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner.

### 3. Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.

### 4. Autonomy and Independence

Co-operatives are autonomous, self-help organisations controlled by their members. If they enter into agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

### 5. Education, Training and Information

Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of co-operation.

### 6. Co-operation among Co-operatives

Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures.

### 7. Concern for Community

Co-operatives work for the sustainable development of their communities through policies approved by their members.

Source: ICA Website <http://ica.coop/en/what-co-op/co-operative-identity-values-principles> accessed October 2012.

**Table 1 – Institutional levels**

LEVEL	COOPVERATIVE NICHE CULTURE	PURPOSE
<b>a) Values</b>		
<p>I. INFORMAL INSTITUTIONS Individual values and believes, culture on the organisation of economic activities</p>	<p>Self-help, self-responsibility, democracy, equality, equity, solidarity, justice, mutual help, social responsibility and caring for others</p>	<p>Fulfilment of needs</p>
<b>b) Principles</b>		
<p>II. FORMAL INSTITUTIONS Property rights: who controls and appropriates resources</p>	<p>Voluntary and open membership Ownership of members</p> <p>Cooperatives of cooperatives, consortia, cooperative groups, short and long-term collaboration contacts</p>	<p>To increase members' welfare</p>
<p>III. GOVERNANCE STRUCTURE How control is implemented</p>	<p>Democratic member control. Participation in the finance and in the allocation of surplus. Autonomy .</p> <p>Contracts promote heterarchical relations</p>	<p>Procedural fairness</p>
<p>IV. RESOURCE ALLOCATION Incentive structure</p>	<p>Limited remuneration of capital Reinvestment for mutualistic and communitarian purposes</p> <p>Mutual benefit; non-exploitative contractual conditions</p>	<p>Distributive fairness Long term sustainability Creation of societal value</p>

**Table 2 – Inter-firm coordination involving cooperatives**

Coordination features	Exclusive hub-led coordination	Cooperative hub-led coordination
<p><b>Formal Institutions:</b> property rights, contracts defining the nature of the relationship.</p>	<ul style="list-style-type: none"> <li>- A core organization with contractual/financial linkages with other cooperatives or investor-controlled companies;</li> <li>- When the focus is on ownership rights by means of financial linkages, the coop owns a share of a conventional company and coordination is internalised within a group.</li> <li>- Groups can be formed also as ways to create scale economies on specific functions and coordinate activities across cooperatives.</li> </ul>	
<p><b>Governance Structure/ Strategic Control:</b> power distribution, or who controls the broad direction of production activities.</p>	<ul style="list-style-type: none"> <li>- The core organization consolidates aspects of control beyond internal membership through ownership (subsidiaries) or through contracts (e.g. ventures, subcontracting) and practices (e.g. problem solving).</li> <li>- Strategic decision-making power is concentrated in the core;</li> <li>- The core organization controls the strategic direction of linked firms.</li> </ul>	<ul style="list-style-type: none"> <li>- Albeit subject to the overarching rules of the relationship (venture, contract or group) strategic decision-making rests in each cooperative.</li> </ul>
<p><b>Incentives:</b> the rules underpinning resource allocation towards relation-specific aims.</p>	<p>Incentives are set to maximise the core cooperative/group interests, even disregarding those of other cooperatives or conventional investor-owned firms (e.g. cost minimisation).</p>	<p>Incentives are set taking into account the needs and aims of other connected firms, both cooperatives and conventional investor-owned companies.</p>
<p><b>Degree of tension and problem solving:</b> due to power distribution across firms, incentives, and attitude towards problem solving.</p>	<ul style="list-style-type: none"> <li>- Tensions amongst firms are addressed through processes that emphasize authority and control.</li> <li>- Processes can be codified by means of property rights, within contracts, or promoted by practice when contracts are incomplete.</li> </ul>	<ul style="list-style-type: none"> <li>- Tensions are part of the interaction amongst firms, and are addressed through deliberative processes that reinforce communication and enquiry rather than authority and control.</li> <li>- Deliberative processes are especially suitable in the face of incomplete contracts.</li> </ul>
<p><b>Consistency of values:</b> whether the normative principles of cooperation are reflected in inter-firm relationships.</p>	<ul style="list-style-type: none"> <li>- Relationships are mostly functional to the objectives of the core.</li> <li>- The principles of cooperation (as expressed by internal cooperative governance) are applied within the core to some extent, <i>but not</i> with respect to other organizations.</li> </ul>	<ul style="list-style-type: none"> <li>- Relationships are mutually beneficial to the core and other linked firms.</li> <li>- The principles of cooperation (as expressed by internal cooperative governance) are applied, to some extent, within the core, <i>as well as</i> externally, to inter-firm relationships.</li> </ul>