

This paper has been prepared as a background paper for the
World Employment Report 2004-05

**Productivity in cooperatives
And worker-owned enterprises:
Ownership and participation
Make a difference!**

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Foreword

This volume has been prepared as a background paper for the ILO's World Employment Report 2004: *Employment, Productivity and Poverty Reduction*. It examines how the ownership structure and the active participation of workers and members in cooperatives and worker-owned enterprises impact on the productivity of such enterprises.

Employee-owned firms and cooperatives are commercial organizations that operate according to a broad set of values that govern their pursuit of economic gain. As democratic member- or worker-controlled enterprises, they try to balance diverse goals such as job and income security, democratic control and participation, safety and health at the work place, profit sharing and patronage dividends, and concern for their communities. The conventional definition of productivity as "value added per worker" is therefore not fully satisfactory when we examine it in the context of employee-owned firms and cooperatives, because these organizations typically deliver a combination of economic and social returns to their member-owners and the community at large.

John Logue and Jacquelyn Yates of the Ohio Employee Ownership Center at Kent State University have found that employee ownership by itself does not necessarily have a positive impact on productivity. However, a combination of employee financial ownership with real participation in decision-making at the enterprise level does improve labour productivity and other aspects of business performance. In addition, employee-ownership and participation generate "collateral benefits" in terms of social participation and living standards.

In the case of agricultural and small business cooperatives, productivity has to be measured at two levels: the level of the cooperative enterprise, and the level of the member farm or business. Logue and Yates have found that farm and business cooperatives have a net positive impact on productivity when both the cooperative and its member units are taken into account. Moreover, cooperatives too produce a broad range of "collateral benefits" for their members, workers and the community. These may not be directly related to productivity, but are clearly associated with key elements of the ILO's Decent Work Agenda and to poverty reduction. The authors propose a range of activities in the fields of research, promotion of cooperatives and technical assistance and training that the ILO and its development partners could undertake to harness the positive impact on productivity and the quality of work of ownership and participation in employee-owned firms and cooperatives.

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Abbreviations

AAFCOOP	Association des Auditeurs et Formateurs des Coopératives
COB	Coopérative des Ouvriers de Bâtiment
ESOPs	Employee Stock Ownership Plans
EU	European Union
GAO	General Accounting Office
GNP	Gross National Product
ILO	International Labour Organization
IOFs	Investor Owned Firms
NGO	Non Governmental Organization
SBC	Small Business Cooperatives
TVE	Township and Village Enterprises
US	United States
USDA	United States Department of Agriculture
USAID	United States Agency for International Development

Executive summary

Productivity is the baseline measure of the economic efficiency of firms. It is typically reported as value added per worker, value added per unit of investment or value added per unit of assets. Enterprises will fail to thrive in a market economy if they cannot meet or exceed the productivity of other firms in their sector.

The survival rate of worker cooperatives and employee-owned firms in market economies appears to equal or surpass that of conventional firms. But they typically return a different combination of economic benefits to their member-owners than do conventional firms, because they place more emphasis on job security for employee-members and employees' family members, pay competitive wages (or slightly better than their sector), provide additional variable income through profit-sharing, dividends or bonuses, and offer better fringe benefits. They also support community facilities such as health clinics or schools.

In the developing world, cooperatives and employee-owned firms have usually been supported as parastatals, to implement various governmental goals. When governmental support was withdrawn due to budgetary shortfalls or structural adjustment policies, most parastatal cooperatives failed, because productivity had been of little or no concern, and they were not prepared to compete in a market economy.

However, these failures were not due to any intrinsic shortcomings of employee ownership. Considerable evidence from the developed countries shows that participative worker cooperatives and employee-owned firms can match or exceed the productivity of conventional firms. Most evidence from the former centrally planned countries is confounded by exceptional conditions. Evidence from much of the developing world is slim, in part because basic economic and political conditions are often absent.

For agricultural and small business cooperatives, the research is less voluminous, but leads in the same direction. Well-run cooperatives can compete with traditional firms and can effectively increase the productivity of their members. But their profits are distributed differently: the farm and business cooperatives charge lower prices and return patronage dividends to members. The dearth of research on the productivity of agricultural cooperatives may possibly be explained by the widespread assumption that they create benefits for their member-owners. Empirical studies and stock market data suggest that agricultural cooperatives regularly generate economic benefits for their members that equal or surpass comparable private sector returns to shareholders. Promising new forms of the cooperative include small business cooperatives and shared service

cooperatives that provide branding, marketing and other business services for producers.

In sum, there is no great accumulation of evidence to suggest that cooperatives and employee-owned enterprises are less productive than conventional firms, and substantial evidence that they at least equal, and probably exceed, the productivity of their conventional counterparts. In addition, they create collateral benefits for their communities and societies.

1. Introduction, Conceptualizing broadened ownership and Productivity

How does broadened ownership of enterprises by workers, by agricultural producers, or by small businesses affect enterprise productivity? Do agricultural and small business cooperatives and various forms of worker-ownership measure up to conventionally owned firms?

The present analysis focuses on five specific questions:

- Does ownership of capital assets by employees and/or worker-members in the enterprises in which they work (whether employee-owned companies or workers' cooperatives) have a positive effect on their productivity as a result of increased motivation and worker satisfaction?
- Does ownership, when combined with an ownership culture involving meaningful participation in decision-making, have a quantifiable, positive effect on productivity?
- Do user-owned cooperatives (such as agricultural supply and marketing cooperatives, machinery rings and shared service cooperatives of small businesses) enable their individually owned farm or business members to improve their productivity?
- Do these cooperatives provide their members with a means of achieving economies of scale and enhancing their bargaining power in the market through pooling resources and undertaking support services (such as the supply of agricultural inputs, joint marketing of products, provision of credit on a group basis, branding and advertising)? In other words, does the vertical integration of functions at the level of the cooperative enable a more specialized division of labour by its members that leads to higher productivity, and does pooling these functions enable the individual member enterprise (farm or business) to focus energy on its core activity?
- Do these various forms of ownership increase labour productivity, create decent jobs and reduce poverty?

1.1 Defining “broadened ownership”

This analysis focuses on two separate but related areas of broadened ownership:

- the impact of worker ownership¹ (and especially participatory worker ownership) on productivity and enterprise performance and
- the impact of ownership of cooperatives by agricultural producers and small businesses on both the productivity and performance of the cooperative and of the farms and businesses of the cooperative’s member owners.² There is a substantial literature –some of which is methodologically rigorous – on the first area in the United States and Europe, but this is less true in the case of the second.

The underlying concern here is to examine the degree to which employee ownership (in its various legal forms) and agricultural and business cooperatives enhance the opportunities for working people in both developed and developing countries to secure and maintain decent work with adequate wages and benefits. Ownership, whether by workers of the companies that employ them or by users of agricultural supply and marketing cooperatives and of small business cooperatives, can give working people greater opportunity to shape their economic destiny and to achieve individual and collective goals consistent with the International Labour Organization’s commitment to the “promotion of opportunities for women and men to obtain decent and productive work, in conditions of freedom, equity, security and human dignity”.³ Further, as will be discussed at some length, broadening ownership creates significant economic resources that can provide more secure retirements for current workers, and better education and a more secure future for their children. Last, but certainly not least, these forms of broader ownership anchor capital and jobs locally despite increasingly rapid capital flows in the global economy, and provide some benefits as well for community members who are outside the ownership

¹ The terms “worker ownership” and “employee ownership” are used synonymously. These include a variety of differing legal forms of ownership: workers’ cooperatives; Employee Stock Ownership Plans (ESOPs) in the United States, the United Kingdom, and several other countries; “common ownership” in the United Kingdom; *sociudades laborales* in Spain; People’s Enterprises in Russia; and various forms of direct ownership using partnership or joint-stock structures. The common denominator is that all provide ownership rights to most or all employees, and that there is an element of individual ownership in which workers receive individual benefits based on the performance of the enterprise they own.

² Productivity and employee ownership in which the dominant form of employee ownership is through stock options or pension funds are not examined.

³ ILO, 1999.

circle.

Conventional wisdom has it that investor ownership is the most efficient and productive type of enterprise, and this form of ownership is often credited as the source of the remarkable economic growth of capitalist economies. Yet, one may reasonably ask, "What is the evidence for the superiority of investor ownership over cooperative ownership?" A rough answer can be found in the survival of cooperatives: if the private sector were providing sufficient goods and services at highly competitive prices, farm and small business cooperatives would not have developed and persisted. The survival of many cooperatives into the present day and the formation of new cooperatives suggests that manufacturing, retail and agricultural cooperatives are able to compete in a market economy, and that overall the productivity they generate must be at least comparable to that of investor-owned firms. But they are not exactly like them.

1.2 Defining productivity

Productivity, measured as value added per worker, value added per work-hour, or value added per unit of investment, is the economist's measure of enterprise efficiency. The measures are simple to understand, and information on productivity is relatively easy to collect and compare among enterprises. However, conventional definitions of productivity cause some difficulty in comparing cooperatives and employee-owned firms with investor-owned firms (IOFs). Because cooperatives and employee-owned firms pursue different goals and allocate their profits differently from conventional firms, the standard definitions are less appropriate for comparing IOFs and cooperatives. The benefits to members and community created by cooperatives must be considered in assessing productivity.

1.3 Defining productivity in worker cooperatives and employee owned enterprises

First, employee owners and members in workers' cooperatives have a different relationship with the business than outside shareholders do. Employee owners' livelihoods depend on continuing employment through the success of the firm they own. This is far more important for them than the return on investment. Consequently, employee-owned companies may be willing to accept a lower rate of return on their capital and a lower rate of overall profit than an investor-owned company.

Second, profitability, the usual standard for business success, may not be a very good measure of the productivity of the worker-owned business. In periods of slack demand, workers' cooperatives may pay their members only a basic wage comparable to what is paid in traditional firms. But in more prosperous periods, they often raise compensation with an additional,

variable wage, paid as a bonus, dividend or profit-sharing. Tax law plays an important role in how variable compensation is implemented, because enterprises will normally seek to minimize tax liabilities as they direct additional income to the employees. The method of variable compensation may affect conventional measures of enterprise productivity.

Third, the sources of productivity in employee-owned firms may differ from those in conventional firms, so the measure used matters. Employee owners may arrive at competitive levels of productivity through different combinations of labour, capital, skill and initiative than do conventional firms.

Fourth, the risk picture for employee owners is different. The risk they run by keeping their assets in their own firm is greater than if they invested an equivalent amount in the stock market or a bank account, but ownership allows them to influence the return to investment by their own efforts, rather than depending on the less well understood and less controllable services of investment professionals and movements in the stock market.

1.4 Defining productivity in agricultural or small business cooperatives

The standard definition of productivity also causes problems for measuring the productivity of agricultural or small business cooperatives. Because cooperatives are designed “for use” of members, rather than for profit, they try to sell inputs to members at a lower price and buy products from them at a higher price, enabling members to reap higher returns in their own businesses or farms, rather than retaining profits in the cooperative. IOFs, by contrast, try to sell high and buy low. The success of a farm cooperative is more appropriately measured by the success of its members than by the profitability of the cooperative itself. For example, a farm cooperative that sells supplies to its members for slightly less than the price at an IOF and which pays members slightly more per bushel of grain delivered will have less value added per transaction than the IOF, but will increase the rate of return to its farmer-owners in their own agricultural production. Likewise a small business cooperative, run on a “for use” rather than a “for profit” basis is not necessarily trying to maximize the value per work-hour worked by cooperative employees. On the contrary, it tries to keep prices for its member owners down while spending on brand advertising and other services to increase the member owners’ sales.

The standard definition of productivity at the level of the cooperative ignores the impact that cooperative enterprises have on their members’ productivity. This is a serious problem. After all, farmers or small businesses that join cooperatives do so to achieve the economies of scale that their small size otherwise denies them. The cooperative (1) cuts the costs of their inputs into

their own operation; (2) provides services (application of fertilizer, pesticides and herbicides for farmers, veterinary services, and branding (e.g., Land o' Lakes, Ace Hardware) that farmers and small business people could not otherwise obtain; (3) buys members' outputs at a higher price and markets them where the members otherwise would not be able to; (4) rebates most of its earnings to members in cash payments and capital accounts; and (5) provides a sheltered opportunity for investment: the cash and capital account returns, at least to farmer members in the United States, exceed the historical rates of return on both bonds and stock ownership in public equity markets. In short, it is necessary to take into account the fact that the farm or small business cooperative is an extension of the business of the member owners.⁴ Gains in productivity may be captured either at the level of the farmer producer or the small business, such as retail outlets of Ace Hardware, or at the level of the purchasing or marketing cooperative itself. This needs to be considered when looking at the empirical studies.

1.5 Societal productivity versus enterprise productivity

So far, discussion has focused on problems in defining productivity at the micro level of the firm and not on the broader, macro level of society. In advanced industrial democracies running at nearly full employment, maximizing the productivity of the enterprise may coincide with maximizing the productivity of a society. On the other hand, in developing countries or in underdeveloped regions of developed countries with large unemployed and underemployed portions of the labour force, increasing the productivity of the firm at the cost of reducing employment may lower the societal level of productivity. Take, for example, the common strategy of improving firm productivity and profitability in multi-plant companies by simply shutting the bottom 20 per cent of operations. Firm productivity goes up, but societal productivity goes down as laid-off workers apply for unemployment benefits and incur other expenses to government. If unemployment is close to the frictional level, displaced workers quickly find new (and hopefully more productive) jobs, but that is rarely the case in developing countries and underdeveloped regions, where the costs to government may be substantial and long-term.

⁴ Writing in 1920 as a member of the Royal Commission on Income Tax, economist A. C. Pigou concluded that the returns to cooperative members in fact were not profits of the cooperative but reflected an overcharge to its members. He reasoned that dividends were merely an overcharge that was refunded to members. Consequently they were not taxable because, if taxed as income, the cooperative could simply cut its prices to members, eliminating the dividend by eliminating the overcharge (Pigou, 1920). This sort of rationale encourages the conclusion that measuring the productivity of the cooperative (like its income) must include its impact on individual members.

Cooperatives can also enhance social productivity by enabling small, otherwise marginal farmers and craftworkers to capture enough of the value of their production to stay on their farms or continue their businesses rather than being forced off the land or out of business to join the ranks of the unemployed or underemployed. In the same spirit of creating and maintaining productive work, cooperatives of the unemployed or underemployed may pool small funds to buy capital equipment that members can share to enable them to perform some paying work. As Bill Winpisinger, president of the International Association of Machinists and Aerospace workers, was wont to say, "There is no productivity in an unemployment line."

Finally, as democratic enterprises, employee-owned firms and user-owned cooperatives may provide a variety of other benefits to their member owners and to their communities. They are not compelled to have the single-minded fixation on profits that characterizes some investor-owned businesses, particularly absentee-owned conventional firms. Other benefits may include more secure employment, health clinics, training and education and other services offered to members only or to the community at large. Exploring these collateral benefits of ownership is another focus of this report.

2..Work ownership and productivity

“We need a new business model. Financial participation schemes for workers – shares, share options or profit-sharing – can contribute to this. Financial participation should not be confined to the boardroom but should be an option for all workers. Where the rules of the game are crystal clear, up front and sound, it can be a win-win situation for business and workers by building commitment in the workforce and raising productivity while providing workers with a share of the benefit.”

Anna Diamantopoulou, European Union Commissioner for Employment and Social Affairs, July 11, 2002

Workers’ cooperatives and employee-owned companies are ordinary business enterprises that are wholly or partly owned by a broad group of the people who work in them. Not everyone in the firm has to be an owner, and employees need not own every share. There is no hard and fast shared understanding of what percentage of the employees must be owners or what total share of the enterprise the employees must own before employee ownership becomes meaningful, and so every researcher must specify a definition. There is a widespread understanding that workers’ cooperatives are usually 100 per cent owned by the employees and that more than half of the employees are owners, but there are enterprises that consider themselves cooperatives that do not fit these criteria. The broader phrase, “employee-owned firm” may include companies where less than half of the employees are owners and they own a small percentage of the stock. In many countries, the terms are defined in law.

Confining the focus only to enterprises with a high percentage of employee ownership and broad ownership among most employees runs the risk of ignoring important uses of employee minority ownership. These uses include making a transition from traditional ownership to broad employee ownership, or rescuing struggling companies by taking an employee share in exchange for wage concessions, and the impact of employees owning a substantial minority share of their company over the long term. This report takes the inclusive approach, with a broad survey of the impact of employee ownership on enterprise productivity.

The International Co-operative Alliance estimates that there are more than

100 million people employed in workers' cooperatives around the world.⁵ The biggest and most successful worker-owned cooperatives are in Western Europe – France, Italy, and the internationally known Mondragon group in Spain – but most cooperative members live in the developing world, especially in Asia, with a total of two million members in Indonesia, 25 million in India, and 30 million in China. In the United States, with its active stock market and well-developed judicial system, employee ownership has taken complex legal forms: nine million people are estimated to participate in 11,000 broad stock ownership plans or employee stock ownership plans (ESOPs), and an estimated 36 million more are enrolled in 10,200 other company plans for employee stock ownership.⁶ New approaches to employee ownership and to agricultural and enterprise cooperation are the subjects of active experimentation and policy development, particularly in North America and Western Europe.

Despite the prevalence of cooperatives in the developing world, most of our empirical knowledge about worker ownership and productivity is from experience in Western democracies. (The case study evidence of astonishing initial increases in productivity of enterprises privatized through worker ownership or leasing in former communist countries⁷ probably reflects other factors in addition to worker ownership.

2.1 Historical perspective on ownership and productivity in worker cooperatives and employee-owned firms

Before considering current theory and research on employee or worker ownership and productivity, let us review the history of ownership in a market economy. Ownership has been established by political processes that define and enforce property rights by balancing historical claims, social values, practical realities, and technical considerations. Perhaps because the life of a property can extend beyond that of its human owners, we are inclined to think of property rights as immutable. But a quick look at history proves this not to be the case. Hernando de Soto's *Mystery of Capital* (2000) shows that property rights have often been redefined by the State, sometimes with profound economic consequences. The powerful effects of redefined property rights are amply illustrated by the British enclosure movement, the

⁵ Thordarson, 1995.

⁶ National Center for Employee Ownership 2002. Employee-owners in the United States can own employer stock through stock options, stock purchase plans, and 401(k) matching grants. They, like the majority of employees in ESOP pension plans, cannot be considered owners in the sense of collectively holding a controlling stake in the enterprise or having the ability to participate meaningfully in the governance and management of the firm. There are perhaps 2,500 firms in the United States where there is meaningful and substantial employee ownership.

⁷ See, for example, Logue, Plekhanov and Simmons, 1995.

expropriation of properties under communism, and in various colonial policies.

As a type of ownership, investor ownership is a fairly recent arrival on the historical scene, developing along with market capitalism. It began simply as an extension of individual ownership, and all the rights of ownership that had belonged to individual owner-entrepreneurs were inherited by the investors. Investor ownership was a means for creating capital-intensive enterprises too large for the wealth of any single individual, for diversifying individual wealth to minimize the risk of loss, and for obtaining additional value and income from the breathtaking returns of early entrepreneurial capitalism. As a result of investor ownership, the role of owner-manager gave way to the more remote role of owner-investor with hired management. With this change, much of the obvious justification for the superior efficiency of investor ownership was eroded. Owners were no longer present on the premises to ensure the most productive use of their capital. But industrial capital could be so wildly productive and profitable that moderate losses in productivity arising from hired management were tolerable to the investor. Social and economic inequities of the early capitalist period, far more pronounced than now, facilitated a steady supply of eager and compliant workers and managers, and competition disciplined labour.

No doubt many hired workers hoped to participate in the market system. But for those who lacked capital, there was little chance of realizing such a dream. In early capitalism, most employees were so poor, so uneducated, and so excluded from the credit system as to have almost no possibility of acquiring their own capital and benefiting from the economic system. The few who parlayed their luck and talent into successful ownership were more interested in joining the class of owner-investors than in creating owners among their peers from the factory floor or mineshaft. Even Robert Owen, the storied founder of cooperatives and utopian communities, was more a benefactor and communitarian than an advocate of employee ownership of factories.

Like poor people everywhere, workers in early capitalism drew on rural and village traditions of cooperation and engaged in mutual aid to shelter themselves from unemployment, job loss, illness, and the expenses of untimely death. From mutual aid societies sprang many of labour's current institutions, including cooperatives, labour unions, workers' banks and credit unions, and consumer cooperatives. Many workers' cooperatives were created in response to strikes and lockouts, although most had no realistic prospects of long-term survival or economic success without capital or managerial expertise. Puny as they were, they posed a challenge to the business class, and the history of many labour cooperatives ends with a story of active hostility from the business community. When cooperatives failed,

the business class was quick to place the blame on workers' incompetence or moral depravity.

But their failures are not conclusive evidence that employee-ownership is less efficient or productive. Aside from strikes, many nineteenth century workers' cooperatives were created to meet genuine social needs that made for business opportunities. For example, consumer cooperatives have sold goods competitively for over a century in the United Kingdom, lowering the cost of living for working families by returning a regular dividend to their member-customers based on patronage. The consumer cooperatives encouraged the development of workers' cooperatives to supply them with goods. The cooperative model was also widely and successfully adapted to agriculture, and to an environment in which farmers were accustomed to helping each other through catastrophes of every variety.

Without belabouring the point, our modern idea of ownership can be seen as a bundle of rights including the right to manage the enterprise, to hire and fire, to set prices, to appropriate profits, to select suppliers and consumers, to sell the enterprise to a buyer of one's choice, to invest the proceeds of the sale, and even to terminate or destroy the enterprise.⁸ In most countries, ownership also includes the right of access to certain public goods (the right to draw water, emit waste substances into the air, water or soil, to use the public transportation system, or to prospect for minerals). But through the political process, ownership rights have been unbundled. Some ownership rights have been "socialized" or regulated in some countries – for example, rights over personnel management including procedures for hiring and firing, wages and hours, rights to externalize the costs of pollution and waste disposal. And some ownership rights have been made subject to negotiation between the owners and trade unions under collective bargaining law.

When employees or consumers own an enterprise, they may assume all the rights of other enterprise owners, or certain of these rights may be legally denied. For example, cooperatives in some European countries are forbidden or discouraged from selling the assets of their enterprise, or are controlled in allocating the surplus. Because laws and regulations on cooperative ownership may affect every stage in the life cycle of the enterprise, they also affect its productivity. In addition, when employees or consumers are owners, they exercise their bundle of ownership rights with reference to their interests, and so different organizational structures and practices develop within cooperative enterprises.

At every step, political decisions played a key role in legitimizing and facilitating cooperatives. Through politics, the cooperatives achieved

⁸ Putterman, 1993, 245 ff; see also Adler-Karlsson 1969 (pp. 20-22).

legal status so they could participate in the justice system. As the social and economic value of cooperatives was recognized, governments at times provided tax and programme supports. The new economic form introduced healthy market competition into provisioning the working class. As a result, working people benefited from the impact of cooperatives on competition in the retail market, whether they belonged to a cooperative or not. The retail cooperatives and the workers' cooperatives that supplied them could not have survived if they were not productively competitive with conventional enterprises.

In the developed economies, some older cooperatives still thrive today, and new kinds of cooperative and employee-owned enterprises are emerging to provide goods, services and prices not available through the investor-owned economy. New workers' cooperatives and employee-owned companies are created to meet needs and fill economic niches not met by conventionally owned enterprises, arising from the retirement of owners of small and medium-sized enterprises, bankruptcy, spin-offs from big firms, a sudden burst of lay-offs, and market competition from multinational companies.

In the developing world, the very conditions that created a need for cooperatives in early capitalism still exist – there is a shortage of employment, of low-cost goods, of decent housing, of social security and of social services (child care, elder care, health services and education). There are traditions of cooperation from the countryside and village, but linguistic, tribal, clan and religious differences can be impediments to cooperation in national and international markets. Cooperatives in the developing world also face competition from international firms with vast economies of scale.

Although criticisms of incompetence, incapability and moral depravity still echo in the literature (albeit under more polite names today), the reality of successful operation and survival carries a weight of its own. It is this weight of evidence that is examined here. Worker cooperatives and employee-owned businesses are created for a variety of motives – by workers to preserve jobs and spread wealth, by employers to improve productivity, by governments to promote economic development and other national goals. But, in the end, workers' cooperatives and enterprises must be sufficiently efficient to compete in a market economy, or they will fail.

This implies that in the long run, cooperatives, like any other enterprise, must generate a surplus of income after expenses. Sometimes an enterprise surplus is the result of luck or law, but over the long run, profitability depends on productivity, or the efficiency of the firm. Productivity arises from a combination of factors – capital, labour and management. Innovation and entrepreneurship enhance productivity by developing new ways of utilizing these factors. In early industrial capitalism,

as in the developing world today, productivity was strongly based in capital goods, because machines and factories greatly multiply the productivity of unskilled labour.

In developed economies, on the other hand, productivity is primarily a function of labour: capital accounts for only about 30 per cent of costs⁹ and many companies can finance new capital investment out of profits. So capital no longer holds its pre-eminent place. More than ever before, the labour force enhances productivity by its training and its diligent attention to the work process. In a capital-rich economy, the contribution of the labour force to productivity can be the main competitive advantage, particularly for service and high-technology firms.

Regardless of the level of economic development, innovation and entrepreneurship enhance productivity by introducing new methods and materials. The many owner-employees in cooperatives and employee-owned enterprises have a direct economic stake in productivity enhancements, and that fact creates the potential for an effective management system of broad participation for developing and implementing the ideas of those who would otherwise be silent or ignored.

But none of the benefits can be realized if the environment for cooperatives and worker ownership is unfriendly.

2.2 The context of worker ownership: What is the proper role for state patronage and support of cooperatives?

*"The State will always profoundly shape how cooperatives function."*¹⁰

*"Every cooperative is in some way or another a reflection of a certain cultural and political background, and indeed must fit into its own society in order to survive. This accounts for the considerable difference in cooperatives from one country to another."*¹¹

The context of culture, law and politics is supremely important for the structure, operation and performance of worker-owned enterprises.¹² A primary requirement is a secure legal basis for ownership (de Soto 2000). For example, in the Spanish Basque country, the Falangist political and economic context was sufficient for the Mondragon cooperatives to survive, simply by permitting them to exist (tolerated perhaps because of their connections with the Catholic Church) rather than shutting them down. By

⁹ Blinder 1990, (p.2).

¹⁰ Taimni, 2001, (p. 26).

¹¹ Laidlaw, quoted in Taimni 2001, p. 33.

¹² Poutsma, de Nijs and Dooreward, 1999.

contrast, in Bulgaria and Yugoslavia, workers' self-management in the early 1980s failed because of problems in the larger political context – continued political interference, central planning, inadequate preparation of workers and a dearth of financial incentives.¹³

Another important contextual factor is a sense of trust and identity among employees. It can exist prior to establishment of the cooperative. The limited labour mobility and ethnic solidarity of the Basques, for example, may have played a role in the success of Mondragon, by stabilizing workers' capital investments in the cooperatives.¹⁴ High unemployment in the sluggish Falangist economy may have allowed the Mondragon cooperatives to select the most stable and cooperatively oriented employees.¹⁵ In Japan, Fukuyama (1999) found that foreign-owned credit cooperatives 1992-1996 were more efficient and experienced greater productivity. Ninety per cent of them were owned by Koreans. Trust and identity can also be developed through employee selection, socialization, and on-the-job experience.

The importance of legal and political context is highlighted in Taimni's 2001 study of cooperatives in Asia. All Asian countries had parastatal cooperative systems, resulting in the imposition of political goals and values on cooperative organizations.¹⁶ The result was micromanagement motivated by political goals, excessive regulation and abuse of regulation,¹⁷ seeking of jobs and contracts for political supporters, and failure of apex organizations to recognize and represent the needs of primary cooperatives.¹⁸ Moreover, because cooperatives and their apex organizations were receiving resources from the State, they became targets for capture by various ethnic groups and social classes.¹⁹ Where the State is playing such an active role, the productivity of cooperatives cannot be understood or measured in the same way as in a market system. In fact, productivity is not a central issue in such a system. However, in the end, these parastatal cooperative organizations were "caught" by their failure to meet a minimum productivity threshold. In the late 1970s, when internal and external economic pressures began to reduce state budgets, support for cooperatives was lessened or eliminated, and the parastatal cooperatives and apex organizations faced serious, even fatal, challenges.

2.2.1 Stabilizing capital in the cooperative enterprises

One important question that relates to state policy and enterprise

¹³ Jones and Meurs, 1991; Estrin, 1982; Prasnikar and Svejnar, 1991 (pp. 30-31).

¹⁴ Bradley and Gelb, 1982, (p. 159).

¹⁵ Ibid., pp.157-8; 165.

¹⁶ Ibid., p. 36.

¹⁷ Ibid., p.127.

¹⁸ Ibid., p. 136.

¹⁹ Ibid., p. 147.

productivity is stabilization of the capital in the cooperative enterprise. If employee turnover is high and departing employees are continually withdrawing cash from the firm, this undermines investment and reinvestment. A variety of state-structured approaches to stabilizing capital are in use. For example, in some European countries, law requires that the cooperative contribute a share of annual profits to a collectively owned, indivisible reserve that can be used for capital equipment or other common purposes, but can never return to the members unless the cooperative is dissolved. In some countries, the reserve can never return to the members at all. It must go to the government or be used for charitable purposes if the firm closes or is sold to a private owner. The requirement that cooperatives create the reserve builds a fund for replacement of obsolete or worn-out equipment and new capital investment. Without such a fund, employee-owned enterprises would lag in capital investment and reinvestment, and they might close sooner and more often. Of course, requiring such a reserve does not ensure that it will be invested well and contribute to productivity, but it does create a floor of possibility. Some countries allow the firm to raise additional capital by taking loans from employees, but often the interest rate is limited by statute or regulation. This means that employees may not choose to lend money to their firms when the market interest rate is higher than the statutory limit, and the firm will be starved for capital. However, the evidence suggests that employees will invest in their firms even if they receive a below-market rate. For example, Mondragon workers decided that they would not take any stock dividends out of their accounts, thus making the capital available to their cooperatives. Another example is the Anjuman weavers who invested in their cooperative even though the cooperative's economic position was weakening.²⁰ This is not as irrational as it seems. The below-market investment keeps the firm alive and employing the worker-investor; for worker-owners wages are always far more valuable than any eventual investment return. And there is always the hope that the investor will eventually receive substantial returns on the capital, however bleak the present prospect.

The United States takes a different approach to stabilizing capital in ESOPs. Employees cannot remove their capital until they leave the firm. But when they do leave, they can extract the full value of their shares as valued on the public stock market or by an independent evaluator. This requirement stabilizes the firm's capital, but leaves nothing "for the company," in case of unanticipated large expenses or investment opportunities. By not requiring collectively owned indivisible capital, the law assigns no value to the future existence of the company and future benefits it might generate. Fear of being unable to meet this "repurchase obligation" has even inspired some employee-owners in the United States to dissolve their ESOP and sell their

²⁰ Couture, 2002, pp. 19, 22.

shares to a private owner. If the cost of capital is too high, whether the cost is paid in interest, dividends or capital gains, businesses cannot invest and grow.

Some of the most successful cooperatives have enjoyed stability of capital because of the local identification of their employees, because they pay wages that discourage labour mobility and by selection of employees who have a good attitude toward cooperation.²¹ The history of cooperatives is replete with examples of cooperatives where the members decided to take less income in wages, dividends and interest so that their company could invest.²² There are those who argue that requiring workers to hold substantial amounts of their capital in the enterprise for long periods of time exposes workers to greater risks and deprives them of the opportunity to make better investments.²³ And there is the reply of Robert Oakeshott: "It would be perverse not to prefer the risky prospect of a larger share in enterprise income when the alternative is no prospect of any such share at all."²⁴

Another possible regulatory question for the State is defining the role, if any, for outside investors in the cooperative enterprise. Firms often need the flexibility of equity investments rather than debt. New capital can enhance their productivity. Most capital in traditional cooperatives is raised internally from members. Should cooperatives and employee-owned firms be able to take outside equity, and what role should outsider equity be able to play in the firm? Should this decision be left to the enterprise, or should the State set limits through policy? The choice has consequences: in times of recession, outside investors may be able to purchase controlling interests at bargain basement prices, even closing firms and taking their production out of country. In the newly privatized economies, outside investors are generally associated with larger investments in capital improvements, but also with greater lay-offs.

In the developing countries in particular, the role of the State in encouraging cooperatives will probably remain important. Although many cooperatives have had some governmental or NGO help to get started, the survival and growth of cooperatives in Armenia, China, Ghana, Poland, the Russian Federation, Uganda and Viet Nam attest to their ability to compete with private enterprise once they are established.²⁵

²¹ Bradley and Gelb, 1982.

²² Abell and Mahoney, 1982.

²³ Drucker, 1976 (p. 10).

²⁴ Cited in Clayre et al., 1980 (p. 53).

²⁵ Couture et al., 2002.

2.2.2 *Comparing productivity in worker-owned enterprises and conventional firms*

Because context is a decisive factor, cross-cultural studies on the productivity of enterprise forms often fail to illuminate the questions which lie at the heart of the present analysis. How does the productivity of worker-owned enterprises compare with that of conventional firms?²⁶ Law shapes the form and practice of the worker-owned enterprise and defines its status in the political system. Structure and legal status in turn can affect productivity. For example, in the United States, ESOP law allows the employee to realize the value of ownership only after separation from the firm through resignation, termination, retirement or death. The evidence suggests that the absence of a “line of sight” from the employee to the value of his/her employer stock erodes the potential productivity of this form of employee ownership, and indeed, simply establishing employee ownership is not associated with productivity gains in firms in the United States.²⁷ European law, by contrast, variously recognizes, encourages and regulates direct stock ownership policies, cooperatives and relatively short-term stock ownership accounts (typically 3-7 years). Japanese employee ownership falls somewhere between the two, allowing for stock to be converted to cash only in 100-share lots, effectively making it a retirement plan.²⁸ The Japanese ESOP also seems to obscure the employee’s “line of sight,” but possibly the arrangement has a different meaning to employees in a nation of savers.

The importance of context can be seen in the fact that political issues, not productivity problems, are judged to have led to the near extinction of Israeli worker cooperatives. Russell (1995) attributes the demise of most Israeli worker cooperatives to generally poor economic conditions, the ambiguous stance of organized labour and actively hostile attitudes and policies of Likud-led political coalitions after the mid-seventies. He reports that some believe that worker cooperatives could have

²⁶ Jones and Meurs (1991) include a brief discussion of the main literature on cross-cultural comparisons. An excellent example of such studies is Hofstede (1980). In one of the best efforts at cross-cultural theorizing to date, Levine and Tyson bring home the importance of context in a thought experiment (in Blinder, 1990, pp. 214-222): in a supportive economic environment, with long time-horizons, relatively mild recessions, an economy where many firms are participative, egalitarian and non-hierarchical, and debt is not expensive, a higher-performing equilibrium can develop than in the economy where motivation is achieved through fear of job loss, debt is expensive, and the technology depends heavily on “star” producers. In the first situation, workers and employers are willing to invest more in education and training leading to higher productivity because they expect long-term employment, and see no reason to switch jobs because of an egalitarian job structure.

²⁷ GAO, 1987, p. 11.

²⁸ Jones and Kato, 1993a.

survived with just a little rhetorical and policy support, which was never provided (or even thought of) until it was too late. The Likud government proactively privatized many workers' cooperatives, which was easily accomplished because government and the labour union Histadrut were partial owners of many of the cooperatives. Anecdotal evidence suggests that internal Histadrut politics also played a role in the disappearance of most of the Israeli worker cooperatives. Today, only kibbutzim still exist in substantial numbers, kept afloat by more supportive government policies and the strong emotional and ideological attachments of their members. By comparison, two-thirds of Israel's more individualistic moshavim farms had vanished by 1992.

Historical experience has shown that self-help is the strongest foundation for cooperatives, and that governmental involvement should be kept to a minimum, because state-sponsored parastatal cooperatives are "easily hijacked by ambitious politicians," and "in a partnership between the State and fledgling institutions, ... the all-powerful state and/or its agents will ultimately emasculate and enfeeble the weaker partner, irrespective of the safeguards"²⁹ What the State can do is create a political and economic climate in which cooperatives can be recognized and operate under protection of law, formulate a clear policy of encouraging and facilitating cooperative development but not interfering in operations, develop a regulatory framework which limits the state role to record-keeping and adjudication of disputes if the ordinary courts are unavailable, and establish independent support and financing organizations to promote cooperatives and similar institutions. In historical experience, successful support organizations and financing institutions have become self-sustaining within a decade. If cooperative and employee-owned companies are productive and competitive in their markets, they will be able to repay loans from a financing agency and contribute to their support organizations. If they cannot, policy review is appropriate.

Because of the complications of the political, social and economic context, and the varied organizational and practical options for structuring and managing ownership of worker cooperatives and employee-owned firms, the connection between ownership and productivity must be studied empirically. There is a substantial body of literature from the United States on employee ownership and productivity, and a smaller body of literature from Europe. There is a limited literature concerning employee ownership and privatization in former communist countries, and even less literature on the developing world. Outside of the industrial democracies, empirical studies have been few and are more frequently case studies of exceptional companies rather than systematic analyses.

²⁹Taimni, 2001 (p. 93).

The evidence for the industrial economies is now examined, followed by a discussion of the privatizing economies, and concluding with evidence from the developing world. In light of these, theoretical perspectives from economics are briefly discussed.

2.3 The empirical evidence for worker ownership and productivity in developed economies

For worker ownership in the developed economies, there are four points of departure in the empirical productivity studies. These are: (1) early studies with small samples and frequent sample bias; (2) later, larger studies which usually found a relation between employee ownership and productivity; (3) larger studies that identify employee involvement and participation as the nexus of higher productivity, and (4) large-scale studies from data on publicly traded companies without data on management practices.

Early studies in the 1970s and 1980s, mostly from the United States, with uniformly low response rates, typically found that employee ownership produced improvement in employment, productivity, sales, or profitability.³⁰ Companies more favourable to employee and worker ownership were more likely to respond to such surveys, so these studies rarely, if ever, included companies with negative experience or unsuccessful performance. For example, Conte and Tannenbaum (1978) found that among 30 American and Canadian ESOPs which supplied profit data (in a survey of 83 companies), the greater the percentage of ownership, the higher the profit per capita. But later, better-designed small studies of employee-owned enterprises also returned favourable reports on productivity. For example, a matched sample study of 35 Italian private firms and 49 worker cooperatives in Emilia Romagna and Toscana found that the cooperatives had higher productivity, measured as value added per employee, value added per hours worked or value added per unit of fixed assets.³¹

Worker-owned plywood cooperatives in the Pacific Northwest of the United States have been intensively examined in several independent studies and found to be more productive overall than their conventionally owned competitors.³² The exceptional skill of employee-owner-operators of veneer peelers is discussed in Bellas (1972), and is held to be the key to

³⁰ Many of these early studies were summarized in 2002. See *The Journal of Employee Ownership Law and Finance* 14:1. A recent addition is Kruse et al., 2003, which collected employee attitude data and economic data on performance from 13 companies.

³¹ Bartlett et al., 1992.

³² See Berman, 1976; Bellas, 1972; Craig and Pencavel, 1992, 1993, 1995.

understanding the high productivity of the plywood cooperatives.

However, not all studies with small samples found benefits from employee share ownership. A small proportion of studies had more mixed findings. Jones and Backus (1977) found that British worker cooperatives with collectively owned capital were smaller and tended to invest less than conventional firms in the footwear industry during a period (1885-1970) when the industry was in long-term decline. Without investment, productivity would be expected to decline. However, they also found some support for the idea that efficiency (measured as value added per worker) improves with broader participation, as measured by percentage of the management committee that were employees, proportion of cooperative members who were employees, proportion of the labour force that were employees but not owners, and proportion of share capital owned by employees. A 1978 survey of 50 British retail consumer cooperatives found that the presence of worker directors modestly increased productivity in a regression equation predicting to value added, whereas financial participation in the firm by employees reduced productivity.³³ However, the percentage of ownership by the employees was small, as were the financial rewards they received, because the customers were the primary owners of the cooperatives. On balance, the net impact of the board representation and ownership was small but positive, around 1 per cent. In a subsequent investigation of cooperatives in the United States, Jones (1979) documented the long-term prosperity, success and survival of some cooperatives, but faulted them generally for underinvestment, and found that to be a common cause of failure.

The problem of low response rates and small numbers was later addressed by larger and more systematic studies comparing employee-owned companies with conventional ones. Higher response rates lent credibility to the existence of a link between employee ownership and productivity.

Using official and comprehensive data, Estrin and Jones (1992) demonstrated that French worker cooperatives remained healthy over long periods (50 years). Although survival attests to at least minimally competitive productivity, the researchers faulted French cooperatives for being less productive than they might be and suffered from excessive capital accumulation in the collectively owned assets of the firm. Typically founded with little capital, the cooperatives struggled to accumulate needed capital but, later, as their capital accumulated and became more than enough for their obvious needs, they found it difficult to shift from a building-and-hoarding mentality to a growth-and-investment mindset that could accelerate diversification or return on capital. Details of law and policy may have

³³ Jones, 1987.

contributed to the hesitation.³⁴

Another European study, of 631 Italian manufacturing and construction cooperatives, found that profit-sharing and employee ownership (share of the company owned in individual accounts) had significant positive productivity effects in both manufacturing and construction.³⁵

Regression studies using Japanese government data with high response rates and surveys with moderate response rates (30-40 per cent) also found an association between productivity (measured as value added) and employee ownership; Jones and Kato (1993a) found the productivity effects of introducing an ESOP to be 6-7 per cent. In a subsequent study, the same authors, using surveys of companies traded on the Japanese stock market in before-and- after comparisons of 324 ESOP firms, found that the introduction of an ESOP had a favourable impact of 4-5 per cent increase in productivity after a lag of 3-4 years.³⁶ This effect was estimated with data from 1988 annual Survey of Stock Distribution conducted by the National Association of Stock Exchanges (100 per cent of firms listed on eight exchanges).

Starting with the United States General Accounting Office survey of 1985,³⁷ a few surveys with high response rates found that employee ownership by itself did not produce improvement in productivity, but ownership combined with participation did. Jones (1993) found a similar association in Polish cooperatives.

Similarly, a study in the United States by Logue and Yates (2001), with responses from more than 60 per cent of all companies in Ohio with employee stock ownership plans, found strong and significant correlations between a work-unit/shop floor index of participation and manager-reported assessments of operational and financial performance, including productivity. The presence of non-management board members, whether elected or appointed, was also significantly correlated with management reports of operational improvement (including productivity) and improved profits relative to other firms in the same industry.

Just how participation translates into performance is somewhat mystifying, but some light has been shed on the question. Most simply put, participation, combined with communication and training, can address the "line of sight" problem for employee share ownership, showing workers how their individual efforts connect to the bottom line. Effective participation also creates a systematic process for developing, evaluating and

³⁴ French law requires an annual apportionment of profits to internal capital.

³⁵ Jones and Svejnar, 1985.

³⁶ Jones and Kato 1995.

³⁷ GAO, 1987.

implementing workers' ideas for better management of the enterprise. It can also help to overcome the disillusionment that follows unrealistically high expectations that often accompany the introduction of employee ownership.³⁸ Logue and Yates found that participation, along with increased business information and the training to understand and act on the information is strongly (and significantly) related to increases in employee interest in decision-making, and interest in decision-making is in turn a good predictor of economic performance.³⁹ Pendleton et al. (1998), studying a sample of 235 (of 650 surveyed) employee-owners from four British bus companies, find a pattern of connection between a sense of ownership and feelings that company practices have changed. About one-third of respondents attributed their improved work behaviour to share ownership. Even though a majority of the bus company employees did not report a strong sense of ownership and felt that nothing had changed, multivariate analysis revealed that participation had a powerful impact on feelings of ownership and improved attitudes towards work and towards the enterprise.

Research on a Norwegian furniture enterprise revealed a connection between ownership and attitudes even though the employees owned less than 10 per cent of the firm and were not able to vote with their shares.⁴⁰ Those who liked ownership and wanted to be owners (as indicated by an intention to keep rather than sell their shares and a preference for shares over a cash bonus) had a stronger affective commitment to the firm as indicated by pride in the organization, caring about it, pleasure at working there and willingness to put in more work effort. Those who perceived the ownership plan to be fair also showed stronger affective commitment. Although the number of respondents was only 108 (of 200 sampled from a population of about 1200), this research, like Pendleton's, finds that for some employees, ownership is intrinsically motivating.

But not every study has found that participation combined with employee ownership enhanced performance. For example, a study matching enterprises from Swedish government data, found that among firms officially classified as employee-owned (more than 50 per cent of value or stock owned by at least 50 per cent of the employees), there was little variation in the data, and little evidence that the percentage of employees who were owners (a measure of participation) was related to total factor productivity.⁴¹ Subsequent matched case studies⁴² in the United States compared participation and ownership in employee-owned firms with conventionally owned comparable companies. For employment and sales

³⁸ Paul, Niehoff and Turnley, 2000.

³⁹ Logue and Yates, 2001, p. 144-48; Yates 2000.

⁴⁰ Kuvass, 2003.

⁴¹ Lee 1989, pp. 88 and 103.

⁴² Winther, 1995; Keogh and Kardas 1994/5; Kardas, Keogh and Scharf, 1998.

growth, they found either no difference between employee-owned firms and conventional firms (Winther 1995) or a difference in favour of employee ownership (Keogh and Kardas 1994/5).

Public company stock market performance studies have mined freely available information on American public companies (and Dun and Bradstreet information on private companies) to determine the impact of employee ownership.⁴³ While stock market performance is no sure indicator of productivity, and thus of less interest for this research, poor productivity can undermine stock values. Many of these studies compare matched samples of ESOPs and non-ESOPs. However, information available in the public domain does not include the extent of employee participation and involvement in management, so it is hard to tell if the improved performance is concentrated in the most participative ESOPs, as the GAO and other studies suggest.⁴⁴ Some researchers using public companies have found sharp improvements in a variety of measures of performance, including growth in employment and sales.⁴⁵ But other public company studies undertaken by those looking at stock market performance were less favourable. For example, Ducey, Iqbal and Akhigbe (1997) found a decline in operating capital after introduction of an ESOP. However, stock value and other public data are far from perfect indicators of productivity, particularly when investors are looking for capital gains rather than income potential. And not all studies of participation, ownership and share value have found a relationship. Blasi and Kruse (1997) found no relationship between participation, ownership and share value in their study of 82 public companies responding to a National Center for Employee Ownership survey in 1996.

Conyon and Freeman (2001) combined British data from the 1998 Workplace Employment Relations Survey (with a response rate better than 80 per cent) with a 1999 survey of firms listed on the London Stock Exchange (with a response rate of 20 per cent). They investigated the question of bias by comparing the stock market performance of companies that responded and companies that did not and found only a slight bias among their respondents in favour of high-performing companies. In this study share ownership and profit-sharing in the form of share ownership were strongly associated with value added. The data yielded an estimated advantage for employee ownership of 12-18 per cent above conventional firms.

⁴³ Blasi and Kruse, 1991; Iqbal and Hamid, 2000.

⁴⁴ Some of these are reviewed in Blasi and Kruse 1991, pp. 181-183. Where there are not negative factors, such as using the ESOP as a takeover defence, the impact of the ESOP on share prices seems to be neutral or positive.

⁴⁵ Kruse data from www.nceo.org/library/esop_perf_talbes_files/sheet001.htm 4/7/03.

For an overview of the stock market performance of employee-owned firms, the United States employee ownership index outperformed the overall stock market during 1997, but at last report was tending toward convergence with broad market indicators. However, the index is no longer being reported by its originator. In the United Kingdom, a comparable index shows employee-owned firms continuing to outperform conventional firms, although it, too, shows early signs of converging with the market generally.⁴⁶

The gradual accumulation of empirical studies in the developed economies has spawned meta-studies, which summarize and compile the conclusions of many studies, even though they use somewhat different samples, methods and measures.⁴⁷ The weight of these studies (but not every single finding) suggests that employee-owned firms, whether cooperatives or other employee-ownership forms, perform as well or better than traditional firms, whether performance is measured as productivity, value added, job stability, longevity, wages and bonuses paid or benefits to workers.⁴⁸ A review of the literature in 1993 found that empirical work comparing producer cooperatives or employee-owned firms finds positive relationships between profit-sharing and productivity, but studies that match pairs of cooperatives and conventional firms have mixed results. This survey of empirical research did not support the theory that cooperatives will be underinvested, a condition which can lead to poor productivity. However, the paucity of cooperatives in the United States is noted, and the authors call for further investigation of problems or obstacles, suggesting that perhaps most workers do not like the risks associated with being an owner.⁴⁹

Doucouliafos (1995), taking a more quantitative approach, examined 43 published studies from the United States, Europe and Japan. He concluded that the weight of the studies suggests that co-determination is negatively associated with productivity, but profit-sharing, worker ownership and worker participation are all positively associated with productivity. In 2000, the most recent of the meta-studies was summarized in testimony before the US House of Representatives by Kruse, who reports meta-analysis suggesting a gain of 4-5 per cent when an ESOP is adopted.⁵⁰

Overall, then, the weight of the evidence comes down on the side of greater productivity for cooperatives and substantially employee-owned companies, whether comparisons are made with conventional firms or

⁴⁶ <http://www.ffwlaw.com/equityincentives/content/library/ukeoi/April2002.pdf>.

⁴⁷ Bonin, Jones and Putterman, 1993; Doucouliagos, 1995; Blasi and Kruse, 1997.

⁴⁸ Studies reporting collateral benefits include employment stability. See Blasi 1992; Estrin and Jones 1992; Kardas et al. 1998; Pugh, Jahera and Oswald, 1999; Blair et al., 2000; Scharf and Mackin, 2000.

⁴⁹ Bonin, Jones and Putterman, 1993.

⁵⁰ Kruse, 2002.

among employee-owned firms with different levels of ownership or cooperatives with different mixes of membership and employees. At the very least, there is an excellent probability that any form of cooperative or collective ownership will do no harm, and there is a good probability that it will increase productivity within a few years.

Interestingly enough, productivity performance may not be central to the decision to share ownership. Research on 17 companies in 6 European Union countries (Finland, France, Germany, Netherlands, Spain, and the United Kingdom), firms did not emphasize productivity as a goal they hoped to achieve by sharing ownership. Instead, they viewed employee ownership chiefly as a commitment mechanism and an additional benefit for employees.⁵¹

However, few, if any, studies have taken into consideration employee ownership plans which were dissolved⁵² or employee-owned companies which failed or terminated their ESOP plans. There is a substantial need for longitudinal studies to examine the roots of sales, dissolutions and business failures of employee-owned companies. It appears that the only extant research is one small study of 27 publicly owned companies with more than 20 per cent ownership in 1983.⁵³ It revealed that employee-owned companies had a slightly better survival rate (over 12 years) than conventional firms.

2.4 The empirical evidence for ownership and productivity in Central and Eastern Europe

Even before privatization of the state socialist economies in Central and Eastern Europe, participation and self-management there were found to be associated with productivity. Jones (1993), examining 183 Polish cooperatives in 1976-78, found that increased worker participation in control and shared economic returns provided positive effects on productivity, particularly in clothing cooperatives, with less apparent effects in construction and least of all in printing cooperatives. Estrin, Jones and Jan Svejnar (1987) found that state-mandated participation had no effect (or sometimes a positive effect) on productivity, but that financial participation – especially profit-sharing and employee ownership – had a consistently

⁵¹ Poutsma, 2002 (p. 23).

⁵² There is a high termination rate for ESOPs in the United States. In 1990, the General Accounting Office found that 30 per cent of ESOPs studied in 1985 had terminated their plans, a “substantially higher” termination rate than other pension plans (GAO 1991, p. 2). ESOP termination rates, however, reflect their character as pension plans, rather than structures for employee ownership.

⁵³ Blair, Kruse and Blasi, 2000.

positive impact.

Since privatization, some small-sample empirical studies from newly privatized employee-owned firms in the former centrally planned states of Central and Eastern Europe have found that the impact of employee ownership, along with participation in firm management, has generally resulted in improved firm productivity and profitability, despite the uncertainties of economic transition in these economies.⁵⁴

For example, a sample of 20 of 1,200 companies privatized to the employees by “liquidation” in Poland (studied in 1994-95) found that almost all firms reported better profits, and all paid dividends that helped employees repay loans they had taken out to buy shares. However, after an initial wage increase, the firms had resisted further increases. Most tended to underinvest compared with other firms in their sector. While this might well lead to lower productivity, all except three unprofitable firms reported an improvement in productivity measured as value of output per employee and generally outpaced productivity growth in their sector.⁵⁵

There are some indications that foreign investors in the privatizing economies may view employee ownership and participation as a stabilizing and assuring factor,⁵⁶ but there is also concern that shares are concentrating in the hands of management and outside investors. Taken as a whole, these studies make it clear that economic, political and social context are fundamentally important, and that employee ownership and participation are only two of a very large number of factors that impinge on productivity. The right combination of internal and external factors is required for success, but this is a question that is generally ignored in the extant research. What little is known points up the need for further inquiry. For example, one might think that tradability of shares would be preferred and beneficial to both employee and outside shareholders, but researchers report that it can have the negative effect of reducing work effort and productivity because employees fear share sales will result in loss of their jobs.⁵⁷ (External conditions are also linked to the failure of employee ownership trusts in Japan after World War II, when employees were able to purchase 31.4 per cent of shares in designated companies.⁵⁸)

The conditions under which employee ownership developed in each country have played a large role in their productivity and success. For example, in Russia, where privatization created the largest employee-owned sector in the world, most employees have enjoyed few benefits from

⁵⁴ Uvalic and Vaughan-Whitehead, 1997 (pp. 28-29).

⁵⁵ Hashi, 1998 (pp.72-78).

⁵⁶ Uvalic and Vaughan-Whitehead, 1997, (p. 33).

⁵⁷ Earle and Estrin, 1996.

⁵⁸ Jones and Kato 1993b.

ownership. Economic collapse greatly reduced the value of shares, and after a brief frenzy of selling which is believed to have concentrated shares under management control, Russian insider owners (both employees and management) have been slow to sell their shares to outsiders, leaving their firms starved for capital. Capital shortage is not only a problem in the Russian Federation. The debt load of Hungarian firms that borrowed to buy their companies has left them unable to leverage needed funds for capital improvement.⁵⁹ Scholars and practitioners disagree over the Russian policy of giving extra shares to management: did managers have a greater incentive to improve their firms, or, with easily manipulated workers owning a majority of the shares, was it easier for managers to steal from the firms than if there were outsider ownership? It is impossible to determine if the privatization program is enhancing productivity, because of the general Russian economic situation, cultural attitudes toward profit, and other factors.⁶⁰

Interestingly, in Yugoslavia and Poland, where workers' self-management had been established under state socialism, the transition to employee ownership was accompanied by legislative initiatives to limit workers' self-management rights. Here, the question arises, Will fewer rights and opportunities to participate decrease workers' efforts and enterprise productivity?⁶¹ In the context of the political collapse of Yugoslavia, the question is unanswerable.

In general, Central and East European studies tend to support earlier research findings that employee-owned companies are reluctant to reduce the workforce even when lay-offs might contribute to productivity – but they also demonstrate that they will proceed with workforce reductions rather than allow the firm to collapse. These studies also indicate that when the economy recovers, the employee-owned business is quick to restore work and wages to members, encouraging more work effort and a speedier return to full efficiency.⁶²

2.5 Worker ownership in developing countries

In developing countries, the context for worker ownership is always difficult and sometimes daunting, lacking in one or more of Taimni's basic requirements (2001). There must be a basic level of order and security before any private business can survive, the State must take a hands-off attitude toward enterprise management, and cooperatives must have legal standing and be easily incorporated and registered.

⁵⁹ Galgóczi and Hovorka, 2000 (p. 6).

⁶⁰ Brown and Earle, 1999.

⁶¹ Uvalic and Vaughan-Whitehead, 1997 (p. 36).

⁶² Ibid. (pp. 39-41).

Israel is an excellent example of a (once) underdeveloped country that used worker cooperatives for development. Although Israeli socialists were troubled by workers' becoming owners and joining the capitalist class, they put aside their qualms because of the necessity to quickly create both an agricultural and industrial sector and absorb many immigrants. And so the workers' cooperative sector was created by a political decision. At its peak in 1955, the worker cooperative sector alone accounted for 2 per cent of the labour force.⁶³ The labour economy of kibbutzim, moshavim, worker cooperatives and labour-owned enterprises amounted to about one quarter of the entire Israeli economy in the post-war era through the early 1970s.⁶⁴ However, it is difficult to evaluate the productivity of collectively owned enterprises in Israel because of the role of outside philanthropy and state financing in creating them. It is clear that they provided jobs and established production in a weak and underdeveloped economy that needed every kind of service and goods and that many of them ran at a profit, which returned to the Histadrut treasury.

As in Israel, cooperatives in the developing world have been primarily parastatal. As government support has dwindled, their economic viability has been clarified, usually to their detriment. Many have failed outright. Some have seriously reorganized. A few have succeeded. Evidence to explain the differences is generally lacking. One can guess that the economic, social and political context played a large role, and one can surmise that every country is different. This area clearly requires more systematic research. We now know that some cooperatives have worked. For example, Abell and Mahoney's (1982) comparison of worker cooperatives in India and Peru show that although returns to capital were slight at best, cooperative members were willing to save and invest in their enterprise, perhaps because of the difficulty of finding work of any kind. In Latin America, at least two of seven cooperatives formed to create employment and investment with Inter American Foundation grants in the 1960s⁶⁵ are listed on the Internet, suggesting that even very poor people can operate enterprises productively over considerable periods of time.

In China, worker ownership has been quite significant in privatization, mostly in the transformation of small state-run enterprises and agricultural collectives into township and village enterprises (TVEs). The privatization of larger enterprises presents a less encouraging picture. As early as 1984, China transformed the Beijing Tianqiao Department Store, Ltd., into a share company and sold shares to the employees.⁶⁶ This was

⁶³ Russell, 1995 (p. 45).

⁶⁴ Daniel, 1976 (pp.157-160).

⁶⁵ Described in Wasserstrom, 1985.

⁶⁶ Situ 2001; 2002.

followed by the creation of a stock market and the sale of some shares to employees. By 1999, employees held 1.87 per cent of shares in companies listed on the stock market, but share sales of state-run enterprises were suspended because of rampant speculation, profiteering and other problems with the newly issued shares, including perhaps fears of massive discontent in the labour force. Many state-owned enterprises run at a loss, and share privatization might result in substantial lay-offs or closures.

However, privatization continued on the provincial and local level. More than 30 provincial and municipal governments established guidelines for creating employee ownership, and over 3 million TVES were created as shareholding cooperatives by 1995. Early limits on the percentage of employee share ownership in small and medium enterprises were later liberalized. And local authorities acted to create employee share ownership among most of the foreign trade companies. However, the Chinese conception of share ownership appears to extend only to the right to use certain materials and facilities, and not to the stronger ownership rights familiar in the West.⁶⁷ In spite of this, the aggregate picture was a large gain in productivity, led by the TVEs and share-privatized small and medium enterprises. For larger firms, Qi, Wu and Zhang (2000) found that among firms listed on the Shanghai Stock Exchange from 1991 to 1996, return on equity varied inversely with the proportion of state-owned shares. Here is a second area where research is needed: formal and broad-based measures of productivity for individual enterprises in China are lacking.

In Africa, despite a long tradition of solidarity, case studies suggest that African worker cooperatives (most were parastatal) are having trouble surviving the transition to market competition.⁶⁸ There can be no doubt that much of the challenge for cooperatives in Africa lies in establishing a basic political and economic context.

Schwettmann (1997) reports mixed results among worker-owned cooperatives in Africa. The Union of Green Belt Cooperatives in Mozambique survives with help from NGOs and the United Nations. In Ethiopia, after government aid was cut off, the number of handicraft cooperatives rose from 719 to 759 and membership grew from 46,000 to 60,858. In Tanzania, drastic cuts in governmental aid to the cooperative sector caused many small industrial cooperatives to become dormant or be transformed into traditional ownership, but other cooperatives formed to replace them. Schwettmann is convinced that such cooperatives cannot flourish without support across “a broad range of technical and financial services ... because their members lack capital and managerial skills” (1997, p. 38). Nonetheless, reductions in state spending have not always meant the

⁶⁷ Ibid., 2001.

⁶⁸ Couture et al., 2002 (p. 4).

disappearance of all services to cooperatives. In Cameroon, former employees of the parastatal cooperative development agency have formed the Association des Auditeurs et Formateurs des Cooperatives (AAFSCOOP) to offer auditing, training and consulting to cooperatives. Further evidence that cooperatives can be as productive as conventional businesses is in the record of takeovers. Schwettman reports that in Zimbabwe, many small and medium-sized enterprises abandoned by their owners after independence were taken over by the employees, and many have been successful.

However, even in African countries that have favourable conditions, such as South Africa, successful privatization through worker ownership has been a hard sell (Naidoo, 2002). Privatization has directed shares to workers, but the massive lay-offs that followed have outweighed any possible productivity benefits arising from share ownership. Industrial restructuring has also increased unemployment. Laid-off employees are far too poor to hold their shares if there is a market for them. As in Russian and Eastern European privatizations, freely transferable shares undermined the goal of broadening ownership and destabilized companies, at least for a transition period.

Comparing China and South Africa, there seem to be some missing elements for understanding the usefulness of cooperatives and employee ownership. South Africa's GNP per capita in 1999 was US\$ 3,160, more than three times China's US\$ 780.⁶⁹ And 35.8 per cent of South Africans were living on less than US\$ 2 per day, as compared to 53.7 per cent of Chinese. Yet the outlook for employee ownership seems brighter for China than for South Africa. Is this because local and provincial governments in China have implemented a piecemeal, step-by-step approach instead of a swifter and more thorough transformation to a market economy?

2.6 Theoretical issues

Quite a large body of work has been produced by theoretical economists who have written on employee ownership and various aspects of productivity and performance from a deductive perspective. This literature goes back to the early twentieth century, and much of it seems to be founded on highly unrealistic assumptions about the motivations of owners, workers and managers. A good summary can be found in Jones and Svejnar (1985). Much of the early literature is critical of all forms of employee ownership, and seems to be argued at least as much on the basis of politics and social beliefs as on sound reasoning and dispassionate observation.

Early critics complained that worker democracy would undermine the efficiency of the firm, that individual interest in maximizing returns would

⁶⁹ World Bank Development Report 2000/2001 (pp. 276-77).

result in shirking (letting others do the work while one collects the rewards of one's equal share), in paying above-market wage rates, in resisting layoffs to protect workers' incomes, in gradually eroding ownership by hiring ordinary employees who would not become members or receive dividends, in the selling of successful enterprises in order to extract capital gains, in workers' dislike of the risks of having their wealth concentrated in the ownership of a single enterprise, in depriving worker-owned enterprises of growth and retooling capital, and in taking loans from outsiders or selling shares that would undermine the advantages of ownership. Theoretical criticism along the same lines continues to come from modern-day economists such as Simon (1983), Jensen and Meckling (1999) and also Alchian and Demsetz (1972). Hansmann (1990) additionally argues that democratic governance is doomed to fail in an enterprise of employees unequal in skills, status and compensation.

However, theoretical support for employee ownership has also developed, beginning with Vanek (1975), who posited both favourable and unfavourable consequences for the productivity of employee-owned firms.⁷⁰ Vanek (1987) worked out an extensive economic model for a worker-managed economy. Steinherr (1977) pointed out that relatively minor adjustments of economic assumptions are needed to find that productivity can be improved with participation and profit-sharing such as might occur in a labour-managed firm. Following Vanek and Steinherr, Bowles and Gintis (1993) offered theoretical economic analysis suggesting that with improved and slightly more realistic assumptions, employee-owned and managed firms can theoretically be more productive than outsider-owned firms. With additional assumptions about the market economy, theoretical worker-owners are likely to work harder, tolerate less shirking, and reduce costs of monitoring. However, theorists also predict that employee-owned firms are likely to be more risk-averse, to pay higher wages, to spend more time in governance, and to have less ability to raise capital. Scholars staking out a theoretical halfway line seem to have gained ground in recent years, as the demonstrated reality of successful employee-owned companies has belied the theoretical predictions. Paul, Niehoff and Turnley (2000) develop a theoretical perspective that emphasizes the possibilities and risks of rising expectations created by employee involvement and the need for education of employees and managers, frequent communication, and prompt response to dissatisfaction when it appears.

2.7 Discussion

While it is mildly surprising to find that the empirical data contradicts the predictions and expectations of several generations of

⁷⁰ Vanek, 1975; see also Ward, 1958.

economists (whom Sen (1977) once called “rational fools”), the evidence that employee-owned firms can and do equal or outperform conventional firms is not the end of the story.

2.7.1 Decent work

The purpose of an employee-owned firm or cooperative is always more than just making money for its owners. Some of these purposes are easily seen and easily quantified: more secure work, a greater role in management and governance, better benefits, a secure retirement, jobs for family members. Cooperatives can also provide social services that are not supplied by the private market at prices members can afford: health care, child care, funeral services, insurance policies. For example, the great cooperative corporation of Mondragon grew out of the simple motive of creating local employment for newly graduated students and others in their profoundly depressed home region.⁷¹

Other benefits for the individual are easily seen, but not easily quantified: more dignity and respect at the workplace, pride of ownership, the satisfaction of meeting the intellectual and practical challenges of running the firm. Employee-owned firms also contribute to the good of society by levelling the distribution of income, both by paying a living wage and by sharing the wealth generated by profits among many employee-owners. Ownership anchors firms and jobs in communities, creating a more stable economic environment.

2.7.2 Collateral benefits for the community

Ownership may also create a diffuse beneficial impact on the community at large. Comparing three northern Italian towns with different levels of employment in cooperatives, Erdal (1999) found that on 16 of 17 measures of community well-being, there is a positive, nearly always monotonic, relationship between employment in cooperatives and desirable social outcomes, including children’s educational achievements.

Beyond the simple issue of whether employee-owned companies of any kind can compete alongside conventional firms, there are subsequent questions. For example, what difference does the percentage of employee ownership make? Is majority (or 100 per cent) employee ownership necessary to achieve productivity improvements? Most studies in the United States and anecdotal evidence from the United Kingdom suggest that companies where a majority of stock is owned by employees are more progressively managed in every sense of the word – more participation in the work unit and the boardroom, more communication of business information and more training on using information.⁷² Blasi, Kruse and Bernstein (2000)

⁷¹ Whyte and Whyte 1988, (p. 32-33).

⁷² See, for example, Logue and Yates, 2001 (p. 153).

found that as little as 17.5 per cent ownership was sufficient to generate a small “ownership effect” on company survival. Data from Bulgaria, however, indicates that enterprises majority owned by employees did worse than other firms.⁷³ For new cooperatives, as for new business generally, access to capital is often difficult. These findings raise several questions: Is there an optimal range of employee ownership percentage that would allow for infusions of equity capital by outside investors without sacrificing the productivity and performance advantages of ownership? What about minority employee ownership combined with participation? What about non-voting shares for outside investors? Are there thresholds below which employee ownership has no impact – or even an adverse impact? At what percentage of ownership does the “ownership effect” begin to operate?

2.7.3 Unions and employee ownership

There are also many questions about the role of organized labour in employee ownership. The data are slim, but they generally indicate that unions can “make or break” employee ownership.⁷⁴ Unionized companies (for example, Dimco-Gray in Centerville, Ohio) have been successful employee-owned unionized companies with few labour difficulties. Other employee-owned firms seem never to have progressed further than the adversarial model, and report no change in the number of grievances. Of 42 unionized firms in Logue and Yates’ (2001) Ohio study, 22 excluded the union from employee ownership. Among the 22, the reasons for excluding the union varied: at one extreme, anecdotal evidence suggests that management schemed to keep the union out of the ESOP. At the other end of the spectrum, the unions themselves refused to join because they mistrusted management or simply preferred the security of a traditional pension plan. Some companies kept traditional plans and brought the unionized employees into the ESOP by treating ownership as an additional benefit rather than a substitute pension plan. One would reasonably expect labour relations to improve after employee ownership, and indeed more than 70 per cent of unionized firms where the employees owned a majority of the business reported fewer grievances after the ESOP was established; but where the employees owned only a minority share, just 10 per cent of firms reported having fewer grievances.⁷⁵

On their side, some unions have been slow to embrace employee ownership, often viewing it as a threat to the organization and its leadership, or spurning it for fear of eroding class solidarity by converting workers into capitalists. Only in 2002 did the powerful Swedish labour unions

⁷³ Rock and Klinedinst, 1997.

⁷⁴ Oakeshott, 2000 (pp. 430-433); Wheatcroft, 2001; Logue and Yates, 2001 (pp. 110-131).

⁷⁵ Logue and Yates, 2001 (p. 126).

acknowledge that employee ownership might have a role in a modern economy. Many labour leaders in the United States still view employee ownership as a last resort or a transitional form for failing companies that can be brought back to health and resold to the private market. There have been a few well-publicized cases where a unionized firm with highly adversarial labour relations has been bought by employees with catastrophic results.⁷⁶ But there is also evidence that unions can coexist well with employee ownership. In general, the presence of a union is not a negative factor for firm performance.⁷⁷ At present, unionized workers are a smaller share of the private-sector American work force than are employee owners. When the interests of labour and management are aligned through employee ownership (this is not automatic), and the organizational power of the union works harmoniously with management, productivity and all indicators of firm performance can improve rapidly.

The help a union can provide goes beyond the level of the individual firm. For example, the Steelworkers' Union in the United States created a supportive network, the Worker Ownership Institute, to educate, advise and connect its employee-owner members. And the Steelworkers Union has been in the forefront of developing model provisions on employee ownership that can be negotiated into bargaining agreements.

2.8 Changing transnational policy

With the notable exception of the ILO, which has supported the development of cooperatives since its cooperative technical service was established in 1920,⁷⁸ transnational governmental organizations have generally been silent on employee and cooperative ownership. That has begun to change, however, in Europe. The accumulation of evidence from two major pan-European studies on employee financial participation undertaken in the 1990s for the European Commission (summarized in European Commission 2001) and the interest of the social partners spurred the Commission to issue its Communication on promotion of employee financial participation in July 2002. The Commission's Communication analyzes the principles underpinning national policies within the European Union, sets up an expert group to issue recommendations on how to address transnational barriers to European-wide employee financial participation, and calls for EU measures benchmarking best practices and national conferences on the subject in member states (European Commission 2002).

⁷⁶ Blair, Blasi and Kruse 2000, (p. 280).

⁷⁷ Logue and Yates, 2001 (p. 125-128).

⁷⁸ The ILO adopted Recommendation (No. 127) Concerning the Co-operatives (Developing Countries) Recommendation in 1966 and the Promotion of Cooperatives Recommendation (No. 193) in 2002.

In February 2003, the European Economic and Social Committee, representing the social partners including labour unions and employers' organizations, endorsed expansion of employee financial participation throughout the EU (European Economic and Social Committee 2003). It endorsed employee share ownership as "the fullest form of participation" (section 4[5][1]) and highlighted "the contribution that financial participation schemes, particularly in the form of equity participation, can make to corporate governance" (section 4[6]). Employee share owners "represent a type of investor concerned with the long-term performance of the business, compared with the pervasive short-termism which is characteristic of market investors," who "can make a significant contribution to monitoring company management," and who can strengthen corporate governance (section 4[6][1-4]). The Economic and Social Committee concluded that employee "financial participation is entirely consistent with the European Union's established objectives of social cohesion and economic development, and therefore advocates stepping up efforts to promote this instrument" (section 7[2]).

3..Agricultural producer and small business cooperatives and productivity

“It seldom happens... that a great proprietor is a great improver.... [In times of disorder he] had no leisure to attend to the cultivation and improvement of land. When the establishment of law and order afforded him this leisure, he often wanted the inclination, and almost always the requisite abilities.... There still remain in both parts of the United Kingdom some great estates which have continued without interruption in the hands of the same family since the times of feudal anarchy. Compare the present condition of those estates with the possessions of the small proprietors in their neighbourhood, and you will require no other argument to convince you how unfavourable such extensive property is to improvement.”

Adam Smith (1776), *An Inquiry Into the Nature and Causes of the Wealth of Nations*

Since the days of Adam Smith, there has been a strong argument that small farms were more productive per unit of land than larger scale, more extensive agriculture whether the latter is farmed with slaves, serfs, hired labour, or sharecroppers. The family farm has constantly been juxtaposed against other forms of land tenure as both a superior way of life and superior form of production.

Yet whatever the productivity and moral virtues of small-scale family-owned farms, such units have lacked the clout to get their production to market in a way that created prosperity for their owners. Instead, the fruits of the farmers' labour too often were harvested by intermediaries – the grain companies, the railroads, the food processors and marketers. And by those who supplied the inputs and the financing – the fertilizer companies, the seed companies, and, above all, the banks. Family farmers simply lacked the scale to have much influence in a market dominated by large companies.

For more than a hundred years, family farmers have turned to cooperatives to achieve economies of scale in buying supplies and in processing and marketing their products. In recent years, small business owners have also turned to cooperative purchasing and branding. The millions of farmers and small business owners who have organized and joined cooperatives attest to the appeal of this vision.

What impact does achieving cooperative economies of scale for small producers have on their productivity? And what impact does it have on their prosperity and on employment?

There are two levels at which there may be an impact on productivity, prosperity and employment:

- at the level of the cooperative, and
- at the level of the producer, farmer or small business.

The remainder of this section explores the evidence on (1) how the cooperative businesses compare with conventional capitalist firms in terms of productivity and (2) how their member farmers and enterprises compare in terms of productivity with farmers and small businesses of comparable size which are not members of the cooperative.

3.1 What are agricultural and small business cooperatives?

Cooperatives are membership organizations which do business on a “for use” rather than a “for profit” basis. Members generally select the leadership of the cooperative on a one-member, one-vote basis, not on the basis of their capital investment. Similarly, the profits (generally called “net margin” or “surplus” in cooperatives) are allocated among members on the basis of the use of cooperative services as “patronage” dividends (for example, their volume of purchase of farm supplies or bushels of grain marketed through the cooperative), rather than on the basis of their invested capital. Net margins (surplus) are divided between unallocated equity (which belongs to the members of the cooperative as a whole, but is not allocated among individual members), allocated equity in individual capital accounts, and allocated patronage dividends that are paid in cash. When the cooperative experiences a loss, it is first subtracted from the unallocated equity, if any, and, if this is insufficient to cover the loss, prorated among individual members’ capital accounts. In short, the user owns, controls, and benefits from the cooperative.⁷⁹

The origins of the modern cooperative movement are generally traced to the organization of the Rochdale Pioneers in 1844, and the Rochdale principles remain current in their updated form.⁸⁰ It should be

⁷⁹ Dunn, 1988.

⁸⁰ The recent restatement of the Cooperative Principles by the International Co-operative Alliance is incorporated in the ILO definition of cooperatives in Recommendation No. 193 on the Promotion of Cooperatives (2002) – both describe a cooperative as “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.” Cooperatives are voluntary, open-membership organizations, autonomous and controlled democratically by members, who benefit economically from their transactions as members. Cooperatives emphasize training for their members and employees, concern for the community, and cooperation among cooperatives. For an authoritative discussion of the cooperative principles, see MacPherson, 1995.

noted that cooperatives are multipurpose organizations that have non-economic goals, such as training and education for members, collaboration among cooperatives, and attention to the broader community alongside their economic goals.

Agricultural producer and small business cooperatives produce economies of scale in at least six different areas:

- purchasing or supply cooperatives (for small retail or wholesale businesses, as well as farmers) pools members' buying power and lowers the costs of their inputs;
- shared service cooperatives for agriculture or small business cooperatives provide their members with specific services such as mechanized planting, tilling and harvesting (e.g., Vardeniss district cooperative in Armenia); land preparation for rice farmers, veterinary and breeding services, soil testing and production consulting, and irrigation and drainage consulting (e.g., Xiangcheng Supply and Marketing Cooperative in China); and a communications network for product availability (e.g., Ghana Cooperative Pharmaceuticals);⁸¹
- marketing cooperatives pool members' production and seeking larger contracts to increase the price paid to cooperative members while increasing access to markets;
- processing cooperatives pool members' production for processing such as cooperative dairies and meat packers – and capturing additional value added for producer members through vertical integration;⁸²
- credit cooperatives reduce the cost of financing; and
- branding activities for retail cooperatives, such as Ocean Spray, Sun Maid, Florida's Natural, Sunkist, Land o'Lakes, Welch's, and Ace Hardware in the United States, or Danish Crown, Dairygold, HK Ruokatalo, MD Foods, and OPTIC in Europe, or Bangladesh's Vita Milk, increase consumer attention to the brand and allow small farmers and retailers to compete with national and international

⁸¹ Couture et al., 2002 (pp.8-49).

⁸² The so-called "new generation cooperatives" in American agriculture essentially strive to capture added value for their farmer members in additional areas in which cooperatives had not been active, such as "Growers' Pasta" in North Dakota, or in cooperative ethanol plants. This is fundamentally identical to the strategy that dairy farmers in the United States and pig producers in Denmark have used for more than a century in capturing added value downstream from the farm in processing their products.

marketers.

3.1.2 Cooperatives also serve other functions

In addition to providing economic benefits to their members through economies of scale (which may include enhancing productivity), cooperatives provide other benefits including broadening ownership (with the economic, social, and political benefits that may result from a more equitable distribution of resources), an emphasis on responsiveness to members, and schooling for members in democratic practices and procedures. As membership organizations, they offer an opportunity for bootstrap development by their members in multiple fields, including health, housing, and credit as well as primary economic activities.

In developing countries, one of the goals of many cooperatives is creating employment for the unemployed or underemployed and maintaining gainful employment for farmers and small business owners who might otherwise be forced into the ranks of the unemployed. The ILO 1996 Recommendation (No. 127) Concerning The Co-operatives (Developing Countries) recognized the employment creation goal. In 1976, the ILO World Employment Conference⁸³ called for the general development of rural cooperatives; its 1986 International Labour Conference Paper on Youth⁸⁴ recommended the exploration of cooperatives as a means to employ young people; and the 1990 report on promotion of self-employment to the International Labour Conference emphasized the utility of both worker cooperatives and shared service cooperatives for artisans in employment.⁸⁵ The 1993 ILO cooperative experts meeting recognized the importance of all forms of cooperatives in creating employment and raising income in the rural and informal sectors of the economy in the developing world. It was suggested that cooperatives can be an effective mechanism to ameliorate some of the negative employment effects of structural adjustment policies.⁸⁶ Subsequently the ILO made cooperative development a notable element in its Decent Work agenda and a response to globalization.⁸⁷

In 2002, the ILO returned to the issue of cooperatives in a broader context that included developed as well as developing countries. It adopted a new international labour standard, Recommendation No. 193 on the Promotion of Cooperatives. Its main thrusts are recognition of the global importance of cooperatives in economic and social development (there are

⁸³ *Economic growth, income and employment: An analysis prepared for the World Employment Conference*, Geneva, June 4-17, 1976.

⁸⁴ *Youth – Report V*, 72nd International Labour Conference, Geneva, 1986.

⁸⁵ Lindenthal, 1994 (p. 132-35).

⁸⁶ ILO, 1993. This report also stressed the role of cooperatives in promoting member participation, education and training and in diffusing innovations in rural areas.

⁸⁷ Schwettmann, 2002.

already 800 million individual cooperative members worldwide), reaffirmation of the cooperative identity based on values and principles, equal treatment for cooperatives vis-à-vis other types of enterprise, definition of the government's role in creating a supportive policy and legal framework, and in facilitating access to support services and finance without interference, an active promotional role for employers', workers' and cooperative organizations, and encouragement of international cooperation.⁸⁸

For many of the world's people, cooperatives are the only hope of amassing sufficient capital to create small businesses and decent shelter, as the private sector takes little interest in people who have no money. In these cases, it may not even matter whether cooperatives are inefficient and or fail to raise productivity noticeably. They are simply better than nothing, which is the real alternative.

3.2 Theory of cooperatives and productivity

There has long been discussion among economists about the efficiency of cooperatives relative to their private competitors as an organizational form. The two poles in this debate agree that the various collateral benefits of cooperatives should be disregarded, and they should be treated as purely economic units. Thus, on the one side, over 50 years ago Clark (1952) argued for separating "the usual arguments in favour of cooperative action by farmers, such as increased efficiency in marketing, increased income for low income farmers, and anti-monopoly action" – all advantages to the farmer member – from "an objective comparison of the results of the two forms of enterprises in ... the probable allocation of resources in relation to economic welfare." Clark found that generally private firms were closer to the social optimum allocation of resources. Proponents of this view compared cooperatives with investor-owned firms and generally concluded on theoretical grounds that cooperatives would under-perform their investor-owned competitors.

On the other side of the argument, others disputed the basic focus. For example, Phillips (1953) – who also argued for disregarding the social and ethical collateral benefits of cooperatives – responded to Clark that, "When a group of individual firms form a cooperative association, they agree mutually to set up a plant and operate it jointly as an integral part of each of their individual firms (or households in the case of a consumer cooperative). The cooperative has no more economic life or purposes apart from that of the participating economic units than one of the individual plants of a large multi-plant firm." Phillips goes on to argue that "cooperating firms individually seek to maximize their profits – considering that part of their operations in the jointly operated plant as well as their

⁸⁸ Levin, 2002 (pp. 4-6).

individual operations outside of it.”

What do empirical studies show? This question is answered in the following section.

3.3 Empirical studies of cooperatives and productivity

Surprisingly – given their long history and substantial dissemination – there are relatively few empirical studies of the impact of agricultural purchasing (farm supply cooperatives), processing, marketing, branding, and credit cooperatives on the productivity of their members or relative to those who do not belong to a cooperative. Cooperative experts assume the case as given. The International Co-operative Alliance (2001a) puts it simply: cooperatives “are at least as efficient in their business operations and use of capital as others in the marketplace.”

The cooperative is created for the benefit of its members: to obtain inputs for them at lower prices and to sell their outputs at higher prices than they would otherwise be able to obtain. In particular, the cooperative is able to pay its farmer-owners a higher price by cutting out the profit (and perhaps a local monopoly) of the middleman purchaser. Nilsson (2001) concludes that the cooperative “is able to pay a higher price to the farmers than would any other organizational type, or otherwise offer better trade conditions. So, it is no wonder that agricultural cooperatives have become dominant in most raw product markets.”

The consequence is that cooperatives often achieve a very high degree of organization. For example, a United States Department of Agriculture (USDA) study found that in 1986, 87 per cent of American dairy farmers were affiliated with agricultural cooperatives as members or non-member patrons, up from 83 per cent in 1980. Ninety per cent of the members marketed through the cooperative in 1986, and 80 per cent of members purchased supplies through the cooperative.⁸⁹ Dairy farmers are at least equally cooperative elsewhere in the world. The International Co-operative Alliance reports that, in 1999, cooperatives accounted for 97 per cent of dairy production or milk collection in Denmark and Finland, 100 per cent in Malta, 84 per cent in the Netherlands, 80 per cent in Portugal, 80 per cent in Slovenia, 99 per cent in Sweden, and 90 per cent in Uruguay. They play an important role in supporting family farming in numerous other branches of agriculture including pigs (90 per cent in Denmark, 100 per cent in Malta), beef (69 per cent in Finland, 80 per cent in Slovenia, 80 per cent in Sweden, 93 per cent in ex-Yugoslavia), cotton (77 per cent in Burkina Faso), edible oils (51 per cent in India), fisheries (90 per cent in Malta),

⁸⁹ Gray et al., 1990.

flowers (95 per cent in the Netherlands), forestry (73 per cent in Canada, 38 per cent in Finland, 70 per cent in Slovenia), fruit and vegetables (25 per cent in Cyprus, up to 80 per cent of some fruits in Greece, 58 per cent in the Netherlands), and wine production – 30 per cent in Cyprus, 43 per cent in Portugal.⁹⁰ This degree of organization encourages cooperatives to consider providing more value-added processing, vertically integrating their industries and capturing more value for producer members.

The empirical literature on the relative efficiency of cooperatives and comparable non-cooperative firms is quite limited and the findings are rather contradictory.⁹¹ Some studies find that cooperatives outperform their investor-owned counterparts. Lerman and Parliament (1990) compared the financial performance of cooperatives and non-cooperatives in the American fruit and vegetable processing and dairy industry between 1976 and 1987. They found that cooperatives performed as well or better than investor-owned firms in profitability, leverage, and interest coverage.

Some investigators find no difference. In a study published in 1994, A. M. Hind (1994) assessed the relative performance of 31 agricultural cooperatives and 82 non-cooperatives in the United Kingdom. Hind found no significant difference between the two groups in profitability, capital gains, liquidity, and operational efficiency indicators such as sales to working capital ratios. (Cooperatives were found to turn their inventory more frequently.) The conclusion: in the United Kingdom, cooperatives and non-cooperatives performed equally well.

Others, such as the American economist Phillip Porter with his various collaborators, have argued that cooperatives are innately inefficient and found supporting empirical evidence in the American dairy industry. Ferrier and Porter (1991) state succinctly that “cooperatives are theoretically an inherently inferior form of organization” because problems with time horizons, non-transferability of ownership shares, and control have led to technical, allocative and scale inefficiencies in cooperatives. In a test using 1972 data for 84 milk-processing cooperatives and 84 proprietary milk processors, Ferrier and Porter found the cooperatives to be less efficient on every measure of efficiency leading them to conclude that there is “a probability of .95 [that] the mean level of non-co-operative cost efficiency exceeds that of the co-operatives.” In an earlier article using the same data, Porter and Scully (1987) concluded that “the average cooperative fluid-milk-processing firm is only 75.5 per cent as efficient as its proprietary, for profit counterpart” which they attribute to the “inherent weakness in the structure of property rights within cooperatives”. Porter acknowledges the fact that

⁹⁰ International Co-operative Alliance, 2001b.

⁹¹ For a survey of the empirical literature on farm cooperatives, see Krivokapic-Skoko, 2002.

cooperatives were once useful in keeping a monopoly buyer from dictating prices to farmers and that cooperatives still “fare well in agricultural markets in the United States”⁹² but he and his collaborators ascribe this to “taxpayers’ largesse” in providing “tax breaks, interest subsidies, and the gratis services of the Department of Agriculture”.⁹³ Curiously, Porter and his collaborators make no effort to determine the tax status of non-cooperative milk processors so as to compare the total taxes paid by both types of enterprises, nor do they discuss public subsidies to proprietary firms.

3.3.1 Cooperatives: Matching or beating investor-owned firms?

Simple measures of profitability suggest that cooperatives match or beat the IOFs. The most recent USDA survey of farm cooperatives’ financial performance in 1997 found that the net income of farm cooperatives responding (1929 of 3791 surveyed; the responding cooperatives are estimated to account for 80 per cent of total business volume of American farm cooperatives) to be \$1.9 billion (on \$103 billion in sales) of which 31 per cent was paid in cash patronage refunds, 42 per cent was allocated to individual capital accounts, 2 per cent went to dividends on capital, 15 per cent to unallocated equity, and 10 per cent to income taxes.⁹⁴ Note the much higher average payout rate to cooperative members than characterizes shareholder dividends from public agribusiness corporations in the United States. At the end of 1997, reporting cooperatives held just under US\$ 15 billion in member equity. Equity amounted to 41 per cent of assets. Return on assets was 5.3 per cent; return on members’ equity was a respectable 12.7 per cent.⁹⁵ By contrast, for its 2001 financial year, the global agribusiness giant Archer Daniels Midland reported a return on assets of 2.7 per cent – a US\$ 383 million return on assets of US \$14.3 billion.⁹⁶ In the same year, another agribusiness giant, ConAgra, reported a 4.9 per cent return on assets, and 19.9 per cent return on equity.⁹⁷

Regardless of their findings, all of these studies consider the cooperative as an economic unit completely separate from its producer members. They ignore the fact that the “for use” principle in cooperatives leads to higher prices paid to members and to the distributions of “net margins” – “profits” in proprietary firms – as patronage benefits to members.

These numbers are not inconsequential. Just consider the importance of patronage. In the USDA 1997 farm cooperative survey, the cooperative

⁹² Ferrier and Porter, 1991, (p. 161).

⁹³ Porter and Scully, 1987 (p. 511).

⁹⁴ Rathbone and Wissman, 2000 (pp. 1; 7).

⁹⁵ Ibid. (pp.15; 27).

⁹⁶ Fortune Global 500 website

(<http://www.fortune.com/fortune/global500/snapshot/0,15198,240,00.html>).

⁹⁷ Standard and Poor’s Stock Report (<http://www8.fs.ml.com> 7/11/03).

dairy sector provided a return on assets of 7.5 per cent and return on members' equity of 18.6 per cent. Of the dairy cooperatives' total net income, 75 per cent was paid to cash (36 per cent) and non-cash (39 per cent) patronage. The remainder went to unallocated equity (14 per cent) and income taxes (11 per cent). Total member patronage dividends in dairy cooperatives in 1997 amounted to 14.3 per cent of equity,⁹⁸ certainly better than the long-term rate of return on publicly traded equities in the United States.

Cooperatives' ownership form shapes their business strategies. The major study of 83 cooperatives and 228 investor-owned firms from 1988 to 1992 conducted by Katz (1997) found that cooperatives "maintain a focused corporate strategy to ensure the firm continues to serve the market linkage needs of its owner-patrons. Their business strategies have the hallmark of risk aversion: financially conservative, reliant on board involvement in managerial decisions, and hesitant to use technology to positively affect performance." Why? "Because the cooperatives' owners encounter risk in their primary business enterprises, and cannot easily or quickly diversify their investment in the cooperative by selling their ownership interest in the firm, they are motivated to seek a risk averse set of strategies."⁹⁹ In short, cooperatives' business strategy reflects their ownership structure.

3.4 Small business cooperatives

Far less information is available on the small business purchasing and branding cooperatives. This group of cooperatives seems to be growing rapidly. For instance, the National Cooperative Bank estimates that more than 50,000 small businesses are members in about 250 cooperatives in the United States, and that the number of members and of cooperatives has doubled in the last decade.¹⁰⁰ In other developed nations, the evidence is also beginning to accumulate in the form of growing numbers of small and medium-sized business cooperatives in crafts, food retail, production and service, services, fishing and forestry, and professional services. These include small business cooperatives for such varied groups as bakers (Beko-Benelux, Netherlands), bookstores and record shops (Plein Ciel, France), building maintenance services (Aichi Building Maintenance, Japan), construction materials (Inkoop Contact, Netherlands), lawyers (Sogiphar, France), management consulting (Co-Aim, Netherlands), opticians (OPTIC, France), and retail grocers (Systeme U, France, and EDEKA, Germany).¹⁰¹ In each of these cases, the cooperative handles business activity where there are economies of scale for the members, such as purchasing, marketing and

⁹⁸ Calculations based on Rathbone and Wissman, (2000), tables 1, 2, 3, and 7.

⁹⁹ Katz, 1997 (p. 491).

¹⁰⁰ Reynolds, 2003.

¹⁰¹ Couture, 2002a (p.7-9).

training.

3.4.1 Operating in the present environment

In the developing world, small business cooperatives (SBCs) must emerge from a history where cooperatives and cooperative associations were treated as parastatals – arms of the State. For example, as Taimni notes, “Governments in the Asian continent have always been closely involved with cooperatives, have had a policy for their development and growth, and have had special arrangements to provide capital and credit to them. A host of unstated nationalistic and political considerations and compelling social reasons have influenced the governments to support cooperatives.” This researcher also observes, “Almost all apex cooperatives in the Asian region have close, collaborative and inter-supportive relations with the government, except perhaps in the Philippines.”¹⁰² The result of those close relationships is that cooperatives received resources from the State and experienced neither the pressures nor the opportunities of a true market. Many were never properly audited, gave jobs to friends and relatives of elected officials, and allowed business practice to be set by political outsiders rather than by economic conditions. Political interference was not always a result of corruption, but sometimes arose from well-intentioned efforts to nurture and protect the cooperatives, which were considered too important and too naïve to manage on their own.¹⁰³ In any event, requirements and expectations were imposed on cooperatives that were not imposed on ordinary firms.

Structural adjustment policies and the subsequent economic failure of many cooperatives have pressured governments to end support for cooperatives and let them proceed through self-governance, limiting the involvement of the State to registration and deregistration of cooperatives, technical support and training for cooperative personnel.

3.4.2 Operating in the present climate

This, then, is the climate for the emergence of SBCs in the developing countries today. Some are created by privatization and some simply form around a leader to seize economic opportunities. Examples include the Anjuman Textiles Handloom Weavers’ Cooperative Society in India, the Akamba Handicraft Industry Cooperative Society in Mombasa, Kenya and in Senegal, the Coopérative des Ouvriers de Bâtiment (Construction Workers Cooperative). The Anjuman Textiles Handloom Weavers’ Cooperative Society, with 75 active weavers and five employees (a secretary-bookkeeper, master dyer, apprentice, a quality controller and a watchman), purchases materials for the weaver-members and distributes their rugs and carpets, but there is not enough work for the weavers to

¹⁰² Taimni, 2001 (pp. 120; 183)

¹⁰³ Ibid., (pp. 99-100).

produce throughout the year. Its 1999 earnings were US\$ 27,829. Services to its members include installing electricity, health care, education grants, financing for weddings, installing water pumps and other benefits. Members, in turn, have made loans to the cooperative, to the extent that its debt position is dangerously high and its profit margin is hair-thin – 0.008 per cent of sales in 1999-2000.¹⁰⁴ The Akamba Handicraft Industry Cooperative Society in Mombasa, Kenya, brings together artisans producing for the tourist industry by offering workspace in production sheds on a single property. Members agree to sell only through the cooperative, which has 100 employees servicing 2,902 artisans. In the past there have been problems with auditing the cooperative's records, including lost cash sale books and lack of proof of payment of tax returns.¹⁰⁵ In Senegal, the Coopérative des Ouvriers de Bâtiment (Construction Workers' Cooperative) or COB brought together 40 small contractors who wished to bid and negotiate on larger projects. The COB also leases tools to members and offers training, information services, literacy training, and a savings union. It also establishes small cooperatives to employ young people. It is governed by an annual general meeting of all members, which elects the nine members of the Board of Management Committee. Members pay the cooperative 10 per cent of their profits on COB-negotiated contracts, but do not receive any dividends, nor is accounting for the Cooperative's funds completely transparent. Cooperative income has hovered around US\$ 11,750, although 1997 and 1998 were exceptionally good years, when income rose to a high of US\$ 13,921. COB members face intense competition from larger firms, from new small and medium enterprises that have sprung up as a result of structural adjustment policies, and from unskilled migrants from the countryside.¹⁰⁶ They have also suffered as a result of high interest rates and fluctuating currency values.

3.4.3 Facing the problems of enterprises in developing countries

These examples illustrate that small business cooperatives seem to be struggling with the problems that face every enterprise in a developing country: severe and extreme economic fluctuations rooted in the global economy, a stagnant local economy, inefficiencies associated with undercapitalization, a too-politicized process for awarding governmental contracts and regulating business, and a lack of affordable, high-quality professional services, particularly in management, accounting, and auditing. Recurring themes in Couture's 2002 report emphasize needs for more professional management, regular and complete professional accounting and auditing; the active use of business planning; more energetic investigation of additional business opportunities, including partnering with other

¹⁰⁴ Couture, 2002a (pp. 20, 22).

¹⁰⁵ Ibid., (pp. 26-28)

¹⁰⁶ Ibid., (pp. 35-39).

enterprises; and more training and education for cooperative members and management. Taken as a whole, the needs are mostly for long-term and lasting enhancements in knowledge and actions. The long-term commitment, however, must come from within the cooperative and the country. Outsiders can only facilitate the changes needed. Other cooperatives might provide help. Three possible solutions would be partnering, mentoring, or a network that includes successful business cooperatives (like the CEO club of Canada's Crocus Investment Fund, which brings together the CEOs of investee companies for a quarterly meeting and exchange of information and advice).

In her analysis, Couture (2002b) sets forth clear and specific goals and standards for successful SBCs: members should be successful before joining the SBC, and committed to using its services; it should offer only those services which members actually need; the elected leaders must be good managers in every sense of the word – competent, committed, responsible leaders with business acumen. The cooperative should set up clear expectations for management and both the cooperative and its members should follow the cooperative's rules, particularly in providing complete and transparent accounting and auditing; the cooperatives should do strategic planning, develop the flexibility to meet challenges, and take advantage of opportunities that arise. The cooperative should plan to meet its financing needs out of members' own resources and focus on expansion and diversification of its income streams before turning to external funding sources. Training and education for members, leadership, management and staff are also a clear priority for cooperatives.¹⁰⁷

There is a very limited theoretical literature on non-agricultural cooperative enterprises. One 1979 article starts by bemoaning the fact that, since Enke's article in the *American Economic Review* in 1945, "the vast majority of the literature concerning cooperatives has appeared in agricultural economics journals and has focused almost exclusively upon producer and marketing cooperatives".¹⁰⁸ In their treatment of consumer-owned firms (which include the category of small business cooperatives), Anderson, Porter and Maurice conclude that "consumer-owned, consumer-managed firms, organized to maximize the utility of each member, reach the same long-run equilibrium position as the perfectly competitive firm" (p. 129). In a second theoretical piece the following year that focused on the production aspects of consumer-owned and managed firms, they concluded that "the theory of factor usage for the consumer-owned, consumer-managed firm is rather similar in many areas to the theory of factor usage for the competitive firm and industry". They "note in closing that this and our

¹⁰⁷ Couture, 2002b (pp. 56-62).

¹⁰⁸ Anderson, Porter and Maurice, 1979 (p. 119).

previous paper probably carry the purely static theory of the consumer-owned and managed firm about as far as is profitable".¹⁰⁹ Neither of these pieces provides any empirical evidence.

3.5 Agricultural cooperatives and land reform

The purpose of land reform has been to put land ownership (or other forms of land tenure rights, such as long-term leases) in the hands of those who actually till the soil. The replacement of landless agricultural labourers, sharecroppers, and other modern forms of feudalism through land reform is generally held to improve productivity by (1) increasing incentives for those doing the actual work, (2) intensifying cultivation, and (3) improving the quality of the land over time. It also permits farmers to diversify their production and reduce their risk, typically increasing production for family consumption and often reducing production of cash crops. They are feeding people, even if they are not contributing to global trade.

On the other hand, dividing estates into small family plots of several acres, as done through land reform in Egypt, Japan and Taiwan (China) for example, also reduces the economies of scale held to be crucial to efficient, modern farming. Cooperatives offer a means to address this issue.

There have been a number of studies of the impact of cooperatives as part of a generally supportive system of participatory self-organization and governmental pooling of resources (e.g., for irrigation system) on agricultural productivity in developing countries.

To the European-American view of the cooperative "as a business organization through which farmers can improve their lot in life and protect themselves from exploitation, ...the developing countries have added an image of the cooperative as an institutional bridge between the low-productivity work of subsistence agriculture and the high-productivity world of scientific agriculture," wrote the USAID rural development specialist Edgar Owens (1976) more than a quarter of a century ago. Owens argued that the cooperatives often fail in developing countries ("the debasement of an honorable institution") because of organizational programmes initiated by government rather than by farmers; because of the absence of farmer buy-in and influence; because of governmental control and corruption as well as because of business reasons (too small scale, absence of regional federations and secondary cooperatives). But cooperatives do not always fail: the initial experience with running the formerly private sugar plantations in Jamaica as cooperatives compared favourably in terms of profits and productivity with the record of their capitalist plantation predecessors.¹¹⁰ On the other hand, in

¹⁰⁹ Ibid., (pp. 129 and 527).

¹¹⁰ Richards and Williams, 1982.

developing countries where small farmer participation through cooperatives and through local government is strong, Owens found substantially greater increases at the macro level in food grain production between 1948-1950 and 1970-72, typically by a factor of 2 to 5 over lower-participation countries. Interestingly, agricultural productivity per acre in some of these high-participation developing countries (Egypt, the Republic of Korea and Taiwan, China) roughly matched productivity increases in the United States, despite the dwarf holdings of the former. Interestingly, Japanese productivity increases per acre matched American increases despite the Japanese pattern of tiny holdings. Further, Owens noted that “small farmers in high participation countries not only produce more food grains per acre: they produce more fruits and vegetables and other cash crops as well.”

The World Bank’s Klaus Deininger argues persuasively that voluntary, democratic “service cooperatives” that supply inputs, marketing, credit and technology to farmers enhance agricultural efficiency in developing or transitional economies by enabling farmers to overcome “imperfect markets” for their inputs and their products that otherwise lead to their exploitation. Further, they “contribute to relatively rapid rural capital formation”.¹¹¹ He argues that the land reform experiences of Cuba, Nicaragua, Peru and Viet Nam as well as in transitional economies (Bulgaria, Romania and Russian Federation) establish the relative inefficiency of large-scale collective production or production cooperatives as compared to small farm cultivation with cooperatives, even when farm sizes are suboptimal. Service cooperatives “contribute to increased competitiveness of agricultural and financial markets and technology transfer in competition with the private sector.”¹¹²

Cooperatives offer an opportunity for small, undercapitalized, and otherwise marginal producers to compete in the market with larger capitalist concerns on a relatively equal footing. This is not only the case in the developing world; it also occurs in the developed world. Thus, in their analysis of the Spanish olive oil cooperatives, for example, Marti, Ortiz, and Jimenez (2002) see the cooperatives’ primary goal “to defend members against big private businesses and to achieve economic and social independence from major landowners who, with their private olive oil companies, exerted great influence and power”.

The employment impact is striking. To use Owens’ figures, in 1970-72, Egypt, the Republic of Korea and Taiwan (China) had between 78 and 106 farmers per 100 acres versus about 1 farmer per 100 acres in the United States. Both their productivity per acre in food grains and increase in production per acre over the previous two decades matched that of the

¹¹¹ Deininger 1995 (p. 1318).

¹¹² Ibid., (p. 1328).

United States.

3.6 Impact of farm and small business cooperatives on their member enterprise productivity

Recalling the earlier discussion in this report, the purpose of farm and small business cooperatives is not maximizing the return on capital invested in the cooperative but maximizing the benefits to the individual businesses associated in the cooperative. As one Danish cooperator summed it up, “the purpose of investment by farmers in their cooperatives is not to maximize return on capital, but to provide the services they need at the best prices, and to maintain their proactive position in the market.”¹¹³

Thus, farm cooperative members expect and receive lower prices for their inputs and higher prices for their outputs through the cooperative than they would elsewhere. The cooperative may also provide substantial services, such as fertilizing fields and laying down herbicides and pesticides, at member prices. Even matters of family consumption, such as the delivery of home heating oil, may be provided by the cooperative. In addition to the price advantage that cooperative membership brings, its owners also benefit from the allocation of the cooperative’s “net margins” or profits, with a portion received in cash and a portion retained as individual capital accounts, working in the cooperative, until that too is ultimately distributed in cash.

No systematic empirical studies of the impact of these lower purchase prices and higher sales prices on farm or small business productivity and profitability have come to light. Most cooperative members and all cooperative general managers know, however, the price advantages they bring to their markets. (For example, the non-core business services purchasing cooperative for the 55 employee-owned member companies of Ohio’s Employee-Owned Network, which pools their purchasing power with 6 other small business cooperatives, has yielded price reductions ranging from about 5 per cent to about 60 per cent, depending on the product or service purchased.)

Case studies give some sense of the scope of value captured through the cooperative. These tend to be most dramatic in the developing world. The Bangladesh Cooperative Milk Producers’ Union, which markets as “Milk Vita,” has helped landless households acquire dairy cows and marketed the milk, has increased its 40,000 farmer members’ earnings ten-fold, “lifting the household earnings of around 300,000 people (including family members) to well above the poverty line” as well as creating 2,200

¹¹³ Background paper for the COPAC Open Forum on Cooperatives, Farmers’ Organizations and Sustainable Development, March 7, 1995, Copenhagen. Available at: <http://www.wise.edu/uwcc/icic/orgs/ice/un/conf/worldsumm/special/background.html>

new jobs in milk processing and distribution.¹¹⁴ A similar dairy cooperative in India, which served as a model for Bangladesh and which began in 1946, has grown into a national federation of 70,000 village milk cooperatives with more than 9 million members; it is estimated to generate an additional US\$ 90 annually in income for each family as well as having created 250,000 new, non-farm jobs in rural India.¹¹⁵

Shared service cooperatives for self-employed artisans, shopkeepers, and other self-employed persons in the informal sector have a fairly good track record of creating and maintaining employment in some but not all parts of the developing world. “Experiences have shown that handicraft and small-scale industry cooperatives in India have a major impact on the creation of employment opportunities, the improvement of working conditions, and the raising of income levels among the poorer sectors of the economy.” But in sub-Saharan Africa, handicraft cooperatives generally have “had very limited effects on employment”.¹¹⁶ However, individual African cooperatives, such as the Uganda Shoe Shiners Industrial Cooperative Society, have “contributed significantly to improving the quality of life of its members ... creating jobs for a large number of young people ... [which] prevented them from joining the ranks of the unemployed”.¹¹⁷

3.7 Impacts on the broader community

Beyond the obvious impact on their members, purchasing and marketing cooperatives for farmers and small business have a broader salutary impact on non-members and the community.

First, they increase competition in the market. Purchasing and marketing cooperatives have a positive impact on non-members who buy their supplies and market their products through non-cooperative channels. For example, the availability of cooperative supply and marketing channels for grain farmers forces conventionally owned, capitalist farm supply firms to lower their prices for supplies and forces conventionally owned, capitalist grain elevators to raise the prices they pay farmers – if they do not, they will lose out in the competitive struggle with the farm cooperatives.

This is not only true in the agricultural sector; it is even true in banking. Thus, for example, a recent Federal Reserve Bank Board of Governors study in the United States found that banks paid their depositors higher interest rates in cities with high credit union membership than they

¹¹⁴ Birchall, 2003 (p. 36).

¹¹⁵ Ibid., p. 57.

¹¹⁶ Lindenthal, 1994 (p. 20).

¹¹⁷ Kazoora, 2002 (p. 58).

did in cities with weak credit unions.¹¹⁸

Consequently a strong cooperative sector has a positive impact even on those who remain outside the cooperative structure. It tends to make the market more efficient.

Second, many cooperatives are committed to the principle of community concern: they seek to give something back or, occasionally, to build whole cooperative economies, as the Mondragon cooperatives in the Basque region of Spain have done.

Third, as member-owned and controlled organizations, agricultural and small business cooperatives have a tendency to expand services to respond to members' demands. This is notable not only in terms of core services (such as the addition of crop fertilizing and spraying services, soil testing, and other agronomy services) to existing agricultural and marketing services but also through the expansion of non-core services (such as distribution of home heating oil) as independent suppliers go out of business. In rural areas with declining populations, cooperatives have seen their community importance expand because of the difficult profit situation of "for profit" suppliers who frequently exit the area either because profits are too low (the decline of banking in rural Quebec relative to the credit unions) or because retiring owners cannot find purchasers for their businesses and liquidate them at retirement.

Fourth, cooperatives are veritable "schools for democracy." Cooperatives provide other benefits to their members and to the broader community that are harder to quantify. These include:

- close community ties based on the fact that ownership of the cooperative is spread among community members;
- democratic structures where members gain experience in democratic procedures;
- a commitment to member education and financial literacy;
- elected boards that train more active members in understanding and supervising large-scale business organizations;
- open communications with members;
- building trust and loyalty among members; and, possibly,
- maintaining higher ethical standards than conventional business.¹¹⁹

¹¹⁸ Hannan (2003) found that banks in cities with unusually high credit union membership paid 1/10 of 1 per cent more in interest to retail depositors than in cities with average credit union membership.

¹¹⁹ "The history of farm cooperatives suggests that adopting and practicing a higher code of ethics was a major impetus for cooperatives as an alternative form of business" (Lasley et al., 1997, p. 10).

Finally, there are those who would go further still. The International Co-operative Alliance (2001a) argues that cooperatives “build peaceful societies by promoting understanding and collaboration among people of different cultural and income backgrounds”.

4. Conclusion, balancing efficiency, productivity and other goals in employee owned companies and cooperatives

“There is such a thing as the quality of the economy. Behind aggregate economic indicators a variety of possible scenarios of differing qualities may exist. Wealth may be produced by capital-intensive activities alongside mass unemployment, or by labour-intensive activities providing large-scale employment. Economic indicators may mask greater or less income disparities.... The participative ownership of cooperative enterprises ... [is] a specific public good. The essential nature of the public good is twofold: large sectors of the population, instead of being inert and passive in the market, are proactive in seeking to create economic utilities and avail of economies of scale by going into business together. They are individually and collectively self-reliant and thereby create social capital. Secondly, their action and presence in the market can actually change the nature of the market itself, because a different ethic is introduced.¹²⁰”

If there is a singularity of purpose for capitalist enterprises – at least as posited by economists – in maximizing profits for their owners, employee-owned firms and cooperatives clearly have multiple goals that reflect their members’ aims and choices. As democratic enterprises, they balance competing, indeed sometimes contradictory, goals. These include job security,¹²¹ reinvestment, higher wages and benefits,¹²² health¹²³ and safety, and independence for their owners as well as higher financial returns from rising share values, profit-sharing and patronage dividends. Unlike the conventional capitalist firm, which is believed to maximize the single value of profits, employee-owned and user-owned firms clearly must optimize the balance between various goals. Many of these goals are economic, but some, such as voice for members, a focus on local economic development and community, decent work for employees, and training and education for members, are both highly valued and broadly distributed. However, employee ownership is not without its shortcomings. For example, both Greenberg (1986) and Grunberg (1991) found that the health and safety

¹²⁰ Background paper for the COPAC Open Forum on Cooperatives, Farmers’ Organizations and Sustainable Development, March 7, 1995, Copenhagen. Available at :

www.wisc.edu/uwcc/icic/orgs/ice/un/conf/world-summ/special/background.html.

¹²¹ Kruse and Blasi, 2001; Pencavel and Craig, 1994.

¹²² Kardas, Scharf and Keogh, 1998.

¹²³ Erdal, 1999.

record of plywood cooperatives in the Pacific Northwest is worse than average for the industry, and the river that runs through the Mondragon valley is foul with sewage, trash and industrial runoff.

Workers' cooperatives and other employee-owned enterprises generally pay wages that are competitive or better than locally prevailing wages when profit-sharing, bonus and dividends are included. They are less likely to lay off members during economic downturns, preferring to share the work, even accepting a lower price for their product in order to remain in the market and maintain production and employment.¹²⁴ They tend to offer better fringe benefits than conventional companies in their field.

4.1 Employee and user ownership and productivity

What conclusions can be drawn after reviewing the literature on employee-owned firms and on farm and small business cooperatives and the relations of these ownership forms to productivity? First, let us look at employee ownership. Good theoretical arguments can be built for and against a positive relationship between employee ownership and productivity. The results, as in so much of economic theory, appear to depend on the assumptions. But if the theoretical discussion is inconclusive, what do empirical studies show?

Here the results appear to be fairly conclusive. First, that employee ownership of firms by itself does not necessarily have a positive impact on productivity. (American studies in the 1970s and early 1980s which appear to find evidence that all employee ownership leads automatically to improved company performance seem to have suffered from a response bias in surveys with low response rates.) Too often worker ownership is purely nominal, as has generally been the case in the privatization of state-owned enterprises in the former Soviet Union and Eastern Europe. Or it may be too indirect and too stripped of the rights we consider to adhere to ownership, as is often the case in the United States with Employee Stock Ownership Plans, in which worker-owned stock is held in a pension trust, administered by a trustee who is generally either a manager or appointed by the board of directors, voted by the trustee, and pays no ongoing dividend. Not surprisingly, neither of these forms in and of themselves seems to have a positive impact on productivity.

On the other hand, the preponderance of empirical studies which have been done in the developed and developing world have found that a combination of employee financial ownership with ownership rights to information about the business and the right of participation in decisions have positive impacts on productivity and other aspects of firm performance. Worker cooperatives, as the dominant form of employee ownership outside

¹²⁴ Craig and Pencavel, 1992; 1993; 1995.

the United States, virtually by definition provide the full range of ownership rights. However, even the dominant, indirect form of ownership in Employee Stock Ownership Plans in the United States contributes to productivity increases when combined with employee participation in decisions, free flows of information about the business, and the training to understand the form of ownership, to use the participation system effectively, and to understand business information.

Indeed, the evidence has become sufficiently compelling that it may be argued that ESOP fiduciaries who do not encourage employee-owner participation in the business are failing to meet their obligations to employee-owners as future pension beneficiaries, because the productivity enhancements that flow from the combination of employee ownership and employee participation clearly do have a positive impact on ESOP stock value and on the future value of employee-owners' pensions.

Political thinkers have long suspected that worker ownership has collateral benefits for democracy. Theorist Carole Pateman (1970) argued that participative ownership was a training ground for democratic citizenship and citizen involvement. Perhaps the best systematic evidence in support of this claim is Erdal's study (1999) of three Italian towns with different amounts of cooperative ownership. The two towns with a higher percentage of cooperative members have lower crime rates, lower rates of domestic violence, more social participation, better developed social networks, and higher trust in authorities, and the town with the largest percentage of cooperative members is typically the one with best conditions.

The evidence on the productivity impacts of farm and small business cooperatives is more difficult to analyse, because the situation is more complex than in the worker-owned firm. Productivity has to be measured at two different levels: the level of the cooperative and the level of its component members. The cooperative exists for the use of its members. As such, it may act like a conventional company in generating large profits for its owner-members, which it then rebates to them, or it may sell inputs to its members at lower prices and buy outputs from them at higher prices, limiting its net margins or surplus (i.e. profits) to the minimum necessary for the continuation of the cooperative. Measured by the conventional tools of value added per hour worked, the former cooperative appears to be more productive than the latter. However, when the value added per hour worked in the cooperative is combined with value added by member farms or enterprises, it may equal or exceed the value added by conventional farms and firms. However, this notion of a measure of productivity that combines producer and processing/marketing cooperative must remain speculative, as there is no research exploring this particular issue.

Generally speaking, cooperatives neither seek to maximize profits to

rebate to the members nor hold profits to the minimum self-sustaining level. Instead they take an intermediate position, offering members lower prices for what members buy and higher prices for what they sell than investor-owned firms but still seeking to maintain a level of profitability sufficient to meet the cooperative's needs for reinvestment and growth and to provide modest patronage dividends.

Empirical studies of productivity in cooperatives that focus at the cooperative level have found mixed results. Some find that cooperatives have a modest performance edge. Others find that investor-owned firms have a modest performance edge. None take into consideration, however, the impact of the cooperative on members' productivity.

There seems to be a lacuna in the empirical literature in this area. Cooperative advocates argue that members join cooperatives precisely for the productivity benefits, so the fact that cooperatives exist establishes that members perceive a benefit. By contrast, conventional economics offer robust analyses of firms only by factoring out externalities, such as benefits to members in the form of higher prices for their outputs or lower prices for their inputs.

It seems clear from the empirical literature that farm and business cooperatives have a net positive impact on value-added per hour worked when both the cooperative and its member units are included in the analysis.

4.2 Worker ownership and cooperatives in the developing world

Situations differ in developing and developed economies in terms of the behaviour of worker-owned enterprises and cooperatives. These differences are driven in significant measure by the context, particularly the availability of alternative employment in the private or public sectors. Thus, in developing countries, the goal of providing employment often takes precedence over questions of productivity at the level of the firm. Of course, the narrow definition of productivity at the level of the firm assumes that the presence or absence of productivity outside the firm is immaterial – which is never the case in real life. For people who are largely unemployed and always peripheral to the labour market, any regular employment makes them more productive than they were otherwise. As noted earlier, there is no productivity in an unemployment line.

Under these circumstances, the self-help, bootstrap aspect of the cooperative has substantial appeal in developing countries. Cooperatives facilitate people in pooling their greatest asset, their labour, along with small amounts of cash (perhaps all the cash they have), to create a larger enterprise from which they will receive a benefit and return. Whether it is more productive than a privately owned enterprise is not as important as whether it

is productive enough to compete in the market. As long as it crosses that threshold, the cooperative's members can gain a toehold in the economy, and take another step on the journey toward economic development.

Further, as is the case in employee-owned firms, there are substantial collateral benefits to cooperatives which may be unrelated to productivity but which are clearly related to the ILO's Decent Work agenda. These benefits appear to be stronger in the developing world and among marginalized populations in the developed world than in the mainstream economies of developed countries (but they also apply there). They include:

- sufficient economies of scale to make otherwise inefficient small-scale production sufficiently productive in value-added terms to yield higher living standards for small farmers and artisans and to keep them from joining the ranks of the unemployed.
- the personal and community benefits that accrue from self-organization and bootstrap development – cooperatives are, in effect, schools for learning the benefits of collective self-reliance;
- the development of transferable leadership and basic financial skills in poor communities; and
- the likelihood that members of one successful cooperative venture will attempt other cooperative efforts, such as adding a credit union to a successful dairy cooperative, or working with other groups outside the cooperative.

It should also be noted that cooperatives have historically arisen from market failure: from producers' inability to market their crops efficiently or struggles with monopolistic and exploitative intermediaries. Generally speaking, the existence of a cooperative as an alternative mechanism for purchasing and marketing helps to keep the capitalist market economy honest by introducing an element of competition that historically was absent. Thus, cooperatives increase the efficiency of the market even for non-member producers.

Finally, and not least, both employee ownership of the means of production and farmer and small business ownership of purchasing and marketing cooperatives increase income and wealth for employee owner, farmer, and small business owner, in relation to what they would earn and own in the absence of the worker-owned firm or the cooperative. Broadening the distribution of income and the ownership of wealth among working men and women in developing and developed countries improves their life chances and, by improving their economic status, expands their realm of choice and freedom.

4.3 The future role of the ILO

The recently adopted (2002) ILO Recommendation No. 193 on the Promotion of Cooperatives suggests an expanded role in the development of cooperatives and worker-owned enterprises would be appropriate for the ILO. The new European Union commitment to expand employee financial participation in enterprise results and the support of the social partners for this policy initiative, particularly in regard to employee share ownership, underscores its importance in the developed as well as the developing world. The rapid process of globalization reminds us of the need to anchor both capital and jobs locally to secure the foundations of community economics.

There is much that the ILO could do in three different areas:

First, in the field of research

There are a number of key questions which the existing literature does not answer.

It would be useful for the ILO to commission a study of the impact of small business cooperatives and the value added, both in the cooperative and in the individual member business. For reasons that are not entirely clear, there seems to be an absence of research in this area.¹²⁵

There is also a need for comparative research on the impact of cooperative law and regulation on enterprise productivity and on the benefits of cooperatives for societal productivity.

Employee ownership, farmers' cooperatives, and small business cooperatives share the common denominator of broadened ownership. Their legal forms, however, are diverse. Some permit mixed ownership that involves a partnership between outside investors and producers or employees. Others require 100 per cent employee or cooperative ownership. We know less about the advantages and disadvantages of both than we should.

In some countries, such as the United States, partial employee ownership is often part of a transition strategy for owners nearing retirement. Is this something that should be encouraged elsewhere?

It would be useful to identify successful regional and sectoral models, their legal underpinnings, and their organizational structures, highlighting forms of employee-owned enterprise and supporting policy that fit well in their cultural context.

We know far less about the impact of concentrated ownership versus

¹²⁵ It may be that while agricultural cooperatives have a major resource in research programmes at national ministries of agriculture, the same is not true for small business cooperatives.

broader active ownership (that cooperatives and worker ownership inspire) than we should. What impact does broadening ownership have on economic growth? On social welfare? On the tax burden needed to support welfare measures?

How successful are those programmes that use lump-sum unemployment compensation to help capitalize worker-owned businesses, and can they be adapted to other economies?

Second, in the area of promotion of cooperatives

There is much that ILO can do to promote and emphasize the dignity of work and self-help through promoting worker cooperatives and other forms of employee ownership.

The evidence is overwhelming that participatory employee ownership produces improved living standards for worker owners in the present and better wealth and pension creation in the future. Participatory employee ownership is a win-win situation for both labour and management, as the European Union's Economic and Social Committee suggested. It is worthy of promotion by the ILO's Cooperative Branch.

Promoting networks of cooperative enterprises meeting regularly to explore business topics of immediate concern can be extremely effective when the conferees have an opportunity to discuss their problems in small groups and hear advice and information from other members.

In addition to using its publication series to disseminate theoretical and practical information in this area, the ILO can provide workshops in conjunction with the international trade union movement, offer study tours and speakers, and build a library of publications available to help workers become owners. Of course, those publications can also be a segment of the ILO's web site.

Third, in the area of technical assistance and training

It would probably be useful to build some capacity in providing additional assistance with worker employee ownership to add to the Cooperative Branch's work with producer business and consumer cooperatives.

Cooperatives in developing countries often have difficulty in obtaining professional services of all kinds, and they may also be at a disadvantage in the justice system. The ILO could facilitate training for cooperative managers, auditors and accountants, possibly partly through distance learning, and it could encourage national policy to support networks to provide training and effective application of the training.

Finally, friendly and supportive financing has proved to be central to launching new cooperatives. The ILO could disseminate information and

encourage the creation of cooperative-friendly banks with training and networks.

In short, expanding the ILO's competence in the area of worker or employee ownership, and continuing to build on the outstanding ILO record of promotion of consumer, producer and business cooperatives, would be a valuable policy direction for the future. It helps to create employment in developing countries, to anchor capital and jobs in industrial democracies, and to create more balanced economic development policies in both. Broader and more diverse ownership of productive assets is also likely to create a stronger domestic market to cushion local economies in economic downturns. And, last but not least, it builds on social partnership to create win-win outcomes for both employers and labour.

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