Cooperatives As Governance Mechanisms

by

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This article seeks to reestablish academic interest in cooperative law. It is driven by the motive to narrow the gap between the importance of cooperatives in practice and their relatively benign place in legal research. In order to kick-start a comparative and interdisciplinary debate on the subject, some fundamental points are made that are indispensible for any discussion. First and foremost, the notion of the cooperative is explained in order to differentiate it from other phenomena. The contribution criticizes any understanding that is linked to a peculiar societal model. In particular, it is shown that cooperatives can neither be claimed as fiefdoms by the socialist or anti-globalisation movements nor should be considered as a panacea for the shortcomings of the capitalist world. Instead, it suggests to adopt an economic viewpoint and to consider the cooperative as a particular type of governance mechanism that is appropriate in some instances because it is apt to solve specific problems. The article discusses what these problems are and how this governance mechanism is used to solve them. Starting on the basis of the Rochdale Principles, some important features of cooperative governance are highlighted. Finally, a research agenda is set out. It is hoped that academics as well as practitioners will be inspired by this contribution to endeavor their own studies on cooperatives.

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I. A Rift Between Practice and Legal Research

1. Academic disinterest in cooperatives

The cooperative has long been a neglected topic in legal research. There are very few new academic contributions to this field. An overview of current literature reveals that, as a contemporary topic, cooperatives are either superficially discussed or worse, totally ignored. For instance, books on German corporate law only provide some very basic introduction on the cooperative, and merely give the reader a very rough sketch of its structure.1 English books on company law do not even mention the cooperative because it is not considered to be a “company”.2 Italy provides the exception that confirms the rule,3 which seems natural given that the cooperative has received a special place in the Italian civil code, the Codice civile.4

The general disinterest might have something to do with the image of cooperatives. Despite their undeniable importance, they are looked upon with a certain disbelief or even distrust. In the best of cases, they are regarded as a dinosaur type of business organization, appropriate, perhaps, for developing countries, but prone to extinction in modern societies. Worse, they are sometimes considered to be remnants of socially romantic ideas that were current in the 19th century, but have since lost their appeal.


4 See Art. 2511–2545 Italian Codice civile.
2. Why cooperatives are interesting again

Current academic disinterest and the contemporary public image contrast starkly with the economic reality. Cooperatives play a crucial role in everyday life. They exist in many different fields, such as agriculture, housing, insurance, banking, and in the energy and health sectors. To observe their economic potential, one simply needs to go into the biggest Swiss food retail chains “Migros” and “Coop”, the British employee-owned department store “John Lewis”, or one of the 655 branches that “Rabobank International” runs in 29 countries outside of its native country, the Netherlands. Alternatively, one may visit one of the cities in Southern Europe that have been transformed by big cooperatives, like Mondragón, in Spain, or Imola, in Italy.

Within the last few years, the political interest in the cooperative has been renewed. Surprisingly, this interest does not only come from the political left wing, with which the cooperative is traditionally associated, and which largely informs the discussion in Latin America, for instance. Rather, conservatives such as members of the British Tory party also preach for more involvement by employees in cooperatives as a form of societal self-organization. The European Union, equally not suspect of pursuing leftist policies, has introduced a “Societas Cooperativa Europaea (SCE)” or “European Cooperative Society”. Cooperatives have also been discussed as an alternative organizational form for banks because it is hoped that the change in form will help reduce their exaggerated appetite for risk, and also strengthen their financial soundness. These ideas fit squarely into the context of the United Nations General Assembly’s

6 A good example of the variety of activities is the British “Co-operative Group”, which has existed for 165 years. It provides everything from food, pharmacy and clothing to financial and legal services, travel, property investment and even funeral care.
decision to name 2012 as the International Year of Cooperatives, thus encouraging their growth all over the world.\footnote{11}{See http://social.un.org/coopsyear/about-iyc.html (last visited October 1, 2012).}

3. **The need for interdisciplinary comparative research**

In sum, one can discern a certain hope that the cooperative form can be used to remedy today’s societies’ perceived or real illnesses. In order to verify whether this hope is justified, new research is needed. Questions that require answering include:

1. What are the features that distinguish the cooperative from other, more capitalist forms of organization? This question has been discussed within the context of the Societas Cooperativa Europaea (SCE),\footnote{12}{See, e.g., D. Krimphove, Brauchen wir die Europäische Genossenschaft?, Europäische Zeitschrift für Wirtschaftsrecht (EuZW) 2010, p. 892, 893.} but an answer is still outstanding.

2. Why are cooperatives more prevalent in some business areas than in others? Why are they successful on the national level, whereas on the supranational level they are seldom used for incorporations?\footnote{13}{Since the introduction of the “Societas Cooperativa Europaea (SCE)”, there have only been 23 incorporations of SCEs, see the list in http://www.libertas-institut.com/de/EWIV/List_SCE.pdf (last visited 1. 10. 2013).}

3. What is the specific governance structure that enables cooperatives to meet new challenges, and how can it be maintained or even improved? Should multiple voting rights be allowed, or are they incompatible with “immutable” cooperative principles? From where do these principles draw their force? What role for lenders?

4. Is the cooperative particularly suited for a “sustainable” way of economic life, and why? Are cooperatives more stable than companies? If so, which governance rules create this effect?

5. How does the environment, more particularly, the informal rules of a country, impact the formal rules that the respective country chooses to govern cooperatives? Cooperative law often varies within a country.\footnote{14}{One author has counted as many as 15 different general legislative acts and even more specialized acts governing cooperatives in Spain. See M. García Jiménez, La necesaria armonización internacional del derecho cooperativo: el caso español, Revista de estudios cooperativos 102 (2010), p. 79, 83, footnote 5.} At the international level, it is even much more diverse. Is it necessary to
maintain this diversity, as is occasionally supported in the literature?\textsuperscript{15} Or would it, on the contrary, be preferable to harmonize cooperative laws around the world\textsuperscript{16}?

6. How are specific governance problems addressed by cooperative laws? What happens if differences between the members come to light? How much hierarchy is provided for? How “democratic” is the governance structure? What type of sanctions can be imposed on non-cooperative members?

7. To what extent do cooperatives use non-specific methods of governance? In particular, is it more efficient and attractive for them to employ outside labour rather than using their own members? Should this practice be legally restricted, as it is in the Basque country, for example\textsuperscript{17}?

It is obvious that this kind of research cannot be strictly reduced to legal questions. Although the law will take a leading role, lessons from other disciplines that also have valuable input on the matter, such as anthropology, sociology and economics, must be included. Of noteworthy consideration is New Institutional Economics (NIE).\textsuperscript{18} As an intersection between law and economics, it presents a unique tool to analyze the cooperative as a legal institution that fulfills important economic functions.

It should be equally clear that a general approach to the subject cannot be confined to a particular legal system. Rather, it is imperative that a wide examination of several countries and the way they regulate the particular legal institution takes place. Thus, a comparative perspective has to be adopted. The use of a comparative methodology is greatly facilitated by the fact that the cooperative is known in many legal systems. It is a prime example of a transnational legal institution and therefore perfectly lends itself to comparative institutional research.

The kind of interdisciplinary and comparative analysis that has been suggested here requires combined efforts. Ideally, it will be carried out by a transnational

\textsuperscript{15} See, e.g., H.-J. Schaffland, Die Europäische Genossenschaft – eine neue Rechtsform, DZWiR 1991, p. 18, 19.


\textsuperscript{17} Under the Basque Act on Cooperatives, the total number of hours worked by non-member employees must not exceed 25% of the total hours worked by employees that are members of the cooperative. See Art. 99(4) of Ley 4/1993, de 24 de junio, de Cooperativas de Euskadi, as amended by Ley 1/2000, de 29 de junio.

\textsuperscript{18} See in more detail infra sub 2.2.2. and 3.1.2.
network of researchers. They should answer all or part of the questions asked above, using their particular expertise. What can be done here, and what has to be done first, is to expound some fundamental ideas. In particular, the essence of how the term “cooperative” shall be understood has to be clarified (part II). Moreover, we must assure ourselves about the economic and legal reasons for which cooperatives are created (part III). Finally, some basic traits that characterize the cooperative and distinguish it from other governance mechanisms will be described (part IV).

II. The Essence of the Cooperative Idea

1. Two different meanings

a. Wide meaning: Cooperatives as the basic form of social organization

All research presupposes a definition of the subject to be analyzed. At first blush, the subject of the research proposed seems quite clear: the “cooperative”. A closer look reveals, however, that the meaning of this term is everything but easy to grasp. More than one hundred years of writing about the subject have not yet led to a clear definition. Rather, it seems that the issue has become increasingly clouded by the inconsistent use of the term.

Some authors have employed the notion in an extremely broad sense. As examples, one can cite the lawyer Otto von Gierke and the sociologist Max Weber. In his four volume book on the German cooperatives (“Das deutsche Genossenschaftswesen”), Otto von Gierke included a definition of cooperatives all forms of associations, beginning with the tribe, followed by the medieval guild, and extending further still to the municipality.19 Max Weber quarreled with von Gierke about the exact content of the term. But he, too, adopted a broad concept of the cooperative by calling every citizen a “member of the legal cooperative” that is the state.20

Of course, such a broad understanding of the notion is possible. After all, most means of co-existence in primitive or modern societies are in a sense “cooperative”.21 Individuals typically tend to cooperate for achieving larger goals

21 This is the reason why anthropologists and sociologists mostly use the notion in the broad sense, see e.g. G. Runkel, Genossenschaft, Repräsentation und Partizipation (Münster et al., LIT-Verlag 2003), p. 11.
than they could on their own. That is a general trait of human behavior. But by adopting such a wide conception, the term loses its sharpness. If this path were to be followed, every singular form of cohabitation would have to considered a cooperative.

\textit{b. Restricted meaning: Cooperatives as an economic institution}

That is not how we will understand the notion. Ours is a much more restricted concept. We will start from the basic meaning of the “cooperative movement” that emerged almost simultaneously in Britain, France and Germany in the 19th Century. Pioneers of the idea were people such as Robert Owen, William King, Charles Fourier, Jean-Philippe Buchez, Friedrich Wilhelm Raiffeisen and Franz Hermann Schulze-Delitzsch. They have strongly influenced the meaning in which the term is commonly used today. Accordingly, the cooperative is, above all, a form of business organization.

It is the cooperative in this sense that shall be the focus of this analysis. We will deal with private bodies pursuing specific private goals. The research shall not extend to the organization of tribes, municipalities or states. It must, however, be borne in mind that a wider conception of the cooperative is possible; especially to avoid the confusion that is sometimes emphasized in the literature and idealizes the cooperative.

\textit{2. An economic institution of capitalism?}

Even if it is clear that the research should focus on the cooperative as an economic institution, it is still unclear what salient features emerge when viewed from this angle. Two basic approaches can be distinguished.

\textit{a. Cooperatives as an institution of socialism?}

According to widespread belief, the cooperative is inherently linked to the idea of socialism. The consequences that are drawn from this belief are different: While some, for this reason, consider it to be an outdated form of business organization, others, for the very same reason, see it as a way to improve the failures of capitalism. The anti-globalization movement, in particular, likes to


\textsuperscript{23} For other representatives of the cooperative movement, see A.J. Winfred, History of cooperative thought (Coimbatore, Rainbow Publications, 1980).
use the cooperative as an instrument to renew the appeal of socialist ideas that have so far failed to meet the viability test in practice.\textsuperscript{24}

However, a review of the relevant literature instills caution. It is true that Lenin thought cooperatives were a necessary step towards socialism and demanded that all citizens of Russia should become members of such an organization.\textsuperscript{25} Yet Marx’s position has been much more nuanced. He was essentially skeptical about whether cooperatives would be able to take the power from the owners out of the hands of the owners of the means of production and of real property.\textsuperscript{26} He specifically stressed that even if such a transfer of power would be possible, it would come at a high price, since through the cooperative, workers would become “their own capitalists”.\textsuperscript{27}

This is a crucial point. The cooperative model is not an antonym for capitalism. Instead, it can and does exist within capitalist societies. This is evidenced by the numerous examples of successful cooperatives working, e.g., in Italy, Spain, Switzerland, or the United Kingdom.\textsuperscript{28} The cooperative model is also not incompatible with basic Western ideas of private property and democracy. On the contrary, it even emphasizes those ideas in a particular way.

The cooperative idea cannot therefore be misappropriated for a certain ideology. It has been developed to meet certain needs, but is in no way part of a certain model of society.

\textit{b. Cooperatives as governance mechanisms}

What, then, is the cooperative? NIE offers some answers.\textsuperscript{29} NIE describes different governance mechanisms. The two basic forms are markets and

\textsuperscript{26} See E. Bernstein, Die Voraussetzungen des Sozialismus und die Aufgaben der Sozialdemokratie (Stuttgart, Dietz 1899), chapter 4; W. Albers et al. (eds.), Handwörterbuch der Wirtschaftswissenschaften (Stuttgart et al., Vandenhoeck und Ruprecht 1981), Genossenschaften I: Begriff und Aufgaben, p. 553.
\textsuperscript{29} See supra sub 1.3.
firms. Markets are characterized as bilateral structures in which the autonomy of the parties is maintained. Firms, on the other hand, are unified structures that are organized on the basis of hierarchy.

Cooperatives could be thought of as resting in the middle between these two extremes. They maintain the autonomy of the members as entrepreneurs, since the latter are allowed to carry on their business activities. At the same time, cooperatives create a unified structure that includes some degree of hierarchy. Søgaard rightly speaks of a “(changing) compromise between autonomy and coordination”. Cooperatives are thus neither markets nor firms, but some sort of “hybrid”. When Williamson uses this expression, he does not seem to have cooperatives in mind, since he uses the term primarily with respect to various forms of long-term trading, reciprocal trading, regulation, franchising “and the like”. It is nevertheless possible that the cooperative also falls into this category. It might form a sort of “second strand” of hybrid that is in some way closer to the firm (corporation) than the first.

The fact that the cooperative is not treated here purely and simply as a “firm” lends itself to a misunderstanding. From a legal point of view, of course, cooperatives are firms. They have members and organs, and are capable of being attributed rights and duties. What is adopted in this contribution is an economic perspective. Seen from this viewpoint, the cooperative is not a firm, because it is not a fully hierarchical organization, but allows for the independent exercise of the business activities of its members within its framework.

c. Cooperatives for non-economic goals

Some authors, particularly those with a social sciences background, stress that cooperatives can fulfill more than merely economic functions. They argue that cooperatives are useful from a societal viewpoint because they produce...
public goods, for instance by increasing workers’ participation, furthering a sense of community, fostering solidarity, or even giving meaning to life. An example in point would be an Israeli kibbutz. Another illustration is provided by the Mondragón cooperatives in the Basque Country (Spain), which have shaped the feeling of life in an entire city.

There is certainly a point here. Public goods are indeed quite often promoted by cooperative organizations. This is the main reason why legislators around the world encourage their incorporation. Salient examples are the Italian and the Spanish Constitution, which call for the promotion of cooperatives.

Although the furtherance of the common wheel, or public welfare, is thus an interesting feature of cooperatives, it fails to characterize them as a governance method. Cooperatives primarily serve to organize business activities. Even the kibbutz and the Mondragón cooperatives take part in economic life. While it is true that the cooperative does not aim to earn profits itself, the benefits accrue directly its members. Moreover, the myth that the relationship between employees and managers would be different in a cooperative than in a private company has been debunked by anthropological research, precisely using the Mondragón cooperatives as an example.

In the end, the cooperative is not different from other institutions of capitalism, such as the contract or the firm. It is merely a particular mode of governance. The fact that there is typically a certain feeling of solidarity surrounding its form may be attributed more to the attitudes of their founders than to the cooperative form itself. The question that remains to be clarified is why they do, after all, choose this particular mode of governance.

### III. Why Cooperatives Exist

One of the most fascinating aspects about cooperatives is that the very reason for their existence is unclear. This curiosity can be tackled from two perspec-
tives. First, an economic perspective will reveal the function that cooperatives fulfill in the economy. This analysis must be supplemented by a legal view. Given that cooperatives compete with other forms of business organizations, it is interesting to see why this governance mechanism is preferred over others. Second, there might also be sociological reasons that help to explain the existence of cooperatives.

1. Economic perspective

Economic literature is not uniform. There are several branches that rely on different methods and models. These distinctions will have a direct effect upon the analysis carried out here.

a. Increasing efficiency

Traditional, “neoclassical” economics views the cooperative primarily as a means of increasing efficiency. Before the creation of the cooperative, the founders usually have a weak position in the market as small producers, for example. By combining their resources, they can achieve greater economies of scale. This, in turn, increases efficiency.\(^4^1\)

Although, indeed, the increase of efficiency will be a prevailing motive for creating cooperatives, this cannot be the main reason for their existence. The same goal could also be achieved by using other forms of business organization, namely the public or private limited company, or partnership. These alternate governance structures may also allow achieving economies of scale.

b. Vertical and horizontal integration

Transaction cost economics, as part of NIE, provides a different explanation. Its adherents point to problems of human behavior that make economic exchanges difficult.\(^4^2\) Bounded rationality inhibits the writing of complete contracts. Opportunism leads to the exploitation of the other party. The inherent


danger in opportunistic behavior is particularly acute in situations where asset specificity plays a role.\textsuperscript{43} For instance, when processing wine, one has to make specific investments. The producers of grapes from a certain region could therefore successfully exploit the owner of a local wine label who has made such investments by refusing to deliver grapes for a reasonable price. Vertical integration circumvents these pitfalls.

Cooperatives fit into this scheme.\textsuperscript{44} They can serve as an instrument of vertical integration. In the winemaking example, all economic functions, from the production of grapes to their processing, can be integrated into one unit. Thus, the problems related to asset-specific investments and the risk of exploitation by the contractual counterparty can be resolved. Note that competition among the producers of wine will be diminished through the cooperative. But that is not unwelcome. One of the important lessons learned from the application of NIE is precisely that the elimination of competition may, under certain circumstances, lead to increased efficiency.\textsuperscript{45}

The need for vertical integration is a powerful explanation for the existence of cooperatives. On the other hand, it is not the only reason for which cooperatives exist. There are many other purposes that can be pursued. For instance, the cooperative form might be used to create a countervailing power against a dominant market actor, such as farmers facing a monopoly from a big retail company, for instance.\textsuperscript{46} In this case, a horizontal integration between the actors of the supply side takes place. The cooperative also allows for the horizontal integration of the demand side, as the Scandinavian consumer cooperatives illustrate.\textsuperscript{47} In addition, cooperatives may be used to administer common goods, like creating sanctioned fishing grounds to prevent excessive fishing.\textsuperscript{48}

It must be noted that within the cooperative, there are costs that cannot be neglected. These costs are caused by the need to monitor the directors of the cooperation.\textsuperscript{49} Moreover, there are additional costs related to collective decision-making that do not exist in market transactions. For instance, it may be

\textsuperscript{43} Id.
\textsuperscript{47} Id. p. 126.
\textsuperscript{48} For an exposition of the problem, see E. Ostrom, Governing the Commons (Cambridge, Cambridge University Press, 1990).
difficult to convince some members of the cooperative to vote to achieve the greatest benefit for all. In his work, Henry Hansmann has shown that these costs can be comparatively smaller than transaction costs that occur in the open market, provided that one condition is present: the interests of the cooperative’s members must be relatively homogeneous. If this condition is fulfilled, then integration in a cooperative is economically beneficial when compared to contracting in the market place.

c. Self-supply

These reasons do not fully explain the raison d’être of cooperatives. Another reason can be identified by going back in history: When the cooperative was strongly advocated by the 19th Century movements in the industrializing nations, it served a particular purpose that distinguishes it from alternative governance arrangements. This purpose can be described as self-supply. The idea of the cooperative, at least in its original form, was that the cooperative provides something to the members themselves, be it goods, sale opportunities, insurance, or capital. This was especially necessary where other enterprises did not provide these goods due to market failure. In particular, the need arose through the rise of industrialization, which led to the precariousness of loan workers and difficulties in the agrarian sector. The cooperative would overcome these problems by providing finance to its members, by insuring them against external risks, by buying the goods that the members consumed, or by helping them sell the goods and services that they produced. In contrast to other forms of association, the cooperative would not provide something to others, but rather something to the members themselves.

52 This element was clearly highlighted in the definition of “Dr. Fauquet” cited in L. Coutant, L’évolution du droit coopératif de ses origines à 1950: La double tendance vers son unification et son autonomie, la loi du 10 septembre 1949, la codification en cours (Reims, Editions Matot-Braine, 1950), p. 170, footnote 1.
53 Market failure also increases transaction costs, see H. Hansmann, Cooperative Firms in Theory and Practice, 1999 Finnish Journal of Business Economics 387, 388 (1999). Thus, the two points of market integration and self-supply are interlinked.
Therefore, the cooperative was originally aimed at achieving self-sufficiency. This particular purpose has a certain consequence from an economic perspective. The consequence is that through the establishment of the cooperative, the need for an intermediary is eliminated.\textsuperscript{55} The first modern cooperative, the Rochdale Society of Equitable Pioneers, was organized precisely for the purpose of eliminating the need to go to shop keepers who charged excessive prices for food and disguised its bad quality. Instead, the members would directly buy the products they wanted to consume.\textsuperscript{56}

\textit{d. Conclusions}

From the foregoing point, the following conclusions may be drawn:

First, in terms of criteria such as efficiency and market integration, it is possible that cooperatives lose out against other forms of business organization. But they may aim at a special kind of efficiency not available to those other forms: self-sufficiency.

Second, the special effect of eliminating intermediaries explains why cooperatives typically need less capital. The intermediaries involved in the supply chain between production and consumption, for example, often require large amounts of capital to finance their business. By eliminating them, the need for capital is reduced.

Third, from an economic viewpoint, the aim of the cooperative is not solely limited to production. It also lends itself to the organization of aggregate consumption, such as the common acquisition of food, for instance. Therefore, it is more versatile than other forms of governance, in particular public or private companies. On the other hand, the cooperative does not make much sense outside the business realm because the needs to which it responds are always economic in nature.\textsuperscript{57} It is therefore, more restrictive than the contract,

\textsuperscript{55} See L. Coutant, L’évolution du droit coopératif de ses origines à 1950 : La double tendance vers son unification et son autonomie, la loi du 10 septembre 1949, la codification en cours (Reims, Editions Matot-Braine, 1950), p.179.


\textsuperscript{57} This is true despite the fact that some laws specifically allow the cooperative to have a social and cultural purpose, see e.g. § 1(1) German Genossenschaftsgesetz. Such provisions cannot mask the reality that the cooperative always has some connection to paid goods and services. Otherwise, a form of association would be used. See V. Beuthien, Ist die Genossenschaftsrechtsreform geglückt?, Neue Zeitschrift für Gesellschaftsrecht 2008, p. 210, 213.
for example. In a chart, the availability of the different governance mechanisms would look like this:

<table>
<thead>
<tr>
<th>Economic Needs</th>
<th>Non-Economic Needs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumption</td>
<td>Production</td>
</tr>
<tr>
<td>Contract</td>
<td>+</td>
</tr>
<tr>
<td>Firm (Corporation)</td>
<td>–</td>
</tr>
<tr>
<td>Cooperative</td>
<td>+</td>
</tr>
</tbody>
</table>

It is clear from this table that the cooperative provides a scale of economic uses that is much bigger than that of corporations. Its field of application in the economic sector is only matched by the contract. But in comparison to the latter, cooperatives may have certain advantages in that they eliminate the need for intermediaries and all associated governance mechanisms.

Fourth, it has also become clear that even in the economic sector, which is their exclusive field of application, the cooperative form is not available in all circumstances, but only where a certain condition is fulfilled. This condition is that all of the members are *ex ante* in a similar situation and have homogeneous interests. They must not be antagonistic players, like the producer and the consumer, or the holder of capital and the one in need of capital. They need to be, for instance, consumers or producers of the same good, or insurance seekers for the same risks. Thus, there must be a certain harmony of interest among the members. This means that the cooperative form cannot be used to organize the whole society because everybody would be member of several different cooperatives and would therefore have antagonistic interests.

In sum, the idea that the cooperative could be used as a panacea to remedy all illnesses of capitalism is wrong. The cooperative responds to specific needs arising under certain circumstances. It is a particular governance mechanism that suits some situations; nothing more, but also nothing less.

2. **Legal perspective**

   a. *Regulation competition and regulatory competition*

A legal analysis must begin with the premise that the cooperative is just one of many forms in which a business can be organized. Within the framework of

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58 This has been most clearly spelled out by H. Hansmann, Cooperative Firms in Theory and Practice, 1999 Finnish Journal of Business Economics 387, 393 (1999).

59 Id.
most states’ legislation, it competes with other forms, like the public limited company, the private limited company, or the partnership. Therefore, the principal goal that emerges from this perspective is to identify the legal reasons for which the cooperative form should be preferred over alternate forms. This is the question of regulation competition, which is based on the freedom of the founders to incorporate in any form of their liking.

There is also another sort of competition that exists between different legislators (regulatory competition). One must bear in mind that in today’s world of corporate mobility and party autonomy, the institutional environment is not taken as given, but can be freely chosen by the parties. For instance, in the United States and in the European Union, states are obliged to recognize companies incorporated in other states, by constitutional or treaty law.60 This also applies to cooperatives. Moreover, there is also an EU variant of the cooperative – the Societas Cooperativa Europaea (SCE) – which must be recognized as part of supranational law.61 Potential sponsors may therefore choose between the creation of an, e.g., English, German, Italian, Lithuanian or European cooperative without changing their residence. The result is a competition between different regulators.

b. Advantages of the cooperative form

Limited by the framework of this paper, regulatory competition cannot be addressed in more depth. Instead, we have to focus on regulation competition. Determining why the cooperative is chosen over another form of business organization is therefore imperative. Often enough, the reason for the choice is that the members of the cooperative are allowed to exercise their respective business activities independently. For instance, in the winemaking example mentioned above, the members of the cooperative can continue to work individually. They may make many, they may make many business decisions on their own, such as deciding what land to buy and which workers to employ. This would be different if the members had chosen to incorporate as a public limited company, for example. At the same time, as a cooperative, they have introduced some form of integration that allows them to be competitive on the market, and to avoid moral hazard.

There are other forms of business organization that permit similar freedoms. The closest case is a partnership. Like the cooperative, it allows the members


61 See supra I.2.
to exercise their business activities with a remarkable degree of independence. However, the main difference is that in the partnership, the partners must exercise all of their professional functions within the firm, whereas the cooperative may be restricted to some economic functions, such as processing or marketing products.

3. Sociological perspective

The sociological literature has identified completely different reasons for why cooperatives exist. Neo-institutionalist authors, in particular, have claimed that cooperatives would be mainly established in the proximate vicinity of other cooperatives that may give them an aura of legitimacy. In other words, cooperatives would attract cooperatives. The result would be a sort of “institutional isomorphism” or prevalence of one specific type of institutional form in certain geographical or business areas. Others have emphasized that the model underlying the economic analysis would be inadequate. They argue that people would ordinarily be more cooperative than the “homo oeconomicus” and be willing to incur losses in order to achieve collective goods.

These explanations are certainly plausible. Indeed, many people may create or join cooperatives because they already exist in their environment and/or because they follow altruistic purposes. It is very difficult, however, to empirically assess individual motives. Often, they come in a bundle. Moreover, it is extremely hard to distinguish selfish from altruistic interests. For example, the purpose of creating a workers’ cooperation may be considered to be altruistic. But it may also be a means of the workers to avoid being locked into asset-specific investments in the firm that may later be exploited by another owner. Given that the core function of a cooperative is to run a business, it is not farfetched to think that the motives of its founders are primarily selfish in the sense of the classic economic literature. The assumption that everybody is primarily acting in his or her own interest certainly is a crude one. Nevertheless, it still comes closest to the truth; at least as far as business organizations are concerned. Moreover, even where an altruistic motive can be shown to be prevalent, one must not forget that this motive can also be wrong. For instance, it is not always the case that a cooperative promotes solidarity among its members. Finally, the distinction drawn between cooperatives and other

63 V. Søgaard, Farmers, cooperatives, new food products (Aarhus, MAPP 1994), p. 70.
65 See supra II.2.c.
more “capitalist” forms of business organizations fails to recognize that even the latter might also serve non-economic goals. For instance, a private limited company might be operated with idealistic goals. Its members may prioritize ecological or other ethical goals over revenues.

With those reservations, one can draw interesting insights from the sociological perspective. For instance, it clearly shows that what is most needed to further the use of cooperatives – the wish of most policy makers – is information about their functioning. Also, the installation of some “model cooperatives” might help.

IV. The Governance of the Cooperative

As has been shown, the cooperative is a peculiar governance mechanism. We have yet to study how it works.

1. The Rochdale Principles as a starting point

The major problem for any comparative research is that cooperatives are regulated differently in different countries. As a common denominator for the governance analysis, one may refer to the recorded rules of the oldest cooperative. The so-called Rochdale Principles were established in 1844. In 1937, they were adopted by the International Co-operative Alliance (ICA). In 1966, an update followed. Today, they form the basis of the “Statement of the Cooperative Identity”, which ICA promulgated in 1995.66

In their original form, the principles are the following:

1. Open membership.
2. Democratic control (one person, one vote).
3. Distribution of surplus in proportion to trade.
4. Payment of limited interest on capital.
5. Political and religious neutrality.
6. Cash trading (no credit extended).
7. Promotion of education.

From a governance perspective, the most interesting principles are 1–4. The

others are either self-understood if the cooperative is considered as a governance mechanism (principle number 5), or they are specific to certain sectors (principles 6 and 7).

2. Important governance features

 a. Open membership

The Rochdale principles demand that the membership of the cooperative is open. Everybody who wishes to join may become a member, provided he fulfills the membership criteria. One might try to explain this openness to new members by some moral or ethical principle. However, there are also other possible explanations. As has been seen, cooperatives may serve to overcome a lack of power by one market side.67 In light of that purpose, their goal must be to include as many producers, consumers, and so on, as possible – the more, the better. Thus, open membership may not only be inspired by moral or ethical considerations, but can also be necessary for economic reasons. Hence, it is fair to say that there is no contradiction, in this regard, between morals and ethics on the one hand, and economic efficiency on the other.

 b. Democratic control

The next of the Rochdale principles is democratic control in the form of “one man, one vote”. This principle is almost universally applied although under some laws plural voting rights are allowed if the articles of the association so provide.68 The principle of democratic control invites a parallel to the governance of a public body, for instance the governance of the state. It also seems to be in line with the social-romantic ideas that abound in the literature about cooperatives as an alternative to more capitalist forms of business organization.69

Yet again, there might be a different explanation. As has been seen, the advantage of the cooperative over other governance mechanisms is that the members can continue to exercise their business activities independently.70

67 See supra III.1.b.
68 See, e.g., section 43(3) 2, 3 of the German law on cooperatives (Genossenschaftsgesetz) or Art. 2538(4) of the Italian Codice civile. For a comparison, see V. Sangiovanni, Il diritto di voto plurimo nella cooperativa tedesca. Cenni di comparazione con la riforma italiana, Le Società 2005, p. 256.
69 See supra II.2.a.
70 See supra II.2.b.
That independence would be seriously compromised if one of the members could outvote the others due to higher voting rights. The cooperative stands in the middle between the market and the firm. Though it provides some degree of hierarchy, it is still so close to the contractual situation that the equality principle which reigns between the parties to a contract persists. Equality is just realized with different means – equal voting rights instead of the requirements of offer and acceptance.

c. Personal element instead of capital

The last governance feature to be analyzed can be called “intuitus personae”. In short, it denotes the fact that in cooperatives, the emphasis is on persons, not on capital. An expression of this feature can be witnessed, inter alia, in Rochdale principles number 3 and 4. They concern the use of the surplus and the remuneration for capital. According to Rochdale principle number 3, the surplus has to be distributed to the members in proportion to the trade that they have done with the cooperative, not their capital. Rochdale principle number 4 adds that whenever capital has been extended to the cooperative by the members, what they get as a remuneration is not a dividend but only a limited interest. From the perspective of ordinary company law, this seems strange. One may gain the impression that the principles underestimate the value of capital contributions. But it makes perfect sense when seen from the vantage point of intuitus personae. What counts in the cooperative is not the capital contributed by the members, but rather their personal input. The consequence is that capital is not a prevailing governance feature. That is also why the voting rights of the members do not depend on the capital they have contributed.

72 See supra IV.1. The wording has varied on this point. In the 1966 version, it was stated under number 4 that “surplus belongs to members”. The current 1995 version simply speaks of “member economic participation”.
73 It must be noted, however, that some laws create special rights for holders of financial instruments. See the example of Art. 2541 of the Italian Codice civile.
74 See supra IV.2.b.
neglect that at times the cooperative will need large sums of money and will have to pay adequately for them. But this money may have to be borrowed externally. The relationship between the members, especially the share in the surplus and the remuneration for money advanced, will not be based on capital contributions, but rather on persons and personal contributions.

3. Provisional summary

If one is to compare the specific governance of the cooperative to that of contract and the firm (corporation), three features stand out:

1. openness of the cooperative for new members
2. non-hierarchical structure
3. relative unimportance of capital contributions.

All of these traits have their background in the alignment of interest which exists before the members join the cooperative. Because of this alignment, members can be admitted without putting special governance mechanisms in place. For the same reason, members submit to “democratic decision-making”, since they can assume that the others will have similar goals. Finally, capital contributions do not determine who has a say in the organization as the members do not join on a financial basis. Instead, a certain “personal element” prevails.

The ex ante alignment of interest between the members does not mean that the cooperative would be free from governance problems. On the contrary, deep rifts between the members’ interests may exist at the time of contracting or arise later. Whatever the commonalities of interest, they will only go so far. The crucial question is what happens if disagreement is uncovered or the surrounding circumstances change.

V. A Research Agenda

Many questions concerning the cooperative as a governance mechanism remain unresolved. A comparative look into different legal systems, using the looking-glasses of New Institutional Economics, might help to clarify at least some of them. The question will be: “What is going on here?”

As this analysis will be done from a legal basis, it will have to focus on the “institutional environment”, the “rules of the game”\textsuperscript{78}. That does not mean that it has to completely neglect the “play of the game”, i.e. the microanalysis of the individual choice between the cooperative and other governance forms, like markets or hierarchy. Indeed, both are intimately interwoven. One of the most interesting questions is how a change in the institutional environment, i.e. the legal rules concerning the cooperative, impacts on the individual decision between entering into a contract, incorporating a company or creating a cooperative.

The unit of analysis will thus be the law. Guidelines for cooperative legislation have been published and endorsed by ICA\textsuperscript{79}. They need to be analyzed from a scientific viewpoint. Can they provide a sensible framework for the regulation of cooperatives? The different national laws must be analyzed as well. This has to be done from a discretionary legislative viewpoint. That means the focus will be primarily on different regulatory strategies that the legislators of different states adopt and their advantages and disadvantages. The result will not only inform legislators, but also have a bearing on individual decisions. In an environment of mobility and competition between different legislatures, individuals will want to know about the pros and cons of creating a cooperative in one or the other state. Research must provide them with an answer.
