Journal of Co-operative Organization and Management 3 (2015) 3–13

Contents lists available at ScienceDirect

Journal of Co-operative Organization and Management

journal homepage: www.elsevier.com/locate/jcom

Towards a social theory of the firm: Worker cooperatives reconsidered

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ARTICLE INFO

Keywords:
Theory of the firm
Cooperation
Cooperatives
Hierarchy
Inter-cooperation
Japanese firms

ABSTRACT

This paper argues that the predominant economic theories of the firm neglect the importance of cooperation based on trust and loyalty, and that as a result, their criticisms of worker cooperatives are incomplete. While competence-based theories tend to focus exclusively on coordination and thus fail to acknowledge that the development and application of productive knowledge also involves cooperation, contract-based theories cling to a rigid model of behaviour that does not account for the type of cooperation thus involved. Thus, although contract-based theories denigrate cooperatives for failing to achieve cooperation, cooperatives may in fact be more propitiously situated than conventional firms to achieve the cooperation involved in the development and application of productive knowledge. Meanwhile, although competence-based theories imply that cooperatives are incapable of achieving coordination, cooperatives may in fact be more propitiously situated than conventional firms to achieve coordination without incurring potentially adverse effects on cooperation. This ability, however, may be suppressed by a hostile institutional environment, which biases both the options available to individuals and the way they perceive those options against cooperatives. Although inter-cooperative associations can alleviate this institutional bias, they involve structural and cultural obstacles of their own.

1. Introduction

Despite the firm's central role in society and the economy, there is little consensus regarding its purpose, function, and nature. While contract-based theories conceive the firm as an arena of exchange that purports to minimise transaction costs by achieving cooperation, competence-based theories conceive the firm as an arena of production that purports to develop productive capabilities by achieving coordination. These rival schools appear irreconcilable, with attempts to bridge them tending to treat one as subsidiary to the other (e.g. Langlois, 1992; Riordan & Williamson, 1985[1]). Nevertheless, a common implication of both schools is that cooperative firms are generally inefficient.

This paper will firstly argue that both schools overlook the importance of cooperation based on trust and loyalty. Although competence-based theories are correct that the firm's purpose is to develop and apply productive knowledge rather than to minimise transaction costs, they overlook the cooperation involved in fulfilling that purpose by focusing exclusively on the function of coordination. Meanwhile, although contract-based theories focus on the function of cooperation, they cling to a rigid, individualistic model of behaviour that does not account for the cooperation based on trust and loyalty that is involved in the development and application of productive knowledge. By combining insights from a range of disciplines, the paper will further propose a 'social' theory of the firm in which this 'deep-level cooperation', and the solidaristic behaviour on which it is predicated, take centre stage. A crucial feature of the theory is that, through their adverse effects on behaviour, the bureaucratic organisational structures required for coordination may jeopardise deep-level cooperation. Although an appropriate organisational culture can alleviate this trade-off, it must still be substantiated in organisational structures, giving rise to distributive issues.

The paper will secondly show that this social theory of the firm challenges the dismissal of worker cooperatives[2] by the predominant theories. Far from failing to achieve cooperation, as alleged by contract-based theories, cooperatives may in fact be more favourably situated to achieve an organisational culture of

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[1] Some notable exceptions include Kogut and Zander (1992, 1996) and Nooteboom (1992, 2009).

[2] I henceforth refer to worker cooperatives as simply 'cooperatives' or 'cooperative firms'. In this regard, it is important to note that there are in fact a diversity of other types of cooperative (consumer, financial, etc.), which, although perhaps relevant, are not the subject of this paper.

http://dx.doi.org/10.1016/j.jcom.2015.02.002
2213-297X/

deep-level cooperation than conventional firms, in which the organisational structures thus required are likely to threaten power-holders. Furthermore, far from failing to achieve coordination, as implied by competence-based theories, cooperatives may in fact be more favourably situated than conventional firms to implement the bureaucratic organisational structures that may be required for coordination (namely complex divisions of labour and hierarchical management systems) without compromising deep-level cooperation, because worker control can counteract their adverse behavioural effects. However, this ability may be suppressed by a hostile institutional environment, which biases both the options that individuals face and the way they perceive those options against cooperatives. Inter-cooperative associations can resist this institutional bias, but face their own structural and cultural obstacles.

The argument that worker cooperatives may be able to implement complex divisions of labour and hierarchical management systems on more favourable terms than conventional firms is similar to Valentinov's (2007) argument that agricultural cooperatives are capable of garnering the benefits of family-based farms in terms of trust and loyalty whilst also achieving the economies of scale (which can be conceived as a function of coordination) foregone by those farms. It is, moreover, especially relevant to developing countries: even if advanced economies are shifting (or have already shifted) away from Taylorism and Fordism, industrialisation has historically held the key to economic development[3] (Reinert, 2007).

2. Towards a social theory of the firm

2.1. The (economic) purpose of the firm

Following Ronald Coase's seminal 1937 article, contract-based theories maintain that the purpose of the firm is to minimise the "transaction costs" of market exchange, which pertain to the opportunistic behaviour resulting from asymmetric information (e.g. Alchian & Demsetz, 1972; Williamson, 1975, 1985).[4] The firm fulfils this purpose by optimally allocating and enforcing rights over output or decisions that are otherwise non-contractible, thus achieving cooperation. In contrast, competence-based theories maintain that the purpose of the firm is to develop "dynamic capabilities", which denote the capacity for learning and innovation (e.g. Nelson & Winter, 1982; Penrose, 1959; Teece, 1982). The firm fulfils this purpose by productively combining skills and resources, thus achieving coordination.

Which of these accounts is accurate? On the one hand, Williamson (1985, Chapter 9) has astutely pointed out that Adam Smith's (1776) theory of the division of labour (which, according to Langlois and Foss (1999) and Foss (1997), is the foundation of contemporary competence-based theories) does not provide a sound answer to the question that Coase famously posed in 1937 – namely, why production is integrated within a firm rather than performed over the market.[5] Contract-based theories attempt to answer this question, and thus offer a coherent explanation for the purpose of the firm that is supposedly lacking in competence-based theories, by invoking the cooperation problems associated with asymmetric information and the contractual means of overcoming them. By thus focusing on asymmetric *yet hypothetically tradable information*,[6] however, contract-based theories envisage the firm to be a mere constellation of market-like exchanges (a "nexus of contracts"[7]; e.g. Alchian & Demsetz, 1972), or at least fail to explain why it should be anything more than that (e.g. Williamson, 1975; see Hodgson, 1999: 205). This reductionist definition, despite being inconsistent with the activities of real-life businesses,[8] in fact sidesteps Coase's question – the very question that Williamson posed to Adam Smith – by maintaining that there is in fact no such as thing as the firm, at least in the sense of an institution that is qualitatively different from the market.

By contrast, competence-based theories focus on *productive knowledge*, which is often tacit, embedded in groups and practical settings, or not fully developed, and therefore *not tradable even in principle* (Knight, 1921; Penrose, 1959; Teece, 1982, 1986). Indeed, according to competence-based theories, the non-tradability of productive knowledge is precisely why it must be harnessed within the collective organisation of the firm, rather than through market-like exchange – it is "the very essence of capabilities/competences" (Teece & Pisano, 1994: 540). The firm is thus afforded 'emergent properties', because the productive knowledge developed and applied by the combination of individuals cannot be reduced to the knowledge of those individuals (Dosi & Marengo, 1994; Kogut & Zander, 1992: 384; Winter, 1982: 76, 1988: 170).

2.2. The (social) function of the firm

Although competence-based theories are therefore correct that the purpose of the firm is to develop and apply productive knowledge, they have not provided an adequate account of precisely how that purpose is fulfilled. In particular, by focusing primarily on the function of coordination, they fail to sufficiently heed the fact that the development and application of productive knowledge – especially the non-tradable forms of productive knowledge with which they are concerned – also requires *cooperation*[9] (Nooteboom, 2009; Osterloh & Frey, 2000; Polanyi, 1958, 1966). Thus, while stating that competence-based theories surpass their contract-based counterparts by acknowledging that "the competence underlying productive, allocative and strategic decisions is tacit and generated through experience of particularity and idiosyncrasy, *particularly in social settings*", Foss (1993: 134, emphasis added) goes on to acknowledge that it is precisely "the social component of the competences of the firm" that is undeveloped in competence-based theories. As a result of this

[3] There are sound theoretical reasons that explain this empirical fact relating to the unique characteristics of manufacturing that are lacking in, say, commodities and (most) services. These include: increasing returns; scope for synergies and technological upgrading; production for exports and thus foreign exchange; the tendency for increases in productivity to be translated into higher wages rather than lower prices; the ability to absorb low-productivity labour from the rural sector; and so on.

[4] Not all contract-based theories of the firm explicitly appeal to transaction costs. However, they can all be interpreted in the transaction-cost framework, because they are all concerned with addressing the constraining the opportunistic behaviour that results from asymmetric information, whether in terms of workers free-riding on each other's effort (e.g. Alchian & Demsetz, 1972) or investment partners making unproductively strategic investment decisions (e.g. Grossman & Hart, 1986; Hart & Moore, 1990). Indeed, as Dahlman (1979: 148) argues, all incentive problems – and therefore all transaction costs – can be reduced to matters of imperfect, and especially asymmetric, information.

[5] Another way of phrasing this question is: why do workers sign employment contracts, which allow employers to control the workplace, rather than sell their labour (or its fruits) as independent contractors (or merchants)?

[6] It was Coase (1937: 92), after all, who claimed that "[w]e can imagine a system where all advice or knowledge was bought as required".

[7] This phrase is found throughout contract-based theories, including Jensen and Meckling (1976: 311), Fama and Jensen (1983: 322), Fama (1980), Hart (1989: 1763–1765), Moore (1992) and Alchian and Demsetz (1972: 777–778).

[8] See Cohendet and Llerena (2005), Walker and Weber (1984), Monteverde and Teece (1982), Jacobides and Winter (2005: 400), Argyres and Liebeskind (1999), Argyres and Mayer (2004), Madhok (2002). See Carter and Hodgson (2006) for a review of these studies.

[9] Nelson and Winter (1982) attempt to integrate cooperation into their concept of routines, which serve to not only coordinate production but also to establish a "truce" between different members of the firm. However, exactly how relationships are governed is not spelled out. See Cohendet and Llerena (2003), Nooteboom (1992, 2009: 21), Becker (2004) and Teece and Pisano (1994).