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The potential of co-operatives during the current recession; theorizing comparative advantage

ABSTRACT

This paper asks how effective are co-operatives at surviving economic recession, and whether they can grow at the expense of investor-owned businesses and provide an alternative business model that is fairer, more stable and less risky. The paper begins by providing historical evidence concerning the resilience of co-operatives during economic crises. Then, taking a 'member-owned business' approach, it analyses the comparative advantages and disadvantages of co-ops along three dimensions: ownership, control and benefit. It broadens this out to consider advantages to the wider society, and theorises comparative advantages of other business types. It concludes by asking what it would take for the co-operative potential to be realized.

KEY-WORDS

COMPARATIVE ADVANTAGE; CO-OPERATIVE BUSINESS MODEL; RESILIENCE DURING RECESSION.

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1. Introduction

How effective are co-operatives at surviving economic recession? Can they grow at the expense of investor-owned businesses? Do they provide an alternative business model for the future, one that is more sustainable and less risky? These are important questions, particularly in this recession in relation to the banking crisis, but also more generally in relation to the way we do business. The easiest way to begin to answer them is with historical evidence from previous recessions.

There is quite a lot of evidence that co-ops survive crises better than other types of business. The history of the British consumer co-operatives in the 19th century is one of continued growth only marginally checked by recessions (Birchall 1994). Similarly, the Raiffeisen banks in Germany and Austria experienced continuous and almost trouble-free growth during the period from the 1860s to the First World War. Their urban counterparts, the volksbanks, were less reliable, sometimes failing during recessions but due (and this is a startlingly contemporary point) to their having incentivized their managers to make unsound loans (Wolff 1910). Similarly, in the 1930s consumer co-ops in Europe experienced increased customer loyalty, less intense competition and so (except where they fell under fascist rule) continued to expand. Farmer co-ops also experienced greater loyalty, and increased government support, particularly in the USA and the Scandinavian countries, and new utility co-ops provided electricity and telephones to rural USA (Birchall 1997). During the radical economic restructuring of the 1970s, worker co-ops in Europe grew in numbers and demonstrated a lower failure rate than conventional firms (Oakeshott 1978). During the recent banking crisis, co-operative banks, credit unions (and in the UK building societies) began to be seen as a steady, less risky alternative to the big corporate banks, a safe haven for savings. They experienced comparatively minor losses, except where investments went bad (US Credit Union Central, Norinchukin Bank, Dunfermline Building Society), and apart from the \$1bn made available by the US government to two credit union centrals, they did not need bailing out. On all the indicators, their business gained at the expense of investor-owned banks (Birchall and Hammond Ketilson 2009).

However, the problem with historical analysis is that there are always counter-examples. In the period 1828-32 a severe recession wiped out a new co-operative movement in Britain and Ireland, including the first attempt at shop keeping by the Rochdale Pioneers. Worker co-operative movements that grew rapidly in the USA and UK during the 1880s died out quickly in the recession of the 1890s. Housing co-operatives in New York that had been very successful during the 1920s went bankrupt after the crash of 1930. We should not be surprised that history is so complicated. The subject needs careful analysis before any generalisations can be made. Recessions are not all of the same type. First, they vary in degree of severity. In some cases, the poverty of co-op members is so deep that it is not possible to trade one's way out. The co-operative movement of the 1920s that spread rapidly round Britain and Ireland died out in the early 1830s, it is said because societies gave credit (Cole 1944). However, it is likely that this is a symptom of a deeper problem; desperate poverty among their members. The societies that faced recession in the 1870s survived because their members had built up savings out of their 'dividend' that could see them through the hard times (Holyoake 1907). Second, recessions vary in their causes and so in their effects on different types of co-operative. In the 1930s consumer co-operatives were promoted in the USA as an answer to a recession caused by under-consumption, while in the current recession we face the opposite problem of consumer indebtedness and it is co-operative banks that are getting attention.

What we can say for certain is that co-operatives are businesses that have to compete with other businesses for survival. A recession searches out weaknesses, in management, in business strategy, in the

quality of services provided, in the cost structure of the business, and so on. At the level of individual businesses, much of the explanation for their survival or disappearance is similar no matter what the ownership type. Case studies of failed member-owned businesses (MOBs) look quite similar to case studies of failed investor-owned businesses (IOBs). In contrast, if we shift our attention upwards to whole sectors, we find that different ownership types do have different survival and growth rates that must be partly attributable to the advantages and disadvantages of the way ownership is structured.

Hansmann gives the simplest and most powerful explanation in his book *The Ownership of Enterprise*, in which he shows that the costs of ownership and the costs of market contracting are crucial to survival (1996). The co-operative business model survives when the costs of market contracting between the firm and its patrons are too high and it pays to bring one of the patrons into membership. If the costs of ownership are too high, though, this will make the co-operative ownership option less efficient than the investor-owned option. Hansmann defines costs broadly as 'all interests and values that might be affected by transactions between a firm and its patrons', and he makes it clear that the valuation is both subjective and objective (p23). Here, I want to keep this broad definition of costs, but to extend the analysis to include benefits. This is in keeping with Hansmann's intention. His question is 'What is the lowest-cost assignment of ownership', and he means by this 'the assignment of ownership that minimizes the total costs of transactions between the firm and all of its patrons'. However, he also suggests an alternative, 'the assignment of ownership that maximizes the total net benefits' (p21).

My approach is along these lines but the analysis is broader and takes in other factors; I tend to theorise advantages and disadvantages rather than costs and benefits. I also want to take an even broader approach and point out the advantages of co-operatives not just to their existing members but to potential members, to the economic sector they are in, and to the wider society in which the economy is embedded. This is important for public policy.

2. Recession and the co-operative alternative

In the last two decades there has been a relentless drive towards regionalization of markets that co-operatives have found it difficult to keep up with. Farmer co-ops have devised several methods for raising capital, ranging from conversion to mixed ownership to joint ventures, and new types of co-operative that require producers to capitalize the business in proportion to delivery rights (Chaddad and Cook 2004). This has enabled them to compete with transnational food processing companies but it has strained co-operative principles and led to a distancing of members from governance. Large, national-level co-operative banks and consumer co-ops have felt the need to establish a presence in other countries, but it has not been very profitable and some had begun to draw back even before the recession hit. The recession may provide a breathing space that will allow for reflection and renewed commitment to principle. The problem of capital raising is not so bad, as there is less need to keep up with the competition in new developments. The temptation to convert or sell the business is less, as it is not worth so much! Managers value their job security and are more easily incentivised to do a good job. Members may become more interested as the mood switches from individualism to a sense of collective interest. Member loyalty increases as there fewer alternatives and the rewards from membership become more valuable. Members therefore have more of an interest in making sure the business is governed well. Worker co-operatives, in particular, are able to

demonstrate their advantages by laying off fewer workers than their competitors, finding ways to protect jobs and working conditions despite the recession (Craig and Pencavel 1992, 1994; Bonin, Jones and Putterman 1993; Burdin and Dean 2009).

On the other hand, while there is less pressure to behave like an investor-owned business in the drive to expand and dominate markets, there is relentless pressure to cut costs, to stay efficient and to give value to members so as to ensure loyalty. There is less demand for products and services and so worker-owned enterprises may struggle. In fact it is difficult to predict the effects of a prolonged recession on co-operatives; the effect may vary by type, and by market context.

Within the wider debate about the causes and consequences of the recession, co-operatives have the potential to become a very popular option. There is a growing consensus that there is a need for a new economic world order that provides greater stability and less risk-taking, particularly in banking (Cable 2009). Businesses need to develop a more long-term outlook that works against a 'get rich quick' mentality in investors and managers, that ensures greater equity in the share that ordinary citizens get from the economic results (fair shares), that in its results provides a bias towards the poor, and produces sustainable economic growth without ruining the planet. In this search for a new economic order, the potential of co-operatives is beginning to be recognised. Policy-makers are discovering (once again) that co-operatives have the potential to help limit the damage done to ordinary people by economic recession and to aid the recovery. We can expect governments to sponsor job creation through worker co-ops, new types of public service co-ops, support for farmers, and so on. But do co-operatives have the potential to be more than a palliative (treating the symptoms not the underlying condition)? Can they provide a new way of doing business that avoids the excessive greed, risk-taking, and short-termism of investor owned businesses, particularly in banking?

To answer these questions we need to consider the comparative nature of business advantage. The advantages of one type of ownership depend on the relative advantages and disadvantages of other types. It was thought until very recently that investor-ownership had all the advantages. Now we are being forced to rethink that assumption. Investor-ownership is seen to be unstable and risky. Its managers are seen as being out of control by investors, and demanding more and more incentives just to do their job. Government regulation is seen as being ineffective in preventing managerial greed and corruption. In financial services in particular, the arguments for member-owned businesses (co-operative banks, credit unions, building societies) are attracting wide interest.

To find out what the potential of co-operatives might be in this new world order we have to understand them better. I suggest we classify them as 'member-owned businesses' (MOBs); co-operatives are part of a larger class of member-owned businesses that are already a serious alternative to capitalism (Birchall 2010, ch.1). Once we understand their ownership structure we can predict their comparative advantages and disadvantages. In particular we can begin to understand why, in some ways, they seem to be stronger during economic recessions.

3. A member-owned business approach

Business organisations can be divided into different types according to their ownership structure, which then has significant consequences for the way they are governed and who benefits from their activities.

Many people, when they think of how businesses are owned, assume that there is only one type that is worth considering; the *investor-owned business* (shortened from here on to IOB). It is a simple concept; entrepreneurs start up an enterprise, people with money to invest buy a proportionate share in ownership, and they elect a board of directors to oversee the company on their behalf and hire professional managers to run it. Such a business is argued to be uniquely efficient and effective, because its governance is simple; owners all want the same thing - their return on capital in the form of share value and dividends – and boards and managers are given a clear mandate to do whatever it takes to deliver ‘shareholder value’. It is usually contrasted with the *public sector business* (POB) that is owned by citizens in general and governed by elected politicians, and that, while being indispensable for creating a ‘public interest’ and delivering some public goods, may be better at regulating than competing in markets.

There are several other ways of doing business. The simplest form is *individual self-employment*, which combines ownership, governance and management in one person. This is limited in what it can achieve, and it leads naturally to people wanting to work together in *partnership*; this enables a group of people to gain the advantages of joint ownership and collective management, and is particularly useful for professionals such as architects, lawyers and accountants. Governance is straightforward because they share the same values and practice similar skills, and their contribution to the firm can easily be measured. A *family business* is a special kind of partnership that restricts ownership and management to one’s kin, and because the owners are related and tend to have high levels of loyalty and trust, its governance is simple and has proved to be a popular and enduring type of business organisation. A *philanthropic organisation* is more complex, being designed for one group of people to meet the needs of a different group. It is not really owned by anyone, because trustees are appointed who look after the business on behalf of these two distinct groups of givers and receivers (Hansmann 1996).

A *member-owned business* is another distinct type (from here on shortened to MOB). Here, people become members of an economic association through which they choose to meet their needs directly, through provision of food, housing, banking, insurance, medical care, water supplies for irrigation, secure employment or any other goods or services they want to provide for themselves. Such associations are usually called *co-operatives* or *mutuals*, though they can have other names such as farmer association, friendly society, employee-owned business or credit union. If they are small, they can be governed like partnerships, but if they grow larger they become more complex. Ownership then tends to be dispersed among large numbers of people whose interests may be heterogeneous, and who rely on an elected board to deliver value to them not as shareholders but as users. Of course, as Hansmann points out, investors could also be seen as members and the business that they own could also be seen as a type of co-operative (1996); it all depends how far one wants to stretch these terms. However, he recognises a fundamental distinction between owners whose main purpose is to benefit from their investment through dividends and increased share prices, and those whose main purpose is to provide goods or services they need as users. In the latter case, member shares are not usually sold at market value and dividends can be seen as ‘patronage refunds’ rather than profits.¹ Also, user-members tend to allocate voting rights by person or by amount of use made of the business, rather than by level of investment. The idea of membership has become an established way of distinguishing between MOBs and other ownership types, and is the way in which almost all co-operatives and mutuals refer to their owners (Birchall 2010, ch.10).

¹ The patronage refund (known in the UK as the co-op dividend or divi) can be seen as a return to the members of an overpayment since they are providing goods to themselves at cost-price plus expenses, but for convenience are initially pricing their products at around market prices.

Here is a simple classification (see Table 1). Apart from the investors of capital, there are two main stakeholders in a business: its consumers and the producers who supply inputs to or take the outputs from the business.² In an MOB, usually one of these stakeholders is put at the centre of the business. This gives us two classes: consumer-owned and producer-owned businesses.³ It is not quite that simple. There are some complications. First, though most MOBs are 'single-stakeholder' in nature, the people who join them can have more than one identity, being at the same time producers as well as consumers, or employees as well as customers. Farmers are both producers and individually consumers, and so agricultural supply co-operatives often provide them with consumer goods as well as farm inputs. Some of the people who need banking services have their own businesses, and so have both business and personal accounts. Second, in some MOBs more than one type of person can join. Insurance mutuals that set out to insure farmers often extend into general assurance for householders. Credit unions often have in membership individual customers and small businesses. Building societies often have two categories of member; savers and borrowers. Third, a few MOBs are multi-stakeholding. They deliberately offer different categories of membership to more than one stakeholder. The Eroski retail co-operative in Spain has employee and customer members, while the ICoop group in Korea has consumer and producer (farmer) members. The social co-operatives in Italy that provide care services to disabled and vulnerable people are, by law, required to offer membership to employees, service users and carers. However, multi-stakeholder OBs are quite rare; probably because in taking such different interest groups into membership they increase the costs of governance (see Hansmann 1996).

What does it mean to be the owner of a business? There are three aspects: ownership, control and benefit (Birchall, Mayo and Simon 2011). Ownership rights mean at their most basic that one has power to decide if a business continues to exist, is sold off or wound up. This is why, even when members do not have any control over a business it cannot be sold without their permission. In the case of UK building societies, boards and managers had to campaign among members to get them to vote in favour, even though the members had never before been consulted and many were unaware that they were members (Birchall, ed. 2001). Ownership usually gives control rights, even if these are attenuated by rules and practices that allow boards to operate with very little input from members. At the minimum, members have the right to vote on new appointments to the board and to approve annual accounts. They can organise to censure or remove boards that they feel are failing to serve their interests. Ownership also confers a right to share in the benefits accruing from the business and also to have a say in how these benefits are allocated. A straightforward definition of an MOB follows: *it is a business organisation that is owned and controlled by members who are drawn from one (or more) of two types of stakeholder – consumers and producers - and whose benefits go mainly to these members (Birchall 2010: 4).*

We can use this classification to list the different types of MOB in the same way that scientists identify individual genera within a class, and species within a genus (see Table 1). We can then identify hybrids that have mixed ownership but with some of the characteristics of an MOB.

² Hansmann's classification is slightly different (1996). He separates the inputs to producer-owned businesses from the outputs, calling the first consumer-owned and the second producer-owned. However, in practice supply and marketing are often done by the same agricultural co-operative or retailer-owned wholesaler. Also, I prefer to make the distinction firmer between end-consumers and producers who also consume (in order to produce).

³ In a previous formulation a three-fold typology was used, including also employee-owned businesses. These are essentially partnerships in which people provide paid work for themselves either as self-employed or employed workers. The distinction is really one of how members choose to allocate the value added. Pragmatically, some types of production technology are more suited to one than the other.

Table 1: A suggested taxonomy of member-owned businesses

Class	Genus	Species	Hybrids
Consumer owned	General retailing	Consumer co-ops: food, staple goods	Jointly owned business with other retailers
Consumer owned	Specialist retailing	Consumer co-ops: pharmacy, funerals, travel, garage services, etc.	Joint ventures
Consumer owned	Insurance	Friendly societies, mutual assurance, life insurance, health insurance	
Consumer owned	Housing	Market value, limited equity and non-equity housing co-ops	Community housing associations (Scotland)
Consumer owned	Utilities	Electricity, water, telecoms co-ops	Joint ventures with local government
Consumer owned	Education	Child care co-ops, co-operative schools (Sweden)	Schools with multi-stakeholder governance, foundation health trusts (England)
Consumer and producer owned	Banking	Co-operative banks, credit unions, savings and credit co-ops	Mutual savings banks (USA)
Producer owned	Primary producer coop	Farming, fishery, forestry (supply, marketing and/or processing)	Several hybrids introducing investor owners
Producer owned	Retailer-owned wholesaler	Supermarkets, hardware stores, pharmacy	Jointly owned business with wholesalers
Producer owned	Shared services for self-employed, small business & professionals	A wide variety, including taxi drivers, artisans, market traders, dentists co-operatives	Minority producer-ownership in an IOB
Producer owned	Worker co-ops on a continuum: simple labour co-op to co-op group	A wide variety of sectors	Employee share-ownership schemes

4. Advantages of MOBs to their members

We now turn to a more formal analysis of advantages based on the inherent characteristics of member ownership, and look to understand these better with evidence from historical accounts of the development of MOB sectors (see Birchall 2011). The advantages held by MOBs derive directly from the three features of ownership, control and benefit. We can distinguish general advantages that apply to all MOBs, which can then be refined by class of MOB (see Table 2) and refined even further by species (see Table 3). There are also disadvantages that can be linked to the same three features, and there are also, in some cases, other ways of gaining the advantages through action by other types of owner, notably the public sector.

Table 2: Advantages of member-owned businesses by class

	Derived from ownership	Derived from control	Derived from benefits
Consumer OBs	Prevents cartels or monopolies that damage consumer interests. Enables trust in long term relationships under uncertain contracts.	Focuses the business on what matters to consumer members. Enables ethical choices to be made. Manages risk effectively.	Patronage refund acts as a 'cost price' mechanism providing consumers with goods at lowest possible cost.
Producer OBs	As above in relation to producer interests.	As above in relation to producer members.	As above in relation to supply, and with second payment for goods marketed adjusting to cost of providing the service.
Employee OBs (as a subset of producer OBs)	Prevents employers from exploiting workers when labour is in a weak bargaining position.	Prevents asset stripping, hostile takeovers. Provides choice over working conditions, prevents redundancy.	Enables workers to capture all the net added value from their labour.

Table 3: Some advantages of different species of member-owned business

CLASS	Species of MOB	Advantages to members	Wider advantages
Consumer owned	General retailing	Pure food, opportunity for fair trade, local food sourcing, dividend on purchases, consumer voice.	Community engagement, social role, campaigning, ensuring competition and local presence.
Consumer owned	Specialist retailing	As above but varying between sectors.	As above.
Consumer owned	Insurance	Long term trust, especially in pensions. Low cost. Reliability, ability to insure the less insurable.	Ensuring competition, preventing cream skimming.
Consumer owned	Housing	Equity co-ops enable control over multi-occupied blocks, while non-equity co-ops enable tenant control over social housing.	Spillover effects into the wider environment. Demonstration effects for social housing tenants. Prevention of homelessness.
Consumer owned	Utilities	Spread of utilities to rural areas that IOBs are not interested in. Consumer monopoly ensures low prices.	Prevention of monopolies by IOBs. Can be more efficient than POBs. Health and educational benefits.
Consumer owned	Education	Responsiveness to parents' preferences.	Higher educational attainment.
Consumer and producer owned	Banking	Availability of credit for business development. Safe haven for savings. Avoidance of loan sharks.	Low risk banks that can stabilise the wider banking system. Credit available to develop local economy.
Producer owned	Primary producer co-operative: farming, fishing, forestry	Raising of incomes of primary producers through: lower price and better quality of inputs; effective marketing of produce; processing to add value.	Delivery of farm extension services, strengthening of rural economies, increase in income impacting on education, child and maternal health.
Producer owned	Retailer-owned wholesaler	Ability to provide competitive advantage against multiple chains. Provides access to poorer, less mobile consumers.	Ensures competition among different types of provider, preventing cartels/monopoly. Stabilises local economies.
Producer owned	Shared services for self-employed, small business & professionals	Provision of at-cost services to businesses that give a competitive advantage, and ability to grow.	Helps local economies to grow, provides employment.

4.1. Advantages derived from ownership

In general, ownership of the means by which a good or service is produced prevents ownership by a different interest group that might exploit the economic weakness of individual members (Hansmann 1996). Another way of putting this is that without the MOB existing there would be market failure. From the point of view of consumers, small producers and partners, there are four kinds of failure that matter:

1. A monopoly in which one supplier dominates, or an oligopoly (cartel) in which several suppliers collude
2. A monopsony in which one buyer dominates, or a buyers' oligopoly in which several buyers collude
3. A situation in which there may be many suppliers or buyers but each can lock purchasers or sellers in through supplying credit
4. A lack of markets which means the goods are not supplied

Consumer co-operatives have often broken up monopolies and cartels among their competitors. For instance, in the late 19th century in the UK, the 1920s in Scandinavia, and the 1960s and 1970s in Japan, consumer co-operatives set new quality and safety standards for goods, forcing competitors to follow suit (Birchall 1997). In the 1920s Swedish and British co-operative wholesalers joined forces to produce light bulbs and radios against monopoly suppliers, thus forcing down the price (Birchall 1994: 126-8). As buyers they have acted against monopsony through creating new buying chains such as those for fair trade coffee and cotton, while UK consumer co-ops have begun a policy of buying from local producers. They have prevented a less obvious kind of monopoly by saving their members from falling into the power of competitors through debt. Retail co-operatives in Britain in the 19th century provided an alternative to local grocers who charged high prices for adulterated goods because their customers became indebted to them (Birchall 1994: 66-9). Credit unions and co-operative banks are very good at preventing loan sharks from charging high interest rates that impoverish people on low incomes (Birchall 2013a). Sometimes retailers and banks are uninterested in ensuring that essential supplies are distributed in less profitable areas such as sparsely populated rural areas and villages that will only sustain a small store. Here, retail consumer co-ops and credit unions have stepped in because their member-owners are willing to put service before the maximising of profit. For instance, since the 1990s, while banks have reduced their costs by closing branches, co-operative banks in continental Europe and building societies in the UK have resisted the trend (Birchall and Hammond Ketilson 2009). Similarly, retail co-ops in Sweden and Scotland have kept open loss-making stores in villages (Birchall 2009), while in several Asian countries (notably Sri Lanka, Indonesia, Thailand and Malaysia) consumer co-ops have continued to supply rural areas even though this means they are not very profitable (Birchall 1997: ch.5).

Producer OBs have also broken up cartels among suppliers of essential goods. For instance, in the 1930s Scandinavian farm supply co-ops prevented a monopoly in fertiliser by importing and processing it themselves (Fay 1938). More generally, they have guaranteed the quality of inputs such as seeds and livestock through taking a long-term view that is difficult to find in IOBs. However, it is in processing and marketing of primary products that they have shown their greatest advantage. Farmers and fishers are vulnerable to exploitation by buyer monopolies and oligopolies at the point of sale. The particular vulnerability varies by the characteristics of the product. Dairy farmers need to sell milk daily and so need an effective distribution system that gets their product to markets in urban areas and an effective processing system that turns excess milk into dairy products with a longer shelf life. Not surprisingly, in many countries dairy co-operatives have been outstandingly successful; they have even succeeded in

India and Bangladesh where other types of MOB have not been so successful (Birchall 1997: ch.5). Grain farmers need to sell a less perishable commodity but are subject to bottlenecks in distribution systems; in order to prevent monopoly, in the late 19th century Canadian wheat farmers set up their own distribution co-ops with storage elevators giving access to the railway system. Cattle and pig farmers have a need for processing to add value to a product that is otherwise subject to gluts and price fluctuations and so it is not surprising that some of the largest international meat processing companies are owned by Swedish, Danish and Finnish farmers (Birchall 2009). As well as primary producers, other types of producer OB have been set up to counter the threat of unfair trade. Notable are the strong retailer-OBs in grocery and hardware in the USA among retailers facing fierce price competition from Walmart (Birchall 2010: 165-6).

Primary producers are also subject to buyer monopoly through the supply of credit. Farmers have a need for credit that fluctuates around the annual production cycle. Suppliers and buyers are willing to provide this but it can lock in the producers to a vicious cycle of lower prices and increasing debt that can result in a situation of almost bonded labour. Producer OBs cut through this cycle by providing their members with credit, either directly or through separate credit co-operatives. Producer OBs have often been set up to help create the market they are entering into. In the 1890s in Denmark, farmers were beginning to export dairy products and pork, and they chose to do it through farmer co-ops rather than allow the investor-owned sector to dominate. They got in early enough to see off the competition and created a near-monopoly in export-led processing and marketing through their own businesses. A similar situation arose in New Zealand with dairying and sheep, and in the West coast of the USA with fruit farming. Co-operative banks in Europe, followed by credit unions worldwide, have provided small businesses with the credit they need when commercial banks were unwilling to lend at all. Financial deepening in the less economically developed countries depends heavily on MOB becoming established, since the costs to conventional banks of serving the poor make this sector unprofitable (World Bank 2009).

Worker OBs have not addressed such market failures directly. Most come about as a result of employees taking up share options and gradually buying out their employers, or as a result of employers wanting to retire and sell the business to their employees. The change of ownership does not lead to a change in market position and so any market imperfections that exist will remain. However, some worker OBs are from a 'worker co-operative' tradition in which workers set up their own businesses in order to provide alternative employment. They counter the weakness of labour in relation to the buyers of labour by hiring themselves. Sometimes, as in the Mondragon system in Spain, their motivation is to provide jobs where the labour market has not provided them. Sometimes, as in recent takeovers of businesses in Argentina, their motivation is to save jobs where a wider market failure has occurred (Howarth 2007). It is a difficult task to get right, since the workers inherit a firm that for one reason or another has proved unviable. Another advantage sought is in job creation. In Finland, during a severe recession experienced in the 1990s, labour co-operatives were heavily promoted as a way of getting the unemployed back into paid work (Birchall 2003: 48-51).

These 'cartel-busting' capabilities of MOB are likely to be even more important at a time of recession when IOBs are intensifying their attempts to dominate markets and maintain their profits. However, the advantages that MOB have in relation to market failure are diminished if governments take action to regulate the market. Consumer protection legislation in developed countries has removed much of the rationale for consumer co-operatives. Contrast the UK, where in the 1960s the once powerful consumer co-operatives took no part in the setting up of a consumer movement, with Japan, where they were at the forefront of campaigns for food safety and environmental protection (Kurimoto 2010). Mutual insurance

is another example; in the USA in the 1890s this type expanded rapidly because government failed to regulate the industry and mutuals were felt to be safer than IOBs (Birchall 2010: 79-80). The advantages of MOBs will also not be realised if governments decide to do the job themselves; contrast Scotland in the 1930s where a marketing co-operative failed and government set up a statutory marketing board, with Finland where marketing co-operatives were preferred, leading to the development of a powerful farmer-owned sector (Birchall 2009). On the other hand, as well as market failure there is also government failure, and moves to privatise public bodies have sometimes led to their 'mutualisation'. For instance, since the early 1990s the deregulation of European agricultural markets has led to the conversion of some marketing boards to farmer-OBs (Milk Mart in the UK is a good example). In the current recession, the low level of trust that citizens have in IOBs is not matched by a corresponding faith in public regulation; the failure of banks and of regulation are seen to be part of the same shameful episode, and so it is likely that member ownership will come to be seen as an alternative to both market failure and regulation.

4.2. Advantages derived from control

While ownership is a category – one is or is not an owner – control is a variable, in that there can be more or less control by members. It is sometimes assumed that the larger the co-operative the less members are able to be in control. However, the relationship between size and democracy is a complex one. Clearly, in all but the smallest businesses members cannot expect to be in full control as they cede most decisions to a board of directors who then delegate some discretion to managers. The larger the co-operative the more formalised the control mechanisms have to be, but this also means that member governance becomes professionalised (see Birchall and Simmons 2004a).

By member control we mean enough of a curb on directorial and managerial authority to ensure that the business is run mainly in the interests of members and under their ultimate direction. There are at least five advantages that members gain from keeping this kind of control over their MOB.

1. It guarantees that the benefits from ownership will be realised.
2. It aligns the interests of members with those of boards and managers, and so is linked to business success.
3. It lowers risk-taking and so makes the business more durable.
4. It increases opportunities to pursue ethical aims as well as shareholder value.
5. It has intrinsic value to members; they may enjoy taking part and having a sense of control.

In theory, the advantages that are derived from ownership are intrinsic; they apply even if the members do not control MOBs. This means that there are advantages to member ownership even if there are failings in governance. This argument was put in relation to UK building societies when they were threatened with demutualisation. In the rather protected market that building societies were in before deregulation in 1986, members had been minimally involved but had benefitted from a system that recycled credit to house purchasers at low cost and low risk, with nobody taking profits. Demutualisation meant that a different set of owners would take the profits in the future. This argument is even stronger in relation to mutual life insurers, whose with-profits policyholders do not have to compete with investors for the profits. When converted, they have had problems in allocating the residual assets, and have had to be more strictly regulated so that with-profits pension holders are protected (Mabbett 2001).

However, these intrinsic advantages are not guaranteed for long if boards take decisions that are not

in the interests of members. For instance, in the late 1980s Equitable Life gave guarantees to one type of customer-member that virtually bankrupted it over the next two decades. The first advantage of member control is, then, that it guarantees the advantages that are derived from member-ownership. Furthermore, there is strong evidence that effective member control is linked to business success. In a study of several hundred agricultural co-operatives in India, Shah found that success could be explained not in relation to the environment the co-operatives were working in, but more directly in relation to governance. His alternative theory is that there are three conditions for success: the purposes of the organisation are central to the members; the governance structure ensures patronage cohesiveness; and the operating system finds competitive advantage in the relationship with members. To achieve these conditions the members have to be in control of governance (Shah 1996).

Another way of understanding the advantages gained from member control is in terms of risk and opportunity. The more members are involved in governance the more likely it is that the organisation will avoid excessive risk-taking. During the recent banking crisis, co-operative banks and credit unions were recognised to be much less risky than investor-owned banks, and since then they have been increasing their market share (Birchall 2013b). In recessions, worker co-operatives have a good track record in using their power to choose between alternative investment policies to protect jobs (Birchall and Hammond Ketilson 2009). Contrast the Canadian farmer co-operative, Saskatchewan Wheat Pool, which got into serious difficulties in the late 1990s due to risky takeovers and expansions that were not sanctioned by the members (Fulton and Larson 2009).

More positively, the involvement of members creates opportunities for them to pursue other aims than just business success. They can express ethical aims in the way the business is run. For instance, the UK Co-operative Bank has been a market leader in ethical trading, being the first bank to offer free current accounts, pledging that it will not lend to companies its customers regard as unethical, and so on. One reason it has been able to do this is because, as a wholly owned subsidiary of the Co-operative Group, it has had a supportive board that during the 1980s and 1990s was prepared for it not to make much profit (Birchall 2005). Of course, other types of business also pursue ethical aims; it would be a caricature to say that IOBs only care about shareholder value. It is just that the MOB seems particularly suited to the expression of ethical concerns through doing business.

Finally, there is some intrinsic satisfaction in being in control of a business that is run for one's own benefit, and for the benefit of others who are in similar circumstances. In a study of area committee members of the Co-operative Group (carried out by this author with a grant from the Economic and Social Research Council), both individual and collective motivations to participate were measured. One of the most important individual motivations was a sense of being in control (Birchall and Simmons 2004a and b). This is particularly important in employee ownership; the chance to control the production process is one of the reasons people choose to set up worker co-operatives. This argument should not, however, be taken too far. Studies of the Mondragon co-operative system in Spain have disagreed over the extent to which workers feel they are in control and see this as an advantage (Mathews 2001). Hansmann goes even further and suggests that a lack of direct control can be an advantage as it cuts down the costs of governance (1996 ch.6). Certainly, in larger worker-owned businesses co-ordination mechanisms are necessary that are more formalised, and give more control to managers and directors. They balance the desire for member control against the need for improved co-ordination of production and reduce conflict between individuals and groups within the co-operative.

In the current recession it is likely that member control of MOBs will increase, for two reasons. First,

there is a new interest in finding alternatives to discredited IOBs, especially in banking but also in other sectors. The pool of members willing to become activists will increase in size. Second, the recession has coincided with the development of the Internet and social media. This means that the costs of collaboration by members of MOBs and by groups sympathetic to this way of doing business have collapsed. We can expect increased member participation, both in Internet-based and face-to-face interactions (Birchall, Mitchell and Smith et al. 2012). Already the benefits of the Internet are being harnessed to the member-owned business model by leading co-operatives such as the Co-operative Group in the UK and the Mondragon Corporation in Spain.

4.3. Advantages derived from benefits

The advantages to be gained by members sharing in the benefits of MOBs are not difficult to understand; together they can channel the value added from the business to themselves rather than to investor-owners or to 'middlemen'. Consumer OBs and producer OBs on the supply side of the value chain provide goods at the lowest possible price to their members. They operate a kind of cost-price mechanism, first charging members a market price for their goods and then, after each trading period, calculating a patronage refund (known in UK consumer co-ops as the 'dividend') that returns to them any surplus that has been made. Producer OBs on the marketing side operate a similar system, with a two-stage payment system for goods delivered to them by members for selling on. They also operate a refund system for profits made at other stages of the value chain such as food processing. Worker OBs provide their members with wages set by the labour market, and then distribute profits in various ways, including cash bonuses or non-voting preference shares.

These kinds of benefits are particularly important where members are poor; the extra income gained can raise them out of poverty. Increased incomes then have knock-on effects on other aspects of their lives such as improved maternal health and increased school attendance (Birchall 2004). This partly explains why, during the post-colonial period in developing countries, co-operatives received so much support from international development agencies (Birchall and Simmons 2010).

5. Advantages of MOBs to wider society

So far we have been identifying the advantages to members, but there are wider advantages to society in general from having an MOB sector. The most obvious one is the diversity that different types of ownership bring to a market sector. Hannan and Freeman say:

the ability of society as a whole to respond to changing conditions depends on the responsiveness of its constituent organisations and on the diversity of its organisational populations (1989:3).

Diversity is important because it affects the capacity of a society to respond to uncertain future changes; this is of particular importance during the current recession, whose consequences are hard to predict. MOBs are a 'repository of alternative solutions to the problem of producing sets of collective outcomes' (Hannan and Freeman 1989:7). (There are other ways of responding to a rapidly changing environment. Businesses can be reorganised but, because of inertia and the ability of existing coalitions of interest to block

change, this will be costly and may not even be possible. New organisations can be created to deal with new problems, but start-ups are always fragile and have a much higher risk of failure than do established businesses. If we see the global economy as a kind of evolutionary, adaptive system then we can expect one type of business to thrive at the expense of another. However, if one type dies out completely then the stock of existing solutions will have declined. This almost happened with the UK building societies in the 1990s, but around 30% of the sector survived and is now showing that it has some inherent advantages over IOBs; mutuals are more risk-averse and so more trusted by consumers for relatively simple transactions such as residential mortgages and savings, and they have built-in advantages from not having to remunerate a separate group of shareholders (Llewellyn and Drake 2001). They have been lightly touched by the banking crisis, and so their survival is good for the financial system as a whole.

The current banking crisis points up further evidence of the sector's importance. The massive public bail-out of private, investor-owned banks has underlined the virtues of a customer-owned co-operative banking system that is more risk-averse and less driven by the need to make profits for investors and bonuses for managers. Credit unions and co-operative banks all over the world are reporting that they are still financially sound, and that customers are flocking to bank with them because they are highly trusted. The point is an important one, because the co-operative banking sector is extraordinarily large; the market penetration of credit unions worldwide is 7.7% but in North America it has reached 44.1%, while the European co-operative banks have a market share of 21% of deposits and 19% of loans (Birchall 2010: 147-150, 2013b).

Another crisis that has pointed up the advantages of MOBs is the recent increase in food and energy prices that will impact most severely on the world's poorest people. The World Bank estimates that food demand will double by 2030 as the world's population increases by another two billion people. There is an urgent need for developing countries to increase the output of food yet the rural economy has been badly neglected (World Bank 2008). One answer is to encourage farmers to mobilise collectively in associations that organise the supply, processing and marketing of crops and give them access to markets; only in this way will they be able to increase the quantity and quality of outputs. Farmer-owned businesses are growing in most developing countries, but they need a lot more financial help and technical support if they are to reach their potential. India's dairy co-ops illustrate what can happen when a concerted effort is made over a long period of time: here, 100,000 dairy co-ops collect 16.5 million litres of milk from 12 million farmer members every day, making a massive contribution to India's food supply (OCDC 2007).

MOBs are also relevant to the informalisation of economies in the megacities of the less economically developed countries, where the problem is no longer one of economic exploitation by colonial powers but of indifference – one might say that they have been bypassed by the global system; the recession can only make this situation worse. A majority of people in the megacities now find work only in an unregulated informal economy characterised by underemployment and poor wages. One way they can begin to participate in the global economy and find decent work is through association, in credit co-ops that lend them money to start small businesses and shared service co-ops that support them in self-employment (Smith and Ross 2006).

Along with these crises is the prospect of the Millennium Development Goals not being met at their target date of 2015 (the recession and continuing debt crisis in Europe will not help as they divert attention and funding back towards the developed countries). There are good reasons for thinking that MOBs have in-built advantages in poverty reduction. The World Bank has identified three elements in an anti-poverty strategy: opportunity, empowerment and security. Because MOBs are economic associations, they provide

the opportunity for poor people to raise their incomes. Because they are democracies with each member having one vote, they empower people to own their own solutions, and because they pool risks at the level of the enterprise and offer micro-insurance they increase security (Birchall 2003: ch.2). Also, there is now a great deal of evidence to show that they not only raise incomes but contribute directly to meeting several of the other Millennium Development Goals (Birchall 2004: ch.4; Birchall and Simmons 2009).

6. Disadvantages of MOBs

These are just some of the arguments that have been made for the advantages of MOBs to wider society, and some of them have particular salience during a recession and global debt crisis. However, they rely on MOBs being able to realise their potential, and also relate to the comparative advantages of other types of business organisation, which also may or may not be realised. There may be disadvantages of MOBs that outweigh the advantages, and these will be considered next, again in relation to the three key elements of ownership, control and benefit.

6.1. Disadvantages derived from diluted ownership

MOBs tend to be owned by large numbers of people, each having a small, often nominal shareholding. Traditionally, co-operatives have set the shareholding at a low level so as to encourage poorer people to join. They have not rewarded this shareholding with anything other than a nominal interest rate, and when they leave members receive par value for it. Sometimes, in order to raise more capital they offer loan stock (also known as preferred shares or B stock) that does not carry voting rights and is rewarded with fixed interest. This is all according to co-operative principles that have been carefully drawn so as to emphasise the primacy of users over investors (Birchall 1997: ch.7). As a result they face five problems:

1. Members are reluctant to subscribe more capital and so the MOB has to raise money through building up reserves or borrowing from banks.
2. Members only have weak financial incentives to take part in governance.
3. The low level of member investment can lead to lack of loyalty to the business.
4. If the reserves become larger than they need to be to finance the business strategy, or if the potential value of the business in the shares market is much higher than the realisable value to the members, they will have an incentive to unlock the potential value by converting to investor-ownership or selling the business.
5. If the business is doing badly, members have an incentive to use the reserves built up over generations to keep it going. They may be tempted to delay taking more painful decisions about the restructuring of the business.

There are steps that MOB directors can take to minimise these disadvantages. They can set the initial member share at a higher level and, if members cannot afford it, can offer payment in instalments. This is how the Rochdale Pioneers began in 1844, with a one-pound share that was expensive at the time but has not been revalued since. However, consumer co-ops remain disadvantaged by being non-mutual – customers do not need to become members. Only in Japan, where mutuality is enforced by law, do

customers have to buy a membership share, and here the cost is high – around £40 compared to the £1 charged in the UK.

Producer OBs are in a stronger position. They can distribute reserves to members in proportion to their use of the business by issuing preference shares, as some farmer co-ops are doing. They can insist that members buy more of these shares in proportion to their use of the business. For instance, Arla Foods (owned by Swedish and Danish farmers), in doing business with Scottish farmers, is tying them into the business through compulsory share purchases funded through a proportion of the milk payment (Birchall 2009). Producer OBs can issue new shares with extra voting rights attached, revalue shares annually according to some index of company value, or create internal share markets in which members can buy and sell to each other. Many farmer co-ops and employee-owned businesses are taking these steps, while some are creating companies on the stock market in which members can sell shares to outside investors, so that the MOB becomes a hybrid of a member-owned holding company and an investor-owned trading company (Chaddad and Cook 2004).

This aligning of company value with member shareholdings can cause its own problems. It has to be carefully managed to avoid sudden calls on capital when members retire from the business, and both farmer co-ops and worker co-ops are evolving rules that allow the process to be carefully managed. Employee-owned businesses that are majority worker-owned do not have this problem, as they allow workers to own as many shares as they like alongside outside investors in a free market. Some farmer OBs and retailer-OBs have also become IOBs but with members in a majority, and they also avoid this problem of restricted ownership, but at a danger of dilution of the advantages of being member-controlled.

6.2. Disadvantages derived from lack of control by members

A lack of member control may ultimately lead to the MOB becoming effectively non-owned. They can be captured by their managers or by their boards (or a combination of the two). These interest groups may then extract more than their fair share of the profits in salaries, bonuses, and perks, may take the opportunity to make life easier for themselves by working less hard, and so on. The result is lower organisational efficiency, higher prices for consumers and, in worker co-ops, lower salaries and bonuses for the workers.

Economists sometimes take a pessimistic approach that predicts that members will not participate, and so MOBs can be expected to fail. There is a well-known ‘paradox of participation’ that proposes that rational actors will not participate in collective action to achieve common goals (Olson 1965), but will ‘free ride’. This paradox would apply to MOBs in a severe way, if not for empirical evidence that refutes the theory (it is better at predicting abstention than participation), and for theoretical developments that suggest that a much broader range of motivations affect members’ decision whether or not to participate (Birchall, Mitchell and Smith 2012). A ‘mutual incentives’ theory developed by this author has been tested in consumer and housing co-operatives. It provides some evidence that suggests that members of MOBs are motivated by a range of individual and collective incentives, and that activists who compete for places in the governance structure place a high value on a sense of community, shared goals and shared values as well as on individualistic benefits (Birchall and Simmons 2004a). Nonetheless, there are plenty of examples of governance failures brought on by lack of member involvement. However, these point more to the lack of member education (and sometimes to a deliberate strategy among board members to deny members a say) than to a fundamental problem of motivation. Control by members may never become

a mass participation activity. Yet the conditions for effective control by members are not onerous; they demand merely that a small proportion of members interest themselves regularly in the governance of the business, a larger proportion intermittently, and a majority of members when things go wrong (Birchall and Simmons 2001).

6.3. Disadvantages derived from lack of benefits to members

Under conditions of market failure the advantages of MOBs to their members tend to be obvious. However, if governments step in to regulate markets, or if markets that were failing have become more free (sometimes as a consequence of the action of MOBs, sometimes as a policy of economic liberalisation) then it will be difficult for MOBs to justify their existence against IOBs. This is what has happened to consumer co-operatives in Europe, which by the 1980s had lost much of their rationale (though in the UK they have to some extent reinvented themselves as champions of fair trade, bringing back a 'dividend' to members, and so on). Producer co-operatives have not suffered the drastic loss of purpose that occurred in consumer co-ops, but there has been a loosening of loyalty, with primary co-ops in many countries (as diverse as Canada and Tanzania) making alliances with private companies rather than staying with their traditional federal structures (Birchall 2010: ch.8). Similarly, in worker co-ops such as Mondragon there has been a pragmatic acceptance of the need to expand way beyond national borders if the benefits to members are to be protected. This has raised important questions concerning the ethics of a worker-controlled system 'exploiting' the labour of non-member employees in other countries (MacLeod and Reed 2009).

7. The comparative nature of advantage and disadvantage

Advantages and disadvantages can be identified through theory and historical examples but they are always relative to the advantages and disadvantages of other types of ownership. In a relatively open market they translate into competitive advantage, but it all depends on what the competition is like. Here are four scenarios:

- a. there is no competition so the MOB survives even if it is not very well run;
- b. there is some competition but the MOB is strong enough to see it off (having got there first);
- c. there is strong competition but the market is relatively open and a MOB sector holds its own;
- d. there is intense competition and the MOB sector loses market share even though it has advantages;

In the current recession, competition may well increase, and so scenarios b, c and d are likely to apply. Sometimes governments have been put under pressure by the MOBs' competitors, and have discriminated against the MOB sector; the history of American fraternal societies is a good example (Beito 1990). Again, under the stresses of a long recession this kind of attack on member-ownership may be seen again.

Do other business types have advantages MOBs cannot match? IOBs have the ability to raise capital on the money markets through share issues. They can also incentivise managers and align their interests better with those of the business through bonus shares. The threat of takeover is a powerful incentive to good management that MOBs tend to avoid (when MOBs get into trouble they tend to merge with other MOBs). But there are big problems with IOBs because of their short-termism and need to reward

shareholders and managers. These result in governance failure, risk-taking, disinvestment and all the problems of modern capitalism that have been starkly evidenced in the banking crisis of 2008. A few years ago, critics of the co-operative model were able to argue that these significant advantages of capitalism would lead to conversions and that there was now only 'one game in town'. Now, the advantages are seen as liabilities and the co-operative model is being examined more closely.

8. Will the potential be realised?

A theoretical understanding of the advantages and disadvantages only identifies potentials. Whether these will be realised depends on a combination of good leadership, effective management and good member relations. Here are a few signs of renewal that I have observed.

- a. There is a growing commitment to value-based leadership and management among existing member-owned businesses (e.g. US farmer-owned agri-businesses, consumer co-ops in UK, Spain and Italy).
- b. New ways are being found to connect up a large membership to the business, using the internet (Co-operative Group and Midcounties Co-op in the UK are leaders). A real co-operative culture is emerging.
- c. In agriculture, new types of collaboration with IOBs are creating hybrid forms of business ownership without co-op members losing control of the core business.
- d. The problem of how to trade transnationally is being solved by taking customers in other countries into membership (e.g. Arla Foods in Finland and UK, Eroski Co-op in Spain and France).
- e. Co-operative banks in Europe and credit unions in North America are being seen as a stabilising influence on the banking system.

One prediction that can be made with confidence is that the co-operative business model will get a great deal of attention. Some critics of the current crisis are beginning to recognise that if the potential of MOBs were realized we would quickly come to a new world economic order that is more stable, more trustworthy, more equitable, and driven not by profit but by the desire to meet people's needs. It would be a 'people-centred' rather than a money-centred economy. Behavioural scientists are demonstrating that it would not need a new form of human nature to emerge; it is in line with what we know about the human capacity to co-operate, based on 'strong reciprocity' (Fehr et al. 2003; Bowles and Gintis 2011; Birchall, Mitchell and Smith 2012). However, it is still all about survival in an ecology of competing business types. We cannot make the utopia happen just by envisaging it. Yet it is not just the co-operative itself, but the idea of co-operatives that is significant. The idea gives people something to hope for, to strive to bring into being – it creates a hopeful attitude. More than this, it provides a counter-narrative to global capitalism that anti-capitalists need if they are to succeed in turning a reactive movement into something more proactive. In this sense, there is already a co-operative alternative to capitalism.

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