Toward a Social Capital Theory of Co-operative Organisation

Vladislav Valentinov

Introduction

Co-operatives have long been considered to represent a distinctly special type of economic organisation, designed to serve the needs of members rather than generate profits for investors. The primary reason for this specificity can arguably be found in the concept of the so-called 'double nature' of co-operatives, systematically elaborated by Georg Draheim[1] as early as 1955. According to this concept, every co-operative represents simultaneously 1 an association of persons in the sense of sociology and social psychology, ie social group, and 2 a joint enterprise, owned and operated by the same members of the group. The existence of this social foundation of co-operation, giving rise to its expressly democratic and people-oriented character, was the basis for differentiating between the co-operative and 'capitalistic'[2] organisation.

Throughout the history of intellectual inquiries into the nature of co-operation, one of recurring themes was the comparative analysis of co-operative and capitalistic organisation, centred around such questions as: Which type of organisation is more cost-effective? What are their characteristic advantages and limitations? Can co-operative organisation broadly substitute for its capitalistic counterpart or is its feasibility limited only to certain types of business activity? If so, what are the criteria for defining the types of activities which can be organised co-operatively? Is it possible to develop a rational economic explanation for the distinct features of co-operation, such as the above-mentioned 'double nature', democratic control, limitations on compensation for contributed capital, etc? The motivation to find answers to these questions was continually reinforced by the on-going processes of co-operative 'economisation'. This can be broadly defined as 'a move away from co-operative organisations as people's movements towards co-operative organisations as companies and enterprises'[3] or, in other words, the transformation of co-operative governance mechanisms into capitalistic ones.

This paper will continue the tradition of comparative analysis of co-operative and capitalistic organisation by focusing on social capital as the distinctive foundation of the former. The social capital approach will be used:

1 To demonstrate why and in what cases co-operation represents an effective alternative to capitalistic governance mechanisms.
2 To develop an economic rationalisation of the 'double nature' of co-operatives.
3 To identify the major distinctions between the co-operative and capitalistic governance.
4 To understand the co-operative principles as governance instruments aimed as reinforcement of social capital.
5 To develop a new perspective on the economisation processes.

Explaining co-operative organisation

The 20th century witnessed significant advances in co-operative theory. An important theoretical issue related specifically to the organisational nature of co-operation was whether co-operative does really represent a firm or only a pure agency of its members. The latter view was developed by Emelianoff[4] and further continued by Robotka[5] and Phillips,[6] whereas the first view was later initiated by Enke[7] in his analysis of consumer co-operatives as a business firm and Helmberger and Hoos[8] in their neoclassical theory-based model of agricultural co-operative. Still another approach was to view co-operative as a coalition of stakeholders engaged in mutual bargaining.[9] The 'co-operative as a nexus of contracts' approach de-emphasised the importance of firm vs pure agency debate and concentrated on the nature of business relationships among the various co-operative stakeholders, which represent a set of explicit and implicit contracts between them.[10]

The large number of studies devoted to explaining the co-operative type of economic organisation can, within a certain degree of precision, be classified into two types:

1 Those which analysed the co-operative 'as a going concern', (ie attempted to answer the question of 'what co-operative is').
2 Those which sought to rationalise the

emergence of co-operation, (ie, to identify those systems of economic incentives which led to the transfer of certain economic activities from 'capitalistic' to co-operative type of institutional arrangements).

Whereas this classification probably cannot be conducted unambiguously, certain studies within the new institutional economics tradition, especially transaction cost approaches, can be definitely attributed to the second group. In the following, some of them will be briefly reviewed and an alternative approach, based on the concept of social capital, will be proposed.

The transaction cost approaches

The common theme of the transaction cost approaches to explaining the co-operative organisation is the explicit focus on comparative attributes of co-operatives and alternative institutional arrangements. Co-operative organisation is shown to be emerging for governing those transactions where it provides an opportunity to economise on transaction costs.

An interesting transaction cost analysis of co-operative organisations has been proposed by Holger Bonus, whose basic argument is that:

> the main benefits of collective organisation derived by co-operatives are achieved by internalising crucial transactions into a firm jointly owned by the holders of transaction-specific resources, who thereby avoid potential threats to the quasi-rent of their investment by outside opportunists.[11]

Using this approach, the author explains the emergence of local credit co-operatives in rural areas of Germany at the time of Raiffeisen. The urban banks did not possess the required information about the creditworthiness of small-scale farmers, merchants, and businessmen living there, and therefore could not offer them the required loans. The supply of loans was therefore monopolised by the local usurers, who invested significant resources in acquiring (learning) this information. The inhabitants of these areas, however, managed to internalise the loan supply transactions by creating local credit co-operatives, which effectively utilised the pool of local information and the intimate knowledge that members had of each other and charged on this basis acceptable interest rates. Essentially the same logic was used to explain the emergence of central co-operative banks – local co-operative banks required a reliable partner, for which role the urban banks were poorly suited. Local banks, again on the basis of pool of local information available to them, internalised these transactions by creating a central bank, owned by the local banks themselves.

The transaction cost rationalisation of agricultural co-operatives has been conducted by John M Staatz, who explained their emergence by the following reasons[12]:

1 High asset specificity in agriculture generates rents, which farmers' trading partners can potentially capture by acting opportunistically. Farmers can resist and preclude this opportunism by forming co-operatives, which provide them with market power and preserve their access to markets.
2 Co-operatives internalise transactions characterised by high uncertainty due to riskiness inherent in agricultural markets, primarily through their ability to practice contingency pricing via patronage refunds and to offer members some degree of revenue insurance pooling.
3 Co-operatives are able to internalise externalities imposed upon farmers by their trading partners, both on the output side (maintaining quality of farm products) and the input side (ensuring the quality of inputs).

The general principles of transaction cost understanding of co-operative organisation can be found in the economic theory of teams.[13] Although this literature is not explicitly focused on co-operatives, it reveals the general conditions under which co-operative organisation allows economies on transaction costs or, on the contrary, is associated with transaction cost disadvantages. According to this theory, the major motivation for the establishment of team is non-measurability of individual labour inputs. When this condition occurs, team members introduce the profit-sharing system, which becomes increasingly disadvantageous with the growing number of team members due to the increasing potential for shirking behaviour[14] and/or limited information processing abilities of an all-channel network.[15] When the disadvantages reach a critical level, a team is replaced by a hierarchy – a process conceptually corresponding to the widely observed trends of hierarchisation and commercialisation of co-operatives.

It is possible to identify two methodologically important characteristics shared by the transaction cost theory-based explanations of co-operative organisation. Firstly, they are 'protection-oriented' in the sense that they seek to develop safeguards against contractual hazards emerging from the possibility of the trading partners' opportunistic behaviour. Secondly, they are based on the presumption that the governance mechanisms under consideration are really alternative, ie, while they are associated with different levels of transaction costs in governing specific transactions, they still remain within the feasible set. In particular, related to the latter presumption is the designation of co-operative as a hybrid organisational form, occupying a middle place between market and hierarchy.[16]

Whereas there seem to be no grounds to question the transaction cost theory-based explanations in themselves, the two above-mentioned characteristics suggest that these explanations are not exhaustive. First, when co-operative initiatives of any kind are in their inception stages (eg farmers jointly buying a combine, or villagers building a school for their children) the safeguarding of contractual hazards does not necessarily emerge as a motive for this joint action. Specific assets may not be involved, the individual inputs may be easily observable, and no quasi-rents may be in danger of expropriation, as in the examples mentioned. Thus the danger of opportunistic behaviour of trading partners may not always be a necessary prerequisite for the undertaking of such grassroots efforts.

Second, in comparing the co-operative and 'capitalistic' organisation, the fundamental idea of transaction cost economics that the different governance mechanisms are really mutually substitutable, and in this sense alternative, has to be questioned. As long ago as 1955, Georg Draheim proposed to differentiate between the instrumental and market co-operatives.[17] Market co-operatives, as suggested by the term, sought to strengthen the market power of their members by mediating those transactions that could otherwise, although less favourably for the members, be mediated by the market (ie, co-operative governance was substitutable by the market governance). In contrast, the instrumental co-operatives are concerned with those member needs which could not be satisfied through the market mechanism, either through technical or economic impossibility or inexpediency. Draheim argued:

These (ie instrumental) co-operatives practically fill in a vacuum in the economy. As a rule, they undertake those tasks which are not attractive from the income-oriented[18] point of view.[19]

The cited examples of such co-operatives include:

1 Electricity co-operatives, which organise a supply of electricity from a generating company to distant areas, where this would be still unprofitable for the generating company.
2 Health care co-operatives, which run member-owned hospitals in the absence of sufficient public health care.
3 Machinery pooling co-operatives, which allow individual farmers to benefit from the joint use of otherwise extraordinarily expensive large-scale machines.[20]

In other words, these instrumental co-operatives are precisely directed at the implementation of those transactions, which are not possible or practicable within the income-oriented economic organisation, including markets, hierarchies, and any other income-oriented hybrid forms. In contrast to the stylised example of 'make or buy decision', where the transaction is governed either through market or hierarchy, the instrumental co-operative represents **the only possible governance structure for a certain set of transactions**; where the co-operative does not exist or function, the transaction simply does not take place, rather than being governed through a different mechanism. It follows that there may be situations where no real mutual substitutability between the co-operative and non-co-operative governance mechanisms exists. It is in these very situations that transaction cost approaches cannot be applicable.

Thus, the fact that the creation of co-operatives cannot be always traced back to the necessity to safeguard contractual hazards and also that the co-operative governance cannot always be substituted by both markets and hierarchies, calls for a different approach to theoretical rationalisation of co-operative organisation. A possible version of such approach, presented in the following, is based on distinguishing the various types of interdependencies between economic actors, identifying the role of social capital for managing these interdependencies, and the consequent effects of social capital on organisation structures used by interdependent economic actors.

The organisational role of interdependencies

The basic idea underlying our explanation of why co-operative organisation may not be substitutable by 'capitalistic' one is that the different governance mechanisms are intended to address different types of interdependencies between economic actors. This idea will also be used for showing that certain types of interdependencies are associated with minor, although not non-existent, importance of contractual hazards, whereby the 'protection' motives for deeper coordination between economic actors are attenuated.

The concept of economic interdependencies is very broad and in many aspects controversial. In our study we will focus on a specific type of interdependencies, emerging between actors **in their pursuit of a certain known economic resource** with the purpose to use it in their business activities. With regard to availability of any resource, we propose the following stylised classification of imaginable situations:

1 Extreme positive: the necessary resource is fully available to the actor.
2 Extreme negative: the necessary resource is not available and cannot be obtained from anywhere.
3 Intermediate: the necessary resource is not fully available to the actor, but can be obtained through the interaction with other actors.

It is naturally the third, intermediate, situation, that sets the stage for the emergence of economic interdependencies, some of which can be managed only by resorting to co-operative organisational structures based on social capital. Let us, therefore, consider these interdependencies in more detail. An actor requiring a certain resource, which is obtainable through interaction with other members, can pursue a number of organisational strategies, which can be more or less unambiguously attributed to the known types of governance mechanisms:

1 Market: the resource is bought from other actor.
2 ('Capitalistic') hybrid: the resource is procured by means of leasing, in the sense that is regularly generated by using equipment leased from other actor.
3 Hierarchy: some actors hire other actors to produce the resource, or purchase the technical facilities used to produce the resource.
4 Co-operative: the resource is produced through the joint enterprise of economic actors needing the resource.

Is it possible to identify a certain general motivation guiding the choice of these organisational strategies? Although this question has a direct bearing on the research programme of transaction cost economics and certainly can be answered on the basis of analysing the attributes of transactions, the selected conceptual context of 'the pursuit of a resource' makes it possible to identify such a general motivation beyond transaction cost reasoning, which evidently must operate as a shift parameter with respect to the transactional attributes proposed by Williamson.

The motivation in question, in our opinion, is based on **the technically or technologically defined comparative roles** of economic actors in the joint production of the sought resource. What is implied here is that some actors, due to their initial resource endowments, can contribute significantly more (eg, in terms of the financial value of the assets involved) to such joint production than other members. For example, one actor could have developed a core technology for producing the required resource; this technology requires certain physical inputs which may be purchased from other actors, or labour inputs that may be procured by hiring other actors. According to some criteria, eg the above-mentioned financial value, but not necessarily limited to it, the core technology can be considered to be absolutely crucial for this production, whereas the purchased inputs – respectively less important. Whenever these comparative roles of economic actors in the joint production of the sought resource are different, we will denote such interdependency as **asymmetric**.

The general effect of asymmetries in

interdependencies between actors on organisational strategies used by them in the pursuit of the sought resource lies evidently **in the comparative degrees of actor involvement** in participation in and governance of the process of joint production. By considering the position of the maximally involved actor as a reference point, it can be stated that the larger are the asymmetries, the smaller should be the involvement of the other actor(s). Using this reference point, the above-mentioned organisational strategies of interaction-based acquisition of a resource can be characterised as follows:

1 Market: minimal involvement of other actor(s); interaction limited only to the realisation of a transaction; other actor(s) do(es) not participate in the production process and the managerial decision-making.
2 ('Capitalistic') hybrid: low involvement of other actor(s); interaction includes the realisation of transaction and partial participation in production, but not in managerial decision-making.
3 Hierarchy: intermediate involvement of other actor(s); interaction includes full participation in the production process, although not in managerial decision-making.
4 Co-operative: high involvement of other actor(s); interaction includes equal participation in the production process as well as in managerial decision-making.[21]

The co-operative organisational strategy, based on high involvement of other actor(s), is expedient in the case of **symmetric** interdependencies, ie, situations where the inputs of various actors into the joint production process are approximately equal in their importance according to some significant criteria. When interdependencies are symmetric it is natural to expect that the resulting governance mechanism will provide for the equal-footed participation of all partners in the common business.

It can be seen that the proposed scheme allows to define the difference in the types of inter-actor interdependencies manageable by the co-operative and 'capitalistic' governance: whereas the latter addresses asymmetric interdependencies (with various degrees of asymmetry), the former, respectively, is responsible for symmetric ones. Consequently, in the proposed scheme, both markets and hierarchies, though in various degrees, are based on unequal distribution of rights and responsibilities in the organisation of joint acquisition of a resource, whereas in the case of co-operative governance this distribution should be equal. **This explains why certain transactions, characterised by symmetric interdependencies, cannot be governed by 'capitalistic' market and hierarchical mechanisms**.

Being founded on the concept of the degree of symmetry of inter-actor interdependence, the proposed scheme also avoids the overly narrow 'protection' orientation, characteristic for transaction cost explanations of co-operation. It should be noted however that this scheme is not intended to supplant the transaction cost reasoning: **the transaction cost economising logic is dominant in those cases where the actual values of involved interdependencies are intermediate and therefore inconclusive regarding the choice of organisational strategy**. Clearly, however, a small minority of all transactions that are equally feasible under both the 'make' or 'buy' mode. Arguably, for a substantial proportion of actual transactions, corresponding to limiting, rather than intermediate, values of inter-actor interdependency, the set of feasible governance mechanisms is more limited.

Introducing social capital

The different governance mechanisms, corresponding to respective degrees of asymmetry of inter-actor interdependencies, are naturally based on different economic principles of interaction between the actors involved. The role of these principles is to regulate the process of resource allocation in the realisation of a transaction in question. For the cases of high and low asymmetries, these economic principles are represented respectively by price mechanism and authority relation. However, in the case of symmetric interdependencies presupposing the use of co-operative governance, all members have an equal-footed status and are not buying anything from each other; therefore there are evidently no prices and no hierarchical authority to coordinate their interaction. What economic principles, then, regulate resource allocation and inter-member coordination in an organisation of the co-operative type?

Analysis of this question leads to the idea that in contrast to markets and hierarchies, internal coordination and resource allocation in co-operatives is primarily determined by the quality of interpersonal relations between its members. The better is the personal relationship that the members developed with each other, the more flexible and smooth will be the processes of communication, coordination, and collective decision making. The planning of future joint business activities and adaptation to unforeseen contingencies all depend on the degree of mutual understanding, trust, and personal sympathy existing between the members. It can be proposed therefore that the economic principle of co-operative organisation is social capital shared by its membership; social capital performs the same organisational role for co-operatives as price and authority relation – respectively for markets and hierarchies. Consequently, co-operatives can be regarded as representing the social capital-based organisation.

At this point of introduction of the social capital concept into our argument it is necessary to briefly address the issue of defining the concept. As the review of the extensive literature on social capital testifies, its definitions are diverse, numerous, and revealing various important aspects of the concept. Whereas no definition of social capital seems to be generally accepted, most of them contain references to norms, values, relationships, connections, networks as the characteristic features of social capital. In order to classify these diverse components, Grootaert and Bastelaer[23] draw a methodological distinction between the two forms of social capital – structural (established roles, social networks and other social structures) and **cognitive** (shared norms, values, trust, attitudes, and beliefs).

However it seems more appropriate to differentiate between the contents and form, rather than between two kinds of form. In this study, it will be accepted that roles, social networks and other structures represent the structural form of social capital, whereas norms, values, trust, attitudes, and beliefs constitute its contents. **Social capital can therefore be defined as norms, values, and trust embodied in the specific structural forms** (eg co-operatives, networks, associations, groups etc). An insightful comparison is that the co-operative or other structure stands in the same relationship to social capital, as the business firm to physical or financial capital, or the individual to human capital. Contents and form are always inseparable; only in their unity they will be thought to constitute social capital.

Social capital and the double nature of co-operatives

The importance of social and psychological relations for the emergence and development of co-operatives has been recognised a long time ago, most remarkably on the above-mentioned concept of 'the double nature' of co-operatives elaborated by Georg Draheim. Social capital has undoubtedly a certain relation to the 'co-operative group' as conceptually opposed to the 'co-operative enterprise'. The similarity between social capital and the social side of co-operation is their association with certain normative frameworks, consisting of values, norms, and rules. However, the concepts of social capital and the social side of co-operation presuppose different answers to the question of where this normative framework comes from and why it is so important for co-operatives.

Let us consider first the way in which the social side of co-operative organisation has been generally perceived. Writing about the individual motivations for creating a co-operative group, Draheim mentioned the feelings of isolation and longing for social life and 'emotional security', the fear of dependency and exploitation by alien social forces, difficult circumstances of life; the wish to become an active subject rather than a passive object, the wish to be a part of a stronger and larger social whole, the search for social importance; love for other people, readiness to help, sympathy, humanitarian aspirations, religious motives, the sense of belonging to a certain neighbourhood; class- or status-consciousness, the wish to follow examples and/or to innovate; habits; instincts and unclear feelings.[23] Summarising this characterisation, Draheim wrote:

> although these immaterial motivations may not always be separable from economic-rational ones, they predominantly stem from the irrational sphere of man.[24]

The more neutral approach, in the sense of weaker emphasis on irrationality, is to consider the co-operative organisation to be based on certain ethical values, which do not have critical importance for the 'capitalistic' forms of governance. In the words of Böök, co-operative organisations:

> have mostly been economic in character, but have had moral, ethical, social, cultural and political motivations as well. In order to function as vehicles for the values, the co-operative organisations must function efficiently; so the basic ideas and ethics have been supplemented with practical experiences to form instrumental values. [25]

However, a common characteristic of these views of 'the double nature' is that the social side of co-operation is at least conceptually detached and independent from its economic side. Maintaining economic efficiency of co-operative enterprise is seen as a way to enforce the observation of the social values of co-operation, such as democracy, equity, liberty, etc. Although the observation of these values can sometimes positively affect the economic performance of co-operatives, their effect is not always seen as beneficial. In some cases, the necessity to act in accordance with the values represents an additional strain on economic performance of co-operatives and causes the well-known tendencies of their economisation.

In contrast to this understanding of the social side of co-operation, the existing views of social capital, in spite of their diversity, share **a fundamentally rational and instrumental vision of the role that social capital plays in economic development**. Social capital is explicitly regarded as a productive resource just as much as financial, physical, or human capital,[26] which requires investments[27] and generates returns in the form of better access to information, better communication and coordination, reduction of opportunistic behaviour.[28]

Moreover, the factors causing a social orientation of co-operatives, as listed in the above mentioned quote from Draheim, seem to originate from the set of social relations existing in particular segment of a society and reflect the specific social embeddedness of individual members. In contrast, social capital as the economic principle of co-operative organisation originates primarily not from the social embeddedness, but from a special – symmetric – type of interdependency between economic actors: the actors need a certain resource, and can obtain it only through interaction, communication, and coordination with each other. The higher the effectiveness of these interaction processes, the greater the returns that accrue to members. Or, in other words, the more social capital the members share, the higher is the individual welfare of every one of them.

Now, the question is how these different rationalisations of the normative foundation of co-operation relate to each other: are they mutually exclusive or complementary? They seem to be complementary because they relate to different, micro and macro, levels of social orientation of co-operative behaviour. Whereas the social embeddedness in the sense of Draheim is based on a wider set of social relations reflecting the institutional characteristics of the society in general or at least a certain social segment, social capital of a group of co-operating actors is conditioned by the specific (symmetric) nature of their interdependency. Therefore it is closer to the specific circumstances of this co-operation in comparison with the more generic social embeddedness. The types of interdependencies determined by the nature of business activities of individual actors should be able to change more rapidly than the wider social relations. Therefore a transfer to a non-co-operative governance structure (ie, loss of co-operative identity) may be justified from the perspective of a changed type of interdependency (which could have become more asymmetric) while not justified from the perspective of the social embeddedness, the dynamics of which is rather slow and quite disconnected from the specific nature of business activities in question.

Co-operative as a social capital-based organisation: implications of the approach

Co-operative and 'capitalistic' governance: major distinctions

A core question of new institutional economics, and in particular, transaction cost economics, is the comparative analysis of different governance mechanisms, namely markets, hybrids, and hierarchies.[29] All of these governance mechanisms belong to the sphere of 'capitalistic' governance, the social disadvantages of which essentially gave rise to the emergence of Cupertino as a 'non-capitalistic' organisation. In this section, an attempt will be made both to compare some general characteristics of these two broad types of governance, as well as to specify some of them with respect to particular 'capitalistic' governance mechanisms.

The broad comparisons of co-operative and 'capitalistic' governance, available in the literature, point toward both advantages and limitations of co-operatives. The source of the limitations lies in a set of the so-called 'incentive problems', which include:

- Common property problem (the members' equity contribution may not be proportional to the distribution of resulting benefits).
- Horizon problem (members can capture benefits from their investment only over the time horizons of their expected membership in the organisation, which causes bias toward short-term investment and/or underinvestment).
- Monitoring problem (decision management is allocated to decision specialists who are not residual claimants);
- Influence cost problem (some groups of members may have opposing interests and engage in costly lobbying activities).
- Decision problem (large number and heterogeneity of members complicate the reaching of a consensual decision).[30]

Democratic decision making is generally associated with higher transaction costs than hierarchical.[31] These incentive problems and difficulties of collective decision making give grounds to consider the co-operative governance is relatively 'expensive' in terms of transaction costs in comparison to 'capitalistic' governance mechanisms.

On the other hand, however, co-operatives have been recognised as more economical and advantageous in serving the needs of their members than capitalistic governance mechanisms. In his 1922 article, E G Nourse, an early representative of the American school of co-operative research, indicated that co-operation represents "an attack on the real wastes of competition".[32] In particular, the members of consumer co-operatives do not have to pay for the extensive and aggressive marketing efforts undertaken by competing firms, because the co-operative by definition possess the knowledge of what the members really need. The members of marketing co-operatives gain the possibility to sell their products and procure their inputs at better prices and thus avoid the transaction costs of interacting with middlemen and intermediary structures. Machinery-pooling and service co-operatives also create possibilities for improving the overall efficiency of enterprises by minimising the costs of certain specialised services. Co-operatives usually allow an increase in the level of well-being of their members and improve the performance of the markets where they operate by combating the processes of their monopolisation (through developing the 'countervailing power').[33] All these efficiency improvements would not have been possible within the 'capitalistic' governance mechanisms.

How can these two contrasting arguments be related to each other? It can be assumed that specific advantages and limitations of co-operatives must in some ways be mutually compensating. However their direct comparisons are often complicated due to significant difficulties in their quantification and empirical measurement. Is it possible, then, to develop a certain conceptual reconciliation between the costs and benefits of co-operation?

The key to this reconciliation seems to lie in the fact that co-operatives as social capital-based organisations exhibit high social capital-dependence, ie, require large amounts of social capital to ensure their good performance. Accordingly, **the limitations of co-operation (incentive problems and decision making difficulties) emerge as a consequence of insufficient availability of social capital to match its high social capital-dependence**. Arguably, if the right amount of social capital were always there, only the advantages of co-operation would be observed. The shortage of social capital can be caused, for example, by the expansion of membership base, which technically complicates the required communication processes, and the emergence of heterogeneities between members, which might hamper the process of collective decision-making.

An implication of high social capital-dependence of co-operatives is that the interpersonal relations of involved stakeholders play a critical role in determining the feasibility and efficiency of the respective governance mechanisms. It is natural to expect that the regulatory role of the interpersonal relations will be particularly important for symmetric interdependencies, which cannot be effectively regulated by price-based or authority-based governance mechanisms. Accordingly, the governance mechanisms addressing asymmetric interdependencies will exhibit lower social capital-dependence than co-operation, with hierarchy being more social capital-dependent than market.

The critical role of interpersonal relations, just like other organisational attributes of co-operation, may be viewed from the perspective of their relative costs and advantages. Whereas it certainly represents an additional cost factor (since costly investments in social capital are necessary), it allows to reach extraordinarily high capacity for mutual adaptation to changes in market circumstances. In his discussion of autonomous and mutual[34] adaptation, practiced respectively through markets and hierarchies, Williamson wrote:

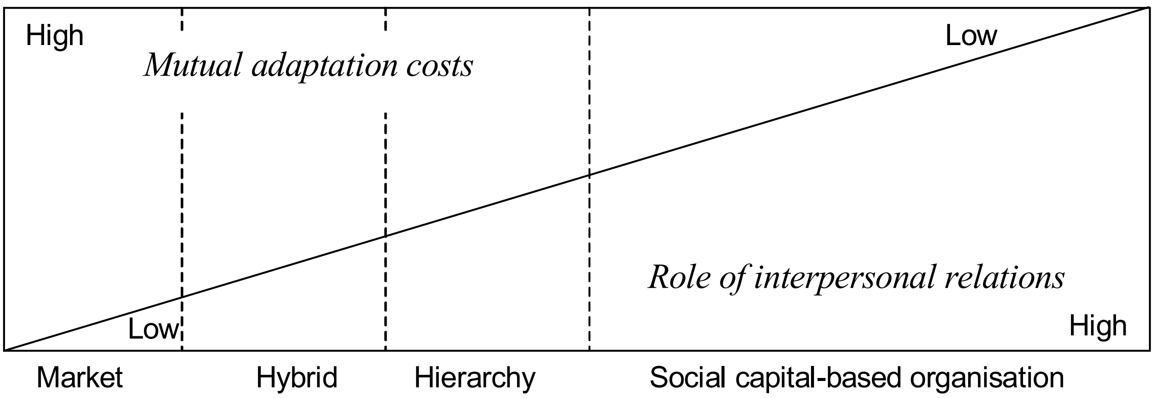
> As compared with the market, the use of formal organisation to orchestrate coordinated adaptation to unanticipated disturbances enjoys adaptive advantages as the condition of bilateral interdependency progressively builds up.[35]

In Williamson's treatment, the type of adaptation, involving mutual adjustment of actors, is realised in a hierarchy at a lower cost than it would have been possible through the market mechanism. This economising on adaptation costs is evidently made possible through the development of a better and more far-reaching relationship between actors who need to engage in the coordinated adaptation. Since relationships are always personal, identity of actors becomes increasingly important as interdependency deepens. This idea allows to extend the Williamson's analysis of adaptation capacities of markets, hybrids, and hierarchies ('capitalistic' governance) to include also the co-operative governance (see Fig 1).

It is interesting to note that when writing about the adaptive advantages of hierarchies,[36] Williamson does not mention that co-operative organisation could theoretically achieve an even better adaptation through utilising social capital possessed by co-operating actors. Whereas advantages of hierarchy are mainly seen in enhanced incentive instruments to combat opportunistic behaviour, (the tendency to which is equally characteristic for all actors, regardless of whether they are connected within hierarchies or across markets), the advantage of social capital-based co-operative organisation lies in eliminating the opportunistic behaviour itself (within the co-operative group). This possibility is created by internalisation of group goals, in the sense that every participating member consciously pursues the goals of the group understanding that the achievement of his own individuals goals is directly proportional to the achievement of goals of his group. The internalisation of group goals is evidently an essential attribute of symmetric interdependencies coordinated by the social capital-based organisation.

The concept of internalisation of group goals allows us to identify still another aspect of comparison between co-operative and 'capitalistic' governance, related to the nature of economic motives determining the behaviour of individual actors. The aspiration to promote the goals of the group necessarily means that **individual gain is not the immediate motive for co-operation but is mediated by mutual self-help objectives**. In capitalistic governance, though, the immediate motive is undoubtedly represented by individual gain, taking the form of profit from transactions made across markets and career rewards within hierarchies.

Fig 1: The relationship between adaptation costs and the role of interpersonal relation in various governance mechanisms
Source: Own presentation.



To conclude the discussion of comparative aspects of co-operative and various forms of capitalistic governance, we will briefly outline their major strengths and limitations. The strengths of markets and hierarchies mainly lie in superior capacities for respectively autonomous and mutual adaptation. Whereas mutual adaptation is seen as advantageous in cases of bilateral interdependency (in Williamson's terminology), our approach suggests that it makes sense to differentiate between asymmetric and symmetric interdependencies, the latter of which is most advantageously managed through co-operative rather than hierarchical governance. Regarding the major limitations of governance mechanisms, it can be noted that markets do not provide efficient governance for interdependencies of other than highly asymmetric type; hierarchies may involve significant bureaucratic costs,[37] whereas co-operative organisation, in order to function efficiently, requires large amounts of social capital. Being the major bottleneck in the development of co-operatives, high social capital-dependence arguably is largely responsible for the on-going processes of their economisation. The argument of this section can be summarised in the Table 1.

Interpreting the co-operative principles

As demonstrated by the previous discussion, availability of social capital has profound significance for the creation and maintenance of co-operative organisations. Namely, co-operative governance presupposes two roles of social capital: 1 as the organisational principle determining the type of governance mechanism, as opposed to price and authority, and 2 as the major resource of organisation, as opposed to all other types of capital, especially including financial, and physical. These two roles are evidently interrelated and mutually supportive. The objective of this section will be to rationalise the co-operative principles as governance instruments designed to promote social capital in both of these roles.

The need to promote social capital naturally follows from the fact that high social capital-dependence represents the major limitation of co-operative organisation. Apart from the difficulties associated with high requirements of social capital, the very nature of social capital is more problematic than is the case with eg

Criterion	Governance mechanism		
		Capitalistic	
	Co-operative (social capital-based)	Hierarchy	Market
Appropriate type of interdependency	Symmetric	Slightly asymmetric	Highly asymmetric
Basic motive	Mutual self-help	Career reward	Profit
Importance of inter-personal relations	Critical	Non-critical	Non-critical
Flexibility of mutual adaptation	Very high	High	Low
Incentives for opportunism	Eliminated	Exist	Exist
Major limitation	High requirements of social capital	High bureaucratic costs	Difficulties in mutual adaptation

Table 1: Comparative analysis of governance mechanisms
Source: Own presentation.

physical or financial capital. Building social capital requires time and is complicated by the fact that this type of capital, in comparison to others, exhibits properties of particularly high idiosyncrasy[38] in the sense of strong connection to the personal identity of its bearers. The consequence from here is that it cannot be easily transferred to other coordinates of space and time without losing an important part of its productive value. Moreover, maintaining social capital as the major organisational resource may become increasingly difficult as the membership base expands and becomes more heterogeneous, causing the growing complexity of organisational goals and activities.

Under conditions where the limitations of co-operative governance represent a 'narrower' bottleneck than those of capitalistic

Governance instrument	Main effect	Explanatory remarks
Voluntary membership	Anti-hierarchisation	Social capital can be built only on the basis of voluntary approaches; hence, practising them promotes social capital as alternative to hierarchical authority, which replaces voluntary action by directed one.
Open membership	Anti-commercialisation	A distinctive characteristic of social capital is that its stock does not shrink if it is shared by an additional person;[39] therefore the size of membership can be indefinitely expanded with the effect of extending the beneficial economic effects of co-operation on all those who share the same norms and rules which constitute the essence of a given local social capital.
Democratic control	Anti-hierarchisation	The uniform voting rule reflects the fact the amount of social capital is determined by the number of personal identities of its individual bearers; each bearer can have only one identity; therefore practising this voting rule is a direct expression of social capital as the organisational principle.
Limited compensation on capital	Anti-commercialisation	This 'repressive' measure is evidently intended to keep down the incentives to build 'economic' capital through the co-operative, and in this way prevent the penetration of 'price-based' organisation into the co-operative governance, which would destroy the stock of social capital.
Autonomy, independence	Anti-hierarchisation	This governance characteristic also reflects the importance of voluntary approaches and prevents any attempts of hierarchical authority to occupy the place of social capital.
Education, training, and information	Investment in social capital	These measures are directly intended at strengthening the internal stock of social capital by promoting the respective norms, values, and rules, and also increasing social capital of co-operatives in the eyes of the general public.
Co-operation among co-operatives	Investment in social capital	Since all co-operatives are supposed to share a set of common values,[40] they have a basis for developing a certain social capital between themselves, and it would be rational for them to use this opportunity, taking into account that it would also reaffirm social capital as the major organisational resource of co-operatives.
Concern for community	Investment in social capital	This measure is intended in building social capital in those communities where co-operatives are located, rather than only between the members or with the general public.

Table 2: Rationalising the social capital-supporting role of the co-operative principles
Source: Own presentation.

governance, it can be expected that organisational principles other than social capital can be introduced in the operation of such co-operatives. Taking into account that co-operative governance 'opposes' two other major types of capitalistic governance, mainly markets and hierarchies, two major processes of such co-operative degeneration (ie, economisation) can be identified:

1 Hierarchisation, whereby administrative authority takes the place of social capital in the form of disproportionate expansion of the competencies of managerial staff.
2 Commercialisation, whereby social capital is displaced by incentives of individual gain, characteristic for price-mediated economic relations.

These processes are, although not identical, closely interrelated and parallel to each other: domination of governance processes by managerial staff can be both a cause and a consequence of the members' retreat from active involvement in them.

The fact that the major reason behind these processes is the insufficient availability of social capital in the face of high social capital-dependence of co-operative governance naturally gives rise to the need in a set of protective measures. These are directed at the preservation of social capital both as the major resource and as the major organisational principle. We believe that these protective measures represent the generic governance instruments laid down in the body of the co-operative principles, and that this protective function represents the major rationale for the co-operative principles (as characteristic only for co-operative, but not 'capitalistic' organisation).

According to the above-mentioned distinction between the two roles of social capital in the co-operative governance, it is possible to classify the principles set out in the ICA's 1995 statement into two groups:

1 Supporting social capital as the organisational resource by promoting it as the organisational principle.
2 Supporting it as the organisational principle by promoting it as a resource.

The first four principles, namely voluntary and open membership, democratic member control, member economic participation, and autonomy and independence, arguably belong to the first group, as they mainly describe the essence of co-operative governance. The last three principles, namely education, training and information, co-operation among co-operatives, and concern for community, expressly relate to the processes of investing in social capital, both intra- and extra-organisational. The rationalisation of the major co-operative governance characteristics laid down in the co-operative principles in terms of their social capital-supporting role is presented in Table 2.

On the 'economisation' of co-operatives

In elaborating the concept of the 'double nature' of co-operatives, Draheim[41] initiated the study of processes of their 'economisation' which can be interpreted as the growing domination of the economic side of co-operation over its social side. The essential characteristics of economisation include:

1 Change in member attitudes (emergence of member apathy and relaxation of commitments to their co-operative).
2 Growing power and independence of management.
3 Organisational transformations in the direction of greater similarity to capitalistic firms.
4 The growing role of economic efficiency as a motivation for members to interact with their co-operative.[42]

This section is intended to show how the concept of social capital can be applied to develop a rationalisation of the economisation tendencies.

As established in the previous section, the maintenance of social capital as the organisational principle crucially depends on whether social capital represents a major resource in a given organisation. This idea leads to tracing the essence of economisation processes back to the fact that they are usually associated with significant expansions of co-operative business volumes and, in particular, the growing importance of what may be termed 'economic', ie, physical and financial capital. It is true in many or most cases that the expansion of co-operative business primarily means expansion of the 'economic' capital and respective relegation of social capital into background. Although the accumulation of the first type of capital does not by itself necessarily lead to destruction of the second type, the very fact that economic capital requires efficient management reduces the possibilities for supporting and re-investing social capital.

Each type of capital can be considered therefore to require a distinct governance: whereas social capital is best governed by the co-operative governance, physical and financial capital require hierarchical mechanisms. Arguably, the co-existence of hierarchical and co-operative governance is more likely to undermine and decompose the second one, since its major limitation – high social capital-dependence – is more restrictive in comparison to the hierarchical disadvantage of incurring added bureaucratic costs.

Moreover, 'economic' and social capital differ in the technical possibilities of their accumulation. Whereas units of the first type of capital can be indefinitely summed, and its greater final amount may be a source of certain preferred economic conditions (lower interest rate on credit, better equipment purchased, wider ranged of services offered to members, etc), the continual expansion of membership base may not be associated with proportionate increases in available social capital due to growing difficulties of maintaining the required patterns of informal communication between the members. The inability to continually invest in social capital at an appropriate level may lead to its dissipation, since social capital usually displays greater volatility than its economic counterpart. Therefore, whereas at the initial stages of co-operative initiatives, its accumulation pattern could be viewed as superadditive, reflecting the advantages of co-operative governance over capitalistic one, under the significant expansion of membership base social capital is likely to exhibit subadditive properties, which is graphically presented in Fig 2.

The shaded area in Fig 2 represents the set of those configurations of organisational resources where the returns on investments in social capital exceed the returns on investment in the equivalent amounts of other types of capital. It is within this set of configurations that the tendencies toward economisation would not be rational and are likely not to take place; respectively, outside this set the economisation tendencies are possible and probable. To be sure, this representation is rather schematic and there is probably no way of establishing the degree of equivalence between the amounts of economic and social capital. Nevertheless, it provides an illustration of why expansion of co-operative business volumes is likely to be associated with lack of social capital and increasing use of hierarchical rather than co-operative governance instruments.

The social capital approach to understanding the processes of economisation proposed here suggests that these are technically, ie objectively determined (in the sense that they are not caused by deliberate activities of certain individuals) for any co-operative enterprise. Consequently, the partial or complete loss of co-operative identity may be justified as the rational adaptation of organisational governance to the changing structure of organisational resources, aimed at increasing the efficiency of governance. At the same time,

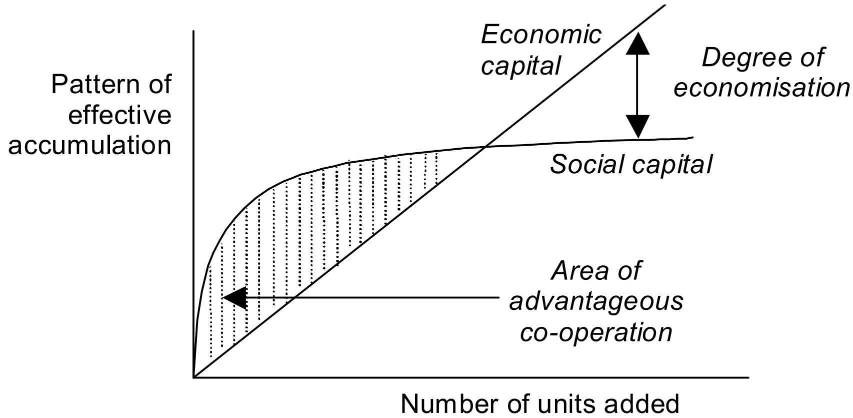


Fig 2: Comparative integrative effects of economic and social capital
Source: Own presentation.

the economisation trend does not represent a threat to co-operative initiatives involving sufficiently small number of participants.

Conclusions

The major argument of this paper is that the co-operative represents the social capital-based organisation in the sense that

1 It is based on social capital in the same way as market and hierarchical governance is respectively based on prices and authority relations as the major organisational principles.
2 Social capital is the major resource of organisations governed on the basis of co-operative principles.

The special role of co-operative organisation in the economy is explained by the fact that this organisation can be only limitedly substitutable by 'capitalistic' markets and hierarchies and accordingly represents the only possible governance mechanism for a certain set of transactions; where the co-operative does not exist or function, these transactions simply do not take place, rather than are governed through a different mechanism.

Whereas the social capital approach is potentially applicable to a diverse variety of issues of co-operative organisation, the paper focused on the most fundamental ones:

1 **The problem of social orientation of co-operatives:** the social capital approach suggests that instead of being an irrational factor, the social orientation reflects the significance of social capital as the major resource for all organisations uniting symmetrically interdependent actors.
2 **Comparative analysis of 'capitalistic' and co-operative organisation:** the social capital approach suggests that whereas co-operative organisation offers greater advantages in mutual adaptation to unforeseen contingencies, its major limitation lies in its high social capital-dependence. The incentive problems and difficulties in collective decision making are accordingly explained by the insufficiency of actually available social capital to match the high social capital-dependence.
3 **The meaning of co-operative principles:** the social capital approach suggests that they represent governance instruments aimed at reinforcement of social capital in two ways: 1 supporting social capital as the organisational resource by promoting it as the organisational principle (the first four of the principles approved by the International Co-operative Alliance in 1995); and 2 supporting it as the organisational principle by promoting it as a resource (respectively, the last three).
4 **The economisation of co-operatives:** the social capital approach suggests that economisation reflects the fact that with greater size of co-operatives, the returns on economic capital exceed the returns of social capital, whereby the first type of capital comes to dominate; co-operative initiatives involving sufficiently small number of participants are respectively not threatened.

Dr Vladislav Valentinov is a research associate at the Institute of Agricultural Development in Central and Eastern Europe, Halle, Germany.

References

Alchian, A, Demsetz, H (1972) Production, information costs, and economic organization. American Economic Review 62, pp777-795.

Beckmann, V (2000) Transaktionskosten und institutionelle Wahl in der Landwirtschaft: zwischen Markt, Hierarchie und Kooperation. Berliner Schrifterreihe zur Kooperationsforschung (5). Berlin: Edition Sigma.

Bonus, H (1986) The cooperative association as a business enterprise: a study in the economics of transactions. Journal of Institutional and Theoretical Economics 142, pp310-399.

Böök, S (1992) Cooperative values in a changing world. Internet: http://www.wisc.edu/uwcc/icic/orgs/ica/pubs/studies/Co-operative-Values-in-a-Changing-World-1/Starting-Points-for-the—90-s—1992-1.html. Accessed 10 May 2004

Böök, S (1992) Cooperative values in a changing world. Internet: http://www.wisc.edu/uwcc/icic/orgs/ica/pubs/studies/Co-operative-Values-in-a-Changing-World-1/Co-operative-Basic-Values—1992-1.html. Accessed 10 May 2004.

Borgen, S (2003) Rethinking incentive problems in cooperative organizations. Norwegian Agricultural Economics Research Institute. Working paper No 2003-25.

Dasgupta, P (1988) Trust as a commodity. In Gambetta, D (ed) Trust: making and breaking cooperative relations. Oxford: Basil Blackwell.
Draheim, G (1955) Die Genossenschaft als Unternehmungstyp. Goettingen: Vandenhoeck & Ruprecht
Emelianoff, I (1995) Economic Theory of Cooperation: Economic Structure of Cooperative Organizations, 1948, reprinted by the Center for Cooperatives, University of California, 1995.
Enke, Stephen (1945) Consumer Cooperatives and Economic Efficiency. American Economic Review 35, pp148-55.
Grootaert, C, Bastelaer, T, van (2002) Understanding and measuring social capital: a synthesis of findings and recommendations from the social capital initiative. World Bank: Washington, DC.
Helmberger, P, Hoos, S (1962) Cooperative Enterprise and Organization Theory. Journal of Farm Economics 44, pp275-290.
Holmstrom, B. (1982) Moral Hazard in Teams. Bell Journal of Economics 13, pp324-340.
International Cooperative Information Center (1996a) Background Paper to the Statement on Co-operative Identity. Internet: http://www.wisc.edu/uwcc/icic/issues/prin/21-cent/background.html. Accessed 10 May 2004.
International Cooperative Information Center (1996b) Statement on Co-operative Identity. Internet: http://www.wisc.edu/uwcc/icic/issues/prin/21-cent/identity.html. Accessed 10 May 2004.
Kaarlehto, P (1954-55) Cooperation as a Form of Economic Integration. Acta agriculturae Scandinavica 5, pp85-97.
Mather, J, Preston, H (1990) Cooperative Benefits and Limitations. Cooperative Information Report 1 Section 3. Internet: http://www.rurdev.usda.gov/rbs/pub/cir1sec3.pdf. Accessed 10 May 2004.
Nourse, E (1922) The Economic Philosophy of Cooperation. American Economic Review 12, pp577-597.
Ohm, H (1956) Member Behavior and Optimal Pricing in Marketing Cooperatives. Journal of Farm Economics 38, pp613-21.
Phillips, R (1953) Economic Nature of the Cooperative Association. Journal of Farm Economics 35, pp74-87.
Purtschert, R (1990) Zur Oekonomisierung der genossenschaftlich organisierten Wirtschaft. In Laurinkari, J (ed) Genossenschaftswesen: Hand- und Lehrbuch. München: Oldenbourg, pp264-275.
Robotka, F (1947) A Theory of Cooperation. Journal of Farm Economics 29, pp94-114.
Schmitt, G (1993) Why collectivization of agriculture in socialist countries has failed: a transaction cost approach. In Csaki, C, and Y Kislev (eds) Agricultural Cooperatives in Transition. Boulder: Westview Press, pp143-159
Staatz, J (1987) Farmers' incentives to take collective action via cooperatives: a transaction cost approach. In Royer, J. (ed) Cooperative theory: new approaches. ACS Service Report 18, pp87-107.
Staatz, J (1989) Farmer cooperative theory: recent developments. USDA ACS Research Report No 84.
Trifon, R (1961) The economics of cooperative ventures: further comments. Journal of Farm Economics 43, pp215-35.
Valentinov, V (2003) Social capital, transition in agriculture, and economic organization: a theoretical perspective. IAMO Discussion paper No 53.
Williamson, O (1975) Markets and hierarchies: analysis and antitrust implications. New York: Free Press
Williamson, O (1985) The economic institutions of capitalism. New York: Free Press
Williamson, O (1996) The mechanisms of governance. Oxford: Oxford University Press.
Woolcock, M (1998) Social capital and economic development: toward a theoretical synthesis and policy framework. Theory and Society 27 (1), pp151-208.

Notes

1 Draheim (1955), p16
2 The term 'capitalistic' organisation includes here all institutions of governance except co-operatives (markets, hybrids, hierarchies). It is used in brackets through the text since co-operation also represents an economic institution of capitalism; certain conceptual opposition between 'capitalistic' and 'co-operative' organisation reflects the fact that the second one emerged as an outgrowth of the economic and social disadvantages of the first one.
3 Böök, S (1992). Cooperative values in a changing world. Internet: http://www.wisc.edu/uwcc/icic/orgs/ica/pubs/studies/Co-operative-Values-in-a-Changing-World-1/Starting-Points-for-the—90-s—1992-1.html.
4 Emelianoff, I (1995)
5 Robotka (1947)
6 Phillips (1953)
7 Enke (1945)
8 Helmberger, Hoos (1962)
9 See Trifon (1961), Ohm (1956), Kaarlehto (1954-55)
10 Staatz (1989), p14
11 Bonus (1986), p335
12 Staatz (1987), p100
13 See Williamson (1975), Holmstrom (1982), Alchian and Demsetz (1972)
14 See Alchian and Demsetz (1972)
15 See Williamson (1975), p45
16 This view is expressed, in particular, in Beckmann (2000) and Bonus (1986)

17 Draheim (1955), pp72-73
18 In German: *erwerbswirtschaftlich*
19 Draheim (1955), p72
20 Ibid
21 The advantage of 'the pursuit of a certain resource' as a reference situation for analysing interdependencies lies in the possibility to conceptually exclude the symmetric interaction in the form of joint ventures, mergers, strategic alliances, etc, which are also importantly based on social capital and co-operative relations among the partners while preserving the hierarchical, rather than co-operative, nature of the resulting organisation. The choice of this reference situation is therefore a heuristic method to avoid some extra levels of classification of organisational strategies to deal with the interdependencies.
22 Grootaert and Bastelaer (2002), p6
23 Draheim (1955), p22
24 Ibid
25 Böök, S (1992). Cooperative values in a changing world. Internet: http://www.wisc.edu/uwcc/icic/orgs/ica/pubs/studies/Co-operative-Values-in-a-Changing-World-1/Co-operative-Basic-Values—1992-1.html.
26 See eg Woolcock (1998)
27 See eg Grootaert and Bastelaer (2002)
28 See eg Dasgupta (1988)
29 See Williamson (1975), (1985), (1996)
30 Borgen (2003)
31 See eg Schmitt (1993)
32 Nourse (1922), p579
33 See Mather, Preston (1990)
34 Instead of the term 'mutual', Williamson wrote about 'co-operative' adaptation to refer to that type of adaptation which requires coordination and mutual adjustment of several actors. In this understanding, however, the term 'co-operative' is used in a broad sense, ie not in the sense adopted in this article. Therefore, to avoid confusion, we will refer to this type of adaptation as 'mutual'.
35 Williamson (1996), p103
36 Namely: 1 proposals to adapt require less documentation, 2 resolving internal disputes by fiat rather than arbitration saves resources and facilitates timely adaptation, 3 information that is deeply impacted can more easily be accessed and more accurately assessed, 4 internal dispute resolution enjoys the support of informal organisation, 5 internal organisation has access to additional incentive instruments – including especially career reward and joint profit sharing – that promote a team orientation (Williamson (1996), p104).
37 See Williamson (1985), chapter 6
38 See Valentinov (2003)
39 Although this would be mainly true only for marginal increases in the number of each individual bearers; significant increases may complicate the maintenance of high social capital as the required communication processes become too extensive.
40 See International Cooperative Information Center (1996b)
41 Draheim (1955)
42 Purtschert (1990), p264