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Future of Cooperatives: A Corporate Perspective

1. INTRODUCTION

Over the past twenty years the theory of the firm, and of organization more generally, has grown into a substantial field of economic research. Yet, peculiarly little attention has been spent on understanding the role of cooperatives and other non-corporate forms of organization. It has simply been assumed that most firms are business corporations and that this is so because having investors own and control firms is an inherently superior arrangement.

Professor Hansmann, in a laudable departure from the mainstream, has reminded us that these generally held presumptions are false; that many competing forms of firm organization exist, including cooperatives; and that understanding the full panoply of firm organization is essential for appreciating not only the outstanding variety, but also the distinctive virtues of the corporate form itself. His excellent book ″Ownership of Enterprise″ has gotten economists interested in non-corporate forms of organization and helped them see these organizational forms, not as anomalies, but as competitive institutions that form an integral part of a healthy market economy.

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Hansmann's paper summarizes and extends some of the book's leading ideas, paying special attention to the intergenerational tensions that arise from termination of membership. In my comment I want to bring up some challenges that cooperatives are likely to face in the near term. My point of reference is the major restructuring of business corporations that has been taking place in the US during the past two decades. Corporate governance and shareholder value have burst on the scene with unprecedented force and stirred up much controversy. Why has this happened? And how will cooperatives respond to the forces that have transformed the corporate landscape so dramatically?

I will first review the economic reasons behind cooperatives, emphasizing exit and voice as alternative forms of influence; then give my interpretation of why markets have gained so much influence in the corporate world; and finally put the two parts together to draw some conclusions regarding the future of cooperatives. This rather indirect approach to the subject is necessitated by my limited knowledge of cooperatives per se.

2. THE ECONOMIC ROLE OF COOPERATIVES

Economists – including Hansmann – take a functional view of organizations. Certain forms of organization have survived because they have proved superior in certain kinds of economic environments. The task of organization economics is to infer the source of comparative advantage from the environment that an organizational form, such as the cooperative, inhabits. This is the exercise that "Ownership of Enterprise" is engaged in.

The starting point for Hansmann is the role of ownership, interpreted as the ability to influence decision making through some sort of direct governance mechanism – or *voice* to use Hirschman's felicitous language. The critical distinction between cooperatives and corporations is the identity of the owner. In the cooperative it is either producers or consumers who are formally in charge; in the business corporation it is investors. Who is the better owner, when and why?

The basic trade-offs are associated with the costs of collective decision making, broadly construed. When a firm makes a decision, it influences a large number of constituents – workers, consumers, producers, creditors, even communities at large. Economic efficiency dictates that corporations should make decisions in a way that takes into account the costs and benefits incurred by all its constituents. In an ideal world where side-payments can be used to compensate those who suffer from a particular decision and extract surplus from those who gain by it, an efficient decision maximizes aggregate social surplus, or more colloquially, the total economic pie.

In practice, it is infeasible to have a large number of people directly involved in corpo-

rate decision making. Democratic processes are notoriously slow and costly. Moreover, even if asked to participate, people will not represent their preferences honestly, compromising the quality of the decision; the shrewd bargainer typically does better than the honest one. The opportunity to influence decisions will invite participants to spend time and energy on maximizing their share of the pie, often at the expense of the total economic pie. There will be gains to rent seeking. The practical response to these problems is to give one or perhaps a few of the constituents formal decision authority through ownership. Who should that group be?

In thinking about this problem, the layman's intuition often goes wrong. The instinct is to give decision making authority to the constituent group for which corporate decisions matter the most, because that group will weigh most heavily in the calculation of social welfare. If this logic is followed, workers would often end up as preferred owners. As long term associates of the firm, they can be argued to have the most at stake when important corporate decisions are made. By contrast, investors in today's world, where shares get sold within weeks or days or sometimes just hours of being purchased, appear too short-sighted to many lay observers. Why should important decisions be entrusted to people with such a fleeting interest in the corporation?

The fallacy in this logic is related to the best known paradox in economics: the water-diamond paradox. If overall importance and total value were the guides, then water should be very expensive and diamonds relatively cheap – after all, water is infinitely more valuable to humankind than diamonds. Yet, diamonds are much more expensive. Why? Because prices are determined, not by total value, but marginal value. Water would be very expensive if there was only a little of it. But since in most places water is plentiful, the value of drinking the marginal unit is very low.

In the same way, the value of control – the right to decide by virtue of ownership – is not a function of overall importance, but of the marginal importance of control for a given group. And that calculation critically depends on what the alternative is – just as in the water-diamond paradox. Those who look at how much impact corporate decisions have on various constituents forget that there are alternative ways to influence the firm's decision making. One doesn't have to have direct *voice*; one can also affect decisions indirectly by threatening to *exit*. Workers who have excellent market alternatives will surely be well taken care of by a firm even if those workers had no formal decision rights. Indeed, in the idealized economic model of perfect competition it is exactly the presence of exit alternatives that allows profit maximizing firms to reach a social optimum.

I have presented this detour, because it highlights – in a slightly different way – one of the key considerations in Hansmann's assessment of cooperatives. Producers and consumers don't need any control if their interests are adequately accounted for by virtue of market alterna-

tives. If consumers and producers can walk away, if they aren't locked into a particular firm, then there is no need to give them any additional say through a governance structure that gives them voice in one form or another. But where exit options are poor, there is a potential mission for cooperatives. The mutual insurance company has done well in areas where policy holders have feared aggressive profit seeking by investor owned firms. For instance, life insurance didn't get going until mutuals began to offer these policies. Electric utilities tend to be owned by cooperatives in rural, but not urban areas, presumably because the lock-in problems in rural areas are big enough for customers to seek protection in a cooperative. Hansmann's book contains many other illustrations, all of which feature limited exit options.

So what's the cost of cooperatives? Hansmann's greatest contribution has been to document the importance of heterogeneity in collective decision making. Collective decision making is always difficult. But it is more difficult the more the interests of the parties diverge. A group with common interests will have a much easier time to reach a good decision than a group with highly divergent interests. The latter may not reach any decision at all, or reach poor compromises that waste a lot of social surplus. Consequently, while voice might be of value, because exit options are poor, it is not worth giving voice to a very heterogeneous group, because it typically cannot effectively use voice. The potential value of voice will be squandered by bickering and indecision.

There is a lot of empirical support for this position. In his book, Hansmann goes through the areas in which cooperatives have been most competitive and finds that in all cases the membership is quite homogenous. Homogeneity is achieved in part by constraining the activities of the cooperative to narrow lines of business – for instance, selling just one or a few kinds of crops, or separating the sale of dairy products from the sale of grain products even though many farms produce both. Note that limiting activities in this manner is a significant liability on the cooperative form of organization.

It is striking that ownership is rarely shared among two or more constituents such as workers and investors or consumers and producers. An exception that deserves more attention is the family firm. By inheritance some of the members of the family often end up in the position of pure investors, while other members continue to work for the firm and therefore are both investors and workers. Consistent with Hansmann's thesis, tensions tend to mount in this kind of situation. As new generations take over, family firms often end up in trouble unless the family decides to sell out or in other ways restructures its ownership.

Why does it help to sell out? The answer again is found in the role of homogeneity. First, financial investors have more closely aligned interests, because they principally care about money. Second, even when risk preferences, time preferences and different views about the future payoffs of the firm lead to disagreements about the right course of action, the trading of

shares help to alleviate such conflicts. The importance of this latter mechanism is underscored by one of the most celebrated results of finance, the Fisher separation theorem, which states that all investors, irrespectively of their risk and time preferences, will agree on how a firm should invest as long as markets for trading are complete.

We see then that the value of homogeneity explains relatively well both the greater demands on cooperative organization and the relative robustness of the joint stock company, particularly when its shares are publicly traded.

This is the place for a brief comment on Hansmann's discussion of exit problems in cooperatives. I agree with him that age differences are a significant source of heterogeneity in cooperatives and that tensions are aggravated by the fact that those who terminate their membership don't get adequate compensation. (Incidentally, retirement is just one reason for exit; moving to another location is an equally significant one.) But I don't think exiting parties get paid too little, just because incumbents want to exploit them. There are undoubtedly contractual ways in which exit can be compensated sufficiently well. The problem is that the cost of over-pricing exit is much more devastating than the cost of under-pricing it. Strategic exit and bankruptcy favor conservative pricing. The logic is the same as in the over-pricing of mutual insurance when the contractual risk is highly uncertain. In that case, members get repaid through ex post dividends. This is not to say that one couldn't improve on the exit mechanism of cooperatives, for instance, by using market based reference prices. Perhaps the increased need for people to relocate is a good reason for considering such changes.

The discussion in this section can be summarized as follows. Constituent interests can be protected either by giving people exit options or by giving them voice.[2] Voice should be given to the group of patrons that can most effectively and responsibly make use of voice and that cannot be protected as cheaply by exit options.[3] Homogeneity has proved to be a key prerequisite for the effective use of voice.

3. CORPORATE RESTRUCTURING

For the past two decades, the US corporate sector has gone through an enormous amount of restructuring. According to some estimates, more than half of all Fortune 500 firms have either been targets of takeovers or been involved in some other sort of corporate struggle that has led them to restructure their operations. Often this has involved a stronger focus on "core compe-

2 Exit is used here in the same broad sense as Hirschman uses it in his famous book Exit, Voice and Loyalty. Hansman discussion refers to a narrower, though not unrelated exit concept.

3 It is important to distinguish individual exit rights from group exit rights. Shareholders often have good exit options as individuals, as I just discussed and this is important for aligning shareholder interests. However, shareholders as a group don't have any exit option and hence voice is their only real source of influence and power.

tencies". Capital markets have been intolerant towards conglomerates and forced firms to sell pieces that don't naturally belong. Those who haven't obeyed have been charged with a "conglomerate discount"; for instance, in Sweden the Wallenberg family's holding company, Investor, currently trades at a price which is about 30% below the value of its investment portfolio. In the US, the conglomerate discount is currently estimated at about 15%. Only a few star performers such as GE or Berkshire Hathaway have escaped the market's critical assessment of diversification.

One view of the increasing conglomerate discount is that markets have become more efficient at allocating capital. Wall Street and other financial centers have expanded their expertise in deal making. Sophisticated financial instruments have been introduced to support new and complex organizational structures. Trading volume in capital markets have grown even faster providing exit opportunities and liquidity for the new arrangements. These developments are important, but they tend to give the wrong impression that markets have become the primary means by which capital gets reallocated. That's not true. Retained earnings remain the most important source of financing in established firms. In other words, managers still make most of the investment decisions, using internal capital markets to reallocate funds. But the boundary between markets and managers has shifted. The question is why? What in the recent past has caused the markets to take a bigger and more active role?

There are many views on this. The predominant economic view, championed by Jensen, is that managers became increasingly irresponsible in the 60s, 70s, building themselves empires and spending shareholder money recklessly. Finally, the market – emboldened and empowered by the growth in pension assets and institutional money – had seen enough. The 80s takeover wave was a reaction against managerial excesses . Many firms were taken private, restructured and sold back to investors at a significant profit. If one measures economic gains by increases in the market value of firms, the 80s takeovers (most of which were friendly) added more than half a Trillion dollars of benefit to the US economy. The actual extent of social gains is harder to assess, because some of the shareholder money could have come from other stakeholders. But the limited evidence on creditor and worker losses brought to light so far suggests that the overall process has created huge social gains. Indeed, the US economy hasn't looked as strong and dynamic in decades.

Towards the end of the 80s, profit opportunities from privatization and takeovers became slimmer as more money entered the bidding, as regulatory changes made takeovers more expensive and as many executives pre-empted raiders by restructuring their companies voluntarily. In the 90s attention shifted from busting up inefficient old corporate structures to building up efficient new ones. Mature industries, like oil, tires and chemicals, were consolidated through large scale horizontal mergers. The cash squeezed out of corporate managers through

restructuring was redirected via the capital markets into growth industries, notably those using or developing information technology. Most of the enormous growth in market capitalization in the US has come from firms less than 40 years old.

There is no question that the rise of shareholder value has forced executives in declining industries to hand over resources to executives in growing industries on market determined terms. But I'm not sure that this was triggered by managerial misconduct or by fatal flaws in the internal control mechanisms of firms. If these are the explanations, why did it take so long for the markets to react? Instead of pointing the finger on organizational features that have been around for a long time – such as managerial bias towards own lines of business – one should look for changes in the economic environment that could explain why shareholder value has risen in importance lately.

The market's authority appears to have expanded in response to two major external changes in the economic environment: deregulation and the emergence of information technology. Deregulation has been very significant, both on the national and international level. In the US, deregulation began in the Cater administration and picked up speed in the Reagan years. Internationally, tariffs have been dropping with agreements such as Nafta. Global expansion has become both economically attractive and accepted by regulators. It is stunning that today's large consumer aircraft business is essentially a two company affair.

The role of information technology is harder to pin down. For a long time, it appeared that information technology didn't have any measurable impact on productivity. As my colleague Bob Solow used to say: we see computers everywhere except in the productivity numbers. But the paradox appears to be disappearing. Productivity has started to increase with the biggest gains coming from information technology. The Internet explosion is likely to accelerate the trend. The market euphoria over internet stocks may be a bubble, yet it is safe to declare that the long-waited information economic revolution is finally under way.

These major changes in the economic environment provide the deeper reasons for the rise of shareholder value, the increased voice of capital markets and the narrowing of managerial authority. Markets have come to play a bigger role, I believe, not because they have become so much better at allocating capital, or because managers misbehaved so grossly, but because the market's comparative advantage has been favored by the current economic environment. When it comes to moving capital long distances, from declining industries to emerging industries, markets do it more effectively than managers. There are several reasons for this.

First, the knowledge base in markets is much broader, though shallower, than in firms. Firms are experts at particular technologies, routines, products and markets. Their organizational capabilities are geared to performing specialized tasks exceptionally well. Markets cannot compete well with this expertise. It would be foolish to have external investors intervene

in decisions concerning DaimlerChrysler's choice of who to supply from or what new car models to use, for instance. But if DaimlerChrysler were to contemplate computer manufacturing, which I assume isn't an area in which the company currently has much expertise, and if that decision would be driven simply by the fact that there is excess cash in the firm's coffers, then the market would arguably have a case for intervening. The market can be expected to move capital more expediently and efficiently from cars to computers, even considering the fact that such moves are by no means costless.

This is one place where Europe may face problems compared with the US. In Europe, capital markets are still less developed and markets less active in pressuring management to return excess funds. Instead of markets reallocating capital across industries, we see management doing the same by having their firms migrate from declining lines of business towards greener pastures. Mannesmann and Preussag are examples. Both where in the metals business just ten years ago. In another five years, Mannesmann is going to be a pure telecom operator and Preussag a pure travel business. While both have been relatively successful, it is hard to say how much better they could have done by letting markets handle the transition. Clearly, management wasn't just acting in the social interest, but very much in their own as well.

Another problem with having firms migrate is that their decisions will be biased or delayed by internal influence activities. Employees as well as management have a lot of vested interests in what the firm does. They have product, technology and other firm specific knowledge, which may become valueless if the firm changes course and pursues new ideas and lines of business. If the transition requires entirely knew knowledge, resistance to change can be enormous. The evidence clearly indicates that the lack of old commitments and old baggage is a distinctive competitive advantage in rapidly growing industries such as telecom or IT. Narrowly focused, new firms perform better than old ones.

Letting markets intervene in the transition of old corporations by forcing managers to adhere more rigorously to shareholder value maximization, avoids costly delays, opportunistic moves to manipulate decision making, and misguided efforts to save jobs and survive. The market is often accused for being heartless and unemotional, but in times of change, this liability can become a major virtue. New jobs cannot be created without destroying old ones. When the market reallocates capital, it decides where the new jobs will be and where cuts should be made. The market doesn't favor one worker over the other. Its unemotional attitude is neutral and objective – and expedient. It is easy to imagine how difficult the change process would be if the decisions of where to cut and where to expand were left to a democratic body of workers.

The third major market advantage relates to evaluating and rewarding future performance. US capital markets have often been accused of short-termism. Fund managers are claimed to

be impatient, moving in and out of stocks on minor rumors. They follow the bandwagon rather than their own information and instincts. As recently as 1992, Michael Porter wrote a much publicized article about the ills of American capitalism, directing his most forceful criticism on the lack of foresight and patience in the stock market. With the explosion of day traders over the past few years, the situation should be even worse today. In fact it isn't. While the incentives of fund managers may be imperfect, leading to excess churn, and while day trading may be little more than legalized gambling, the US stock markets have proved a tremendously powerful force of change.

The accusations of short-termism seem logically misplaced. Swings in stock prices are big in part because the market takes the long rather than the short view. Today, more than ever, companies are valued by their future potential rather than their current earnings. Growth is the single most important determinant of stock prices. Stock prices may be highly imperfect, but they easily beat out alternative ways of assessing future potential. They are unbiased, because they have the kind of integrity that can be achieved only when people put their money where their mouth is. Any other man-made measure falls far short of this mark.

Because the future is by definition more important when there is much change, and because stock prices are superior measures of future performance, the role of the stock market as an incentive system has increased greatly. It is hard to think of a time when the stock market had as much influence on real investments. In the 60s and 70s, managers hardly paid any attention to the cost of capital as measured by market returns, nor did they respond to market signals about valuable external investment alternatives. Today, the situation is dramatically different. Because executive and management compensation, as well as tenure, is so strongly tied to the company's stock, executives listen when the market talks. Whether executives admit it or not, decisions about investment and disinvestment are made very much with an eye on how these decisions will affect the stock price. Few want to go knowingly against the market's view.

Without stock prices, the long-term effect of management actions is much harder to assess. Would anyone have guessed how valuable an idea Netscape was without its early market listing? Not to mention start-ups like E-Bay or Amazon.com and other recent success stories. If their business ideas had appeared internally within a bigger company, the market would not have had the opportunity to put a price tag on their value. Perhaps even more importantly, it would have been impossible to give management as strong an incentive to maximize the value inherent in these ideas. Incentives based on accounting numbers have one huge drawback: they never do a good job on measuring and rewarding long-term performance. In times of change, when the future takes on exceptional significance, the value of market information and market based incentives is at its greatest.

The hierarchical investment approval process characteristic of internal capital markets is another impediment to innovation within firms. There are many layers of acceptance to penetrate and any one of them could typically veto a project. Business history is littered with tales of frustrated entrepreneurs, who couldn't realize their ideas as employees of large corporations, and instead went on to establish hugely successful new businesses. I hasten to add that this shouldn't be seen as a defect of the large corporation as such. There are good reasons why companies require careful screening of ideas. People within the organization don't carry the kind of responsibility that an entrepreneur carries. Incentives for innovation, if allowed to be pursued freely, would be distorted. Easy money could foster excessive and irresponsible experimenting. By design, the large corporation hasn't been well suited for the task of revolutionary innovation. Today, efforts are made to adapt the corporation to the increased need for innovation, but the challenges continue to be huge.

Of course, markets have related problems. Entrepreneurial ideas are never easily financed in the market. Venture capital is scarce and it isn't cheap. One major reason is that the market has to deal with the possibility of adverse selection: how many financiers have already rejected the prospective entrepreneur's idea? Fear of financing an idea that others have rejected, leads to expensive screening and to high hurdles rates for acceptance. The problem is more severe the more homogenous the financiers' information is. In today's uncertain environment, idiosyncratic information is more abundant and valuable, giving market finance an additional edge.

I've listed some of the reasons why external capital markets have extended their influence over capital allocation decisions in recent years and why managers have been pressured to cede control in the process. The current emphasis on shareholder value is a manifestation of that trend. My claim is that these moves are in large part driven by the enhanced value of portfolio thinking in a world that is undergoing significant real change. When resources and decision rights need to be moved long distances, external capital markets have a comparative advantage relative to internal capital markets. This is also a plausible reason why the US economy is doing so well right now. It is better suited to experimenting and exploring new ideas and nurturing new industries than Europe or Japan.

4. THE FUTURE OF COOPERATIVES

I finally come to the cooperatives and their future. By juxtaposing the economic purpose of cooperatives with the reasons behind the increased influence of the market in the corporate world, some tentative lessons can be drawn about the future challenges that traditional cooperatives will face.

If today's shareholder activism is a consequence of the external market's advantage in undertaking fundamental structural reform, as I've asserted, the major challenge for cooperatives is to find an alternative way to do the same. Cooperatives are much further removed from the watchful eyes of financial markets than business corporations. There are no stock prices to signal when change is necessary, nor active investors to drive through a painful restructuring.

The impetus for change will have to come from somewhere else. In Europe, unification and the resulting deregulation of product markets is playing an important role. The whole agricultural sector, which has been a base industry for the cooperative movement, has been subjected to a wave of deregulation. Farming is still subsidized, but the farmer's life is getting distinctly tougher. The food industry is becoming quite competitive, too. Increased competition puts pressure on management to save costs and improve operative efficiency. Consolidation and removal of excess capacity is taking place throughout the value chain. It is less clear to me, however, what will happen to the resources freed up by this restructuring process. If it all goes to the consumer, there is no issue. But if some of the benefits accrue to cooperatives, as seems obvious, one has to ask what principles will guide the use of excess funds. Will management be kept on a short enough leash to control wasteful migration? The corporate world can provide useful ideas of what directions to pursue, but will the advice be heeded?

The biggest dilemma for a cooperative – and any other non-investor owned firm for that matter – is that change itself is bound to increase tensions among its members. There are two reasons for this. One is that change upsets established mechanisms for decision making and cooperation. The other is that change tends to cause preferences to diverge, which as Hansmann has shown, is problematic for ownership.

All collective decision making requires good behavioral rules that expedite the decision process and help it reach outcomes that capture as much of the aggregate surplus as possible. In the political arena, for instance, log-rolling is critical for effective political decision making. With the help of log-rolling, parties can avoid costly compromises and capture long-term gains. But these mechanisms tend to work best in stable environments. The give and take of log-rolling is relatively easy as long as the game repeats itself with sufficient regularity. When entirely new circumstances are confronted, the game changes, challenging traditional patterns. It will take time and effort to find a new equilibrium. Misunderstandings will occur, leading to expensive compromises in place of long-term agreements based on trust.

Environmental changes at the scale we currently observe in the world may also undermine the basis for traditional cooperatives as members find their preferences becoming less well aligned. For instance, the cooperative movement used to play an important role in representing member interests in the political arena. Today, the returns from lobbying have been greatly diminished. Without it, the underlying divergence of interests among cooperative mem-

bers, particularly in farming, has become more visible and in many cases led to split-ups.

The London Stock Exchange provides another illustration. The LSE recently announced that it plans to switch from a cooperative to a joint stock company. The alleged reason for this change is that strong, vested interests have prevented the exchange from responding effectively to the new trading environment. How to deal with electronic trading and whether to merge with other stock exchanges in response to global competition are difficult decisions that challenge deeply held views and traditions, creating intergenerational as well as occupational tensions. Once the LSE becomes a stock company, the member's exit options allow some of these tensions to be diffused, for reasons I discussed earlier. The fact that the long-term effects of today's decisions are reflected in the value of shares goes a long way towards lowering the barriers of change.

The argument above is that voice has become more costly, making exit a more attractive alternative. It is also true that exit has become less costly in many situations. Deregulation has increased competition in a number of markets. For instance, the emerging electricity markets bring competitive pricing even to rural communities, eliminating the need for consumers to join forces in order to get fair treatment. In the food industry, competition throughout the value chain has increased significantly, making it less important for producers to organize collectively. With better exit options there is less need for voice. But one should be careful not to generalize here. There must also be situations where current changes have unified interests or brought about a need for more protection and consequently where cooperatives can find new ground for growth. I assume that some of the New Generation Cooperatives provide examples of this.

Changes in market structure and technology open up opportunities to innovate and find new directions. For many companies the opportunities are necessities. Those who don't innovate, don't survive. It would appear that cooperatives are at a disadvantage in the innovation race. First, innovation is likely to divide opinions within the cooperative, because young members are typically more eager to invest in future activities than are the old, soon-to-retire members. As a consequence, there will be less opportunities for management to experiment and explore. Secondly, outside investors are unwilling to provide much if any risk capital without voice, making capital considerations more of an issue than indicated in Hansmann's treatment. Finally, measures that could be used to evaluate and reward innovative activities are missing, depriving management and employees of the most effective guide for such activities. Samuli Skurnik, CEO of the Pellervo Confederation of Finnish Cooperatives, has expressed concern over the fact that Valio, the biggest Finnish dairy cooperative, has had difficulties taking full advantage of its functional food product, Gefilus, which has significant market potential in the health food business. No one can tell how valuable this product is and hence how much

should be invested in its development. A read on Valio's market value and how it has developed over time would be quite helpful.

My observations come from the corporate world and hence are likely to exaggerate the market's role. Cooperatives have traditionally developed where life has been more stable and where change may still be less pressing. Also, cooperative activities have been chosen to dampen the impact of change. As Hansmann points out, contracts can often be used to take care of potential conflicts of interest; e. g. by determining how revenues should be split up or how costs should be divided.

Predicting the future development of cooperatives is difficult among other things because the cooperative form admits adjustments along many critical governance dimensions. The ease of exit and entry can be altered in response to increased needs for mobility and preference alignment; rules for investor participation can be changed, bringing in new forms of capital; the extent and form of voice can be varied, allowing new forms of participation in decision making; and so on. Like political constitutions, cooperative governance can take a lot of different shapes, most of which haven't been tried or envisioned yet.

Cooperatives will undoubtedly find ways to adapt to changing functional needs. My comments have been directed primarily towards traditional cooperatives, many of which will be broken up or undergo fundamental change, just as corporations have done. The rapid growth of the New Generation Cooperatives indicates that cooperatives continue to have distinct competitive advantages and that they will conquer new territory if they are alert to changes in the economic environment. There will surely be a lot of business opportunities where shared interests and outside threats will make the cooperative form successful. Hansmann's example of cooperative franchising is particularly interesting. Franchising has been the big success story in the second half of this century – an entirely new form of organization that has spread rapidly. But it has been running into problems, where growth has slowed and the imbalance in power has allowed franchisers to exploit franchisees. The law has began to protect franchisees in the same way as employees, but an alternative and perhaps better solution could be to have the franchise become a cooperative with diluted incentives for exploiting its membership. ■

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