Chapter 10

The Silver Lining of Co-operation:

Self-defined rules, common resources, motivations, and incentives in co-operative firms

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> "Dilemmas nested inside dilemmas appear to be able to defeat a set of principals attempting to solve collective-action problems through the design of new institutions to alter the structure of the incentives they face. ... But some individuals and/or communities have created institutions, committed themselves to follow rules, and monitor their own conformance … to the rules in common pool of resources situations".
>
> Elinor Ostrom (1990)

> "… the principal question regarding enterprise ownership is which class(es) of patrons will be made the owners. The answer depends heavily on the governance structures that firms can and do adopt, which in turn depends on the legal and institutional environment. … The full potential of cooperatives should become much clearer when scholarship regarding their governance becomes both broader and deeper."
>
> Henry Hansmann, 2013

Co-operative firms are understood, in this paper, as mutual benefit organisations created by self-organised principals to protect the participation rights of their membership with the aim of satisfying its needs. These are directly invested of the responsibility to define and pursue the objectives of their organisation.[1] Co-operatives do not, as a norm, maximise private returns accruing to the investment of financial capital. They are usually controlled on an equal voting-right basis by different typologies of patrons (e.g. producers, workers, consumers) or by a mix of them (multi-stakeholder co-operatives).

Since the organisation is created to pursue objectives other than the ones of investors, private objectives vested in external owners are substituted with mutual-benefit aims. This puts the burden of the fulfilment of economic, financial, and organisational requirements directly on the self-organised principals.[2] However, the co-operative duty to act in the best interest of its members is put under strain when there is no alignment between the aims of co-operation and individual behaviours. To address this issue, this paper explores the institutional elements of co-operatives, focusing on those that regulate individual behaviour and outcomes. Specifically, we relate outcomes with the interplay between specific individual values and motivations on the one hand, and firm governance and objectives on the other, through the mediating role of the incentive structure. We also suggest that effectiveness responds to the ability of self-defined rules to foreclose the risk of opportunism and, in so doing, allow the achievement of the desired outcomes.

Among the different literatures, new institutional, behavioural[3] and evolutionary[4] economics have provided insights on specific aspects of economic choice in mutual benefit organizations, each of these in its own merit but without providing a comprehensive framework.

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[1]Mutuality is considered by various authors to be directly linked to the reciprocating behaviour of the involved actors (Bruni, Zamagni 2007) and to inclusive versus exclusive preferences (Sacchetti 2013).

[2] External financiers have, as a norm, limited incentives to invest in co-operatives, both because private returns to specific assets are much reduced with respect to for-profit firms, and because the lack of control rights increases the risks of losses and of morally hazardous behaviours by the self-organised members.

[3] Analyses of individual behaviour carried out by the behavioural school question the hypothesis that every human action, and especially every economic action, is governed exclusively by self-interest. Behavioural economics maintains instead that human actions spring from a mix of motivations and preferences. The approach of behavioural economics was firstly inspired by developments in social psychology (e.g. DeCharms 1968; Deci 1975), which took into consideration the relevance of intrinsic and non-monetary motivations. Then it sprang in economics in connection with the doctrine of limited rationality (Simon 1979) and decision-making under risk (Khaneman, Tversky 1979). Frey

New-institutionalism represents one of the most influential schools in the understanding opportunistic behaviours facing asset specificity, contrasting interests and asymmetric information (Williamson 1973; Jensen, Meckling 1976). This approach is also crucial in the study of the management of common pool resources (Ostrom 1994). The assumption is that individuals are self-seekers utility maximisers. Consistently, motivations are mostly taken as exogenous to the explanatory framework. The development of a comprehensive approach to co-operation, nonetheless, requires greater emphasis on members' motivation and wellbeing. Specifically, the nature and persistence of motivations is crucial in evidencing the capacity of the organization to fulfil its duty towards the members. In non-traditional forms of enterprises motivations are not exclusively related to the monetary element. Albeit this is an important driver too, since the outset principals attach value also to behavioural aspects, such as reciprocating behaviours, inclusion in strategic choice, fair procedures, and socially oriented goals (Rose-Ackerman 1996; Ben-Ner, Putterman 1998; Leete 2000; Ben-Ner & Gui 2003; Valentinov 2007b, 2008).

If one the one hand new-institutionalism explains the 'dark side', motivational theory provides the insights to understand the 'silver lining' of co-operation. Both realities coexist and influence one another. Thus, over time, repeated opportunistic behaviours can discourage co-operators. Their trust in fellow members and inclusive attitudes would thin, negatively impacting on their motivations. By contrast, what is

(1997) evidenced the interplay between intrinsic motivations and extrinsic incentives. Behavioural economics introduce social preferences as crucial drives of behaviours. Social preferences include behaviours that are not-self-interested since people can decide driven by the interest for the wellbeing of others (altruism), by a general inclination to reciprocity (Fehr, Gächter 2000), which is as a norm intermingled with a quest for justice and equity (Fehr, Schmidt 2001; Tyler, Blader 2000).

[4] Contemporary evolutionism in the study of the economy was initiated by Penrose (1959) and is based upon the idea that organizational routines in the social world serve a function similar to genetic codes in the biotic world (Nelson, Winter 1982). Organizational routines serve as replicator codes transmitting instructions that support the behavioural propensities of the organization. Organizational routines are interpreted as interlocking equilibria of individual habits and can be equated to habits in individual behaviour, (Hodgson 1993, 2006). Routines can be renewed by organizational innovation and transmitted through imitation, and they define the potential for adaptation (survival and spread) in the socio-economic environment. According to evolutionary theory, organizational routines take the form of institutions, which can be more or less formalized, in terms of property rights, governance structures, and organizational models.

required is the formal elaboration of effective governance mechanisms that reinforce fundamental values and individual experience in a relational context. Seeing the ‘silver lining’ requires, besides democratic participation, relations based on trust and reciprocating behaviours. In this context, we suggest that the creation of an inclusive and fair environment is the precondition for alimenting the intrinsic motivation of individuals.

Building on evolutionary theory, we take rules and practices as the coordinators of the activities undertaken by self-organised principals. Rules and practices represent shared and established ways of dealing with specific operational issues that help the alignment of individual and organisational objectives (Hodgson 1993, 2006). In our case, rules and practices can be considered as evolving technologies designed to harmonise what organisations and individuals value and strategically pursue. Rules and practices can either discourage unwanted behaviours or reinforce desired ones, such as inclusive attitudes, reciprocity, respect and fairness, learning and autonomy, thus reinforcing members intrinsic motivations. (Tyler, Blader 2000, 2003; Tortia 2008).

The strategy of the paper is as it follows: in Section 1 we consider the economic nature of co-operative firms, in terms of entrepreneurial activity self-organised by non-investor principals. Section 1 introduces an example of co-operative misbehaviour in order to illustrate some of the main dangers connected with the process of appropriation and distribution of resources in inclusive governance forms. The organisational dilemmas introduced in Section 1 are taken up in Section 2, where we introduce a new framework that accounts for the monetary and non-monetary qualities of co-operatives. In particular, we argue that pluralism of values, represented also by multiple motivations, should be reflected by formal institutions, but also by self-defined rules, routines, and mix of incentives. Performance would be then assessed on the basis of such values, including monetary, and non-monetary incentives and outcomes. Section 3 concludes the chapter.

1. The socio-economic nature of co-operative firms

Co-operative firms are regarded in this paper as non-profit oriented firms. This interpretation marks their fundamental institutional and behavioural characteristics as against profit maximising firms. Profit maximisation typically depends on the economic nature and institutional features of investor-owned business firms. The latter have been conceptualised as saleable objects (Putterman 1988), which implies that owners aim at maximising market value and are in a position to sell the firm or its shares at the highest possible price. The maximisation of market value requires that expected profits are, in turn, maximised.

In the case of co-operatives firms a different process may be observed, albeit not necessarily, depending on the institutional and legal context.[5] To illustrate, let us consider the Italian and the Spanish legislations as two specific cases in which explicit emphasis is placed on the non-profit orientation of co-operatives. In particular: (1) in these countries co-operatives are required to reinvest at least part of the net surpluses in asset-locked reserves that are exclusively owned by the organisation and cannot be appropriated by members, also in the case of de-mutualisation and/or sale of the firm; (2) members rights are personal rights and cannot be sold as such on the market. In other words, the market for membership rights is excluded or severely restricted by law. Both categories of institutional constraints make the sale of the firm more difficult and less convenient, dampening the tendency to consider the organisation as a saleable object.[6]

[5] When law does not impose the non-profit orientation, as it happens in most Anglo-Saxon countries, diverse outcomes and behaviours can be observed, including profit maximising ones. These are usually linked to income maximising choices, like in the well-known Ward (1958) model of the worker co-operative, by members and to the possibility offered by law to de-mutualise and sell the organisation at its highest possible price. However, the empirical evidence shows that many co-operatives in these national contexts still behave as non-profit-maximising and/or community oriented firms, at times introducing voluntarily the asset lock and trust-held accumulated capital in order to eschew the sale of the firm at its market price (Erdal 2012).

[6]Starting from the seminal contributions by Furubortn and Pejovich (1970), and by Vanek (1970), these institutional features have attracted serious criticisms against co-operative firms, since they have been considered the source of dynamic inefficiencies in the allocation and accumulation of self-financed capital funds (Bonin et al. 1993). These considerations were initially referred to the former Yugoslav economic system, and then extended to all the forms of co-operative firms characterised by the accumulation of asset in locked reserves. However, while the ensuing phenomenon of under-investment and under-capitalisation has found weak empirical support (Bartlett et. al. 1992), these contributions have failed to recognise the positive functions of the asset lock, for example its ability to make the

As mentioned, the nature of co-operative firms is given by the need to devise mutual-benefit coordination mechanisms for the fulfilment of the social rights and needs of non-investor stakeholders. Such needs would include, for example, the stability of employment and a fair wage for worker-members in worker co-operatives, access to financial support for small producers in credit co-operatives, adequate quality and product prices for customers in consumer co-operatives.

More even distribution with respect to for-profit firms, however, does not have to happen at the expenses of efficiency. Evidence suggests that co-operatives can reach high degrees of production efficiency, at times higher than profit maximising firms (Bartlett et al. 1992). These counterintuitive results can be explained by the ability of co-operatives to implement effective coordination mechanisms that favour the mutual alignment of members' motivations and objectives on the one hand, and organisational objectives on the other.

In this perspective, a more in depth review of the economic role of co-operatives would underline that contractual structures are able to align individual and organisational objectives only in a partial way. When all the relevant welfare effects are not internalized by contracts because of coordination problems (for example due to asymmetric information, diverging interests and external effects) co-operative governance can step in as better solution. Examples are found in all typologies of co-operatives. Just to cite one, the long-term nature of work relations in worker co-operatives can be explained by the value attached to democratic participation, employment stability, and harmonization of diverging interests within the organization boundaries (cf. Depedri et. al. 2012 for evidence). The same harmonization is not possible in profit maximizing firm since workers cannot properly factor their objectives in its governance. Relatedly, profit maximization is furthered in many cases by lay-offs more than by employment stability (Navarra, Tortia 2014).

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patrimony of the organization more stable in the long term, and to represent a guarantee fund-shielding members against negative economic conditions. That is, they failed to recognize its coherence with the non-profit nature of co-operatives.

In the praxis of decision-making, consistency between individual and collective objectives can be developed by means of democratic participation and deliberation as a method for discussion (Sacchetti, Sugden 2009). Deci and Ryan (2000) supports this view by suggesting that when extrinsic goals differ from intrinsically determined needs, the wellbeing of the individual is diminished. Participative praxis in strategic decision-making (e.g. in the formation of organisational objectives) can align these goals with individual internal values and needs, improving satisfaction and wellbeing. Consistently, low use of monetary incentives and reliance on intrinsic motivations and involvement improve organisational and production efficiency, as well as individual and social wellbeing (Borzaga, Tortia 2010; Stiglitz 2009). Furthermore, both efficiency and wellbeing can be significantly enhanced when trust and reciprocating behaviours are built in organisational routines and allow the accumulation of new social capital within and outside the organization (Albanese, Villani, in this volume; Becchetti 2010; Sabatini et. al. 2014;). These remarks defy the idea that only hierarchical control is conducive to production efficiency.

This approach to co-operative governance recognises the role of motivational complexity in shaping the interplay between exclusive and co-operative behaviours and highlights the behavioural underpinnings of co-operation. To this objective, incentive mixes represent an emergent property of complex organisations whose function is to improve coherence of objectives whilst leaving their interaction open ended. While traditional economic approaches have mostly focused on monetary incentives, here monetary outcomes represent only part of the desired end results (Bacchiega, Borzaga 2001). We regard non-pecuniary aspects related to inclusive decision-making (such as learning, recognition, fairness) as the integrative foundational qualities of co-operative membership.

2. The ‘dark side’ and the ‘silver lining’: rules as constraining and enabling

The reality of co-operative experiences is varied and shows that in practice, a number of issues still call for critical enquiry. For example, failures to reach mutualistic objectives; instances of misalignment between individual and organisational objectives; the spread of opportunism and breakdowns in coordination engendered by contrasts between different members or between members and managers have been evidenced several times.

Besides efficiency considerations, other approaches acknowledge the paradoxes of formal democratic governance, as for example in Cornforth (2004) and Hernandez (2006). These perspectives recognise the incommensurable tensions that typify internal relationships between groups with different roles, such as between the board and the membership, which the board should represent; or between the board and the management, where the board's role is to assess managerial choices against the best interests of the membership. As noticed in Cornforth (2004), the relationship between the membership, the board and the management contains inherent tensions as it involves democratic participation, reciprocal support, monitoring and concentration of control power within restricted groups (Cornforth 2004; Hernandez 2006). In these contexts, the adaptability of democratic governance to emerging tensions provides dynamic strength. On the other hand, participation is also intrinsically dialectic, carrying with it the constant risk of generation of excessive governance costs.

Threats to democratically managed firms may come also from managerial slack in providing or renewing appropriate platforms for participation and engagement (Spear 2004), but also from the opportunism of the membership, rather than from managerial bias. Managerial slack and members' disengagement, however, are likely to be related. An illustration of misalignment between members' and co-operative aims comes from the United Nations Food and Agriculture Organisation (FAO), which has long aimed at increasing the welfare of farmers and communities by promoting rural co-operatives. In this context, the dangers are associated with members' short-termism, for example when users put pressures on the co-operative to distribute patronage refunds rather than re-investing them in the co-operative (Von Pischke, Rouse 2004).

An understanding of the reasons of membership disengagement from co-operative values, however, requires greater attention to the conditions and history of the organisation. Individualistic attitudes may be related not only to the close horizon of members but rather to frustration, lack of confidence or trust in the co-operative, following experiences of exclusion (when for example members' opinion is not valued) mismanagement, or fraud. Other studies on agricultural co-operatives in developing and transitional countries have emphasised cases of abuses by managers and misalignment leading to the dissipation of members' confidence and trust in the organization. Jamsen and colleagues' study on Kenyan farmer-owned co-operatives highlighted agency problems of this sort, which have been argued to be possibly mitigated by improved transparency and financial reporting, paired by the commitment of public authorities to enforce anti-fraud legislation (Jamsen et al. 1999; see also Kandathil and Varman 2007 on the substantive role of information sharing and trust in reinforcing formal ownership).

Another illustration is in Castle (2009), who describes the fraudulent conduct of some European agricultural co-operatives in the adjudication of European subsidies:

> Because the cooperatives provide agricultural equipment, farmers sometimes sign forms giving co-ops the right to withdraw money from their individual accounts, in the way that many people pay household bills. But fraud investigators found this to be happening even to farmers who had not agreed to the withdrawal of funds. At his home in the village of D., A. L. held up his statement from the Agricultural Bank of Greece for December 2005. On Dec. 28, he received a payment of €3,012 in subsidies for olive oil, even though he farms only 150 trees and would normally claim several hundred Euros. That same day, an unexplained debit removed €2,397. "No one can explain the debit," he said, "not the bank, nor the cooperative. No one can explain *how the money came into my account or who has taken it*." (emphasis added).

In this example the fiduciary duty between farmers (olive growers) and their co-operative has been exploited to carry out unlawful transfers of money coming from EU policies directed to support agricultural co-operatives. In other words, a positive feature of co-operation, that is horizontal relations based on trust between members and the organization, which in positive conditions can substantially reduce transaction and governance costs, has been used to hijack European subsidies. These cases exemplify situations in which the inability of working rules and of public control to deliver effective solutions to governance dilemmas can engender vicious spirals that eventually endanger the viability of the co-operative venture as a whole.

Management, in particular, enjoys a degree of discretionality in the choice of organisational conduct, given the basic normative framework. Contributions have highlighted critical elements in the emulation of the practices and strategies adopted in conventional businesses inducing membership apathy and mining the sustainability of the co-operative organization (Spear 2004). Also, In light of this observations, inclusive governance requires an understanding of the conditions under which individuals accept to behave co-operatively, as against free riding and opportunism, which are recurring in co-operatives and cast doubts on whether co-operatives represent a relevant alternative to dominant organizational forms and welfare-increasing governance solutions (Lichtenstein 1986).

Few studies, however, have addressed what enables self-organised entrepreneurial ventures to be both efficient and effective. Our suggestion, in line with the institutionalist tradition led by John Commons (1931), is to focus on the interplay between values, rules, behaviours and outcomes. Specifically, institutions empower individuals, being <<collective action controlling, liberating and expanding individual action>> (quoted in Mirowski 1987: 1020). In this respect, organizational routines and working rules manifest their dual role of limiting deviant behaviours on the one hand, and promoting individual wellbeing on the other. The implementation of constraining rules serves as a precondition for controlling opportunistic behaviours, while inclusion in the definition of organisational objectives enables representation of the members' interests. Inclusion, moreover, sustains resilience to a changing environment by supporting the regeneration of intrinsic motivations (Borzaga, Tortia 2006; Sacchetti 2013).

3. The definition of a comprehensive framework of analysis

The basic institutional structure of the organisation is typically defined by law and requires compliance by the members of co-operatives. The legal framework reflects a number of consolidated values to which the principals choose to adhere in the first place. Variation, however, occurs. Governance and working rules specific to each single organisation are usually inscribed in specific organisational practices as well as in other forms of self-regulation, depending on members' discretionary decisions (Ostrom 1994). Changes in practices and internal rules occur thanks to the tensions that inevitably originate from experience. Such tensions can exist, to different extents, despite the level of specification of the legal framework or of internal rules. Both in fact can be progressively refined to acknowledge their interaction with the practical conditions and outcomes of self-managed activities. Within the organisation, in particular, formal rules but also routines and shared practices are subject to change. The open-ended nature of institutional evolution has to do, in this case, with the ever-changing features of rules inside each single organisation and relates to the firm's survival and expansion potentials. We refer here to the concept of ontogenetic evolution, more than to the concept of phylogenetic evolution of the institutional set-up of the organisation (see Hodgson 2006).

Legal and self-defined rules together identify criteria for managing co-operative assets and for distributing returns. The multiplicity of perspectives on how to achieve members' welfare through resource allocation can generate, as pointed out, several tensions among groups at different governance levels, the reason being that the utilisation and distribution of surplus is 'subtractive' (Poteete et al. 2010).

Over time, whilst using in-built rules as empowering features for members, co-operatives need to monitor, identify and foreclose inconsistent behaviours that would hamper the survival of the organisation as much as the trust and motivation of other members. Ideally, when reflecting the needs, values and objectives of members, regulation enables common activities to develop consistently with individual fulfilment. We regard therefore internal governance as a set of rules, derived from the law as well as from the shared understanding of co-operative values inside the organisation, that are functional to the expression and accomplishment of individual values and to increased members' well-being. Their role is to provide a space where individual values and interests on the one hand, and the organisation's basic aim and principles are harmonised.

3.1. The design and diffusion of self-defined rules

Members in self-organised enterprises define and implement the working rules governing the organization without resorting, at least as a matter of course, to external enforcement. In many instances, detailed knowledge of the production process and of the socioeconomic context allows members to design rules which are more effective in terms of their ability to lead to desired results (forestalling negative behaviours and empowering positive ones) than what external regulators would be able to achieve. We see this as a sheer possibility, whose actual realisation is not guaranteed and requires specific conditions, especially in terms of the consistency of rules, practices and behaviours with both individual drivers and collective objectives. In particular, low social capital and trust amongst members could exacerbate control pressure, hamper communication, constrain knowledge and ideas, impact negatively on deliberative processes and, ultimately, erode members' motivation (cf. Ostrom 2010; Nahapiet, Goshal 1998; Grant 1996; Kogut, Zander 1992).

Because values evolve over time, subject to experience, similarly rules are understood as evolutionary entities that need to be historically contextualised and tested (Dewey 1977; cf. Sacchetti 2013, for an analysis of Dewey's perspective on values and preference formation). The initial need to which a self-organised membership attaches value is reflected in their activities and in elected common rules of behaviour. Rules and practices (whether they enable action or define boundaries to it) are directed to this primary aim. As an illustration, consider sanctions. The definition of sanctions is not the main aim of self-defined rules in co-operatives, but their role is crucial, at least as 'potential threat' against opportunism and malfeasance, to allow the proper deployment of the activity.

Incompatible behaviours are not likely to be frequent when individual values, motivations, organisational objectives, and the incentive structure are consistently aligned and re-aligned over time. Complementary, the on-going self-selection of members on the basis of shared values, and the establishment of organisational procedures coherent with those values allow co-operatives to benefit also from a reduction of transaction costs engendered by short-term individual interests, opportunism and dishonesty. Indeed, control costs have been shown to be lower in co-operatives than in conventional corporations (Bartlett et al. 1982; Hansmann 1996).[7]

3.2. The governance of common pool resources

Democratic participation implies that the outcomes and the procedures concerning each individual member depend also on the preferences expressed by other members (Stikkers 2011). For this reason and because of the nature of their assets, co-operatives portray some of the features of common pool resources: the value added produced and resources more generally are rivalrous, but at least partly non-excludable. Rivalry in the destination of resources is related to the scarcity and exhaustibility of resources. In parallel, non-excludability is one of the most characterising features of co-operative firms, and derives from the inclusive nature of ownership rights and governance in democratic organisational settings. Decision-making and ownership rights guarantee members to have equal access to the management of common resources and to the distribution of the value added produced. Given non-excludability, behaviours such as managerial slack, free riding and opportunism will have the effect of eroding co-operative resources, ultimately impacting on members' will to endure in the organisation.

The role of rules is to govern access to decision-making and resources in the long-term interests of the membership. The solutions to the appropriation of resources under non-excludability present similarities

[7] Still, respect of reciprocity and conditional co-operation represents necessary conditions for achieving organisational efficiency and individual wellbeing, while and punishment of defectors tends to emerge endogenously to limit deviant behaviours (Fehr, Gächter 2000; Fehr, Fischbacher 2002).

with those envisaged for common pool resources. Ostrom (1994) has demonstrated that self-organised principals can govern common pool resources in an effective way, in many cases more effectively than in the presence of outside control under private or public property. This is possible through the evolution of *ad hoc* rules reflecting context specificity. Defined in this way, rules recognise the interaction between the organisation and its environment, which involves, for example, recognition of specific socioeconomic needs, the type of resources available, the characteristics of activities and production organisation, as well as cultural elements, such as the relational qualities and values background of the self-organised principals. It follows that rules change as needs and objectives evolve, as the organisation and each individual within it interacts with a mutating environment. Given the existence of interconnectedness, co-operatives evolve jointly with the evolution of the principals' values, as well as by suggesting novel solutions to old problems.[8]

In this spirit, appropriation procedures are created, approved and implemented by the same members of the organisation in order to ensure the economic sustainability of activities over time. Because of their nature, a long time horizon is crucial for co-operatives. A short-term perspective would, by contrast, reduce or slow down future appropriation by the same patrons or by new members.

Because of rivalry and non-excludability, conflict is however always a looming risk in entrepreneurial forms run by self-organised principals. For example, the socialisation of new members in the co-operative can jeopardise consolidated practices and generate conflict even in the presence of established rules and routines. This would occur, for instance, when new members join without having ever experienced co-operative praxis and behave as if bonds of reciprocity, inclusion and long-term relationships were not relevant in collective decision-making dynamics. Vice versa, old members may lose perspective over the

[8]Interconnectedness between individuals, the organisation, and other environing conditions can be analysed by introducing, although not in this paper, a dynamic analysis of the continuous adjustment of individual needs and preferences on the one hand, and of organisational change on the other. In this perspective, change in organisations must reflect change in individuals' desires and objectives. The rules underlying the governance of organisations are considered, therefore, as dynamic and plural. We suggest that, to reflect evolutionary dynamics, organisations need to attach value to those processes that keep up the interaction between rules and individuals' historical evolution of values (Sacchetti 2013).

evolving socioeconomic context, failing to acknowledge new needs, preventing access to emerging stakeholders and therefore allocating co-operative resources ineffectively.

3.3. Incentive mixes as a reply to specific values and individual motivations

When we argue for the need to match individual and organisational objectives, we inevitably acknowledge an evolving equilibrium between what the individuals assess as valuable and what is recognised as such by institutions at different levels. The continuous scrutiny of rules is crucial, as mismatching would lower the individual feeling of fulfilment and, therefore, wellbeing.

A non-secondary consequence of the mismatch between individual values and organisational rules would be the emergence of X-inefficiency, for example in terms of members' reduced involvement and commitment, or the rise of behaviours that resist organisational strategies (Leibenstein 1966). Because of these reasons, control and other organizational costs would rise. Orthodox approaches have prescribed a number of remedies, ranging from increasing hierarchy to tightening control and pay for performance (Lazear, Shaw 2007). All these cures are liable of increasing costs without guaranteeing expected efficiency (Frey, Osterloh 1999; Akerlof, Kranton 2000).

One of the consequences of command-and-control relations has been argued to be the generation of strong biases on individual willingness and capability to use their voice and creativity, thus further reducing self-determination and, therefore, overall satisfaction. The negative impact on the desire to participate would then reinforce controlling practices and engender a vicious cycle of dissatisfaction and feeling of "not counting" (Ryan, Deci 2000; Sacchetti et al. 2009).

In self-governed organisations, however, the imposition of hierarchical and exclusive rules is more difficult and more likely to be ineffective, since members with equal rights will tend to reject decisions that do not respect inclusion, equality and mutuality. It follows that the rules and practices of co-operatives need to be shaped on the specific values of inclusion and democratic participation. The desire to reach consensus through deliberation needs to replace authority and exclusive transacting as a decision-making praxis (Sacchetti, Sugden 2009).

Self-organised principals will choose a mix of incentives, which apprises co-operative motivational drivers consistently (Bacchiega, Borzaga 2001). Whilst traditional microeconomic textbooks argue that monetary incentives are the main drivers of efficiency, evidence suggests that rules limiting negative outcomes and reflecting participants' shared values can be crucial for performance. Production efficiency, thus, comes to depend on values beyond monetary incentives at more fundamental levels. In particular it has been argued that monetary incentives should be adequately balanced with non-monetary ones, and match individual motivations that do not have a specific monetary equivalent. Intrinsic motivations often drive individuals because they feel a deep interest in the activity carried out. This is true whether this interest entails increased monetary remuneration or not.

Cultivating intrinsic motivation benefits members and the quality of activities. Recent results coming from the analysis of workers' motivations in social co-operatives demonstrate that stronger intrinsic motivations are also linked to better worker performance in terms of effort and productivity. In turn, they are also likely to positively impact on monetary remuneration (wages) (Becchetti et. al. 2013). This does not imply higher costs in co-operatives with respect to conventional firms because the average level of wages is usually lower in the former (Pencavel et. al. 2006).

3.4. Interaction between layers of governance

The overarching message coming out of our discussion of production governance and its impact on membership has placed emphasis on the idea that linkages exist not only conceptually but also empirically between individual members’ values and normative principles, formal and substantive aspects of internal governance, and the welfare of membership. The reversed pyramid in Figure 10.1 below exemplifies the interplay between the different elements in the framework. It accounts, in particular, for the interaction between the individual and the institutional structure (Hodgson 2007). The organisation is represented as a stratified entity where the different layers interact through specific connectors: rules, individual norms of behaviour, and strategies. At the first layer of the pyramid are the basic institutions, such as control and appropriation rights, which usually undergo a high degree of legal formalisation. Control rights are binding in defining who has access to decision-making; however they do not univocally define how resources are managed (Layer 1).

This pertains to the internal governance of strategic choice making, which is crucially influenced by the organisation’s structure and working rules (Layer 2). The process of evolution of control rights is likely to take place in the long run (Williamson 2000). It follows that control rights can be considered as given and their evolution framed in terms of ontogenetic, more than phylogenetic evolution (Hodgson 2006).

The second layer reflects the means through which the aim is pursued. In this case formal governance connects control rights with the working and final aims of the organization. Working rules, which implement formal governance, can be thought as at least partially defined by the self-organized principals, which exploit their knowledge of organizational aims and production processes. The nature of governance, at this level, is chosen by the self-organised principals, reflecting their values and related objectives. By framing values and objectives, self-regulation determines also the criteria for assessing, internally, individual behaviour.

<Place Figure 10.1 here>

The achievement of a fair environment is crucial in enabling participation, as the latter would work only when relations inside the firm are based on trust and reciprocating behaviours, since with participation each individual position is not independent from the positions and behaviours of the other members.

While in new institutionalism opportunism has a substantive role in individual behaviour (opportunism as self-interest seeking behaviour with guile in Williamson's words), in our framework opportunism represents just one possible (and deviant) behavioural pattern (Williamson 1987). The overcoming of opportunism is never excluded when proper controls and involvement procedures are designed. Hence opportunism is conceived as a potential obstacle to the accomplishment of co-operative behaviours, and to the flourishing of individual motivations, rather than as an ontological feature of all human beings (Ben-Ner, Jones 1995).

The constraining feature of rules is not meant to impair individual potential, but to ensure that an individual's right to participate and share results is respected. Rules that inhibit inclusion, from this perspective, would be perceived as unfair and have the undesirable effect of undermining motives directly related to intrinsic values. Such motivation is impaired also when rules are perceived as external to the individual (Frey 1997). One way to align individual needs and organisational rules is to put in place processes of adjustment which can modify rules to reflect the evolving, shared needs of members.

The third layer represents the expression of actual outcomes, in terms of members' wellbeing and organisational survival. Members' welfare represents the highest attainment of the organisational structure insofar as it increases individual wellbeing, and accomplishes the actualization and the regeneration of intrinsic motivations (Layer 3). Our scheme, therefore, identifies the benchmark for assessing the combined action of control rights, governance, working rules and inter-firm linkages in enabling the full expression of individuals' inner values, whose full expression in the organisational realm requires adequate institutional preconditions. Under appropriate governance conditions, that is the mutual adjustment over time between individual values and the aims and principles institutionally recognised, these conditions appear particularly favourable in self-organised, mutual-benefit entrepreneurial ventures, given their inclusive, non-profit oriented and democratic orientation.

4. Concluding remarks

In developing our three-layered framework for explaining the links between the choice of aims and principles (through governance), the choice of means (through incentives), and outcomes (in terms of members' welfare and economic sustainability), we have placed the individual dimension of motivations and needs at the top of our pyramid. By reversing the pyramid up-side-down we have, at the same time, overturned the order through which we look at the elements underpinning economic decisions, to emphasise that the fulfilment of individual needs and the full expression of individual values is also a result of the interaction with the institutional and organisational spheres. In fact, if on the one hand, we have suggested that what is ultimately distinctive in explaining the choice of rules by the same principals who create and run the organisation is the principals' set of shared values and objectives, on the other hand we have also emphasised that, once defined, rules can reinforce or discourage particular forms of behaviour, thus impacting on individual motivations and organisational performance.

Overall, the reciprocal influences between individual motivations, organisational objectives, and the institutional framework have been given special focus because of their role in promoting consistency between the individual and the contextual level, working toward the improvement of individual satisfaction and wellbeing (Dewey 1977; Deci, Ryan 2000). We have argued that the incentive mix offered by non-profit oriented firms places great emphasis to the appraisal of non-material returns, without ruling out the need to satisfy individuals on both pecuniary and non-pecuniary grounds. In considering co-operative firms as entrepreneurial associations driven by self-organised collective action in which members are granted democratic and non-saleable control rights, we have also set organisational resilience and members' welfare as the benchmark for assessing appropriation and distributional rules.

Our conclusions reinforce that attained outcomes can be explained only by considering the interconnections between diverse institutional levels and by using a comprehensive approach to the evolution of governing rules and practices within co-operatives. Specifically we have identified long-term performance in terms of organisational and motivational resilience, since both elements contribute to the material and immaterial prosperity of the members. The governing rules that contribute to such outcomes must balance two features: the creative and the binding. If, on the one hand, the definition of rules leaves space for the expression of specific values and enables principals to creatively shape the organisation’s governance, on the other hand rules are also directed to foreclose opportunistic behaviour and guarantee a high degree of compliance with collectively defined objectives.

Figure 10.1. Institutional and governance level, values and motivations