New institutional economic theories of non-profits and cooperatives: a critique from an evolutionary perspective

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1. Introduction

- The interest of economists has generally been focused on two particular forms of social enterprises: non-profit organizations (NPO) and cooperatives
- They heavily relied on tools offered by new institutional economics (NIE)
- Objective of the paper:
  - To review the different new institutional economic theories applied to NPO and cooperatives
  - To present some criticisms addressed to NIE. 3 different levels of analysis
    - the individual level
    - the level of the firm
    - the intra-organizational level
  - Proposals to overcome these flaws

2. New Institutional Economics and its two subdivisions

- Firms are institutions that constitute coordination forms substitutive to the market and that allow to minimize transaction costs (Coase, 1937)
  - Costs of contracting VS costs of ownership

New Institutional Economics

The contractualist approach *(Alchian & Demsetz, 1972; Jensen & Meckling, 1976)*

- Need for controlling agents' behavior in a context of asymmetric information
- Main task: defining contracts such that they generate the appropriate incentives to limit opportunistic behaviors stemming from institutional failures
- The firm as a "nexus of contracts"
- best-known example : agency theory (Jensen & Meckling, 1976)

Transaction cost economics *(Williamson, 1975, 1985)*

- 3 essential postulates
  - agents' bounded rationality (Simon 1955)
  - presence of specific assets
  - possibility of opportunistic behaviors
- « Incomplete contract » theory (Grossman & Hart, 1986; Hart & Moore, 1988)

3. New Institutional Economics and theories of non-profits

Hansmann (1980)

- NPO are less likely to exploit market failures than their for-profit counterparts due to their non-redistribution constraint of benefits,
- Competitive advantage for the production of goods and services characterized by a high degree of trust and unobservable quality, such as health care or education

Weisbrod (1975)

- private answer to the inability of the State to face the heterogeneity of demand for public goods

Ben-Ner (1986)

- focus on the creation of NPO by demand-side stakeholders (consumers, government, donators…) in order to maximize the control they have on them in a context of asymmetric information

4. New Institutional Economics and theories of cooperative firms

- Emergence of cooperatives
  - although cooperatives can, in many cases, distribute profits, this distribution is constrained in various ways (Levi, 2005)
  - this surplus generally goes to the members of the cooperative themselves.

  ➔ cooperatives are supposed to be less likely to exploit information asymmetries
  - Attractiveness of the cooperative form to allow producers or consumers to face monopolistic or oligopolistic situations
- Performance of workers cooperatives
- Lower frequency of cooperatives on markets as an evidence for their relative inefficiency compared to hierarchical organizations ➔ "Efficiency test"

5. A Critique of New Institutional Economics (1)

Level of analysis	Criticized hypothesis	Proposals
Individuals	Opportunism	Introduction of intrinsic motivations
	Bounded rationality	Introduction of learning processes
Individual organization	Neglect of non-contractible elements; neglect of learning processes	Explanation of the emergence of firms in terms of routines
Intra-organizational	Neglect of the environment and history	Concepts of institutional complementarities, frequency-dependence and path-dependence

5. A Critique of New Institutional Economics: the individual level

Bounded rationality

- Invoked to justify the incompleteness of contracts
- No room in Williamson's theory for the learning processes that this notion would imply if it were entirely accepted

Opportunism

- Only purely extrinsic motivations?
- There exist other ways of solving agency problems than through the implementation of monetary incentives, sanctions and monitoring devices
- Several aspects of principal-agent theory within NPO and public organizations integrating agents' intrinsic motivations (François, 2001; Besley & Ghatak, 2005; Valentinov, 2007, 2008; Naegelen & Mougeot, 2011)

5. A Critique of New Institutional Economics: the level of the individual firm

- The firm as a tool for coordinating and processing knowledge
- The concept of routines
  - problem-solving procedures repeatedly applied by firms to adapt to their environments
  - *Organizational memory* and *main replicator* of the firm
- Other explanation for the existence of firms
  - Protected and unified cultural spaces to allow for learning, both individual and collective
  - Appropriate framework for the forming of non-contractual elements that are necessary for the negotiation and the conclusion of contracts, such as trust or moral norms
- Why do some managers decide to create social enterprises?
  - Each firm possesses a singular set of routines that constitutes its own "core competency"
  - These organizational forms allow for the development of competences and routines that are particularly well adapted to respond to the challenges they seek to take up

5. A Critique of New Institutional Economics: the intra-organizational level (1)

Standard theory: methodological individualism

- The macro level simply consists in the aggregation of microeconomic data, postulating, when needed, the existence of a representative agent

evolutionary perspective

- **Macroeconomic aggregates**: endogenous patterns of the system as a whole that « emerge » from complex and dynamic interactions of the micro elements, between each other and with their environment, so that the whole cannot be explained by the simple sum of the parts
- Importance of supra-individual factors, such as the influence of **history** or of the **economic environment**

5. A Critique of New Institutional Economics: the intra-organizational level (2)

- Influence of **history**: the notion of path-dependence
  - current institutions are partly determined by historical trajectories and past institutional choices
  - Case of the cooperative firms in nineteenth-century England (Everett & Minkler, 1993)

5. A Critique of New Institutional Economics: the intra-organizational level (3)

Influence of the economic environment

Institutional complementarities

- reinforcing mechanisms between institutional arrangements, so that the presence of each one permits or fosters the existence of the others
- complementary relationship between local banking institutions and cooperative firms in Northern Italy (Gagliardi, 2009)

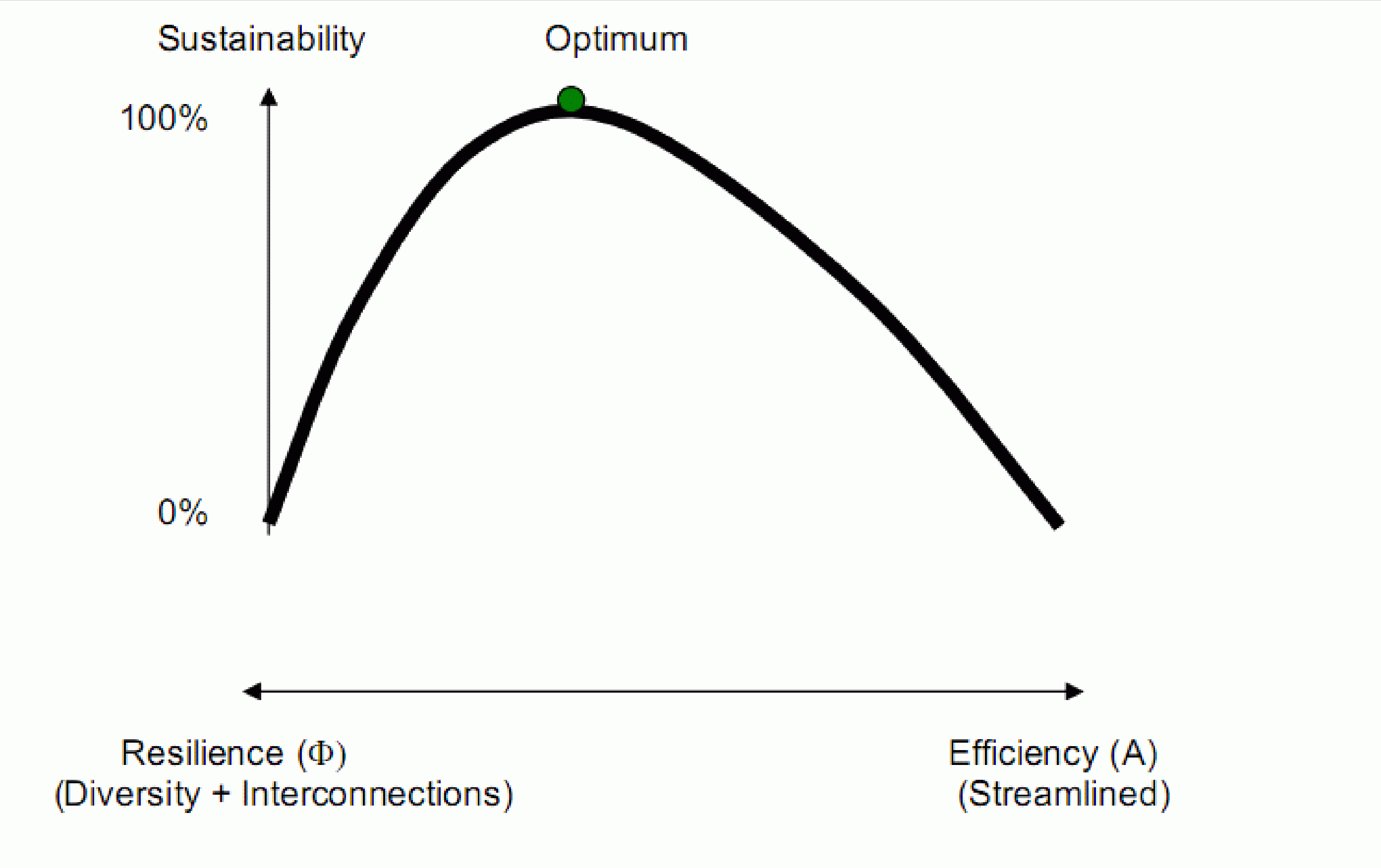
frequency dependence

- The weaker presence of an organizational form on the market may not necessarily be due to an intrinsic inferiority in terms of efficiency, but might be explained by the fact that it has not reached a critical mass of similar units in the population
- Mondragon cooperative group in the Basque region of Spain
- Clusters of social cooperatives in Northern Italy

6. The status of social enterprises in evolutionary and complexity economics (1)

- Organizational diversity as one of the essential elements of the sustainability of our economic systems
- complex systems theory
  - any complex system needs variety
  - Ulanowicz et al (2009) and Goerner et al (2009)
    - 2 fundamental parameters for sustainability
      - Efficiency: ability of the system to process energy, matter or information flows
      - Resilience: stock of diversity of actions to recover from a disturbance, a shock or a change in the environment
      - sustainability: optimal balance between the two
    - Both correlated to the level of diversity and connectivity of the system, but in an opposite way
  - Considering efficiency as the unique criterion of vitality of the economic system leads society to a large-scale economic instability

6. The status of social enterprises in evolutionary and complexity economics (2)



Source: Lietaer et al (2012)

Thank you for your attention.

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