

The value of measurement, or measuring the ‘co-operative difference’

Keynote address

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“In an increasingly performance-oriented society, metrics matter. What we measure affects what we do. If we have the wrong metrics, we will strive for the wrong things.”

MISMEASURING OUR LIVES

Joseph Stiglitz, Amartya Sen and Jean-Paul Fitoussi

“I hold a firm belief: We will not change our behaviour unless we change the ways we measure our economic performance.”

Nicolas Sarkozy

Metrics matter

Metrics matter. They particularly matter to co-operative businesses. Co-operatives are a different kind of business, yet they spent the latter half of the 20th century trying to prove they are not different, and thereby became invisible (Kalmi 2007, Webb 2009). Why is that? In part, the reason behind it is that they functioned in an economic environment dominated by the notion that individual ownership of assets, in search of profit, is the only way to reach efficient economic outcomes, and the way to individual ‘freedom’. This predominant view in neoclassical economics also dominated the creation of less than supportive institutional environments for co-operatives and contributed to the lack of understanding of the co-operative difference.

Meanwhile, the prevailing economic thought about the co-operative form of business since the seminal paper by Benjamin Ward in 1958 has been that co-operatives as a collective of self-centered individuals maximize their own benefit to the detriment of the group. So the co-operative model is inherently unstable, and it is just a matter of time before it would de-mutualize and turn into an investor-owned firm (Webb&Webb, Ben-Ner 1984, and others). Institutional economists offered another set of reasons for the co-operative demise – co-operatives cannot compete in the market place simply because they are inefficient. If they were efficient, there would, apparently, be more of them (Hansman 1996).

Efficiency. What is it, and how is it measured? Technical efficiency assumes minimal throughput of resources for a given level of production. Co-operatives need to be efficient. Economic efficiency, on the other hand, talks about the least costly use of resources for the given level of production. Economic efficiency is behind the predictions of doom and gloom of the co-operative sector. How is it measured? Take your capital resources, your natural resources and your human resources and use them in a least costly combination to produce a unit of output. Between a more costly human and a less costly human, one would opt for the latter; a more costly environmentally friendly process loses out to a less costly polluting one. Are cooperatives inefficient? If they do their job right, they most likely would be inefficient by these standards. The Mondragon group's longevity, innovativeness and resilience can be attributed precisely to 'inefficiency', because they do things differently – they deliberate on institutional changes, they share profits among the group, they do not lay off employees, they invest in training (Arando et al 2010), and that is their competitive advantage. So co-operatives need to set their own standards and measure them.

Growth. What is it and how is it measured? We measure growth either as growth in sales, growth of net income, or growth of dividends. Net income, or profit of the firm, is calculated when all the costs including labour, are subtracted from the revenues. The return to investors increases with increase in net income and/or dividends. This bottom line -increasing the return to investors - forces a business to continually show larger and larger earnings, or growth. Profit may be reinvested in the business, since investors gain in the secondary shares market by mere expectation that the firm will grow. Are co-operatives under the same pressure? They are not. Their net incomes may be smaller because they pay people better wages (Suma, 2010) and invest in training; their growth strategies will be different because they may want to spin off other co-operatives, or start up new ones, rather than become

larger themselves (Zevi et al, 2011). They may build networks to secure scale economies. Co-operatives need to measure and report that.

When co-ops measure growth using the same financial data as investor owned firms, and they measure efficiency using the minimum cost approach, they ‘mis-measure their lives’, to borrow the words of Stiglitz, Sen & Fitoussi, and look more and more like the investor owned business.

What do co-operatives need to measure and why?

First we need to answer the question: what do co-operatives do, what do they strive for? That seemingly straight forward question has not been easy to answer within the (capital) ownership logic of the leading economic theory of the past fifty years. Ownership rights imply control rights and rights to residual income. Since the firm’s managers work on behalf of the owners, there is no difference between a co-operative and any other firm – whether owners are a group of consumers, or a group of investors, the firm is simply managed the same way on the owners’ behalf; so goes the story. There is no inherent difference between the two types of firms. Co-operatives owned by their members are treated the same as any club owned by the members. Worker co-operatives where members are employees are the same as any other employee- owned firm. That is the prevailing understanding of the co-operative form of business, with its implications for management training and education, general public understanding of the co-operative model, and policy-making affecting co-operatives. Anyone working in a co-operative or a credit union knows the difference, even if they cannot quite ‘put their finger on it’.

So, measurement matters. For co-operatives, it matters on at least four fronts, from micro to mezzo and macro level. It matters for: I. Understanding the different business model with its purpose, advantages and disadvantages; II. Understanding how the co-operative identity (ICA 1995) creates a strategic advantage in the business context, particularly in this day and age of financial crisis and discussions about social responsibility of firms and de-growth of the economy; III. Understanding of the impact of co-operative sector on people and communities to influence policy; and IV. Achieving public awareness of the size, the scope, and the benefits of the co-operative sector, and its promotion.

We turn to each of these objectives, with an attempt to identify what needs to be measured and why.

I. Understanding the different business model with its purpose, advantages and disadvantages

If co-operative business is no different from investor-owned business it is difficult to develop a rationale for its existence. The greater the difference based on co-operative purpose, values and principles the stronger the rationale and the greater the contribution to meeting human need and making the world a better place.

Robb, Smith & Webb 2010

Co-operatives are owned by their member patrons and exist to serve their members; they distribute profits or surpluses according to patronage and not according to investment. In addition to their business activity, co-operatives also provide goods and services for which no market values are available: they are active in community development, member education, and government lobbying on behalf of members and are often regarded as providing a training ground for participatory management and democratic governance. The specific features of the cooperative form of organization are sufficiently distinctive to suggest that cooperatives may pursue different objectives from investor-owned firms.

Parliament, Lerman & Fulton 1990

Are co-ops different? If co-ops *are* different, they need to understand that difference, measure it, and use it to their advantage.

We can summarize the nature of co-operative business compared to the investor owned firm (IOF) examining their functional features:

- i) A co-operative is incorporated by a group of people – its founding members- who run the business democratically, and contribute to its capitalization. The motivation is often rooted in social justice, but also market and government failures. Investor-owned businesses typically incorporate to increase their owners' net worth, i.e. maximize the return on investment. The founding investors need not be engaged in the business operations, while co-operative members govern the co-operative and use its services.
- ii) The goal of a co-operative is to meet member needs and increase the human value, as opposed to increase the return to capital investment. In worker co-operatives this may imply providing meaningful jobs, job security, having control over one's own work,

decent pay, and personal growth (training, knowledge, education). In other types of co-ops it may be securing ethical and healthy products, education, insurance, or access to credit. Measuring the value of the co-op to members and stakeholders would highlight this difference (Parliament et al 1990).

- iii) Co-ops are democratically managed and governed. Various indicators of democratic functioning are available, but co-ops also need to capture the perceptions of democratic governance by their members. How democratic a co-op is perceived to be may differ from the conclusions made by the use of indicators measuring turnout in meetings, for example. It is therefore important to use both types of measures.
- iv) Technical efficiency means minimizing throughput of resources per unit produced. This includes sustainable practices, for example. Since co-operatives are likely to internalize the externalities (Novkovic 2008), they need to measure their costs (such as the cost of 'being green'). At the same time, in line with co-operative values, co-operatives should not minimize the return to the human factor. Measuring the income differential, income equality, employee satisfaction, training and development will ensure that this co-operative purpose is satisfied. Co-operatives also need to include employees in decision-making. This approach typically results in increased productivity, so co-ops should measure the productivity rather than profits (The National Centre for Business and Sustainability 2003).
- v) Cash flow is needed for day to day operations in any type of business. Co-ops need to sustain the labour force, carry out democratic governance, hire inputs, and the necessary infrastructure, so a co-operative needs to measure its cash flow capacity (use operating cash flow measures in co-op accounting).
- vi) Investor owned businesses typically adhere to the minimum standards of social responsibility, but having been under public pressure over the past few decades, they are also increasingly seeking regulation to level the playing field. They are therefore leaders in efforts to standardize the requirements for environmental and social responsibility (Harris 2006). The impact on the outside world by co-operatives is multi-layered. It is partly captured by internalizing the externalities (i.e. a different way of doing business, which may be more costly to do and needs to be measured); partly by charitable contributions; but also in part by their strong territorial character.

We discuss this further in part III below. Some important tools to measure these relationships are Sustainability reports and Social audits. Many tools need the human component based on surveys, since perceptions are critical in people-centered businesses.

There is a consensus in the literature that co-operatives produce social value, or public goods. The ‘competitive yardstick’ role is one such value, since its effect does not benefit the co-operative organization, while it does impact members as well as the rest of the economy. Co-operatives also provide goods for which market valuation does not exist. Based on a survey of co-operatives in the dairy industry, Parliament et al 1990 collected some examples of non-market services provided by co-operatives, such as “providing educational programs for farmer members in areas of management and production, offering a form of insurance through milk loss coverage for farm disasters, improving quality control at the farm level through the use of field agents, promoting consumption of milk and dairy products through programs on nutrition, interfacing between the farmer members and state cooperative associations, and lobbying government.”

Assessing and evaluating those non-market functions is important to our understanding of the ‘cooperative difference’. The assessment of the value of co-operative to its members, rather than simply the price differential, would more accurately assess the social function and value of the co-operative.

II. Understanding how the co-operative identity (ICA 1995) creates a strategic advantage in the business context

What role do co-operative values and principles play in the internal interactions and processes? Co-operatives are committed to participatory management and democratic governance. This is one critical component of the difference, but there is no other business form operating on the set of internationally recognized values and principles. Co-ops need to capitalize on that advantage.

If co-operative values inform business decisions on all levels, the co-operative brand will create trust and loyalty of members, but also customers, employees and other stakeholders

sharing these values. Each co-operative may need to examine what these values mean in the context of their business. Here are some examples: a co-operative bank reducing interest rates on loans used for purchase of hybrid vehicles; an agricultural co-operative with producer-members involving their employees in profit sharing; a food co-operative increasing prices on unhealthy products; a worker co-operative selling only fairly traded products, and so on.

But besides marketing, product and pricing policies, each co-operative is a business that needs to treat people with a difference. Co-operatives are often on the ‘best employer’ lists, ‘most socially responsible’ lists, ‘most democratic’ lists, and other lists put together by various agencies. Without the right measures, they would remain anonymous. But the co-operative sector also needs its own measures of adherence to the principles and values. A number of tools and measures are already in use or in development, but a more concerted effort to benchmark ‘cooperativeness’ may benefit the sector. While there may be some co-operatives who will not care for such measures, those who subscribe to the co-operative values and principles will be able to use their ethical stance to their advantage. Besides being able to turn the principles into a strategy tool in competitive markets, measures of adherence to the values of co-operation serve other purposes as well – they weed out ‘phantom co-operatives’; they assist co-operatives in shaping up the organization through a democratic dialogue; they reduce the probability of demutualization; and they assist in consensus building (of particular importance when members are heterogeneous).

There are a number of tools already developed with the purpose to assess adherence to the values and principles of co-operation (tools developed by the MCDRN can be found at www.cooperativedifference.coop). Some tools measure the co-operative life using numerical indicators, others are based on surveys, but all use the ICA Co-operative identity as guidelines.

III. Understanding the impact of the co-operative sector on people and communities and influencing policy;

Some of the ways to measure what co-ops do on the micro level may be aggregated and reported on the mezzo and macro level, and that is a part of the effort that umbrella organizations and research institutions already engage in, with limited resources and varied degrees of success.

Besides this, studies such as David Erdal's about the relationship between the presence of co-operatives in a region and the quality of life, are also critical for our understanding of the impact of co-operatives on society. Erdal (2001) compared three Italian towns in the proximity of each other, each with a different percentage of labour force employed in worker co-operatives (26%, 13% and none). He compared them on a number of social indicators, such as health, crime, education, social environment and social participation, and found a clear correlation between a better quality of life and the density of co-operatives.

Other impacts and measures are also important such as the impact of credit unions on rural communities, or the contribution of housing co-operatives to building social capital. Often the only financial institutions in remote areas, we need to be able to understand the precise benefits that credit unions provide their members and communities, and ways in which they help their members create wealth, financial stability, and well-being (MCDRN, 2010).

Co-operatives and credit unions are often present in various markets due to market failure- it is not profitable enough for the IOFs to service a particular market, for example. But they also at times serve as the 'competitive yardstick' setting a benchmark price for the industry.

One of the roles cooperatives play, as suggested by Nourse, is that of competitive yardstick: cooperatives should add enough competition to the system to give farmers a basis upon which to judge the terms offered by investor-owned firms. Farmers, faced with unsatisfactory performance by IOFs, may form a cooperative firm whose purpose is to force the IOFs, through competition, to improve their service to farmers. If successful in enforcing competition, **the cooperative generates benefits that it does not capture itself** but which accrue to the farmer-stockholders, as well as to other farmers in the area. (Parliament et al 1990)

Besides being present in small communities, co-operatives and credit unions stay in the community longer, and operate longer periods of time than the IOFs. They also attract equity capital from ethical investors who seek a social return, and will accept a smaller financial gain over a long term. Without understanding and measuring the social return it is difficult to attract ethical investments.

The policy impact follows directly from measuring the impact of co-operatives on their communities. If co-operative density relates to improved social indicators, then it must be in the interest of local policymakers to assist the co-operative sector in increasing its presence. In order to increase its presence, the co-operative sector and the social economy more generally, need some specific instruments of support in being able to create community investment funds,

increase availability of patient capital, and increase the opportunities for ethical investments, among other. But in order to reach this stage, we need reliable measurements.

IV. Achieving public awareness of the size, the scope, and the benefits of the co-operative sector, and its promotion

One of the ongoing efforts in raising public awareness about the size of the co-operative sector is the ICA Global 300 list. The Global300 is a quick way to point out to the sceptics that co-operatives exist and thrive in market economies. The legitimacy of the co-operative business should be self-evident from this type of publicly available information. The co-operative sector needs to collaborate in the effort to collect and publish the data. In some cases the country and sector umbrella organizations may be well positioned to undergo the data collection, analysis and publication, but there should also be a more concerted effort to support co-operative research centers and education programs.

Promoting the co-operative sector and the social economy in general, is critical in the effort to diversify the economy for the benefit of all stakeholders (Stiglitz 2009).

Conclusions

Members of the co-operative sector know that co-ops have far-reaching impacts for the members and communities they serve. They are seen as a fundamentally different type of enterprise – in ownership, control, and purpose (Spear 2000, Novkovic 2008, Brown, 2010, Robb, Smith & Webb 2010, and others). Yet, without adequate tools to measure their performance and realize their full potential, cooperatives can have difficulty articulating their value to policy makers and other stakeholders. This in turn limits the potential and purpose that the co-operative form of enterprise was intended to serve – offering a proven means for ordinary citizens to solve social and economic problems through locally owned and democratically controlled enterprises, while fostering community leadership and wealth (MCDRN 2010).

The purpose of co-operative business differs from other organizations since co-operatives strive to meet member and community needs through mutual self-help. Exemplifying collective rather than individual ownership, co-operatives are bottom-up organizations intended to add value to the community; unlike other firms and organizations, they are guided by internationally recognized Co-operative Principles and Values, which, among other things, require that co-ops be democratically governed, that they emphasize member needs over profit, and they seek financing from their members.

Metrics that will a. highlight the purpose of co-operative firms, b. ensure their businesses are guided by the values of co-operation, and c. communicate the difference to the stakeholders, are needed, but many have also already been developed and used by the sector. The challenge in the coming years, besides further sophistication of the metrics made for co-ops by co-ops to capture 'the difference', will be to put these tools into good use by consolidating, aggregating and disseminating the findings.

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