

The Relative Survival of Worker Cooperatives and Barriers to Their Creation

Erik Olsen
Associate Professor
Dept. of Economics
Univ. of Missouri Kansas City
and
Josef Cabral Distinguished Scholar and Fellow

Basic Questions

Are worker cooperatives (WCs) rare because they suffer a comparative disadvantage relative to conventionally-owned firms (CFs)?

Why are WCs created almost exclusively *de novo* rather than as conversions of CFs?

Basic Questions

The survival of WCs relative to CFs provides insight into both of these questions.

Definition

WC is a firm in which worker-members have both *control rights* (participation in management) and *residual claimancy* (distribution of profits to members).

Sketch of WCs in the US

First US WC in 1791 and roughly 2000 since.

Three main waves of cooperation:

1880s: 275 created (Knights of Labor Coops)

1930s: 225-250 created (Self-help Coops)

1970s: 750-1,000 created (Movement Coops)

Sketch of WCs in the US

Two important points:

- 1) Only 223 of the 2000 or so that have been created are still in operation in 2009 (Deller et al.).

Does this high failure rate indicate that WCs (control rights and residual claimancy) are inferior institutions?

Alchian (1950) and Alchian and Demsetz (1972) argue that it does.

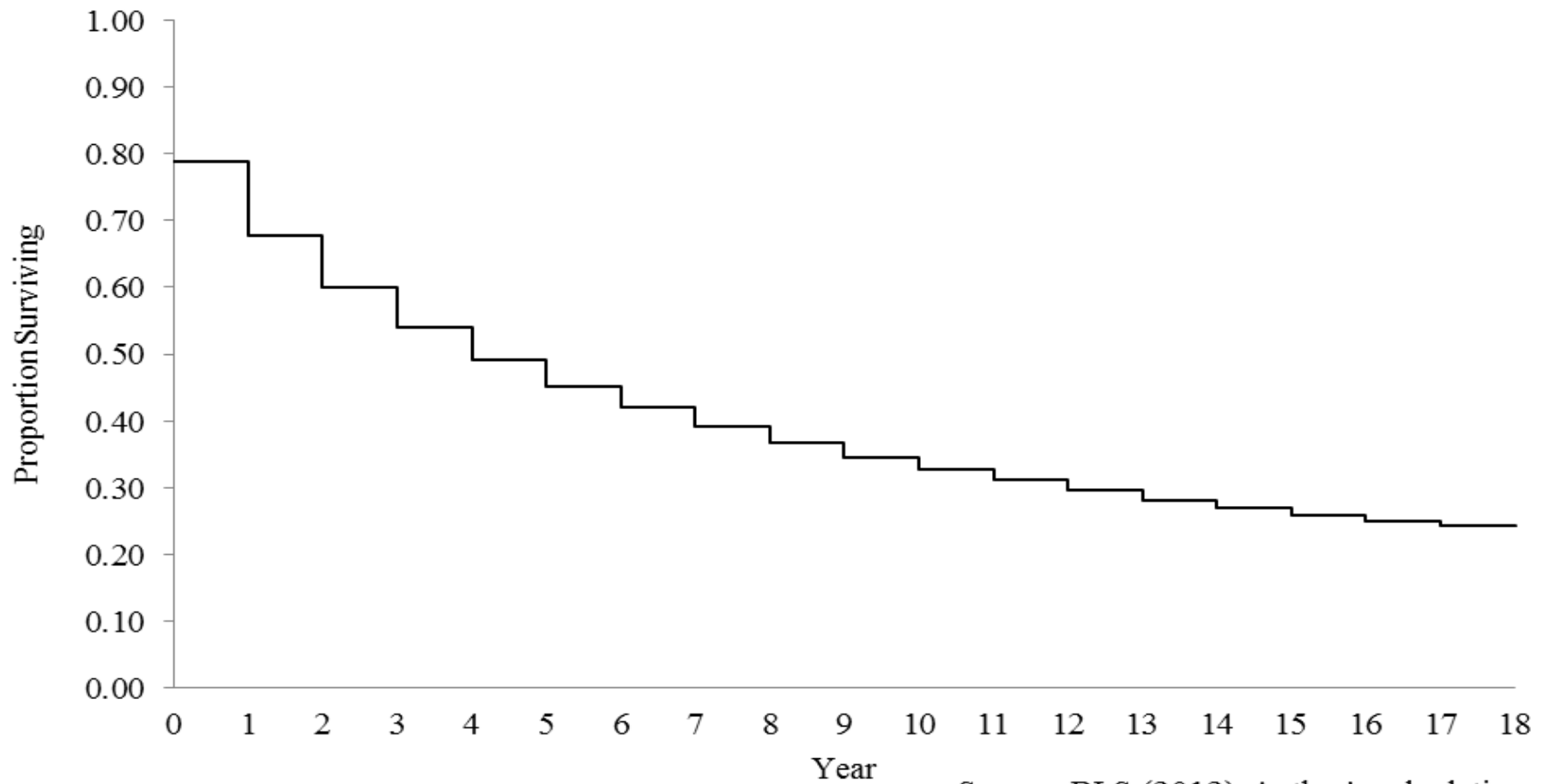
Sketch of WCs in the US

2) Almost all US WCs prior to 1970 were in manufacturing; almost all after 1970 are in trading activities.

This suggests the emergence either of barriers to entry for WCs in manufacturing, or incentives for them to enter trading sectors.

Survival Analysis: US CFs

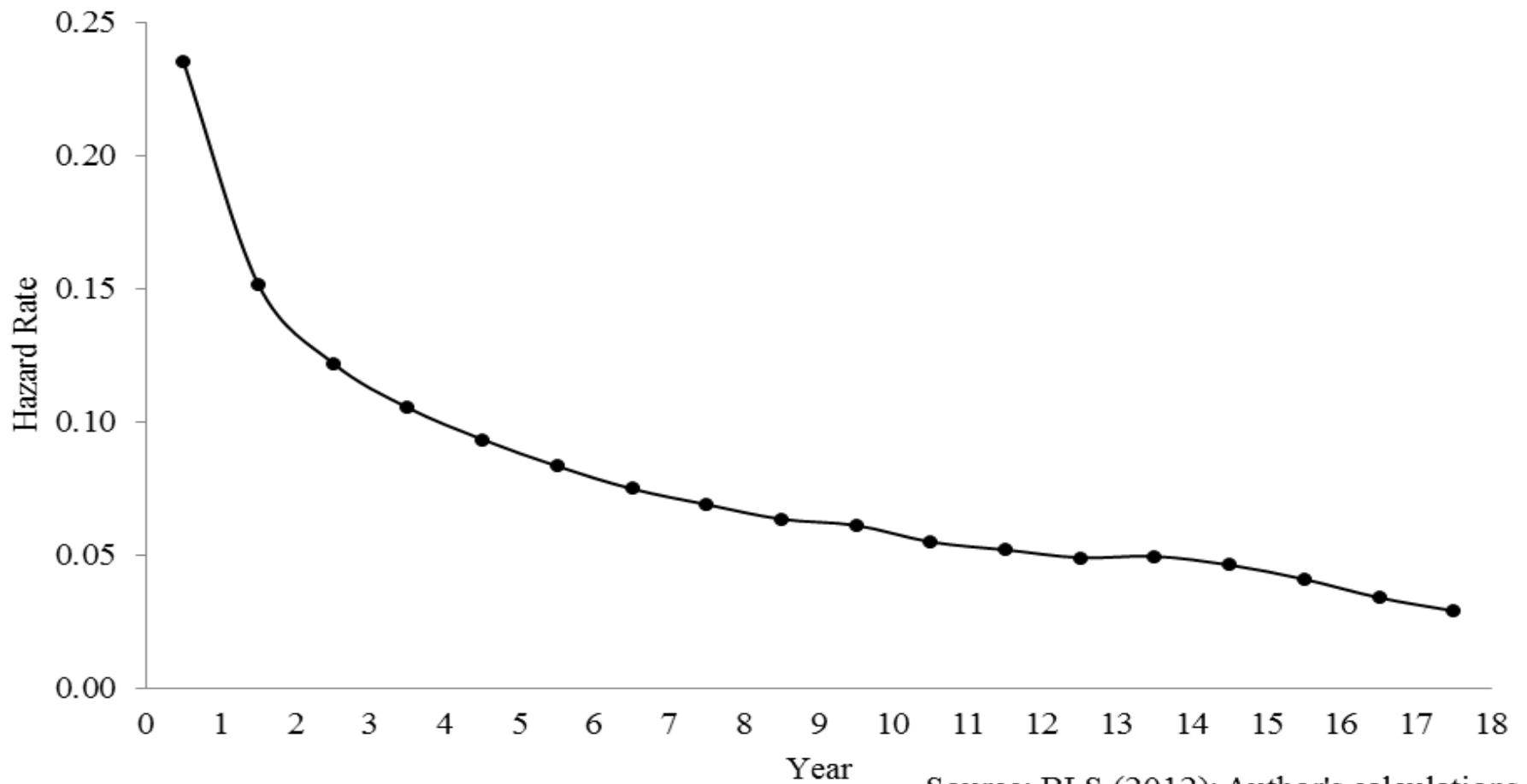
Figure 1: Survival Function
All US Establishments (1994-2012)



Source: BLS (2012); Author's calculations

Survival Analysis: US CFs

Figure 2: Hazard Function
All US Establishments (1994-2012)



Source: BLS (2012); Author's calculations

Survival Analysis: US CFs

This illustrates the well-known “liability of newness” (Stinchcombe 1965).

Is this greater for WCs relative to CFs?

Survival Analysis: WCs vs. CFs

Table 1: Survival Quartiles

Source	Cohort	75%		50%		25%	
		WC	CF	WC	CF	WC	CF
Thomas & Cornforth	1975 - 1981	3	1	≥ 5	4		
Thomas & Cornforth	1982 - 1983	1	1	3	4		
Thomas & Cornforth	1984	2	1				
Pérotin	1987	4					
Burdín	1997 - 2009	2	2	7	5		
Russell & Hanneman	1924 - 1992	2		4		10	
Staber	1940 - 1987	5		18		48*	
US BLS - <i>BED</i>	1994 - 2012		1		5		17
US Census - <i>BDS</i>	1977 - 2010		1		4		

Survival Analysis: WCs vs. CFs

In (almost) all cases median survival time of WCs exceeds that of CFs.

Early survival is also as good or better, though WCs are subject to a “liability of adolescence” rather than newness.

Insufficient data to draw conclusions about long-term survival.

Survival Analysis: WCs vs. CFs

This supports the conclusion that WCs are *not* at a competitive disadvantage relative to CFs.

Survival Analysis: WCs vs. CFs

This puts the question *Why are WCs so rare?* in a different light.

Existing answers to this question can be classed into those that:

- (a) presume some inefficiency must exist that causes them to fail at high rates;
- (b) emphasize low rates of creation.

Survival Analysis: WCs vs. CFs

The analysis in this paper indicates that *explanations focusing on inefficiencies of participatory management or broadly shared profits should be discounted.*

Survival Analysis: WCs vs. CFs

The rarity of WCs must be a consequence of *low rates of formation and growth* rather than competitive disadvantage.

Creating WCs

Low rate of formation and growth can be tied to:

- risk
- credit constraints
- shift to trading activities
- collective action problems
- individual capture of entrepreneurial rents.

Risk

Founding members of a WC face the conjoined risk to their initial capital investment and the cost of job loss.

The elevated hazard in the early years of a firm's existence makes this risk especially high for new firms.

But both WCs and CFs face this risk.

Credit Constraints

Almost all new WCs in the US are funded by the members themselves.

Credit rationing may result from a lack of collateral (wealth).

These credit constraints provide one explanation for the shift from manufacturing to trading activities in the US.

Shift to Trading Activities

Firms in trading sectors expand by creating new establishments in new market areas.

This type of growth is problematic for WCs because existing worker-members face a cost (reduced influence) but may receive no benefit.

Collective action problems

Creating a new firm involves numerous activities that benefit the group as a whole but are carried out by individuals or subgroups.

This gives rise to opportunities for free riding behavior.

Entrepreneurial Rents

Individuals who perceive an opportunity for above average profits have a disincentive to share them with others.

Creating WCs

But in each case these things are reduced when a WC is created by the conversion of an existing firm rather than *de novo*:

- risk is reduced because the expected future lifespan of an existing firm is significantly longer than a new one
- credit constraints are reduced because the existing firm itself serves as collateral
- reduced credit constraints make more industries viable
- collective action problems are reduced because many have already been resolved in an existing firm.
- entrepreneurial rents can be factored into sale price

Creating WCs

Existing US Federal policies that incentivize employee ownership apply to the creation of ESOPs as well as WCs.

A democratic ESOP can also be structured to combine control rights and residual claimancy in a way that is essentially identical to a WC.

Creating WCs

The question that remains unanswered is: *Why are WCs almost always created de novo rather than as conversions of existing successful firms?*

Advocates for WCs (participatory management and broad sharing of profits) should give more attention to the conversion of existing firms.

This avenue of WC creation offers important advantages and is underutilized.

Thank you.