

Introduction

We tend to take it for granted that, in the absence of government intervention, large-scale enterprise will be organized in the form of investor-owned firms. Thus the term “capitalism,” with its implication that the means of production are owned by investors of capital, remains the name commonly given to the system of economic organization found in Western Europe, North America, and Japan. Yet investor ownership is not a logically necessary concomitant of free markets and free enterprise. Rather, it is quite contingent, a form of organization that is often but not always dominant given current technologies.

Even in the United States, the world’s great exemplar of corporate capitalism, non-investor-owned enterprise plays a prominent role in many important industries. Employee-owned firms have long been widespread in the service professions—such as law, accounting, investment banking, and medicine—and are now expanding in other industries as well. The recent employee buyout of United Air Lines is a conspicuous instance. Farmer-owned producer cooperatives dominate the markets for basic agricultural commodities. Consumer-owned utilities supply electric power to 10 percent of the population. Key firms such as MasterCard, Associated Press, and True Value Hardware are service and supply cooperatives owned by local businesses. Occupant-owned condominiums and cooperatives are rapidly displacing investor-owned rental housing. Mutual companies owned by their policyholders sell half of all life insurance and a quarter of all property and liability insurance. And nonprofit firms, which have no owners at all, account

for most nongovernmental hospitals, colleges, schools, and daycare centers, as well as a large share of the nation's nursing homes, health maintenance organizations, and health insurance companies.

The United States is not unusual in this regard. Non-investor-owned enterprise plays a similarly large role in other developed market economies. That role is continuing to expand, and is conspicuously larger in advanced economies than it is in less-developed economies.

In this book I explore the reasons for this diverse pattern of ownership. I seek to explain why different industries, and different national economies, exhibit different distributions of ownership forms. Toward this end, I try to offer a broader perspective on the character and functions of ownership in general, providing insight not only into forms of ownership that are frequently neglected but into investor ownership as well. I also seek to illuminate the roles that alternative forms of ownership can and should play in the future.

I draw my analytic tools principally from economics and particularly from recent work on the organization of the firm. More specifically, this book is largely in the tradition of the "new institutional economics," which is distinguished by its focus on transaction costs and information costs. Yet while I rely heavily on economic analysis, I also bring other perspectives to bear where appropriate, paying particular attention to the characteristics of different structures for decision making, to historical processes, and to the legal and regulatory systems within which firms are organized. I have tried to make the book accessible to noneconomists, and have confined technicalities and discussion of the literature to the notes wherever possible.

The primary focus of the book is on those firms—such as broadly held business corporations, partnerships, cooperatives, and mutual companies—in which ownership is shared among numerous persons. One reason for this emphasis is the dominance of these firms in contemporary economies. Another reason is that widely shared ownership gives rise to special problems that call for focused attention. To create a viable firm in which ownership is shared among persons who have diverse interests is difficult, and the problems involved—what might be termed the internal politics of the firm or, more abstractly, the costs of collective decision making—have a critical bearing on the patterns of ownership that we observe and the ways in which firms are structured internally. This fundamental issue has received far too little attention.

What Can Be Learned?

At the narrowest level, this book addresses a variety of questions about particular forms of ownership. Why, for example, is investor ownership the dominant, yet far from universal, form of ownership in all modern market economies? Why have employee-owned firms traditionally been so common among service professionals and so rare in other services and in industry? Why has the latter pattern begun to change so rapidly in recent years, as investor-owned firms have displaced partnerships among service professionals while, at the same time, employee ownership has been spreading in the industrial sector? Why are consumer cooperatives so common—far more so than is generally realized—among wholesale and supply firms but so rare among retail firms? Why is it that, while farmer-owned and worker-owned firms are common, other forms of producer cooperatives are rare? Why has condominium housing, which was effectively nonexistent in the United States before 1960, spread so explosively through the nation's real estate markets in recent decades? Why did mutual companies play a more dominant role in insurance and banking in the nineteenth century than in the twentieth, and do they continue to serve an important function today? And why—to turn to a much smaller but nonetheless intriguing sector—are there not more investor-owned golf courses?

But one need not have a strong interest in alternative forms of ownership to find the comparative study of organizational types instructive. The exercise has important lessons even for those whose interests are largely confined to investor-owned enterprise. Analysis of the role and performance of partnerships, cooperatives, mutuals, and nonprofits provides a useful means of measuring the managerial efficiency of conventional business corporations and deepens our understanding of the ways in which, and the extent to which, product markets and capital markets—including the market for corporate control—serve to police that efficiency. To look at investor-owned firms in isolation, as the existing literature has largely done, is often misleading. We learn much more about them by comparing them with other forms of enterprise. Otherwise, as a statistician might put it, there are too few degrees of freedom, and too little variance, to assess the influence of key variables.

The study of alternative forms of ownership also offers insight into

broader issues concerning social organization in general. For example, it provides perspective on the extent to which the vagaries of history determine the character of the organizational forms that appear in contemporary societies. More specifically, it permits us to appreciate the processes and the speed with which anachronistic organizational forms are replaced by more efficient ones. It also allows us to explore the ways in which legal structure—including organizational law, tax law, and regulatory law—governs organizational evolution. And it even helps us to see whether and to what degree organizational change drives, or is driven by, legal change.

Finally, since a firm that has numerous owners must employ some form of collective choice mechanism through which those owners can exercise control, all such firms necessarily have a strongly governmental, or political, character. Examining the forms and performance of these collective choice mechanisms allows us to acquire important knowledge about political institutions in general. In fact, because collectively owned firms are so numerous and so varied, and because they are subject to the forces of market selection, for many purposes they provide a better means of studying political institutions than do the governmental entities that are the usual focus of work in political science. By studying the structure of ownership in private firms we gain a strikingly strong perspective on the relative virtues of politics and markets in governing social activity—a question that has been at the center of Western political and economic debate for much of the past two centuries.

The perspective on these issues that this book offers might be useful even if it involved no more than a reaffirmation and extension of prevailing ideas. In fact, however, the evidence assembled here indicates that, in fundamental ways, the conventional wisdom about the forces guiding choice of organizational form is often misleading or mistaken. For example, the capital intensity of an industry and the degree of risk inherent in the industry both play a much smaller role than is commonly believed in determining whether firms in that industry are investor-owned. Similarly, the agency costs of delegated management—the “separation of ownership and control”—that are so much a focus of current literature on the economics of organization are at best of secondary importance in determining which organizational forms are viable; indeed, tight managerial discipline is a two-edged sword that can severely increase a firm’s costs of contracting with

nonowners. Employee ownership offers much stronger efficiencies than it is generally credited with, and would be far more widespread if it were not critically handicapped by the very thing that is often considered its greatest virtue, namely, the opportunity it affords for active worker participation in governance. Nonprofit firms commonly compete quite effectively with for-profit firms even in the absence of public or private subsidies. And governmental consumer protection regulation has often played a critical role in permitting investor-owned enterprise to vie with, and ultimately displace, cooperative, mutual, and nonprofit firms.

Social Science and Social Policy

This book is largely an exercise in positive, or descriptive, social science. As such, its principal purpose is to explore, as objectively as possible, the reasons for the patterns of enterprise ownership that we observe. Yet it has an important policy dimension as well.

There is considerable enthusiasm today for promoting forms of ownership other than the conventional investor-owned corporation. Much of this interest centers on labor-managed enterprise and reflects an unusual convergence of economic thought from opposite ends of the political spectrum. On the left, recent years have brought the final collapse of state socialism as a persuasive economic ideal throughout the world. In the resulting ideological void, "workplace democracy" has emerged as the principal institutional reform that commands widespread support among critics of capitalism. Worker control of enterprise, it is hoped, will succeed where state control has failed in equalizing power and wealth and in decreasing worker alienation and exploitation. Reformers on the right, in turn, have become increasingly discouraged with the efficiency of traditional forms of labor-management relations. As an alternative, many have turned to employee ownership, hoping that it will improve productivity and increase worker identification with the interests of capital.

This enthusiasm for worker-owned enterprise has begun to be translated into policy. Employee ownership is now promoted in the United States by large tax subsidies, by exceptional provisions in the pension laws, and by special corporation statutes for employee-owned firms. In Western Europe, worker codetermination is now mandated for all large enterprise in Germany and has been proposed for the European

Community as a whole. And in the formerly socialist countries of Eastern Europe there is widespread interest in worker ownership for newly privatized state enterprise. Yet the wisdom of all such policies remains subject to intense debate.

Issues of ownership are also central to important problems of policy in a variety of other areas. For example, does the rapid conversion of rental to condominium housing represent an improvement in welfare, or is it a costly inefficiency induced by rent control and tax subsidies? Is the domination of the agricultural markets by farm marketing cooperatives an efficient response to market imperfections and scale economies, or is it simply cartelization at the expense of consumers? Do nonprofit hospitals, health insurance companies, and health maintenance organizations serve a valuable function that the rapidly expanding investor-owned firms in those industries do not, or are they just inefficient anachronisms? Does the recent rapid growth in mutual liability insurance companies offer a promising remedy for the insurance crisis? Might the costly collapse of the savings and loan industry have been averted if stock firms had not been so freely permitted to displace mutual firms in that sector? Is consumer ownership of utilities a promising way to avoid the inefficiencies of both private monopoly and public rate regulation? Does collective ownership of a franchisor by its franchisees avert the problems of opportunism to which franchise contracting is otherwise prone?

More generally, the basic legal framework that governs different forms of enterprise ownership has developed ad hoc, without systematic thought as to the functions played by the various forms or to their interrelationships. The corporation statutes governing cooperative, nonprofit, and mutual companies are generally poorly structured and vary widely from one jurisdiction to another. Tax law, which has been designed principally with the conventional investor-owned firm in mind, creates systematic biases for and against other ownership forms. And alternative forms of ownership operate under special regulatory and antitrust regimes that have never been well rationalized.

In the past, it has been difficult to deal clearly with any of these issues because we have lacked a coherent understanding of the roles that are, can be, or ought to be played by the various forms of ownership involved. I hope to provide the basis for a more informed approach.

Ideology

Much of the existing literature on ownership, and particularly on worker-owned and consumer-owned enterprise, reflects some degree of ideological commitment. Authors frequently come to the subject with a passion either to advocate or to discredit a particular form of ownership. I try here, in contrast, to be relatively disinterested. Although nobody is unblinkered by ideology, I do not consciously bring to this project strong commitments either for or against any particular form of ownership in itself, whether investor-owned, worker-owned, consumer-owned, producer-owned, nonprofit, or governmental. Indeed, I believe the evidence indicates that a broad range of ownership types have useful roles to play in modern economies and that those roles vary with time and circumstance. The principal objective of this book is to analyze those roles.

Comparative Perspectives

The primary focus here is on institutions in the United States. I do, however, pay considerable attention to patterns of institutional development in other countries both to affirm and, where necessary, to qualify the generality of the conclusions offered. In fact, as subsequent chapters illustrate, the distribution of ownership types in the United States is strikingly similar to that found in other market economies, and where differences appear they are generally explicable in terms of the same considerations that explain the U.S. pattern. Consequently the book should have nearly as much value in understanding other economies as it does in understanding the United States.

Nonprofit and Governmental Enterprise

The principal focus of this book is on firms that are privately owned in one fashion or another. But the book's analytic framework is also helpful in understanding when it is efficient for a firm to have no owners at all—that is, to be organized as a nonprofit institution. Moreover, since nonprofit firms are the asymptotic extreme in the separation of ownership and control, their study throws important light on the characteristics of owned enterprise. Part IV devotes specific attention to nonprofit enterprise.

The role of public enterprise is an important issue that deserves much more thoughtful attention than it has received. That role is, I believe, usefully illuminated by the book's analytic framework. Nevertheless, I do not offer an extended discussion of public enterprise. Rather, I deal with it only where necessary to explore important questions about the role and structure of private enterprise, as in the case of the utilities examined in Chapter 9 and the exclusive residential communities discussed in Chapter 10.

Organization of the Book

The three chapters in Part I offer a general theory of enterprise ownership. Subsequent chapters then employ that theoretical framework to explore the role played by particular forms of ownership in particular industries. The chapters dealing with specific industries or organizational forms in Parts II-IV are mutually supporting and cumulative. One can learn much more about the strengths and weaknesses of different organizational forms by comparing them with one another, or by observing how the same form fares in different industries, than one can learn simply by observing a single form within a single industry. Thus one gains an important perspective on problems of governance and capital supply in worker-owned firms (Chapters 5 and 6) by studying farm supply cooperatives (Chapter 8) and housing cooperatives and condominiums (Chapter 11). The significance of the separation of ownership and control in investor-owned firms (Chapter 4) is similarly illuminated by comparing those firms with wholesale and supply cooperatives (Chapter 8) on the one hand and with nonprofit and mutual firms (Chapters 12-14) on the other.

For all the interest in organization theory today, the comparative study of organizations remains much neglected. I hope to prove that it has impressive things to teach us.