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Ownership, Control, Agency and Residual Claims: New Insights on Co-operatives and Non-profit Organisations

Overview:
Much of the historic literature on the theory of the firm and the related governance arrangements observed, derives from Berle and Means separation of ownership and control and draws on publicly listed firms. These are large and have a deal of economic activity so it is probably understandable that they have been a focus for some, but the greatest number of organizations are small and there is a great variety of different ownership models which is the reason we are here today. So we need to work out what it is about ownership and governance that is most relevant for our discussion today.

We are interested particularly in the differences when organizations do not have defined owners as occurs in a non-profit firm especially if that firm is a cooperative and therefore differs from a sports club for example or a charity. The thing that is special about these firms is that the non distribution constraint and the focus on delivering services means there are fewer incentives for the governors to monitor and enforce employees and it has been shown that this may result in them taking higher salaries and perks.

How does more recent theory talk to the definition of the firm? Dumsetz and more recently Hart and Moore see ownership of organizations as a variety of contractible and non-contractible rights. In this they draw on earlier literature, dating back to Coase who theorized that organisationions form when it is more expensive to use the market than collaborate with others. This brings the need to monitor the collaboration. Jensen and Meckling extended these ideas to consider contracts both within the firm and between the firm and the market. The relevance here is that these 'contracts' specify who gets to receive income and the benefits of ownership. Fama and Jensen of course then theorized how these considerations could be applied to firms without owners and they decided that the separation of decision taking and risk bearing functions was the important part and agency theory required monitoring of those 'contracts' within even non-owned firms. This is especially so as there will be arguments between the decision controllers and the decision managers.

However contractual incompleteness is a real issue. More recently Evans, Guthrie and Quigley argued that governance, even in non-owned firms, was best carried out by those who bore the costs and benefits of that which can't be contracted. This helps us to think about what to do with the more fuzzy areas of operation such as occur in health where outcomes like 'wellness' is difficult to define exactly and there are many ways to measure quality, but all of them proxies for the real thing.

This diagram shows the continuum between income stream and owners. Ben-Ner says it is important to distinguish between who owns and controls the income streams and who controls the residual assets of the non-profit firm. This links to Hart and Moore's work in cooperatives where the residual control rights in a cooperative may be distributed on a one person one vote scheme, but the income streams are distributed according to members in proportion to their custom with the cooperative.

The incidence of producer and consumer cooperatives give us pause to think, but this is a nuance we have to leave for another day due to time constraints.

Who do we mean by owners and what type of firms might we have? We see this as a continuum from those organizations without owners to those with defined owners. We've used the term 'instrument' to conceptualize who these owners, who might control these organizations. So we move from no ownership instruments in, say a charity, through to increasingly well-defined instruments. This is a continuum so, for example, the current proposals for Fonterra may end up with Fonterra being very close to a company, whereas a cooperative with only an annual membership fee will be very close to a club. Obviously, the more specific the instrument, the less uncertainty there is in defining the owners.

If we bring this together we find that we have a number of different ways of thinking about these firms. You will see we have placed cooperatives at two points here - those where the members have control over the residual assets as well as income in relation to their trading, and those where members do not have control of the residual assets but they do share in the income.

We wanted to test this emerging theory in relation to PHC in New Zealand. Very briefly the structure of primary health care is shown here. The pertinent point is that when the Primary Health Care Strategy was established, the Labour Government required GPs and their practices to join firms that had a non-profit objective. These were called PHOs. they are to be responsible for improving the health of their communities. This was a change from the ways that the government contracted with GPs and required PHOs to have collaborative governance relationships with community members as well as medical providers.

Same idea of owners and types of organizations we can see what sort of providers existed before the PHCS was introduced. These were along the continuum that I showed previously. But what effect would a reform have on these different models of owners and non-owners.

There has been further changes in the PHO space since the Strategy was introduced which means that there is 31 PHOs in NZ now. Very briefly, we have ended up with a predominance of provider controlled PHOs that do not make a profit, but we can see from our analysis that they are more likely to make no profit than the ones that are consumer controlled. We wonder why the government focused on the profit (or no profit) rather than who controlled them. This slide shows that indeed we have ended up with consumers controlling some PHOs and many controlled by providers. Even when there are former non-profit providers, when they collaborate and join with a previously for-profit provider they appear to end up being controlled by providers. Some empirical evidence shows that consumer origin PHOs have fewer providers on the boards

This is how we see the new forms of PHOs in terms of our model. You will see that we find here the IPAs are provider cooperatives -the GP practices are here on the very left. The iwi-owned PHOs retain the right to control the residual assets, but members do not share in the profits. The Union Health and charitable providers are here on the very right where there is no claim on residual assets.

We can see that consumer controlled cooperatives retain greater reserves than provider controlled cooperatives. This means that these co operatives would be more able to deal with shocks such as occur if there is a bird flu epidemic, and they build up reserves in order to deliver more heterogenous services to their communities which control them. We suggest that, in contracting with PHOs, the government sought just this sort of outcome. That is, they were looking to engage communities in their own health care and to get these communities to improve their own health. These ideals build on the concepts that Dietmar has talked about this morning where community governors seek to improve in this case the health of all of those in their community.

Therefore the policy makers messed up! We believe that they should have referred PHOs to be cooperatives so that instead of PHOs pretending to be non-profit, the real governance issues around primary health can be dealt with.