

The Partnership Theory in Explaining Cooperatives Organizational Structure

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Abstract: This study discusses the application of the partnership theory within the structure of cooperative organizations. A cooperative organization is established from the capital contributed by its members and thus, it directly creates a partnership alliance among them. Partnership and cooperation perspectives represent the structure of the cooperatives in general. As cooperative activities contribute a substantial share to the development of the economy, cooperatives experience rapid growth. However, not all members tend to be committed to the management of cooperatives. This has led cooperatives to experience a number of agency issues such as opportunism action by the member or partner and the manager employed.

Key words: Cooperatives, partnership theory, cooperative organizational structure, Malaysia cooperative, agency

INTRODUCTION

It is common in an economy to have a variety of types of business organizations including sole proprietorships, private-owned partnerships, employee-owned partnerships, co-operatives and investor-owned companies. Cooperatives are established from by capital contributed by its members and this directly creates a partnership affiliation in these organisations. The significant difference of cooperatives organizations compared to other business organizations lies in their capital ownership and democratic governance (Kalmi, 2007). These differences are associated with their main objectives which are the reflection of the social interest of its members. Other scholars such as Norkovic (2008), state that cooperative organizations are considered a labour-owned entity. This means that they form democratic controlled organization that is owned and controlled by its members. The member participation includes the capital of their cooperative firm and the principle implies team work from members, participatory management as well as democratic decision-making. These elements contribute to the accommodating nature of the partnership theory as an important part of the process, ideally in the establishment of cooperative organizations. Therefore, cooperative organizations are

also engaged with the organizational structure or hierarchy to indicate the level of management and key persons that play an important role in them. Hence, the root establishment of a cooperative firm is based on the partnership theory; ownership principle or coordination of capital, working together, sharing knowledge and expertise between cooperative members. However, research on this subject is limited to partnership effects on labour-management relations in the federal sector (Masters *et al.*, 2006), human behaviour in partnerships (Charness and Dufwenberg, 2006) and types of business partnerships in different degrees of social control (Reed and Reed, 2009). In particular, building on this partnership theory, we introduce the principles and circumstances of partnerships contributing to the establishment of cooperative organizations.

Thus, this study aims to review and assess the partnership theory which offers a rich understanding of the establishment of cooperative organizations and structures. The study proceeds in the following sections on how the partnership theory is related to the establishment of cooperative organizations, the assessment of partnerships, agencies and their implication to the cooperative's organizational structure. Finally, we shall come to the inevitable discussion and conclusion.

Partnership theory: unexplained theory for cooperatives organizations:

A cooperative is an organisation that is based on the voluntary agreement of persons to meet their common economic, social and cultural needs and is controlled and managed by its members based on the cooperative principles of 'one-member-one-vote'. Cooperative organizations also trade goods and services to meet their members' needs. Fundamentally, cooperation and dependence or mutual dependencies are common in cooperative organizations. These elements are not new in the partnership businesses, mainly because a partnership is one of the forms of a business entity in society. As a cooperative firm, partnerships can be in the form of capital contribution and sharing of profits among cooperative members in an agreed proportion. Partnership can also be in the form of development and enhanced services provided to members in the form of training, health services, education centres among others.

Moreover, the acting of 'voluntary cooperative arrangement' in a firm has emerged in the cooperative employment relations and union participation in its operations and decision-making. Therefore, the involvement of the union and employees in a cooperative firm represent the concept of partnership in the form of organizational work. Hence, the employment practices in cooperative firm operations and decision-making rely on the cooperative principle of 'belief and attitude' which is a critical factor that segregates the concepts and practices of a partnership.

What is partnership: In the early 1900's, White defined partnership as "a contract of two or more competent persons to place their money, efforts, labour and skills or some or all of them, in lawful commerce or business and to divide the profit and bear the loss in a certain proportion". A partnership formation can be among individuals, business associations and corporations. Each partner normally has common goals and strong integration to commit to an establishment of a partnership. This is consistent with Sellgren (1990) who defines partnership as a scheme that involves funding more than one agency. Similarly, based on Bennett and Krebs (1994) and Talman and Yang (2011), partnership is defined as a group of actors or agents that work in cooperation towards specific economic objectives. When an agent cooperates with another agent, they obtain a joint payoff to be shared between the two consenting parties.

Most researchers including Lui *et al.* (2009), Talman and Yang (2011) and Masters *et al.* (2006), agree that the formation of a partnership generally involves a written contractual agreement that governs the relationship between the partners. Each partner has the right and

responsibility to manage the partnership. In addition to this, each partner also has the right to share the profits and shoulder losses according to the partnership agreement.

As discussed in Bolton and Dewatripont (2005) study a formal structure of partnership involves a signed contract to determine the form of partnership to be established. This emphasizes the importance of having a contractual agreement between partners in order to ensure efficiency and protect trust and commitment level, in the partnership. This is also similar to the economic viewpoint of the agency theory that involves a principal-agent relationship venture and the use of a contract as the governance mechanism that limits the potential conflict between partners.

Guest and Peccei (2001) undertake a partnership practice to work on the definition and concepts of partnership in the Involvement and Participation Association, United Kingdom. They state that there has been no agreed definition and conceptualization of partnership in the academic or policy literature. He also describes the conceptualization of the partnership approach which involves unions that encompass employee involvement and non-union companies. Guest and Peccei (2001) and Knell, treat partnerships involving unions based on the co-operative employment relations which operate on certain principles, belief and attitudes which include protecting the employees' benefit, direct employee involvement in employment issues and organization policies. Knell further locates unionized partnerships in a co-operative industrial relationship in the United Kingdom based on the principles of trust and honesty through common vision, open management, employee voice mechanism, ownership and responsibility, employment security and quality.

In another view, the involvement of employees or trade unions in the decision making process in firms also contributes to the concept of partnership at the workplace. They continuously explain that employees' and union members' participation in firms' decision making has cultivated an arrangement of partnership as well as a relationship of cooperation between them.

Partnership can also be incorporated with mutual gain enterprise (Kochan, 1994) where profit and loss sharing are the main criteria to enforce cooperation, contribution and participation among employees. Kochan (1994) extensively draw US cases that use a multi-level model of principles to guide the mutual gain enterprise. It is divided into a business strategic level that promotes quality and innovation; top level management that provides a sound human resource and credible governance.

Based on the above discussion, we can mention that the partnership theory involves a participation, cooperation and human relationship driven towards achieving mutual objectives. Therefore, the theory of partnership is aligned with the establishment of cooperative firms that involve a contribution of capital and effort between members to achieve their mutual goals as well as the promotion of their economic interest through this collective help. Partnership relations between cooperative members are described as a formation of contract, specifying the ownerships in the cooperative organizations that would further illustrate the cooperative structure or cooperative organization models.

MATERIALS AND METHODS

Partnership theory and cooperatives organizational structure: The partnership theory describes a voluntary relationship among individuals or corporations to conduct business based on cooperation to gain mutual benefit and reap profits. When each individual has decided to form a cooperative organization, each individual is responsible for contributing capital, meaning that the cooperative members have an interest in the cooperative and remain as members as long as they do not claim their capital. This business conduct involves the creation of a contract to protect the members' interests which is normally long-term.

Generally, in a partnership, each partner has the right to receive profits as evidence of the partnership. Similarly to cooperative firms, each member has an equal right of one member, one vote, no matter the size of capital or output. The main financial resources available for cooperative organizations are from the members. Therefore, any surplus from the cooperative firm will be distributed to members to avoid personal gaining at the expense of others.

In this collaborative environment, the cooperative organizations involve an interaction of partnership alliances, whereby every interaction and cooperation involves a relationship with members and other parties. These activities of conducting a cooperative business demonstrate their members' commitment and ability to work together as partners, acting to enhance mutual objectives of the partnership that share a common sense of solidarity, common problems, common trust and members' internal relationship. Therefore, we suggest that partnership is involved to integrate a positive relationship in the cooperatives' organization structure, mainly because the nature of the cooperatives means an involvement of cooperative members to take part in the management or at least to protect their interests by taking

an active part in the process of selecting the CEO or board of directors through their democratic control rights where human resources are available. This gives the cooperative members the right to elect and delegate jobs to respective leaders in order to perform jobs and specific decisions based on members' provision. In this sense, the conflicts between two types of principals can emerge between the controlling shareholders and minority shareholders or between controlling members and minority members of the cooperative that have to succumb to the principal-principal conflict. Private benefits of control have been recognized as a main source of principal-principal conflicts when they exert their control to protect their own interests at the expense of minority shareholders (Young *et al.*, 2008). Principal-principal conflicts have been identified as a major concern of corporate governance in emerging economies (Dharwadkar *et al.*, 2000; Young *et al.*, 2008).

However, when a cooperative organization expands, which means that members are growing in number, and operation and investment becomes wider, the agency conflict may emerge from engaged workers or professional managers. For example, the president of a cooperative organization will be elected by the members and the management job will be appointed by the president to the directors or professional managers who are not patrons. The managers should act on the members' goals (Baron, 2007) and receive a fixed compensation, but not on profitability or dividends from positive financial results. This situation would lead to the separation of ownership and control as Berle and Means (1991) reported in a study on modern organizations. Separation, in a good perspective, would allow responsibility to be inculcated among managers based on specialization and the cooperative members will develop their mutual trust toward the professionals.

Internal democracy and control can be very low if the employees or professional managers fail to report to the president and members of the cooperative on a regular basis. These circumstances may lead to the agency conflict established in cooperative organizations when members (principals) and employed professional managers (agents) have different risk preferences, thus, having the possibility to provoke members' dissatisfaction (Fulton and Giannakas, 2001). Another view by Ortmann and King (2007) also concludes that the agency theory is relevant to the institutional structure of cooperatives due to the manager's (agent) actions which do not act according to the best interests of the cooperative members (principal). These agency problems would incur greater agency costs to the cooperative organization which include the cost of designing a

contract to monitor the agent's activities, cost of control mechanism and incentive mechanism purposefully to avoid opportunism action by the manager (Fulton and Hueth, 2009). Therefore, in a normal manner, the governance mechanism may help to align the interests of all members and partners involved which includes boards of directors (management hierarchy) and executive compensation packages (Demsetz and Lehn, 1985; Fama and Jensen, 1983). Chaddad and Iliopoulos (2013) also agree that the cooperative members' right of control and non-patron control (employed managers) is the basis to determine the cooperative organizational and governance structure.

The research of Chaddad and Iliopoulos (2013) describes governance models based on ownership-right control models in agricultural cooperatives. Their studies describe the assignment of control rights with the concentration on decision management and decision rights control as governance models in different regions. They have dedicated ample time in discussing the extended traditional model, managerial model and corporate model. The General assembly or Chief Executive Officer (CEO) remains the main governance mechanism of these models. Thus, each cooperative member exercises their major influence based on 'one person, one vote' or proportional allocation of residual control rights. However, in extended traditional models, the General assembly or CEO delegates tasks and responsibilities to the management team or to hired non-member patrons. This indicates a clear separation of formal authority (the management) and control authority (General assembly/BOD). It indicates that the cooperative members (principal) delegate more decision control to the management or professional managers. The appointment of the supervisory committee is not compulsory and is normally appointed by the general assembly. Meanwhile, for the managerial and corporate models, the principals (co-op owners) delegate all operational and managerial decisions to professional managers or the BOD. They manage to retain their decision right controls in The supervisory committee (Managerial model) or the member council (Corporate model). The General Assembly of members posit the main decision control in the election of the board of directors, security committee members, approval of annual reports and major decisions of the cooperatives, i.e., mergers dissolution. In the Traditional Model (practices evident in Southern Europe and the Southern Cone Region of South America), the board of director exercises the decision control in operations and management, unless given certain conditions that acquire the General Assembly's approval.

In Malaysia, the cooperatives' organizational structure is also elected by the members in the cooperatives' annual general meeting as stated in the 1993 cooperative act and the board comprises between 6-15 people. The success and failure of a cooperative organization is very dependent on the support of cooperative members and the motive for the establishment of cooperative policy is to provide facilities and services to its members' support. Therefore, all the cooperatives' organizational structures suggest that the board of directors is democratically chosen by the members who exercise their rights through 'one member one vote', no matter how much capital or shares are owned by the members. Here, the different kinds of ownership forms suggest that the way the principals will administer or control their firms may differ according to the ownership structure. According to Zhou and De Wit, an organizational structure indicates a means to organize and coordinate works. Hence, the organizational structure in cooperative firms would represent the level of centralization of decision-making as well as its roles, in the organization. Therefore, the processes of management relation, member socialisation, collective bargaining and administration of contract seemingly serve to be an ultimate partnership impact on cooperative firms' organizational structure (hierarchy), which is hardly found in other types of businesses. There are four important components in the Malaysian cooperative administration, namely: members, board of directors/members, internal audit committee and management committee. However, the government also plays their part in the administration as a monitoring party under the ministry of domestic trade, co-operatives and consumerism. The government occupies the highest position in the cooperatives' hierarchy which offers full support of guidance and supervision over cooperative.

Indeed, the organizational structure or hierarchies of cooperatives are established based on a collection of voices and decisions made between the cooperative members. For example, the collective voice of partnership is formed when most of the cooperative firms in Malaysia are involved with the labour-management cooperative. The members involved in the operation include those working in the finance department marketing department and storage department as well as those who are members of the board of directors. However, large cooperative organizations appoint jobs to non-members, especially skilled or professional ones, to manage the cooperative. The collective partnership's decision in the organization may stimulate dedicated leadership that may further reduce agency conflicts.

The cooperative organizational structure also represents the internal governance mechanism as well as the means of control and protection for the cooperative members. This mechanism can explain the re-gaining of control of power from the cooperative members' right to the board of directors or professional managers. Hence, the structure to delegate the decision from cooperative members in their general assembly have associated the CEO or professional managers to have direct reports on the business activities and become more involved with business operations and with subordinates is in response to the changes in their business environments.

RESULTS AND DISCUSSION

A cooperative is a voluntary organization where equal members participate in the democratic environment and the objective of its business operation primarily rests in the advantage of members. The unique rules of cooperative principles are factors which distinguish cooperative organizations from other capital organizations. The cooperative organizational structure results from the cooperation among the members of the cooperative that choose its own board and management are based on a high level of trust. However, the new addition to cooperative principles for improvements, increasing number of cooperative members and growth in cooperative business, have brought changes to the organizational structure of the cooperative where the members' (principal) control and authority on the cooperative managements are reduced due to the delegation of control to agents or professional workers.

Chaddad and Iliopoulos (2013) show that organizational structure acts as the governance structure of agricultural cooperative organizations. Thus, the movement of cooperative members (principal) demonstrates giving up control in the management, operational and strategic decisions to professional managers (agent) in their governance or organizational structure enables a cooperative to gain specialization, acquire knowledge expertise from hired professional managers, build a trusted relationship between them and choose the right governance mechanism to facilitate the managers involved. This study places significance on the partnership theory in the establishment of cooperative firms because every interaction by cooperative members involves a relationship and partnership among members and the management hired. The practical implication of this partnership or collaboration involves a contribution of capital (resources), specific job carried by partners/members (expertise) and time to commit and

responsibility in forming, operating and supporting activities in a cooperative organization, along with a contract that purposefully structures the management and ownership of the organization. A cooperative is concerned with a unique organizational form created from a collective voice of partnership alliances between members in order to carry out common economic activities to achieve mutual benefits.

Partnership arrangement in cooperative organizations may exacerbate a management or agency crisis due to different levels of risk preferences, imminent changes in the decision making power, unfair treatment between members and opportunistic behaviour by partners who do not perform to the best interest of the organization. It must be perceived that these circumstances of members or partners' fault in a cooperative organization do not provide any significant gains from the partnership. Thus, it requires a dynamic control and governance structure to minimize the agency or principal-principal conflicts.

As a cooperative is rooted from the social interaction between members, they act as partners-cum-agents that have common objectives to serve the interests of the members. Based on the definition of partnership and cooperative, we can conclude that the establishment of a cooperative organization is based on the partnership arrangements with respect to cooperative principles. The partnership practices can be seen from principles and beliefs such as direct member involvement, member's representative in decision-making and mutual equitability from the profit which is consistent with the cooperative principles. The history of the establishment of a cooperative organization has demonstrated that pivotal events of fraud in commercial transactions, oppression by the authority and costly basic needs to the poorer existing in the capitalist economy may be critically influenced by a concept of partnership to provide a positive impact on other members and the social community. The antecedents of a partnership in a cooperative organization have emerged in the aspects of economics, and in the interactions for mutual benefits and organizational features of social, economic partnerships at a local level.

With regard to decision making and control, cooperatives cover not only the member-patrons but also non-member patrons. The professional non-member patrons should be selected for their professional expertise and skills which demand a close involvement in the development and growth of cooperative organizations. Hence, a cooperative organizational structure acts as a governance model based on the fact that it allocates the decision making functions, and formal and real authority in their management (Chaddad and Iliopoulos, 2013).

Partnership enthusiasm approaches with professional boards, which enable different agencies to cultivate the interest to work together, can offer substantial impact on governance in terms of accountability and openness.

CONCLUSION

It is found that some selected board members and proper hierarchy in management would overcome local opposition from members, and in turn contribute to the proper efficiency of governance which may reduce agency problems.

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