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by

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The Cooperative-Corporate Interface: Interfirm Contact Through Membership on Boards of Directors

Julie A. Caswell

Interfirm contact through membership on boards of directors is a means of increasing the expertise and information available in firm decision making. Data for a sample of 455 U.S. firms in 1976 show that levels of such contact varied widely among 212 large agribusinesses. Corporate firms in the sector, except those that were privately held, maintained significantly higher levels of director and firm contact through board membership than did cooperatives. The absence of a range of outside directors on cooperative boards serves the principle of democratic control but may have adverse effects on the quality of board decision making.

Membership control, exercised through a board of directors, is widely recognized as a core principle of cooperative organization (Schomisch). It is also widely recognized that boards elected from among the member-patrons of a cooperative may be limited in the diversity of expertise they are able to bring to management decisions (Staatz; Rhodes). In particular, the expertise of member-patron board members, who are customers or suppliers of the cooperative, is often almost exclusively specialized in the cooperative's input and/or output markets.

In contrast, public corporations' boards of directors typically include inside directors who are officers of the firm and a range of outside directors. These outsiders often come from large stockholders, banks, insurance companies, law firms, and manufacturing and service companies, bringing diverse types of expertise to the board. The presence of outside directors also establishes contacts that serve as an information network.

Altering current rules to open the cooperative board to a range of outsiders could contribute to better decision making but would likely involve a sacrifice of membership control. Recent work argues that the role of elected directors has been an ignored issue in cooperative theory (Condon, p. 22). Cooperative leaders have called for research on the functioning of boards of directors. One such call was for evaluation of "cooperative boards of directors in terms of composition, effectiveness, and size" and comparison of "cooperative boards with those of winning non-cooperative food system

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companies" (*Washington Cooperator*, p. 4). This article contributes to this process by comparing levels of contact with other firms through membership on boards of directors for cooperative and corporate firms in the agribusiness sector. Such contact occurs when outside directors sit on the firm's board of directors and when a firm's management or directors serve as outside directors on other firms' boards.

Background and Theory

In firms where ownership and direct management are separated to some degree, the board of directors functions as a governance structure that guides management decisions in the owners' interest (Williamson; Chandler). Cast in terms of agency theory, the board of directors, as representative of the owners, hires the managers as its agents to carry out the day-to-day business of the firm (Fama; Fama and Jensen). There is widespread disagreement, however, as to how well this monitoring mechanism works (Herman; Kotz; Berle and Means). If ownership is relatively diffuse and owners lack expertise compared with the firm's hired managers, then effective control of the firm may shift to the managers with the board of directors acting as a rubber stamp.

Concern over and measurement of this shift is central to debate about the locus of effective control in cooperatives and corporations. This locus in cooperatives has been controversial at least since the publication of Linda Kravitz's *Who's Minding the Co-op?* in 1974. Kravitz argued that as cooperatives grow they become dominated by professional management hired to direct such growth. This new breed of managers is "more concerned with the growth of profits of the business enterprise than with the growth and profits of the farmers who are members" (p. 79). Heflebower argues that de facto leadership by the managerial group "is but a logical consequence where the individual member's percentage interest in the cooperative is tiny" (p. 200).

These arguments mirror those concerning the locus of effective control in corporations first made by Berle and Means in their 1932 book. They are important background to the analysis of contact between firms through interlocking membership on boards of directors, which is the focus of this article. In the case of corporations, several theories seeking to explain the economic motives for such contact have been put forth. The first theory actually constitutes a null hypothesis where contacts are the result of current board members and management choosing directors for friendship or prestige rather than for economic reasons. Overlapping memberships occur because new directors are chosen from a limited pool of people who are known to and known as business leaders.

Other theories emphasize economic motivations for intercorporate board contacts. Mizruchi labels these theories coordination, cooptation, and control. From the coordination viewpoint, interlocking directors are a means used by boards of directors and management to keep contact with and harmonize policy between related firms. They can, therefore, be viewed as a means of reducing transactions costs (Williamson) or of coordinating collusive action.

The cooptation or resource dependency theory assumes that management is in effective control of the corporation and chooses directors as a means of controlling its environment (Pennings; Pfeffer). Management seeks to place representatives of firms that control resources that are crucial to it on its board. These representatives are coopted in the sense that their intimate contact with the firm makes it possible for the firm to gain their support and cooperation. The interlocks are again between related firms, but their function is to allow the initiating firm to become more effective through cooptation of others.

The final theory, control, turns the cooptation scenario on its head. Here nonmanagers, who may be stockholders or have other interests in the firm, pressure for outsider seats on the board of directors in order to monitor and control the firm's decisions. The need to limit management discretion by placing nonmanagers (outside directors) on the board is stronger in public than in private corporations where there is little separation of ownership and direct management control. What is unique about cooperative board composition, in this context, is that the boards are nearly exclusively made up of a single type of outsider (nonmanager member-patrons). This composition reflects the stress placed in cooperative organization on member control.

This article does not seek to distinguish interfirm board contacts based on control relationships from those having a coordination or cooptation motivation, particularly since many contacts likely serve more than one function. Instead it compares patterns of director contact with other firms, especially financial institutions, by cooperatives and corporations. Regardless of the initial motivation for such contact, it serves to increase the amount of information available to the firm in its decision making. The information may be in the form of specialized expertise (e.g., that of a lawyer or banker) or generalized knowledge of market conditions (e.g., that of a supplier or buyer) held by an outside director. It may also be in the form of information gained by the firm's officers and directors when they serve as outside directors on other firms' boards. Where such information improves firm decision making, outside contact through boards of directors will be likely to increase firm performance (Baysinger and Butler).

Data

This article compares the prevalence of director contacts with outside firms for a sample of 222 large agribusiness firms for 1976. Since rules governing who may sit on cooperative and corporate boards are little changed in the interim, the patterns in these data are likely to be representative of current levels of contact.

The sample of large agribusiness firms operating in the United States was constructed by the Corporate Data Exchange (CDE) in publishing its *CDE Stock Ownership Directory—Agribusiness*. CDE identified leading agribusiness firms in the farm input, food processing, and food distribution subsectors. In order to select companies that occupied the leading positions in the industries that make up these subsectors, CDE employed different revenue cutoff points for inclusion in the sample for each industry.

The smallest minimum revenue level was \$175 million for commercial feed and seed operations, and the largest minimum level was \$850 million for retail grocery chains. In 11 of the 16 industries included, the minimum revenue size ranged from \$200-\$350 million.

Of the 222 large firms in the sample, 170 were publicly held, 25 were private, and 27 were cooperative. Nearly half the sample firms had operating revenues greater than \$1 billion, and another quarter had operating revenues between \$500 million and \$1 billion. Cooperatives and privately held firms are more heavily represented than publicly held firms among the smaller firms in the sample. Although only 23 percent of the public firms had operating revenues of less than \$500 million, 52 percent of the private firms and 33 percent of the cooperatives were below that level. Sixteen firms (14 public and 2 private) were foreign companies operating in the United States.

Contact with outside firms through membership on boards of directors was measured over a broader sample of 455 firms. Measuring contacts between the sample agribusiness firms alone would be too limited in scope. The number of such contacts is relatively small because antitrust law generally prohibits interlocking directors between direct competitors and because many director contacts are with firms in other sectors of the economy. On the other hand, measuring all contacts with other firms is an unmanageable task since data on interfirm contacts through board members must be generated by coding and matching the names of firms' directors and officers.

Here contacts are measured over a sample of 455 firms that includes 212 of the 222 agribusiness firms,¹ 111 commercial banks, 52 other financials, 69 insurance companies, and 11 other manufacturing, utility, and service firms. Thus the sample heavily emphasizes director contacts with firms in the financial sector.² This emphasis is justified by the key role access to capital plays in firms' success. It also provides an important basis of comparison between cooperative and corporate firms in the agribusiness sector. There is widespread concern that the financial structure of cooperatives places strong constraints on the ability of these firms to raise sufficient capital (Rhodes; Kraenzle, Street, and Richardson; Vitaliano). The absence on cooperative boards of outside directors representing financial institutions may reinforce this constraint by limiting financial institutions' ability to monitor the cooperative's use of borrowed capital. This sample allows direct comparison of levels of interfirm board contact in the corporate and cooperative sectors.

Levels of interfirm contact through membership on boards of directors are compared by organizational type and type of direct control. Under organizational type, comparisons are made between large publicly held, privately held, and cooperative firms in the agribusiness sector. Publicly held firms are expected to have more board contacts than those that are privately held because, due to a greater separation of ownership and direct management, they have larger numbers of outside members on their boards. Cooperatives, like privately held firms, are also expected to have lower numbers of board contacts but for different reasons. Unlike private firms, cooperative boards do have large numbers of outside directors. Neverthe-

less, their presence is not expected to result in many board contacts because nearly all the outside directors are member-patrons who are not associated with other firms that make up the sample.

The first comparison by organizational type is somewhat rough since the publicly held category is large, including firms with diverse types of control structures. Thus firms are further compared on the basis of type of direct control. Each agribusiness firm was classified as being under owner, financial, cooperative, no-identified-center, miscellaneous, or mixed control based on the identity of its leading stockholders and the size of its stockholdings (Caswell). The miscellaneous and mixed categories include firms under the direct control of nonfinancials or under the shared control of more than one type of stockholder. The no-identified-center-of-control category includes agribusinesses where no center of direct control was found, so they did not fall into any of the five other categories (Caswell, p. 13).

As noted, the breakdown of firms by type of direct control allows a more refined comparison of interfirm contact through membership on boards of directors by separating the large category of publicly held firms into smaller direct control categories. In this breakdown, publicly held firms that are under strong direct owner control are grouped with privately held firms. Both are likely to maintain fewer contacts with outsiders through board membership because they more frequently concentrate ownership and management control in the same hands. They are less vulnerable to pressure from outsiders for seats on the board and have less need for the capital resources outsiders can offer. Financially controlled firms and firms with no-identified-center-of-control do not have such protection and are therefore likely to maintain higher levels of contact. Thus analysis of interfirm contacts based on direct control categories allows comparison of cooperative behavior to a range of corporate behavior.

The data set on interfirm contacts were constructed by coding the company, name, and position held by the officers and directors of the 455 firms included in the sample. Name matches were verified using biographical sources when necessary. A director contact is counted for the firm each time it has an officer or director in common with another firm in the sample. Therefore, the data set includes information on whether each firm maintained contacts through membership on boards with any other firms in the sample, the number of such contacts, and the number of other firms with which the firm was connected.

Comparison of Levels of Interfirm Contact

Among large firms in the agribusiness sector, public corporations are about twice as likely as cooperatives to be interlocked with other firms through membership on boards of directors and nearly three times more likely to be so than privately held firms (table 1).³ More than 85 percent of the public firms were connected to at least one other firm compared with 44 percent for cooperatives and about 30 percent for private firms.

Marked differences in interfirm contact are also evident when agribusiness firms are compared by type of direct control (table 1). None of the financially and miscellaneously controlled agribusinesses were isolated by

Table 1.—Number of Interlocked and Isolated Agribusiness Firms by Organizational and Direct Control Types, 1976

	Total		Interlocked		Isolates	
	Number	Percent ^a	Number	Percent ^b	Number	Percent ^b
Organizational Type:						
Public	170	80.2	147	86.5	23	13.5
Private	17	8.0	5	29.4	12	70.6
Cooperative	25	11.8	11	44.0	14	56.0
Total	212	100.0	163	76.9	49	23.1
Direct Control Type:						
Owner	105	49.5	76	72.4	29	27.6
Financial	23	10.8	23	100.0	0	0.0
Cooperative	25	11.8	11	44.0	14	56.0
No-identified-center	43	20.3	40	93.0	3	7.0
Miscellaneous	5	2.4	5	100.0	0	0.0
Mixed	11	5.2	8	72.7	3	27.3
Total	212	100.0	163	76.9	49	23.1

^aColumn percentage.^bRow percentage.

no board contacts with other firms in the sample. Similarly, only 7 percent of those firms with no-identified-center-of-control were isolates maintaining no interfirm board contact. About one-quarter of the owner and mixed controlled firms were isolates. Cooperative behavior is quite different; more than 50 percent of these firms were isolates with no board contact with other firms.

Comparison of mean levels of director and firm interlocks (number of other firms to which the firm is linked) show publicly held firms to be more highly connected than either cooperatives or privately held firms (table 2). The average large, publicly held agribusiness had 5.41 director interlocks with 4.24 other firms in the sample. In contrast, cooperative and private firms on average had about 1 director interlock with 1 other firm. Comparison of mean levels of director and firm interlocks using t-tests confirm, at a 1 percent significance level, that public firms maintain higher levels of interfirm contact than do cooperatives. Private and cooperative firms do not significantly differ in their levels of interfirm board contact.

Comparison of mean levels of director and firm interlocks by direct control type also shows a divergence in behavior between cooperatives and other large agribusinesses (table 2). Financially controlled firms maintain the highest levels of contact followed by firms with no-identified-center-of-control and owner controlled firms.⁴ T-tests for comparisons of mean levels of director and firm interlocks confirm, at a 1 percent significance level, that all three groups (financial, no-identified-center, and owner controlled) have significantly higher levels of board contact than do cooperatives.

Discussion and Conclusions

Low levels of interfirm board contact by cooperatives were expected, given that board positions are strictly limited in most cooperatives to member-

Table 2.—Mean Levels of Interlocking Directors and Firms for Agribusiness Firms by Organizational and Direct Control Types, 1976

	Director Interlocks		Firm Interlocks		
	Total Number	Mean	S.D. ^a	Mean	S.D. ^a
Organizational Type:					
Public	170	5.41	5.05	4.24	3.77
Private	17	.88	1.90	.76	1.52
Cooperative	25	1.32	2.46	1.00	2.04
Total	212	4.57	4.93	3.58	3.72
Direct Control Type:					
Owner	105	3.58	4.59	2.76	3.33
Financial	23	8.35	4.72	6.43	3.78
Cooperative	25	1.32	2.46	1.00	2.04
No-identified-center	43	6.93	5.02	5.74	3.87
Miscellaneous	5	3.60	2.07	3.00	1.58
Mixed	11	4.64	5.39	3.00	2.79
Total	212	4.57	4.93	3.58	3.72

^aStandard deviation.

patrons. The absence of other types of outside directors, the low frequency of corporate involvement in cooperatives (Schneider), and the rarity of a member-patron sitting on the board of more than one cooperative explain the low level of this type of interfirm contact. The contact that does exist is largely the result of intercooperative relationships.⁵

Cooperatives are nearly completely isolated from the exchange of board members that results in a range of outside directors with varying expertise participating in firm decision making. Corporate firms in the agribusiness sector maintain varying levels of director and firm contacts through board membership. Privately held firms, like cooperatives, maintain little contact, apparently preferring to keep close control of the firm by limiting the participation of outsiders on their boards. In all other cases, corporate firms have significantly higher levels of both director and firm contact than do cooperatives. If this exchange of board members is an important source of information and expertise, then the structure of cooperative boards may inhibit the quality of their decision making (Robbins; Condon; Rhodes). As noted at the outset, however, opening cooperative boards to a range of outsiders may well dilute membership control, which is a core principle of cooperative organization. The data and analysis reported in this article should provide background for debate over the composition of cooperative boards of directors.

Notes

1. Ten of the agribusiness firms in the CDE sample were excluded from this analysis because information on membership on their boards of directors was not available. Of the 10 excluded, 1 was publicly held, 7 were privately held, and 2 were

cooperative. A complete list of the 455 firms included in the analysis is available from the author.

2. The sample was constructed based on patterns of stockholding in large agribusiness firms as part of a larger study on patterns of corporate control in the agribusiness sector (Caswell, p. 12).

3. In this and the following comparisons, size of firm may be an additional factor influencing levels of contact. Other analysis (Caswell, p. 18), however, suggests that although this may be true for public firms, privately held and cooperative firms have uniformly low levels of board contact regardless of size.

4. The mixed and miscellaneous control categories include firms with diverse control situations. They are excluded from this analysis because their group averages are not meaningful.

5. For example, CF Industries had interfirm board contact with eight other cooperatives who sent directors to its board.

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