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The Foundations of the "Public" Organisation: Strategic Control and the Problem of the Costs of Exclusion

Silvia Sacchetti♦ and Carlo Borzaga♣

Abstract

Henry Hansmann has argued that ownership is best allocated to only one group of homogeneous patrons, the group for which the total of cost of governance and contracting is minimized. This paper suggests a different model of governance, which is inclusive of multiple affected patrons, and which is growing especially in welfare service provision. The model considers an additional set of costs, the costs of excluding certain groups of patrons from the firm's strategic control. The objective, which is Coasean in both spirit and formulation, is: (1) to reiterate the need to separate ownership and control by considering strategic control beyond ownership, (2) to show that the emergence of firms where control is shared among different groups of patrons can be explained as a way to economize on exclusion costs, and (3) to argue that the efficient governance structure must minimize the sum of internal costs for sharing control and the costs for contracting, and add also the costs of exclusion for all the firm's patrons combined. The paper argues that this setup helps explain the public organisation, defined as a private organisation with public interest objectives, and further claims that this model helps justifying the recent emergence of multi-stakeholder social enterprises within the third sector.

Keywords

Firms, Governance, Externalities, Stakeholding

JEL classification codes

L2, H23, M14, O16, P14

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In devising and choosing between social arrangements we should have regard for the total effect. This, above all, is the change in approach that I am advocating.

(Coase, 1960: 44)

1. Introduction

Scholars of the theory of the firm, and especially Hansmann (1996), have long argued that ownership is best allocated to the group of patrons for which the total of cost of governance and contracting for all the firm's patrons combined is minimised. He also has argued that the cost of governance are minimized when the patrons who own the firm share the same interest and aims. The model presents a number of limitations. Among the most highlighted criticisms is the fact that it disregards the difficulties that diverse firms can have in terms of their capacity to generate different amounts and types of value (Adams and Deakin, 2017; Borzaga and Tortia, 2017). Instead, our approach keeps its focus on costs, but reformulates the firm costs calculus by taking into account an additional set of costs, the costs of excluding certain groups of patrons from strategic control, expressed in terms of uneven development. In addition, our approach hints to a set of opportunity costs activated by exclusion, such as the amount of value to which patrons and society have to renounce when exclusion costs are present.

The objective, which is Coasean in both spirit and formulation, is: (1) to reiterate the need to separate ownership and control by considering strategic control beyond ownership, (2) to show that the emergence of firms where control is shared among different groups of patrons can be explained as a way to economize on exclusion costs, and (3) to argue that the efficient governance structure must minimise the sum of internal costs for sharing control and the costs for contracting, and add also the costs of exclusion for all the firm's patrons combined. This setup helps justify what can be called "public organisations", defined as private organisations with public interest objectives, and further claims that this model helps explaining the recent emergence of multi-stakeholder social enterprises.

The theoretical framework is set up by Hansmann's model. Hansmann (1996) focuses on the costs of ownership. He thinks that the most efficient form of ownership occurs when a firm is governed by "the class of patrons for whom the costs of market contracting are highest" and "the costs of ownership are lowest" (1996: 47). More generally, his calculus indicates that in order to reach efficiency, governance must minimise total costs or the sum, over all the firm patrons, of costs of contracting (CC) and costs of ownership (CO).

$$CO_j + \sum_{i=1}^{n-1} CC_i$$

In this way, ownership economises on transaction costs by avoiding market contracting without ownership for one class of patrons. If it were not for CO, it would follow that all patrons should be assigned ownership rights to minimise costs.

Even in the presence of CO, however, there is no a priori to believe that such costs are less than CC for only one class of patrons – this could be the case for multiple patrons, and perhaps even all patrons. Hansmann (1996: 44) actually points this out in his book in the sub-section entitled "Why Not Make Everybody an Owner?", but maintains that CO would multiply if multiple groups were involved due to heterogeneity of interests. He suggests that control over strategic decision-making should be given to only one patron, specifically the one whose interests are less safeguarded by a contract with respect to other interest holders, provided that CO are kept at reasonable levels. This would happen, for example, if clients (e.g. patients in healthcare; debtors and creditors in banking, etc.) did not want to be directed by investors' interests and recognised the advantage of self-directing themselves, according to their own interests. The ownership of the most vulnerable public (for instance, in healthcare, patients *vis a vis* investors) is the solution to contract incompleteness, information asymmetries and ultimately a response to the possibility that investors pass the risk of enterprise onto users or clients. This criterion works towards producing more value for the owners, hence it allows to minimise conflict and total costs.

The problem we identify with substituting market with organised transactions under the ownership and control of one single category of patrons lies in Hansmann's assumption that there is only one market that does not coordinate resources efficiently. However, as Hansmann in part recognises in his treatment of CC, when multiple and potentially conflicting interests are at stake and transaction costs are present, nor market contracting, nor the ownership of one class of owners can avoid producing negative (intended or unintended) effects – externalities – on the excluded patrons and on society more broadly, unless there is a way to broaden the scope of strategic control, or decision-making. These negative effects also generate opportunity costs in terms of the positive effects (e.g. greater effectiveness of services, greater equality in material and non-material surplus distribution) that excluded patrons, and society more broadly, have to give up.

Though economic theory has explained why giving control rights to multiple patrons can be costly (besides Hansmann see also Olson, 1991; Birchall, 2014; Vidal, 2014), it is less clear why so little attention has been devoted to the fact that excluding patrons from strategic control can also be costly. We wish to introduce the costs originated from exclusive control rights, and ask: what is the lowest-total-cost assignment of strategic control? In so doing this work re-founds the governance economic calculus presented by Hansmann, including, alongside the costs of market contracting and the costs of ownership, the costs of exclusion.

In shedding light on the allocation of control rights to multiple patrons, the model sets the premises for defining what can be called the "public organisation". Clearly here the word "public" is not used in the traditional sense of being owned by the public authority. It is rather understood in the sense of giving control rights to multiple patrons so that they can pursue a plurality of needs and interests by

means of organised activity. In the literature, the closest example of public organisation is the multi-stakeholder social enterprise, to which we will refer in more details towards the end of the paper.

Following the line of reasoning developed in transaction cost theory (Williamson, 1985), the paper's model indicates that the public organisation will share strategic control with a plurality of patrons:

i. The higher the costs of exclusion from strategic control; which means the higher the costs of relying on market contracts without control, or of not having any form of transactions (costs of exclusion);
ii. The higher the value of continuity in transactions;
iii. The less the rise of the cost of organising (or costs of inclusion) as one more patron is included, and the slower the speed of the rise.
iv. The higher the economic value of the final product when one additional patron is given controlling powers (with or without ownership).

Bridging theory with practice, the new governance model suggested in the paper also helps to explain the emergence of what are increasingly identified as multi-stakeholder organizations, especially in welfare sectors, albeit not exclusively. This growing tendency is evidenced in the literature, in policy documents, and by some of the regulations that several organizations, especially social enterprises, have voluntary adopted, or were asked to respect by law, in order to guarantee the participation of multiple patrons in strategic control[1]. Likewise, it contributes to identify the shortcomings of the application of private business mono-stakeholder models to state-owned organisations and public administrations in general. The paper also contributes to the policy debate around the creation of more inclusive economies, under the so-called "inclusive capitalism" agenda promoted by the former US Treasury Secretary Lawrence Summers, which recently featured also in a Governor of the Bank of England's speech (Carney, 2014), as well as in the renewed awareness of the UK Labour party in cooperative forms of ownership[2].

The structure of the paper is as follows. Sections 2 complements this introductory Section with a discussion of Hansmann's model. Section 3 discusses the shift from ownership to strategic control. It presents the problem of exclusion from strategic control, and lays the foundations for justifying why strategic control can be extended to multiple patrons. Sections 4 presents a new model which accounts for exclusion costs. Section 5 discusses the new model in terms of supporting institutional solutions and highlights research implications. Section 6 concludes.

[1] Cf. Cafaggi and Iamiceli (2009) on a comparative study of legal requirements across European countries. Also, policy on stakeholder inclusion is exemplified by the European Social Business Initiative (European Parliament, 2012). The 2014 report on European social enterprises prepared by Borzaga and Galera for the European Commission has highlighted the rich range of stakeholders that form the social enterprise ecosystem (European Commission, 2016). In addition, Cordery and Howell (2017) offer a perspective on stakeholder involvement in private healthcare organisations in New Zeeland.

[2] "This standard capitalist model of business organization may be loosely defined as a legal structure in which private capital investors have the collective right to appoint management, as well as ownership rights to any residual income generation. The hegemonic position of this form of ownership does not necessarily imply that it is the most beneficial method through which to provide economic and social well-being to our society" (Labour UK, 2017: 6).

2. Discussion of Hansmann's model

Hansmann's model is based on a set of assumptions and focuses on contractual and ownership costs which are, however, insufficient to account for the effects of the exclusion of patrons from strategic control.

First of all the model's focus is on ownership, which – in the model - overlaps with control. Exclusion costs are resolved with market contracts.

Secondly, in the model, only one market can fail or fails with high costs, thus justifying single-ownership (and control). The assumption that underpins the imperative of single stakeholder ownership is that this solution maximises efficiency, since CO for the controlling patron is lower than the sum of the costs of trading with all the remaining patrons. Occasionally, however, Hansmann notices that "enfranchising" a patron requires that another is "disenfranchised", and that yet another patron is denied franchise (Hansmann, 1996: 43). The disenfranchised, in Hansmann's calculus, are all the organisation's patrons linked to the controlling patron (who bears CO) by means of market contracting (for which the firm and other patrons bear the sum of CC generated by transactions). For example, an investor-owned organisation is justified by high levels of transaction costs affecting investors. Because of this, investors would be "enfranchised," whilst other patrons (e.g. consumers, workers, volunteers, creditors) would be disenfranchised. With all the disenfranchised patrons, the owner would set contracts on the assumption that markets work with low transaction costs and, overall, market relations are assumed to protect disenfranchised patrons using regulation and well-defined contracts. But Hansmann's model undervalues that multiple markets can fail for a variety of patrons at the same time, such as the market for capital, for labour, for credit, for goods or services. Typically, contractual solutions are likely to fail when non-owners engage in transactions of highly specific type, since opportunism may become an expensive possibility (Williamson, 1985): for example, in an investor-owned company, workers with sunk skills can be subject to management's opportunistic behaviour (cf. Navarra and Tortia, 2014). If this is the case, then, improving the efficiency for one patron only, whilst disenfranchising or denying any form of association to other patrons cannot be argued to be, overall, a Pareto-improvement (cf. Sacconi, 1991). However, Hansmann does acknowledge that there are circumstances under which both ownership and contracting costs are high for all patrons, which is the type of situation that justifies the non-profit organisation, and we will refer to this in more detail later in this section. Multiple failures occur, at least in part, because market contracting is a good solution only when there is no power asymmetry, when transactions are non-specific, standardised and recurrent, and when any of the parties can turn somewhere else if transactional costs emerge (Williamson, 1985).

The third critical assumption is that, because the reduction of total CC is assessed in terms of reduced costs for the firm or its contracted patrons, the effects of interactions that are not mediated by ownership or market contracting are excluded from the calculus altogether[3]. Actors who are affected,

[3] Hansmann (1996: 21) writes that "[A]assigning ownership of the firm to one or another class of the firm's patrons can ... often reduce the costs of transacting with those patrons – costs that would otherwise be borne by the firm or its

but are not tied to the firm by means of market contracting or ownership, are not considered as patrons and are not involved in any form of association or control on the organisation. For example groups who are out of the welfare system (e.g. people with no citizenship), categories who have no exchange power, or future generations would not be acknowledged neither through ownership, nor through contracts.

These limitations to the model emerge in Hansmann's treatment of non-profits. He acknowledges that non-profits may prevail when the costs of both ownership and contracting are exceptionally high for a given class of patrons (usually donors/users). On the one hand, giving ownership to any other class of patrons would "inefficiently threaten those patrons' interests". Nonetheless, giving ownership to the weakest class would incur very high CO, since the non-profit structure incurs costs of its own in the form of the managerial agency problem (Hansmann, 1996: 48-49). Notably, this logic is inconsistent with his usual calculus of comparing the costs of contracting with those of ownership. As a solution, he suggests that non-profits should have no owners, and be controlled by a board of trustees However his analysis does not consider assigning ownership to multiple categories of patrons, even if this some non-profit organisations feature this form of governance.

It therefore seems that even his analysis of non-profits confirms that the calculus is based on some missing type of cost (that he does not explicitly identify) but which seems to be related to the absolute CC as opposed to just their comparison with CO. What Hansmann suggests is that, even if it is not efficient to make a certain class of patrons owners, excluding them from governance would incur such a high level of costs (unspecified) beyond information asymmetries for it to be undesirable (what Hansmann dubiously refers to as "inefficiently threatening their interests"). The point here relates not only to non-profits but to all types of firms, since Hansmann in fact states that "the distinction between non-profit firms and firms owned by patrons who are very poor monitors is often negligible" (Hansmann, 1996: 49) and goes on to show how this is true for all forms of enterprise (e.g. worker co-operative, user co-operative, investor-owned firm, albeit he acknowledges that this latter typology can be equivalent to a co-operative of investors).

3. The problems of exclusion

Because multiple markets often fail at the same time, the sources of market failure that Hansmann identifies as costs of contracting[4] persist for all or several other patrons except for the owners. For

patrons. To assign ownership to someone who is not among the firm's patrons would waste the opportunity to use ownership to reduce these costs."

[4] Theory recognises a number of market failures in connection with market contracting. In the chapter entitled "Costs of contracting," Hansmann (1996) elaborates on what costs can be reduced by assigning ownership to patrons. In particular, he catalogues the following: simple market power leading to monopoly pricing and under-consumption, lock-in problems due to idiosyncratic investments and uncertainty, risks associated to long-term contracts, information asymmetries between owners and patrons, time and effort spent for strategic bargaining in the presence of asymmetries, inefficiencies arising from obstacles to communication of patrons' preferences, and from compromise among diverse patrons' preferences by choosing what suits the average patron's preferences, costs that patrons bear because of the negative subjective effects of the contracting ("adversarial") experience that induces alienation (Hansmann, 1996: 33).

example, information asymmetries (e.g. in the labour market, in health, social or educational services) and lock-in situations (for example in energy markets or financial services) imply under-consumption due to higher prices, lower quality, or the unethical employment of users' resources (e.g. users' personal information; clients savings) to extract extra profits. A focus on the minimisation of ownership and contracting costs can generate also failure to produce goods of higher societal value. In addition, besides these classic types of market failures, we identify an additional failure, which is not necessarily originated by the distinction between owners and non-owners, or between those who buy and those who sell a service within the market.

This is the failure to allocate strategic control rights (rather than ownership rights) evenly across patrons, which Cowling and Sugden (1998) call "strategic failure". As argued in Zeitlin (1974), strategic control is the power to take strategic decisions, with or without ownership (cf. Berle and Means, 1932; Hymer, 1972; Cowling and Sugden, 1998). The relevance of strategic failure is in the inequality it generates. Uneven distribution of strategic control power concentrates benefits (in terms of income, status, knowledge, self-actualisation and wellbeing) in the hands of those who exert strategic control, while leaving out those who do not partake in it (despite their interests) (cf. Hymer, 1972; Zeitlin, 1974; Cowling and Sugden, 1998). It is therefore strategic failure which generates exclusion costs. These are carried by those excluded from strategic control and can affect society as a whole. They can be observed in the uneven distribution of income, status, and knowledge (due to lack of involvement in decisions of interest), as well as in uneven levels of self-actualisation and overall wellbeing of patrons (due, for example, to the failure to produce goods with a substantive impact on people wellbeing). These costs derive from an imbalanced distribution of strategic decision-making power (rather than to failures generated by the use of the market, or organised transactions so as to maximise restricted interests) and are generally related to the role that each patron has with respect to strategic control rights. In general, exclusive control solutions (which are typical of industrial capitalism organisations) impose quantifiable costs to society, which can be approximated by the size that welfare expenditures have reached (subtracting societal resources from other uses), and by the rise of material and immaterial forms of poverty where welfare and social ties are absent or insufficient.

Exclusive control generates exclusion costs also for specific categories. In social care, for example, when the service offered by private businesses or by the public sector does not respond to specific care needs, the result is a worsening of status and income or an opportunity cost in terms of time used to provide unpaid care instead of undertaking other activities, for families and especially for women (cf. Himmelweit, 1995). These dynamics lower family and women's income and reinforce social and economic inequality. They also reinforce other exclusion costs attached to loss of individual self-actualisation, which social psychologists have associated with lack of recognition, the feeling of not counting and being locked in undesired situations which limit people wellbeing (Maslow, 1968; Deci and Ryan, 2000). Likewise, concentration of control restricts the applications of the knowledge and creative intelligence of excluded patrons, thus imposing a cap that can reinforce path dependence and the persistence of undesired problems. Patrons could instead contribute to resolve societal challenges if included in strategic control (a good example is that of common pool resources, Ostrom, 1990).

Exclusion costs are also associated with the increase of exchange and authority relations across society, to the detriment of relations based on cooperation and reciprocity (Polanyi, 1977). In particular, authority relations intensify as a result of concentration of strategic control in the hands of one patron. Complementary, exchange relations rise because of contractual solutions with all other patrons. By substituting cooperation with authority and contractual solutions, single-patron governance erodes the space for relations based on cooperation, deliberation and reciprocity, and can contribute to reinforce patterns of intolerance, isolation and loneliness in society.

The need to reduce undesirable social costs by enlarging control over strategic decisions is also supported by the specific view on externalities proposed by Meade (1973). He defined externalities as "an event which confers an appreciable benefit (inflicts an appreciable damage) on some person or persons who were not fully consenting parties in reaching the decision or decisions which led directly or indirectly to the event in question" (quoted in Cornes and Sandler, 1996: 39). Interestingly, Meade relates the occurrence of externalities to the exclusion of interested actors from the decisions that led to the external effect. Another peculiarity of this definition is that it does not refer to any specific context or institutional solution (Cornes and Sandler, 1996). Therefore, this interpretation of externalities explains their existence by pointing at the exclusion of patrons and their interests, rather than to the absence of markets and property rights. In addition, Meade's definition leaves the option open for multiple markets and organizations to fail at the same time; or not to fail at all, but in fact changing the distribution of surplus (broadly encompassing income, social recognition, knowledge, self-actualisation and overall wellbeing)[5] when decision-makers alter prices, technologies, organisation of labour also for other patrons (Hymer, 1972; Cowling and Sugden, 1998; Sacchetti, 2004).

We refer to exclusion costs rather than externalities because commonly (and differently from Meade's interpretation) externalities are understood as "uncompensated interdependencies" in the context of competitive markets. The solution proposed by economic theory is to define the external effects as a good or a disutility that can be traded. It is then necessary to define who has ownership rights on the good to be exchanged, that is who can claim a monetary compensation or derive income from excluding others from exchange (cf. Alt and Shepsle, 1990). Thus, in the externality literature, costs of exclusion are understood as the costs maintained by owners to exclude others from the use of production factors and from the appropriation of the resource units generated by production factors. They are, in other words, transaction costs borne by the owner of property rights. Differently, in this work, exclusion costs are meant as the costs borne by the excluded patrons to the advantage of incumbent patrons. They are externalities borne by those who do not have strategic control rights, whether they own or do not own production factors, and whether they engage or do not engage with the organisation through market contracting. Because they foster overall inequality, patron-specific effects also extend to the entire society.

[5] Meade (1973) referred in particular to externalities affecting the distribution of income and property, while Hymer (1972) more comprehensively referred to the effects of uneven distribution of strategic control in organisational hierarchies in terms of uneven distribution of income, status and authority across people and nations.

4. From ownership to membership

The reduction of exclusion costs requires a variety of institutional solutions, within which Hansmann's model portrays a specific case, consistently with negligible exclusion costs and strategic control coinciding with ownership. This is because ownership rights do not imply strategic control when decision-making bodies fail to give representation to all types of owners (such as: minority and majority shareholders in business corporations, small and large farmers/users in co-operative firms; old and new member workers in worker co-operatives), or when management cannot be monitored, or is not made accountable to all owners[6]. In addition, there are actors who bear the effects of the organisation's activity but are denied any form of association with the owners. These can be community constituencies or patrons at the so-called bottom of the pyramid (Hall et al. 2012), who do not have the resources that enable them to be involved either through ownership, or through market contracts[7].

Strategic control requires, therefore, the use of other forms of representation in decision-making bodies. To encompass multiple types of control, *we refer to membership rather than ownership*, where membership is broadly understood as involvement in the strategic control or governing function of the organisation, with or without ownership. This shift is consistent also with Pestoff (2017: 90), who argue for the need to "making membership meaningful".

With enlarged control rights, managers can be asked to justify their actions in front of multiple patrons. At the same time, managers' extended fiduciary duty would enable managers to take into account a wider set of interests, beyond those of owners, when making strategic decisions.

As an illustration of what extended strategic control may imply for patrons, consider the case of a hospital and community care clinics owned by investors who, in Hansmann's terms, are good monitors and homogeneous enough to bear low ownership costs. The owners decide to centralise diabetes community services within the hospital in order to take advantage of scale economies. This implies a closure of local diabetes clinics. Besides market failure costs, such as under-consumption caused by the difficulties in reaching the hospital premises, costs of exclusion arise, including a decrease in patients' health and wellbeing and an increase in family care duties, which as a norm, impact on women, increasing their load of unpaid work (Himmelweit, 1995). Despite the costs of exclusion engendered for specific patrons and the collectivity, it would be hard for managers to reject this strategy if they owed a fiduciary duty exclusively to investors. However, if the duty of loyalty is broadly understood to apply to a wider set of patrons (i.e. patients in general, and specific classes of

[6] The problem has been originally identified by Berle and Means (1932) who observed the separation between owners and managers controlling the firm, and then developed by Jensen and Meckling (1976) who theorised the opportunity of making managers owners in order to align the objectives of managers with those of owners. Agency theory sees the firm as a complex system of contracts between different agents with conflicting interests. Internal contracts, in particular, specify: the decision rights of agents, how performance is evaluated, the rewards, how residual claims are distributed for each agents involved in internal contracting, and finally decision-making rules on issues such as performance measurement and reward distribution (Fama and Jensen, 1983).

[7] As an illustration, consider the development of economic activities across parts of North-America, and how over the last 150 years this has been based on the Western market capitalism model: e.g. on economic exchange for gain and accumulation. Consider also that the concentration of strategic control that pairs with market capitalism has had the effect of changing the environment and landscape profoundly, and of marginalising First Nations, their lifestyles, and interests.

patients such as elderly people and people with reduced mobility, but also medical staff who would not want to place their professional ethics at risk by denying healthcare to patients with reduced mobility) it would be possible for health managers to reject the indication to centralise services on the grounds that there are vulnerable members and society at large who would suffer from centralisation, and increasingly so given demographic trends. Losses for the weakest classes of patrons (e.g. worsening of health conditions) and for society (e.g. in terms of under-consumption of preventative care, hospitalisation or increased marginalisation of the elderlies and of family carers, for instance) would outweigh the gains for investors. By extending control rights to multiple patrons, managers would not be able to support and justify their actions (and preserve their position) while, at the same time, disregard the interest of vulnerable patrons. Extending governance rights to multiple patrons and, therefore, managers' fiduciary duty, would have the effect of reducing the production of exclusion costs, as well as market failures.

Following these considerations, we rely on different premises with respect to Hansmann's analysis of the governance problem:

- we consider strategic control rather than ownership. We associate control with membership (with or without ownership). Our focus is therefore on membership rather than ownership.
- a focus on strategic control highlights strategic failure, besides failures in the use of market exchange, contracting, and organised transactions.
- strategic failure is identified as the cause of uneven distribution of income, status, power, knowledge, self-actualisation and overall wellbeing among patrons. These are the costs of exclusion, which we introduce in the governance economic calculus.

5. The total costs model

The existence of exclusion costs suggests the need for a new firm model which takes into account the overall coordination costs, rather than being confined to the costs of ownership and market contracting. Moreover, because we consider strategic control rather than ownership, we do not talk of ownership, but of membership (where by membership we mean the right to partake in strategic control with or without ownership).

The question would be: when does the public organisation stop including patrons? The demand hints to the trade-off between the costs of extending membership to patrons (costs related to inclusion) and the costs of excluding patrons from membership, with or without the use of contracts (costs related to exclusion). Given a total number of patrons, N, who are interconnected with the organisation (directly or indirectly, informally or on a contractual basis), the inclusion of patrons minimises a function that includes membership costs (CM), contractual costs (CC), and the costs of exclusion (CE) for each group of interested actors: those who have membership (m), those who hold contracts without partaking in strategic control (c), and those who have an interest but have no voice either through membership or contracts (N-m). To simplify, we assume that within each group of patrons

there are no collective action costs. We also assume that the cost of the interaction between patrons is the same for all combinations of patrons.

$$TC = \sum_{m} CM + \sum_{e} CE + \sum_{N-(m+e)} CC$$

Starting from a firm with only one type of owner, the choice of whether to include additional patrons needs considering CM, CC and CE together. Accordingly, more patrons are included if, for each patron, the sum of CE and the sum of CC taken together is lower than the sum of CM.

CM are dynamic in our model, and change with the number of patrons included. The inclusion of one more patron implies an increase in CM and a change in the distribution of resources and outcomes (income, status, power, knowledge, wellbeing) that lowers the costs of exclusion (CE). In addition, if a contractual relation is internalised and transformed into a membership relation, contractual costs (CC) decrease as well. In order for CE to be irrelevant, contracts should remain in place only for patrons whose interest is largely satisfied by means of market/contractual exchange (for instance, if the interests of the patrons who do not have membership can be largely protected by means of contract).

In this interpretation, the most efficient solution (from both the allocative and distributive points of view) is one for which *total* costs (thus including CE) are the lowest. The model is therefore useful to compare different alternatives on the basis of the total level of governance costs generated. Following this construct, when ownership and control coincide, Hansmann's model would be a specific solution that can be applied only when the sum of CE is negligible or, in other words, when only one market significantly fails and all the other patrons can be usefully compensated by means of market exchange.

6. Discussion

The total costs model entails that the inclusion of an additional patron in the strategic control of the organisation increases efficiency if it reduces the sum of CE more than it raises the sums of CM and CC. This means that the efficiency of solutions is assessed in terms of the extent to which the combination of membership and contracts supports a reduction of inequalities in income, status, power, knowledge, and overall wellbeing. It follows that a patron must have a considerable advantage in joining the organisation, which can happen only if the decision making-process succeeds in including the patron's needs more than contractual solutions can do. On the other hand, incumbent members must have an advantage from including one more patron. The additional patron brings in new resources and, at the same time, CM does not rise uncontrolled.

At governance level, the aim of reducing the sum of CE requires extending control rights. To explain how the sum of CE is reduced, we consider decision-making processes as relevant tools for including

the interests and knowledge of multiple patrons. In particular, we consider the deliberative process, because of its participatory nature and its focus on the creation of the conditions for voice.

At the same time the sustainability imperative asks that the reduction of CE is done at the lowest possible CM. The rise of CM is avoided by introducing shared binding agreements among patrons. For example, a binding agreement to favour the inclusion of multiple patrons in governance bodies. In particular we reflect on the emergence of multi-stakeholder governance solutions.

6.1 Deliberation

Consider an organisation with a board of directors where different patrons are represented. Depending on the governance of the organisation, some can be elected among the owners while others can represent non-owners. In order to reduce the sum of CE, formal inclusion must be paired by participated decision-making processes, during which the board needs to reach binding agreements and joint decisions on the strategic direction of the organisation, which managers can then implement. Case studies and experimental results, one for all the work of Ostrom (1990; 2010), indicate that shared decisions and binding agreements emerge from cooperation among patrons. A precondition to cooperation is especially identified in communication. Studies show that when individuals can communicate between and among each other, agreements are respected (Sacconi and Faillo, 2010). In addition, experimental results show that co-operative agreements are respected also by those who are not co-operative in the first place. This happens because, as individuals interact within a co-operative institutional setting, they develop preferences that enable them to respect the agreement (Grimalda and Sacconi, 2005). In other words, preferences towards cooperation are shaped by the interaction of actors within an appropriate agreement.

What is the consequence for CE? A co-operative outcome can lower CE. The condition is that patrons engage in non-opportunistic communication. This form of communication has been discussed as co-operative deliberation, especially in the context of democratic and participatory institutions (Dewey, 1927; Elster, 1988; Bobbio, 2007). Deliberation works as a form of substantive involvement, which goes beyond the formal engagement entailed in the right to vote in organisational assemblies (which is typical of the ownership relation), as well as beyond the contractual obligation to deliver a service. Rather, the function of deliberation is to make each and every patron's interests explicit and yet transform it by the co-operative interaction, generating solutions based on argument rather than on power unbalances. As Elster (1988) notices, collective decision-making is democratic: a) when interested actors can participate, and b) when it is deliberative, meaning that decisions are based on rational and impartial arguments. In addition, patrons can develop a sense of 'ownership' for the decisions taken. In this way, decisions (from *de-caedere* or 'cut through' the multiple arguments and points of view; cf. Floridia 2011) are more likely to be legitimized, therefore respected and effectively implemented, than solutions generated by exclusive processes (Dewey, 1927; Granovetter, 1991; Young, 2000; Fransen, 2012; Sacchetti, 2015). Deliberation, in this sense, is not seen as a waste of resources and time but, rather, as a way to inject the experience and knowledge of multiple actors in the co-operative decision-making process, thus lowering the sum of CE. In addition, since it favours

reciprocal knowledge and trust, deliberation can work towards the reduction of opportunistic behaviours, thus lowering CM.

6.2 Multi-stakeholder solutions

The total costs model can be usefully applied to the study of multi-stakeholder organisational forms. These have emerged years ago and are rather diffused (especially in healthcare where health cooperatives are often governed by patients and medical doctors together). Multi-stakeholder organisations have already been acknowledged and regulated by law in several countries. However, they are still largely unknown and under theorised, having only recently attracted the attention of scholars. As discussed, multi-stakeholder organising is a way of governing production where various combinations of patrons (such as managers, workers, volunteers, users, donors, funders) share strategic control for their common, reciprocal good. How patrons share control remains, to date, an issue for research. What we know is that the democratic rule of one-head-one-vote has been considered inadequate also in co-operatives, because power would concentrate in the hands of the most numerous patron (Munkner, 2004). Rather, multi-stakeholding is a binding agreement meant to complement deliberative decision-making processes. Through multi-stakeholdership multiple patrons are legitimised by a binding agreement to include multiple interests. This agreement shapes the nature of the organisation, and allows it to pursue multiple aims through a careful distribution of voting rights and representation in decision-making bodies. Turnbull (2001), for example, has suggested that multiple interests can be represented through separate boards, which can then be re-joined in a common board, leading to a form of distributed control (cf. Birchall and Sacchetti, 2017).

Often the aim of multi-stakeholder organisations is to produce meritorious goods, such as welfare, health, educational, cultural, and community services, including public utilities, but not exclusively. The role of the multi-stakeholder structure has, in fact, been especially discussed by scholars who have emphasized its role in the provision of social and welfare services in the form of voluntary associations or enterprises (e.g. specific forms social enterprises such as social co-operatives in Italy) (Pestoff 1994, 1996; Borzaga and Mittone, 1997; Laville and Nyssens, 2001; Sacchetti and Tortia, 2008; Cafaggi and Iamiceli, 2009; Borzaga and Depedri, 2015).

Case studies show that multi-stakeholder forms capitalise on the resources of multiple patrons at different levels. For instance, multi-stakeholder organisations tend to make capital reserves indivisible. This also is a binding agreement that can encourage the inclusion of new patrons, since it represents a form of insurance against opportunistic behaviours (Cf. Williamson, 1975; Simon 1997), such as the emergence of short-term objectives either from patrons who are about to exit the organisation, or from new entrants (on the time horizon issue in non-conventional firms, cf. Furuboton and Pejovich, 1972; Navarra, 2010). Moreover, the constitution of reserves does not incentivise the maximisation of monetary surplus and prices, hence it allows for the distribution of surplus in favour of users in the form of lower prices and higher quantities/quality of output (Borzaga, Depedri and Tortia, 2011). Results also show that socialisation of surplus is related to higher performance levels (ibid.).

More generally, we can observe that multi-stakeholding legitimises participation and deliberation, enabling co-operative inquiry at collective level (or the creation of what Sacchetti, Sacchetti and Sugden 2009 call "public creativity forums"). By sharing control, this socially participated form of governance leads to a unique feature, which is that the activities of the organisation are run co-operatively and in the public interest (Sacchetti and Sugden, 2009). It follows that the outcomes of economic activity can benefit multiple patrons, especially because the processes include owners but also non-owners (cf. also Borzaga and Mittone, 1997; Sacchetti, 2015).

6.3 Implications for research

The total costs model sketches a general theory of the firm, which comprehends all organisations, private and state-owned, and explains a new way of conceiving the "public organisation", that is an organisation that sustainably extends control rights to multiple interested actors consistently with the common good. Moreover, the implications of the total costs model apply to private organisations, and are in line with concerns raised around the inequality effects of business (cf. Brammer, Jackson and Matten, 2012). For instance, within the corporate social responsibility (CSR) literature, specific perplexities have been presented by scholars who question "the paradoxes and ambivalences of CSR as a form of private governance" which, in systems of neo-liberal inspiration, has failed to challenge the primacy of shareholder value (Amable, 2011; Fransen, 2012; Kang and Moon, 2012; Kinderman, 2011: 50).

The model also applies to public administrations, helping to resolve the problem of how to govern organisations efficiently and in the public interest. Besides, the application of our model contrasts with new public management solutions that over the past decades have aimed at improving efficiency by introducing a private business model in public sector organisations (cf. Grönblom and Willner, 2009 for a critique).

Our model entails that the main reason why it is advantageous to establish an organisation with multiple patrons and deliberative processes is when, in its absence, the sum of CE is higher than the sums of CM and CC taken together. Multi-stakeholder governance and deliberation are therefore desirable when they minimise total costs. This point can explain why the inclusion of multiple patrons may require more than regulatory prescriptions. Experiences of multi-stakeholding in fact suggest that recent legal requirements in support of multistakeholding have had a slow impact (Borzaga and Depedri, 2015). Our model suggests that in order to implement inclusion in strategic control, major organisational innovations are required, not least to create the conditions for participation and deliberation, with varying costs attached (Sacchetti and Tortia, 2014). The explanation offered by the total costs model is that, in order for multi-stakeholder and deliberative solutions to become more widespread, organisational innovations must reduce CM (e.g. controlling the insurgence of opportunism and power unbalances among patrons). In addition, organisational innovation needs to develop fora for deliberation where new ideas can emerge from patrons' participation in strategic control, thus reducing CE. Moreover, advocacy initiatives may be needed to raise awareness among excluded groups. This may require a change in management culture. Limitations, may come from

managerial slack in providing or renewing appropriate platforms for participation and engagement (Spear, 2004). Threats may also come from free-riding and short-term orientation of existing members, who may not want to share strategic control and benefits with a wider set of patrons. Though we cannot go into the details of suggested solutions to these problems, we refer to literature that has emphasised the importance of the role of well specified rules and procedures in enhancing co-operation and in casting members' preferences towards it (Ostrom, 1990; Grimalda and Sacconi, 2005; Shaw, 2006; Cornforth, 2012). For instance, light has been shed on: the role of fair and shared rules that reflect the long-term interest of patrons (Ostrom, 1990); the importance of selecting managers who understand the value of an enlarged fiduciary duty and pursue the interests of multiple patrons (Hart, 1993; Blair, 1996; Heath, 2011; Sacconi, 2013); the positive role of diversity of board representatives for both social and economic performance (Zahra and Stanton, 1988; Fryxell and Lerner, 1989; Siciliano, 1996; Cornforth, 2012), the importance of monitoring and sanctioning free-riding problems (Williamson, 1975; Ostrom, 1990); the centrality of education, and management education, oriented towards the features of inclusion, cooperation and deliberation (Dewey, 1927; Enslin, Pendlebury and Tjiattas, 2001); the intensity of relational interactions between members and external patrons (Bridoux and Stoelhorst, 2016).

Following from experiences of multi-stakeholder organisations, further research is needed to explore what institutional solutions and organisational factors can lower CM and promote a culture of shared control and deliberation, and to what extent these can reduce CE. Clarifying these points could improve the understanding of the specific drives and solutions designed by organisation in order to implement plural membership. We know, in fact that in specific sectors, such as care or educational services, the inclusion of more than one patron can be required or strongly encouraged by law (for example in French SCIC – Société Coopérative d'Intérêt Collectif – in Italian social co-operatives and in Primary Health Organizations in New Zeeland)[8]. A growing amount of experiences, however, evidence that multi-stakeholdership can occur in a variety of sectors and prior or instead of regulation, through voluntary multiple membership[9].

In addition, research can address how the efficacy of collective action is ensured, how cooperation and preferences towards cooperation are developed, so that membership can be extended, agreements are respected and CM kept under control. This would imply to research when patrons are best included via ownership, or via board representation, or both.

In parallel, research can address when strategic control cannot be shared or shared to a limited extent, even in the presence of high CC, hypothesising for instance the presence of conflicts of interest leading to the effective possibility of opportunistic behaviour.

[8] In France multi-stakeholding in social enterprises has become a specific requirement. In the SCIC three patrons must be represented in the board: workers, beneficiaries, plus a third category to be nominated (this can include public administrations). In Italy, differently, the number and typology of patrons is open. In fact the law has instituted a "non discrimination principle" in the selection of members and the principle of independence from public administrations, which cannot be present in the board.

[9] Examples are the retail co-operative Eroski, in the Bask Countries, which includes both workers and consumers, or the Korean ICoop whose members are farmer and consumer organisations (cf. Birchall and Sacchetti, 2017).

7. Concluding remarks

Hansmann focused on ownership, but his model explains why ownership is a solution only when one market fails. It is not a general model and fails to explain multi-stakeholder solutions in the private sector, as well as the functioning of the public sector organisations. Moreover, it does not explain the persistence of unsatisfactory solutions, and the persistence of inefficiencies and societal issues. To develop a more general model this paper has argued that there is no reason to assume that important levels of market and contractual failure exist only for one patron. This can be even more relevant in sectors (such as health, social services, education) where the complexity of the interests affected requires a "public organisation" (as defined in the introduction) and can be regarded in practice as an explanation for the emergence of governance solutions where control is shared among multiple patrons. For this reason, we have introduced a new category of costs, the costs of exclusion, which are generated whenever interested patrons are not included in the making of decisions that produce effects on them.

The total costs model suggests that there are multiple coexisting ways of coordinating economic activities, and that failure to consider CE is associated with the coordination process in all its possible alternative forms. This means that both market and organised transactions can fail. We have argued that shared control can be used when CE remain high, after control rights and contractual obligations have been defined. In our model, CE are not a transitory feature of markets or governance solutions, but an intrinsic consequence of the failure of these coordination solutions to identify and address the needs of multiple patrons and society at large. The total governance costs model offers a solution and explains that CE can often be effectively reduced by opening strategic control to multiple patrons, not necessarily through ownership, but also using other forms of inclusion, participation and representation in decision-making. In addition, the model indicates that governance innovations must provide clear benefits for the new patrons and for incumbent members. In order to reduce CE, multi-stakeholder solutions have already emerged, though the challenges posed by CM for these organisations require further research.

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