

Expanded abstract

Legal persons in cooperative governance: financial effects on cooperatives in Colombia

Objectives

The purpose of this paper is to determine whether there is a statistically significant relationship between the composition of cooperative governance and the organization's capital structure and profitability. Although a range of studies identify the management and governance of social organizations as sources of sustainability and growth, they do not examine in depth the relevance of the composition of cooperative governance. Colombian law allows both boards of directors and supervisory boards to include representatives of other cooperative organizations as well as natural persons who are members of the cooperative. However, not all cooperative governance bodies in Colombia choose this option. Some cooperative governance structures are composed exclusively of cooperative members. Other governance structures include not only cooperative members but also representatives of other cooperative organizations. This study seeks to identify whether capital structure and profitability differ under these alternative cooperative governance compositions.

Methodology

This paper employs a quantitative methodology. The database was obtained from Colombia's Superintendencia de Economía Solidaria (SuperSolidaria). The database includes 3,600 Colombian cooperatives, for which information is available from 2003 to 2016. The available information includes characteristics of the solidarity-based organization, such as its taxpayer identification number (NIT), geographic location, financial statements disaggregated to six-digit accounting accounts, and the composition of the cooperative's governance bodies, distinguishing between natural persons and legal entities.

The estimated models employ capital structure and profitability as dependent variables. The explanatory and control variables include cooperative size and type, geographic location, number of members, asset tangibility, growth opportunities, and loan interest rates. In addition, a set of dummy variables is constructed to capture the presence of representatives of other cooperative organizations within the cooperative's governance bodies. Specifically, the variables include the ratio of legal entities to total directors, as well as binary indicators reflecting the presence of legal entities in specific governance bodies, namely the supervisory bodies and the board of directors. The models are estimated using ordinary least squares, fixed-effects panel estimators, and GMM to address potential endogeneity concerns.

Results

The estimated models reveal a statistically significant relationship between the presence of legal entities in cooperatives' governance bodies and both the capital structure and profitability of solidarity-based organizations. The presence of legal entities in cooperative governance contributes not only to greater discipline in leverage but also to higher financial profitability. Debt discipline is more pronounced among small and medium-sized cooperatives than among those with larger asset bases. Stronger debt discipline is observed when oversight bodies – such as the supervisory board or the statutory auditor– are composed of legal entities. By contrast, boards of directors that include legal entities are associated with higher levels of leverage. However, this higher indebtedness does not appear to be detrimental to cooperative performance, as the participation of legal entities on boards of directors is also associated with increased profitability.

With respect to profitability, the results show that, regardless of the governance body in which legal entities participate, such participation is positively associated with higher organizational profitability. Moreover, the largest profitability gains are observed when the supervisory board or the statutory auditor is composed of legal entities. The positive effect of legal entities in cooperative governance on profitability can be explained by the monitoring these entities provide against value-destroying diversification into activities that do not add community value, thereby improving overall performance (Delios & Wu, 2005), and by their role in enhancing performance among firms with fewer resources (Zona et al., 2018). In addition, legal entities tend to promote compliance with cooperative principles of solidarity, trust, and prosocial behavior (Hernandez, 2012), principles that strengthen the organization.

Legal entities also make their social networks available to the board of directors, enabling solidarity-based organizations to make better organizational decisions by expanding access to suppliers, partnerships, and specialized expertise in specific business areas—either by improving information quality or by providing the cooperative with superior resources and contacts (Olson, 2000). Finally, the experience of legal entities in enforcing bylaws, legal requirements, and cooperative principles helps solidarity-based organizations both to manage debt and to increase profitability. When legal entities participate in oversight bodies, opportunistic behavior becomes more difficult, since it is harder to bribe an entire organization than an individual, primarily due to reputational costs. Overall, these findings represent a novel contribution that should be considered when making decisions about the composition of governance bodies in non-financial cooperatives.

Conclusions

This research supports the idea that the presence of legal persons in the governing bodies of cooperatives allows for both debt control and increased financial profitability. It was found that debt control is more effective when legal entities participate mainly in control bodies (e.g., Supervisory Board and Fiscal Audit Committee) than in the board of directors, and that the positive effect of legal entities' participation in cooperative governance on profitability is independent of the governing body in which they participate.

Theoretical reflections show that it is possible to develop oversight mechanisms in cooperatives that enable them to follow the recommendations for good governance suggested by the OECD, aimed at avoiding agency problems, without losing sight of the specific interests of the type of governance required by cooperative organizations, including the pursuit of their goals related to solidarity, prosocial behavior, and the well-being of all cooperative members. In this behavior, beyond the apparent antagonism between Agency Theory and Stewardship Theory, it can be argued that the behavior of representatives of legal entities in cooperative governance reflects responsible professional conduct, which helps to resolve the governance dilemma identified by Sundaramurthy and Lewis (2003). Without disregarding agency risks, legal entities exert control where necessary while simultaneously fostering collaboration and building the trust required for effective cooperative governance.

Similarly, this participation could contribute to resolving the paradox raised by Cornforth (2004), mitigating the tension between regulations requiring member representation in governing bodies and the need for independence between the supervisory board and the board of directors, where the application of agency theory and stewardship theory also appears to be antagonistic. From a practical point of view, the results of this research lead to the recommendation of majority participation by legal entities in the Supervisory Board and the Board of Auditors, and minority or equal participation in the Board of Directors. Future research is encouraged to move beyond the financial variables examined in this study and to assess additional effects of legal entities' participation in cooperative governance.