The Co-Operative Group And Corporate Governance

The history and current problems of the Co-operative Group and the wider Co-operative Movement in the United Kingdom provides an excellent case study to illustrate the principles behind our Five Golden Rules of good corporate governance. This is written from a perspective of first hand knowledge and large scale primary research on a national scale.

Future articles will explore other co-operative models from around the world and whether "co-operation" represents the past or the future of business.

In this in-depth article we look at:

The history of the Co-operative Movement in Britain
How a very focused service set up on a mutualised basis in the industrialising north of England in the early 19th century evolved into one of the biggest organisations in the UK in the early part of the 20th century.

Co-operative Group's position in the market today
How co-operatives then progressively lost out to new ways of retailing and how ultimately the Co-operative Group has largely lost its raison d'etre (whatever politicians with a vested interest, or simply ignorant, might say on the subject).

The heart of the consumer cooperative principle:
Members are customers and customers are members – but are they really?

Do the representatives of members really represent members' views?
A look at the voting structure, board make-up and decision-making, and the distance between members and decision makers.

How to govern an organisation where the goals of key stakeholders are radically different?
A disastrous bid to build a bigger presence in the UK banking market, a new CEO who quit after less than a year after concluding the group is "ungovernable" and proposed changes to governance.

Lessons from successful examples elsewhere?
Can we learn anything from co-operatives?

Where do we go from here?
A look at the Co-operative Group against our Five Golden Rules.

History of the Co-operative movement in Britain

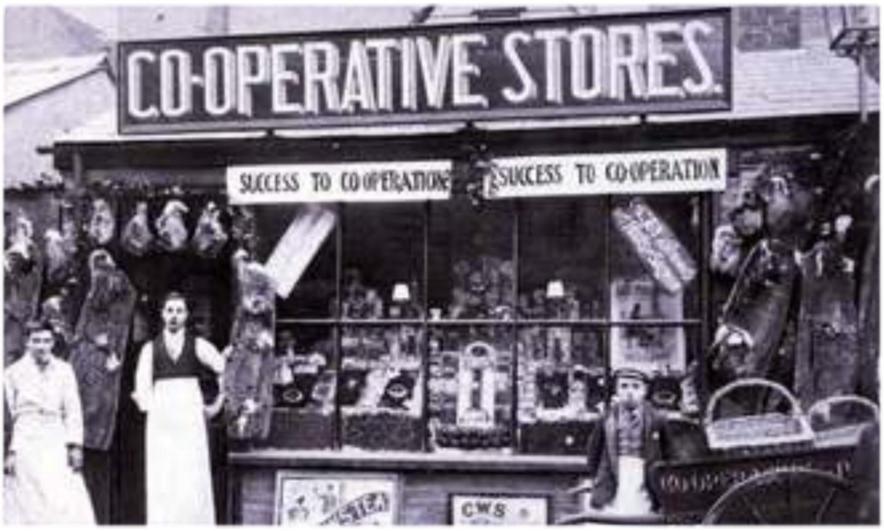
In the early years of the 19th century England was rapidly developing its major industries in the north of England and major cities such as Manchester, Liverpool and Leeds were growing fast. The life quality of the working classes was not much advanced from the mediaeval "short, nasty and brutish". In the town of Rochdale, near Manchester, a world-changing project was started. To quote the Rochdale Pioneers' website:

> *The story is set in 1844 when a group of working-class people from the town of Rochdale came together to change the unfair society they were living in.*
>
> *Fed up with dishonest and corrupt shopkeepers selling poor quality products at high prices they decide to take matters into their own hands. By pooling the few resources they have, the group manage to get enough money together to open their own shop and pledge to only sell quality, unadulterated products, sharing the profits fairly with their customers.*
>
> *The shop is only small and stocks just a handful of products like butter, flour and sugar, but the idea itself is revolutionary and the way they do business fundamentally different in its nature.*

From this tiny enterprise, started by 28 people, the co-operative movement in Britain was born. There had been other attempts, but this was the first to endure and it set the example for many other co-operative societies to be set up around the country. The goal was clear: wholesome food at affordable prices for vulnerable people, provided through a consumer co-operative where members were the customers, and ethical principles were highly moral.

Through the 19th century, consumer co-operative societies were started all round the United Kingdom, usually on the governance principle of one member, one vote. Thus, purchasing a one pound share gave a member one vote, and no member was allowed to own more than one share each. In due course, it made sense for the individual societies to associate with each other for their mutual benefit. Hence common service organisations were set up in fields such as insurance, banking, funerals, agriculture and above all in purchasing. The societies had a stake in these service organisations and voted some of their own directors on to their boards.

By the early years of the 20th century, the Co-operative Wholesale Society (CWS), which acted as a common buyer for the Co-operative Movement, was one of the biggest and most important organisations in the country. Around this time, to improve the professionalism of retailing in the Movement, Co-operative Retail Services (CRS) was established.



Naturally some of the weaker societies got into difficulties from time to time, and rather than fold and disappear, were invariably merged with one of the stronger societies. In this way Co-operative Retail Services grew rapidly by absorbing many failing societies until by the late 20th century in was the biggest society in the Movement, after the Co-operative Wholesale Society, which, itself had long ceased to be solely a purchasing body and had, itself absorbed a number of large, failing societies, hence becoming a major force in sales.

Over the years, many hundreds of local societies were consolidated into a small number of large regional societies and the final major consolidation was in the late 1990s when the CWS took over the CRS. In an attempt to project an up-to-date image in a fiercely competitive retailing environment, the Movement rebranded itself as simply Co-operative, the biggest society became Co-operative Group and the historic CWS name disappeared.

Position in the market today

Sadly, from a dominant position in the UK consumer market before the 2nd World War, even introducing one of the first "supermarkets" after the War, the Co-operative Movement progressively and increasingly rapidly lost ground to the new retailers who developed the supermarket concept much more successfully. The banking and insurance operations continued to compete, with a loyal following, but always subscale compared with the big banks and insurers.

By the end of the 20th century, the retail side of the Co-operative Movement was a minor player compared with the big supermarket chains of the time: Tesco, Sainsburys and ASDA. Niche businesses such as Funerals were powerful players in their market, but the integrity of the whole Movement was coming into question. Essentially, it was moving forward by absorbing its weakest members and liquidating the assets of the acquired societies.

Furthermore, a corporate structure which didn't permit funding by issuing shares meant that bank borrowing was the primary source of funding, together with the ability to take limited deposits from members, with favourable tax privileges. This has always been a limitation on the growth of mutuals and a danger when times get hard, and is one of the reasons why the company funded by share capital has been a more successful model over the years.

So we now consider the governance question: what do members want today?

There are two very interesting aspects to consider in relation to the development of the Movement over the past 170 years: what is it for and how should it be managed and governed?

The heart of the consumer cooperative principle: members are customers and customers are members - but are they really?

The principle of a consumer co-operative is that the members are the users and vice versa. However, in the retail trade, our own research shows that customers of supermarkets do their major shop at their nearest supermarket, and our research working with one of the biggest co-operative societies also showed that today's co-operative members are no different. Similarly, only a small proportion of customers of the Co-operative Group's shops are now likely to be members, compared with fifty years ago. However, our own research showed that the members' most loyal use of the co-operative societies was in their use of interest-bearing deposits. All this surely brings into question the legitimacy of societies' claims to be consumer co-operatives.

Extending this further, when the biggest co-operative society attempts to build a bigger presence in consumer finance by using the Movement's banking operation to acquire one of the largest building societies, with a commercial loan portfolio (itself surely a challenge to the purpose of a mutual building society), and follows this up with a government-supported bid to acquire several hundred branches of a major high street bank, one must surely question whether this is in line with the wishes of the members of a consumer co-operative society.

A further question arises in relation to the several million members listed as owners of the Co-operative Group.

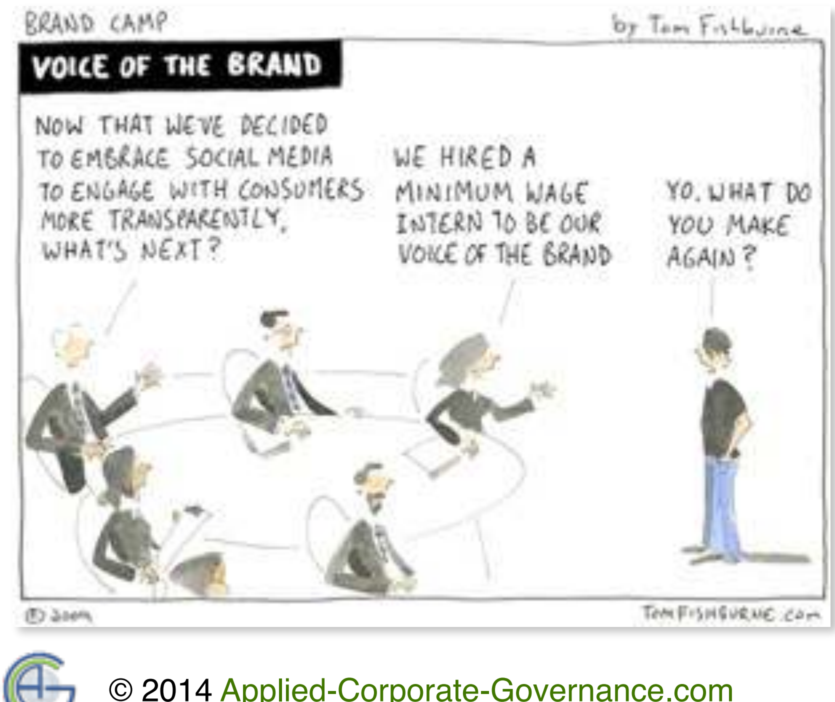
A society is only allowed to strike off members when it has been reliably notified of their resignation or demise. Again, our research has shown that a significant number of members are untraceable and at least as many are undoubtedly dead. It is thus very difficult for the societies to clean up their records, which hasn't stopped them using the numbers without qualification.

The problem was compounded historically by the succession of acquisitions of smaller societies by larger ones, resulting in blocks of new members being incorporated in the members lists. Couple this with the fact that individual societies had stakes in the early service providers like CWS and the ownership and control was highly complex. Indeed, when the financier Andrew Regan tried to acquire CWS in the late 1990s, the problem he faced was finding a list of members and their addresses. His thought was to offer members a fancy price for their £1 shares, based on his assessed value of the business. He never got the chance to put his proposal, though if he had there must have been a very strong possibility that the huge individual gains offered would have won over many of the members.

Which brings us to the issue: what do members want from the Co-operative Group? And the answer is far from clear.

Do the representatives of members really represent members' views?

The voting structure of the societies in the Co-operative Movement has been compared in its hierarchical structure and complexity to that of the old Soviet Union. Members are allowed to elect committees to represent them and committees elect higher committees and so on, up to the board. From a governance point of view, they have stayed true to the original democratic principle of one member one vote. However, over the years there has been a progressive loss of interest by members as the societies grew larger. Inevitably the management structure changed to effectively a two-tiered one with a management board of professional managers capable of running huge businesses, but answerable to an elected board of representatives of members who might have no experience at all of business.



This had two major consequences:

One was that the ultimate decision-making was in the hands of people with very limited qualifications for taking such decisions. The second was that these elected representatives were, by their nature, politically committed people who were dedicated enough to attend sparsely attended meetings and vote for each other to represent the society at local, district, regional and national level. These were the people who attended conferences where policies were adopted by the historically related Co-operative Party, which, itself, was historically related to the Labour Party. These were the people who committed financial support to MPs, paid out of the funds of the societies they represented. These were the people who had the ultimate say in the commercial policies adopted by the very big organisations on whose boards they sat. Did these policies and these views represent the interests of the members who owned these consumer co-operatives?

In the case of the large society we studied, the board consisted of a disparate group of men and women with backgrounds ranging from rural primary school headmaster to polytechnic lecturer via London Underground operatives, and chaired by a former communist. None of them had any experience or necessarily understanding of what was involved in running a multi-billion pound business. Committed “co-operators” all, and wanting to do good works in their different ways, their views represented those of the small groups who had voted for them at local meetings and our research showed that they were quite unrepresentative of those who shopped in the society’s stores and the broad membership generally. The current furore in regard to the Co-operative Group suggests that this is probably typical of the Movement as a whole.

How many members of the Co-operative Group wanted the Society to “bet the farm” on a big plunge into financial services? Probably about as many as the Lloyds Bank employees who saw their shares in Lloyds nearly wiped out by their board’s acquisition of HBOS.

In a consumer co-operative, the members are assumed to want the goods and services that the co-operative provides to them. Note that this is not a producer co-operative but an organisation supposedly committed to providing goods and services for its own members.

Let’s examine briefly the rather holier than thou ethical dimension, which is at the heart of the Co-operative Movement’s preferred image.

Going back to the beginning, this was simply about being honest with customers about the quality of the food they bought and not gouging them on price. It surely cannot be argued that in the ultra-competitive world of today’s supermarkets the customer gets anything other than top quality produce at the cheapest commercially feasible price.

Doing good around the world, or, indeed, spending the society's funds on supporting small and often unviable local mutual enterprises might appeal to the interests of the committed committee members but hardly contributes to the core goal outlined above. Anyway, the big supermarket chains can, and often do, provide charitable support at a local and national level on a greater scale than the Co-operative Movement can afford today.

Couple this with the morally questionable behaviour of one of the leading members of the Co-operative Group board and the uncommitted outsider (and even most of the members of the society) might remark about the Co-op's "ethical" stance: "who's kidding whom?"

How to govern an organisation where the goals of key stakeholders are radically different?

The disastrous bid to build a bigger presence in the UK banking market will have led the Bank of England to look at the governance structure outlined above and rapidly draw the conclusion that it could never comply with the standards expected of a large bank. In its aftermath, Co-operative Group appointed a new chief executive to sort out the mess in the bank and get a grip on strategy. After emergency action to deal with the bank, which resulted in breaking the mutual model by obliging the bank to take in a majority outside shareholding, the new CEO set out to put in place a practical commercial strategy. Sadly, after less than a year, he resigned, citing the "ungovernability" of the organisation. Senior independent director Lord Myners is reported as proposing replacing the elected board by a smaller board made up of professional directors, an independent chairman and two executives.

This will clearly be a major change and it is unclear whether these proposals will be approved by a voting structure and voters who are suspicious of big business and not temperamentally at all in tune with the types of individuals Lord Myners has in mind. It all illustrates the terrible mess an organisation can get into when the goals of the key stakeholding groups drift far apart.

It would appear that Lord Myners, a person naturally sympathetic to the goals of the Labour Movement, is nevertheless looking at a commercial fix to the Co-operative Group's problems rather than attempting to address the fundamentals. Indeed, it may be that the fundamental problems are so fundamental that they cannot be fixed. In essence, they can be summed up as:

- the original raison d'etre of the consumer co-operative society has largely disappeared; English society has moved on
- the interests of the typical member (competitively priced good quality produce, conveniently located) are very different from those of the average committee member (leftish political goals)

- the voting structure makes it unlikely that the views of the totality of the membership will ever be expressed fairly without a radical change in the constitution
- though the Co-operative Movement likes to portray itself as one body, the reality is that the individual societies do not, in practice, work together, and the retail societies as a whole are now second order players in a very professional and ferociously competitive market
- the governance is quite unsuited to today's conditions and renders it very difficult, if not impossible, to take the decisions to survive and thrive.

Lessons from successful examples elsewhere?

There is considerable confusion between what is meant by a consumer co-operative and other forms of co-operative and mutuals generally.

The John Lewis Partnership is often quoted as an outstanding example of a mutual in which the members (employees) share the profits. This ignores the fact the when John Spedan Lewis bequeathed his business to his employees, this was not then, and is not now a consumer co-operative. Moreover, though there have been other examples of a founder giving his/her business to the staff, John Lewis is the only example that its advocates point to. If it was an easily replicable model, there would surely be lots more.

There are many co-operative societies around the world, but the most common co-operatives are producer co-operatives, often in agriculture, and they are hardly relevant models for the UK retail world.

Building societies were the usual model for mutuals in the United Kingdom, but, like the co-operative societies, they have progressively reduced in number, with the stronger societies absorbing the weaker and failing societies. Moreover, despite their ethical beginnings, since deregulation in the latter part of the 20th century, they have been subject to their own scandals of mis-selling and poor management.

Where do we go from here?

Let's look at Co-operative Group against our five golden rules:

- on the ethical dimension, whatever its projected image, it scores badly on the evidence of a morally unsound senior director whose behaviour was condoned by his peers. More generally, it is surely no more ethical than its bigger competitors
- regarding a common goal, it is hard not to conclude that the goals of the key stakeholders (customers, members, elected board members, management) are quite irreconcilable

- strategic management has become almost impossible, in the words of the recently departed chief executive
- the organisation hence cannot be adapted adequately to the needs of the business
- accountability by the board to the stakeholders would appear to be a distant memory.

This is therefore an organisation which would score very poorly against our rules and we would predict that unless the goals and interests of the key stakeholders can be aligned, it is destined for a long, slow but inevitable demise. The only thing that would alter this forecast would be either a sudden catastrophe (as nearly happened through the banking disaster) or a break-up and acquisition by a commercial enterprise (possible though unlikely in the short term).

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