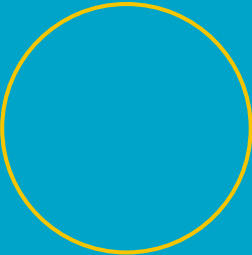
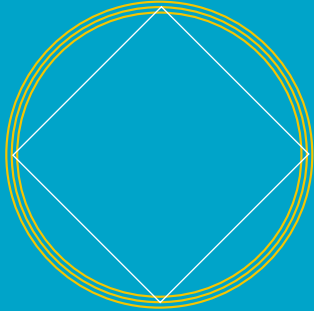


The Governance of Large Co-operative Businesses



A research study by
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CO-OPERATIVES UK



This is the second edition, comprehensively revised, of a research study which has been widely recognised as the first comprehensive research study into how co-operative businesses worldwide operate in terms of their governance.

The opinions contained in this document are those of the author and do not necessarily represent the formal policy of Co-operatives UK.

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Summary

Core to the identity of the co-operative form of businesses is the claim that it can be clearly distinguished from investor-owned enterprise through its member ownership and governance. How this distinction works in practice, however, has been less clear. Focusing on the world's largest co-operatives, the first edition of this research study set out to fill gaps in our knowledge.

Since its publication in 2014, a focus on governance in co-operatives has been evident in many countries, reinforcing the value and relevance of a return to this research in a comprehensively revised second edition.

The report stands alone, to be read afresh. The research focused on sixty of the largest co-operatives across a range of sectors, an updated list that follows the outline of the annual World Co-operative Monitor. These include many of the great names of the international co-operative sector, such as: Zen-Noh from Japan, Fonterra from New Zealand, Migros from Switzerland, Mondragon from Spain, Unimed from Brazil, Credit Agricole from France, Rabobank from the Netherlands, Desjardins from Canada and State Farm from the USA.

The result moves beyond the descriptive focus of the first edition - a constraint born out of the co-operative tendency to use different names in different contexts for the same thing - to offer a more systematic and analytical account of comparative governance. Drawing on this, it is then able to present some practical considerations for the design and redesign of good governance in co-operatives over time.

Co-operative governance emerges on balance as healthy and effective compared to investor-owned business. The quality that marks out the most successful is being member-centred. However, there are also risks associated with a more participative model of ownership.

In producer co-operatives, there have been few governance failures, and the ones that have happened have been confined to individual businesses. Consumer co-operatives have been more prone to governance failure. Because they tend to have many members whose relationship with the co-operative is slight, they face the risk that they are more easily captured by special interest groups or by ambitious managers, sometimes without the members even noticing. a)
Competition over resources - people and money.

Across these different models of member ownership, there are five categories of governance:

- **Direct** when members (individuals or co-operatives) elect the board of directors, on the basis of one person or co-operative one vote, or proportionate to the amount of business done

- **Indirect** when members (individuals or co-operatives) elect delegates to a member council that then elects the board of directors

- **Direct via electoral constituencies** when members (individuals or co-operatives) elect the board of directors, but their votes are channelled through an electoral district or region, or through bodies that represent different types of member

- **Conventional shareholder** when co-operatives who are part owners vote for a board of directors on the basis of the number of shares held

- **Subsidiary** when a co-operative appoints directors to a subsidiary.

The structures of co-operative governance across these may then make use of some or all of the following common elements:

- A **member council** is a large body elected by the members that oversees the board of directors. Its powers vary on a continuum from direct election and supervision of the board of directors to a merely advisory role

- A **board of directors** consists of elected representatives, sometimes including independent non-executive directors, overseen by a chairperson

- A **management board** consists of the chair or president and all the top managers

- **Electoral constituencies** are arrangements for bundling member votes typically by geographical area

- **Subsidiary** when a co-operative appoints directors to a subsidiary

- An **advisory committee** is any group that supplements the board of directors, but with no formal powers and a purely advisory role.
-

Of the sixty large co-operatives surveyed, twenty one operate with indirect elections to the Board with a key role a member council, seventeen with direct elections and a further thirteen with direct elections supplemented by advisory groups, electoral constituencies. Six operate with ownership by co-operative enterprises, using conventional shareholder weighting for voting. The remaining three are subsidiaries, with an appointed board.

Across these, the design architecture of a large co-operative has to foster three sets of relationships: between members and the board, the board and the managers, and the managers and the employees:

- A successful board finds out what are the members' priorities, turns these into organisational aims, and then holds managers accountable for pursuing these aims
 - The board energises the managers, making demands but also offering support
 - Managers, in their turn, energise the employees, making demands on them but also offering support
 - The circle is complete when the relationship between employees and members becomes mutually reinforcing, with both employees and members gaining energy from each other.
-

There are three qualities of governance systems that emerge as most relevant, with different emphasis in different co-operatives in terms of a settlement on where the balance should lie. These are to achieve **representation**, **expertise** or **member voice**.

Only when all three types of authority are present can a co-operative be governed effectively. However, there can be trade-offs between them, and the challenge of governance design is to encourage an optimal balance for the co-operative over time.

Glossary of terms

Types of ownership: The types of ownership can be described fully in two stages, the first distinguishing between consumers and producers, and the second distinguishing between those co-operatives that have individual members and those that have co-operatives in membership.

Stage 1:

A **consumer co-operative** offers membership to individual people who need the goods or services the co-operative provides. These can be any combination of food, banking and financial services, insurance, utilities, health and social care, and so on. Some co-operatives, particularly in the insurance sector, are mutuals; people cannot gain access to the product unless they also become members. For our purposes, **mutuals** can be seen as a subset of consumer co-operatives.

A **producer co-operative** offers membership to self-employed people and businesses that benefit from the services the co-operative provides. These can be any combination of supply, marketing and processing. Supply includes (for example) raw materials, fertilisers, seeds, savings and credit, insurance, and less tangible inputs such as training and product development. Marketing includes storage, transport and sale of produce, while processing delays the sale so that the co-operative can add value to the product on behalf of members.

An **employee co-operative** offers membership to workers who are individually employed but collectively own a business enterprise. They could be seen as a subset of the producer co-operative, since there is not much difference between a group of self-employed people coming together to obtain work and a group of employees doing the same.¹

Stage 2:

A **primary co-operative** is an association of individuals or small businesses who come together to meet their needs. If all customers have to be members it may be called a **mutual**. In the insurance sector, the term mutual is often used.

A **co-operative of co-operatives** is an association of co-operatives that come together to meet their needs. It can be referred to as a federation or union.

A **co-operative group** is a co-operative of co-operatives that has reached a stage of integration at which it operates as a single economic entity, and the accounts of the primary co-operatives are consolidated into those of the group.

A **majority-owned investor-owned business (IOB)** is a hybrid in which the majority of shares are owned by co-operatives.

A **consortium co-operative** is a company owned by businesses such as local authorities. If it allocates voting rights and dividends by size of shares, it might be better seen as just another company owned by other companies.

A **subsidiary** is an enterprise owned by a co-operative.

Components of governance:

A **member council** is a large body elected by the members that oversees the board of directors. It can have from 35 up to 600 representatives. It is otherwise known as a general assembly, delegates meeting, delegate assembly, shareholders' council, board of representatives, co-operative meeting, partnership board, or advisory board. Its powers vary on a continuum from direct election and supervision of the board of directors to a merely advisory role.

A **board of directors** consists of elected representatives, sometimes including independent non-executive directors, overseen by a chairperson. It is otherwise known as a supervisory board, board of trustees, or standing committee.

A **management board** consists of the chair or president and all the top managers. It is otherwise known as an executive board, strategy team, or general council.

Electoral constituencies / districts and regions are arrangements for bundling member votes, typically by geographical area.

An **advisory committee** is any grouping that supplements the board of directors, but with no formal powers and a purely advisory role. It is otherwise known as a patient council, advisory board, or co-operative development committee.

Introduction

It is said that when a conventional investor-owned company fails people ask why it failed. When a co-operative fails, people ask whether co-operatives can ever be made to work. This is still true, even after all the disasters that conventional companies have inflicted on the world's citizens over the last few decades.

Co-operatives are always going to be in the spotlight because they are different. Things may be changing, though. More people are beginning to appreciate the co-operative difference, and to see member-owned businesses as an alternative to investor-ownership. This makes the occasional co-operative failure even harder to bear, because with it go the silent hopes of people who had a suspicion that there might be a better way but who now feel let down. For these reasons, it is imperative that we make sure co-operatives are as well governed as possible, and that we learn by our mistakes.

The task of governance

When we think of all the inventions that have propelled human society forward into the modern age, we tend to think of steam engines, industrial machinery, antibiotics and computers and overlook one of the most significant - the business corporation. It is a strange animal, dependent on humans to give it life but regarded as a legal 'person' that can hold property, enter into contracts, and outlast by many years the people who started it.

In modern society, it has come to dominate our lives. It is our creature but often it seems – to those who work in it and those who are affected by its actions – to be a force that nobody can control. However, it only seems to be out of control, because it is always under the control of somebody - this is why corporate governance is so important. Looked at from one angle, governance is 'a set of relationships between a company's management, its board, its shareholders and other stakeholders'.² Looked at from a different angle, it is a structure within which people make decisions about what the company aims to do and how it aims to do it, and make judgements about whether or not it has been successful. Whether or not a company is successful depends in part on the quality of its governance.

How difficult the task of governance is depends on the size and complexity of the organisation, and the kind of environment it is operating in. It also depends on who owns it, and how far ownership is separated from management. Self-employed people combine ownership, governance and management in one person. A family business combines them in a small group who, because they usually trust each other, make its governance simple. A partnership enables groups of people who practice the same profession to own and control the company jointly; because the partners have similar skills and their individual contribution can be measured, it can be governed efficiently. However, the most common type of large company is the investor-owned business, owned by many shareholders who hire professional managers to run it and rely on a special group of directors to govern on their behalf. The key issue in such companies is how to control managers so they work in the interests of the shareholders, and an independent board of directors is seen as essential.

Some of the largest businesses are co-operatives, owned by their user-members. When these are small they can be governed like partnerships but, when they grow larger, ownership becomes dispersed among many people who may be uninterested in governing, whose interests may be heterogeneous, and who therefore rely on an elected board to govern for them. The key issue in co-operatives is similar to that in investor-owned businesses: how to control managers so they work in the interests of the members. Other things being equal, the larger the co-operative the more difficult is its governance.

Large co-operatives

If there were only a few large co-operatives then the problem would not be worth investigating. According to the World Co-operative Monitor, there are 1,420 co-operatives across 52 countries with a turnover of more than US\$100 million.³

They can be divided into business sectors. 34 percent of the total number are in *insurance*, 30 percent in *agriculture and food*, 19 percent in the *wholesale and retail trade*, 6 percent in *industry and utilities*, 3 percent in banking and financial services, 5 percent in *other services*, and 2 percent in *health and social care*. Another way to emphasize the importance of these very large co-operatives is to focus on the top 300. They have a combined turnover (or 'income' in the case of banking and insurance) of \$2.5 trillion.

The first edition of this study examined the top 10 co-operatives in each of the six main sectors listed in the Monitor for 2013.⁴ Now, the second edition will do the same with the 60 co-operatives listed for 2016. There has not been much change: 48 appeared before, while 12 are new. There is even less change than it appears. There are six new entries in the top 10 in health and social care because Unimed Brazil has chosen to provide a single national entry incorporating regional co-operatives that used to be listed separately. Sometimes the changes that we see from year to year are just due to changes in statistical practices. Zen-Noh in Japan has been knocked off the 'number one spot' by its counterpart in Korea, because one of its regional co-operatives has chosen to list separately. The co-operatives that have disappeared from the listing are still there, having slipped back to 11th or 12th position. This is to be expected; these giant enterprises are tough survivors, strong in their chosen markets and not willing to give ground to their competitors.

In the first edition, the whole subject was new and we spent time just describing each co-operative; surprisingly, nobody had yet done this and we simply did not know enough about these large co-operatives. There will be less description in this second edition, and more analysis. Chapter 1 poses

the question this study sets out to answer: 'Is there a problem of governance in co-operatives?' It provides a background to the subject by describing the ways in which, in the first decade of this century corporate governance in shareholder-owned companies and banks has been in crisis, with many scandals and failures that have impacted on the world economy and the environment. It then investigates cases of governance failure in co-operatives, concluding that there is cause for concern, but certainly no general crisis. This chapter is largely unchanged from the first edition, except for an update on the governance redesign in the Co-operative Group. Readers who are familiar with the first edition might skip this and go straight to Chapter 2.

The rest of the study is surprisingly new. Chapter 2 provides an expanded 'Theory of co-operative governance'. It asks why the conventional critique of co-operatives by economists is so negative, and why we need a more realistic theory of co-operative governance. It



"These giant enterprises are tough survivors, strong in their chosen markets and not willing to give ground to their competitors."

describes some false starts in building such a theory, and then argues that a 'member governance' approach provides the guidance we need in assessing the current practices of co-operatives. Then we introduce three elements that underlie all governance systems in co-operatives: representation, expertise and member voice. It is the relative strength of these three elements that explains the variation among co-operatives.

Chapters 3 to 8 report on the governance of the top 60, divided into the six sectors: agriculture and food; wholesale and retail; industry and utilities; health and social care; insurance; and banking. Chapter 9 adds up the results and provides a short set of findings. Chapter 10 provides some guidance on how to redesign a governance system so that it is more balanced, providing a fairer and more creative mix of representation, expertise and member voice.

This second edition provides a comprehensive taxonomy of ownership types and types of governance that cuts down on the 'noise' and provides some consistent terminology (see the Glossary of Terms). Readers who are familiar with one of the co-operatives described in the next few chapters may be alarmed to find that their 'stakeholder council' is referred to as a 'member council' or that their 'supervisory board' is called a 'board of directors.' This is not a mistake but a long overdue attempt to understand the underlying similarities between co-operatives.

Chapter 1 : Is there a problem of governance in co-operatives?

Good governance is difficult to achieve in any organisation, no matter what its size or type of ownership, and no matter how well designed its governance structure. In this chapter we look at the record of co-operatives, but first we need to put this in context.

All types of business are prone to governance failure; one might say that it is always 'just around the corner' and businesses need constant vigilance if they are to prevent it. Investor-owned businesses have a particularly poor track record, particularly in the USA. Just consider what has happened since the new century began.

Governance failure in investor-owned businesses

In 2001, the largest bankruptcy in US history occurred, when the seventh largest company, Enron, collapsed with a loss of 27,000 jobs and \$63 billions in assets. ⁵ It had been growing rapidly through derivatives trading in the energy sector, but was committing a massive fraud by hiding its losses in 'off-balance sheet' companies.

All it took was the bursting of a stock market bubble, and the losses were exposed. At the time it was seen as a failure of supervision by outside auditors and government regulators, but it was also a complete failure of governance by its board of directors. In 2002, Worldcom went bankrupt with the loss of \$104 billions in assets and \$41billions in liabilities. It was another story of massive personal enrichment by top managers, corruption, and failure of the regulators. These failures were the tip of an iceberg: Qwest, Global Crossing, Xerox, Adelphia, ImClone, HealthSouth, Tyco, all followed. There was a fundamental failure of outside regulation but also of internal governance. It was not that the managers were enriching themselves at the expense of the shareholders, but that they were doing whatever it took to boost

stock market prices so that they (as recipients of stock options) and the shareholders could enrich themselves in the short term.

Then in 2007 came the financial crisis, which is probably the worst since the Great Depression of the 1930s. Combined with a severe downturn in housing and stock markets, it precipitated a global recession, triggered a Euro-debt crisis, and through the bailout of some of the world's biggest banks entailed a dramatic increase in the public debt of developed countries, notably the USA and UK. Its causes are still being debated. The immediate cause was the bursting of another housing bubble, but the longer-term causes include risky and fraudulent lending in the housing market, coupled with the development of high-risk, complex derivative products that spread risks while masking their true extent. Government is blamed for deregulating the banking system, and then completely failing to use



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what regulatory powers it still had.

The failure in internal governance is a large part of the picture; with boards of directors being content to allow managers to drive many previously sound businesses into bankruptcy, all in the search for ‘shareholder value’. The eventual cost will not be known for some time but Joseph Stiglitz says that in

the US ‘the magnitude of guarantees and bailouts approached 80 per cent of GDP, some \$12 trillion. It included a huge gift to the banks of hundreds of billions of dollars in buying up poor quality mortgages and lending money at near zero interest rates.’⁶

One part of the story is of particular interests to supporters of the co-operative alternative. The UK bank Northern Rock was one of the first to collapse, and commentators pointed out that its problems had begun after the demutualisation of this former building society. If we go back to a previous US banking crisis – the ‘savings and loans’ crisis of the 1980s – we find that demutualisation has been a big part of the explanation for this pattern of reckless growth followed by collapse, followed by government bailout.⁷

The failures in governance in the complex, multi-dimensional meltdown of the world’s largest banks are not easy to pin down. When greed and short-termism become endemic, the particular role of boards of directors is hard to isolate. The governance failure is easier

to spot in a disaster that happened only two years later. In 2010, on the Deepwater Horizon, an oil-drilling rig in the Gulf of Mexico that was owned by BP, there was an explosion followed by a devastating fire, and the largest offshore oil spill in history began. As a result, BP's stock market value declined by nearly \$100 billions. The immediate cause was a series of decisions to ignore safety procedures in an attempt to cut costs, but the ultimate cause was the kind of ruthless 'shareholder value' thinking that leads managers to increase share price at any cost. The policy backfired badly; the company's share price fell to less than half its previous value.

This illustrates a wider malaise; something is very wrong with the whole edifice of corporate governance in shareholder-owned companies. In the USA, during this century stock market returns have been declining, and companies have been buying back shares in an attempt to become more 'closely held' by a smaller number of less demanding shareholders.⁸ Their governors do not want to be answerable to large numbers of people who do not really care about the business. Is there a similar problem with the governance of co-operatives?

Governance failures in producer co-operatives

Co-operatives, owned by their members rather than by shareholders, have a relatively good track record in governance, but there have been some notable failures as well. It is helpful to distinguish between producer and consumer co-operatives. The members of producer co-operatives are people who rely on the co-operative to help them run their own business - farmers, foresters, fishers, medical doctors, and many other types of business.

Supply co-operatives provide inputs without which the business would not be productive, and marketing and processing co-operatives take the output, add value to it and then sell it in the market. A subset of the producer co-operative is the employee-owned co-operative that exists to provide work for its members. The members of consumer co-operatives are people who rely on the co-operative to help them meet their everyday needs for food, clothing, banking facilities, insurance, funerals and so on. There is an overlap because co-operatives in banking and insurance often have individual members and small

businesses in membership, and farmer co-operatives often provide consumer goods for rural communities. The distinction is, however, very useful when we consider their governance.

There have not been many governance failures in producer co-operatives, and the ones that have happened have been confined to individual businesses. Here are two examples. The Saskatchewan Wheat Pool was a long-established and successful co-operative that organised export of wheat from Canada to the UK on behalf of the grain farmers.⁹ During the 1990s, it needed to modernise its business while facing a demand from retiring farmers to redeem their equity. In search of new capital, in 1996 it issued non-voting shares to outside investors. However, the board did not have the expertise to manage these changes and the result was a transfer of power to its managers. They made international investments that led to significant losses. They attempted to dominate the market by buying another business but paid too high a price. There was a growing gap between the information possessed by the management and by the board. Yet they were used to trusting their CEO, and lacked the ability or the willingness to challenge management.¹⁰ There was no pressure on them from their constituents, the farmer-members, who had begun to choose alternative ways of marketing their grain and so had lost the vital economic linkage with the business. Eventually the board was restructured from 12 members down to eight, with four independent expert members brought in, but it was too late: in 2005 it converted to an investor-owned company.

Dairy Farmers of Britain was one of the major players in the UK milk market, with 10 per cent of total milk production and 1800 farmer members. It was formed in 2002 by the merger of two small co-operatives, and from the start it pursued a strategy of growth through vertical integration. In 2004 it bought a dairy company from The Co-operative Group. Experts agree that it ignored advice and paid too much, and tied itself into a loss-making agreement to supply milk to the Group. It did not have the financial resources or experience to make the strategy work, and when it lost the contract in 2009, it went into receivership, at a considerable loss to its farmer members. A parliamentary report commented that the governance of the co-operative was partly to blame.¹¹ It would have benefitted from having executive directors on the board, from giving the farmer directors

proper training, and from having a more transparent transfer of information between the board and the members.

No doubt other farmer co-operatives have experienced governance problems, but these have been masked by conversion to a different form of ownership or by merger with another co-operative. However, producer co-operatives do have a significant advantage over consumer co-operatives in that there is usually a strong economic linkage between their business and that of their members.

Governance failures in consumer co-operatives

Consumer co-operatives have been much more prone to governance failure. Because they tend to have many members whose relationship with the co-operative is slight, they are more easily captured by special interest groups or by ambitious managers, sometimes without the members even noticing.

During the 1980s and early 1990s, consumer co-operative groups in Austria, Germany, France and Belgium collapsed. The cause was intense competition from national supermarket chains, which meant that what had previously been strengths of the co-operatives – organisation into small, locally based, autonomous societies backed up by a national wholesaler that did its own manufacturing – became weaknesses. There was a combination of mediocre management and oligarchic local boards of directors, both caught in a downward spiral of poor performance and lack of member involvement. At the back of the whole dismal story was the fatal loss of the economic connection they had previously had with their members - the dividend on purchases. When, under falling profits and pressure to cut costs, they gave up this device, there was nothing to distinguish members from customers in general, and so the link between members, boards and managers in the governance structure was fatally broken.¹²

In the UK, consumer co-operatives were suffering from the same weaknesses and, although they did not go bankrupt or demutualise they had some notable governance failures. Dividend was abandoned in the late 1960s, so the meaning rapidly went out of membership. Small cliques dominated many societies, relying on the votes of employees and their friends and families to ensure re-election. At the time, some observers felt that they had become virtually employee-

owned co-operatives, in that the interests of employees were put first, and the assets built up over generations were being squandered.¹³ The 'democratic deficit' resulted in several frauds by executives at CWS Engineering (a false invoicing scam), Central Midlands (where bribes were taken from a wholesaler), and five other societies. The merger of two very large societies, United and Norwest in 1991 became notorious, as the CEOs were able to claim payouts of £5.4 millions (as opposed to the anticipated £1.4 millions) when they retired. They had failed to inform their boards of the arrangements.¹⁴

In Japan, during the 1990s 'major mistakes were uncovered at several consumer co-operatives that resulted in industry setbacks and a loss of public confidence'.¹⁵ The mistakes were made by management, but showed up the lack of a functioning governance system that should have prevented them. There was a crisis in Coop Sapporo after the managers pursued a high growth strategy that led to excessive debt. As at Saskatchewan, the management failed with a market domination strategy that was pursued for too long when it was not working, but the failure to put proper controls in place was also to blame. At Osaka Izumi Co-operative there was misappropriation of funds by a senior executive that went on for a long time and then, when it was discovered, was not brought fully to light. Then there was the embarrassing case of Co-op Saga, where poor performance was covered up by the substitution of cheap imported beef for prime 'Tokachi' beef. The culprits resigned or were dismissed, but 'the lack of a governance structure that would have held management responsible' is also to blame.¹⁶

During the 1990s, in Europe the situation began to improve. After the Cadbury Committee report into governance failures in investor-owned businesses in 1991, corporate governance codes were created for co-operatives in the UK and Europe that led to significant improvements in governance. More generally, those consumer co-operative sectors that survived the problems of the 1980s – notably in Finland, Sweden, Norway, the UK, Italy and Switzerland - reorganised themselves into cohesive federal groups and from the 1990s onwards became much more successful. Their governance structures benefitted from compliance with new codes, and a strategy of reconnection with members that included the reinstating of dividend through an electronic members' card.

Governance failures in insurance and banking

Poor governance structures are also partly to blame for the demutualisation of US savings and loan societies in the 1980s and of UK building societies in the 1990s.

In both cases, there had been a tradition of self-perpetuating boards and low member participation, so that many of their customer-members did not know they had ownership rights over the business. In both cases, too, the opportunity to demutualise came about through government deregulation and was driven partly by the opportunity for personal enrichment that the conversion offered to directors and managers. In the American case, the demutualisations led to a huge crisis in the sector, with the all too familiar government (really, taxpayer) bailouts, while in the UK they led to the demise of Northern Rock and the eventual sale of the other demutualised societies to banks.¹⁷

Governance problems have also arisen in insurance mutuals, which have large numbers of members who are only weakly incentivised to take part. In 2004, a review was carried out of the governance of life insurance mutuals in the UK.¹⁸ The ‘Myners review’ came about because of the demise of one of the largest mutuals, Equitable Life. In 2000 Equitable lost a court case that meant it had to honour an agreement to service high interest-bearing life insurance policies entered into many years previously when interest rates were much higher. In the subsequent financial crisis it had to sell off parts of the business and cease to write new policies. An Inquiry into the collapse by Lord Penrose found that there had been ‘ineffective scrutiny and challenge of the executive of the Society’, the board had insufficient skills, was totally dependent on actuarial advice, and ‘was never fully advised of the financial implications of the decisions that were said to be open to them’. Crucially, the board itself was ‘not subject to effective external scrutiny or discipline’. Yet ‘policyholders were effectively powerless, and the Board was a self-perpetuating oligarchy amenable to policyholder pressure only at its discretion’.¹⁹



“many of their customer-members did not know they had ownership rights over the business.”

The Myners Review commissioned research that found that members valued their membership and had a very positive view of mutuality. They had high levels of trust and believed mutuals could deliver superior performance. The majority were not interested in taking part in governance, but there was a substantial cohort who *were* interested in becoming engaged, suggesting that 'while engaging members may be difficult, it is certainly not impossible'.²⁰ The Review went further than Penrose, recommending that mutuals find ways of connecting with their members, and calling for their trade associations to provide best practice guidance in member relations. It set out detailed principles for fair and accessible voting procedures, and called for mutuals to be obliged to notify members of major transactions and to have to seek their permission for very major changes. Many of their recommendations have been implemented, and the situation is now much improved.

We might expect that the 2008 financial crisis that brought down some of the biggest investor-owned banks would also damage co-operative banks and credit unions. Before the crisis, financial co-operatives were competing successfully against investor-owned banks.²¹ During the crisis, in general they were not badly affected, though losses were made by central banks in several countries. These were mainly due to investment in derivatives that, before the crisis, had been passed by the rating agencies as safe (and so the losses cannot really be blamed on internal governance). Only in a few places did these central banks have to accept government assistance, and, rather than being allowed to fail, weaker co-operatives were mainly taken over by stronger ones. Most of the losses incurred were made up quite quickly, within a year or two, though in some countries primary co-operatives had to bail out their centrals. Now, after the crisis nearly all the indicators show that they have bounced back and are growing again, though not at the same pace as before the crisis; the worldwide economic slowdown and the Euro crisis are to blame for that.

Since the financial crisis only two co-operative banks have failed. There used to be a central bank for the Volksbank system in Austria called OVAG, but in 2012 it had to be bailed out by the Government, which put in \$1.7 billion and took a 43 per cent stake. To prevent the need for a further bail out, the Government then turned it into a 'bad bank' and gradually wound it down. Its good assets were taken over by the rest of the Group. The problem was that, through a subsidiary, Volksbanken International, it had expanded into central and Eastern Europe, at its height having 600 banking outlets in nine countries.²² Then the

subsidiary began to make serious losses, bringing the Austrian bank down with it.

It is when member-owned banks expand into other countries, and into investment banking activities that their own members do not need, that they become vulnerable.²³ Provided they stick to their main purpose of meeting the members' needs they are much safer than other types of bank. OVAG failed because its governance system did not protect the members against the ambitions of managers who were driven by an inappropriate desire to make profits.

The other bank setback is the demutualisation of the UK Co-operative Bank, the majority ownership of which has transferred to investors, after a £1.5 billion capital shortfall was found that could not be made up any other way. Sir Christopher Kelly has reviewed the causes at the request of the Co-operative Group.²⁴ The factors include losses made by the Britannia Building Society that merged with the Bank in 2009, a failed computer project and costs associated with an abortive attempt to buy over 600 branches from Lloyds TSB. The Bank was unique in being a wholly owned subsidiary of The Co-operative Group, which is a retail consumer co-operative. Some commentators argue that it was not a real co-operative bank, in the sense of having direct members. Though customers could join the Group through the Bank, they did not vote directly for the Bank's board, which was entirely appointed by the Group.

The failure is partly one of governance, for two reasons. First, the Bank and Group boards failed to see the extent of the Bank's capital shortfall, and allowed managers to pursue risky projects that failed. Second, it came to light that the Bank's chairperson was appointed (and approved, in regulatory terms) even though he had no expertise in banking, and this raised the question of whether elected boards can govern such large, complex businesses. The Group has now sold its last one percent share in the Bank and so it is no longer a co-operative, though it has been allowed to retain the name for the moment because of the ethical values written into its constitution.

Co-operatives are not immune to failures stemming from changes in the culture of the business sector they are in, and from falling



“these are not failures in the co-operative business model, but failures in banking.”

standards of conduct among professionals. This is illustrated by the recent conduct of some of the managers of co-operative banks. One of the contributors to the UK Co-operative Bank’s shortage of capital was the money it had to set aside to compensate

people for misselling of insurance products. In October 2013, the Dutch co-operative, Rabobank, was fined €1 billion by Dutch, UK and USA regulators for its part in the LIBOR rate fixing scandal, and the chief executive had to resign. Were the governors of the bank to blame? Yes, because there was ‘serious, prolonged and widespread misconduct’ at the bank and if they did not know about it they should have done. When they did find out, they took too long to put it right.²⁵ The French co-operative groups BPCE and Credit Agricole have also been fined. Of course, it could be argued that these are not failures in the co-operative business model, but failures in *banking* that have been universal across banks of all ownership types.

The UK Co-operative Group’s recent governance crisis

The crisis at the Co-operative Bank spread to its owner, the UK Co-operative Group. In 2009 the Bank took over a much larger building society, Britannia, without its governors and managers fully realising the fragile state of the society’s loan portfolio.

In the aftermath of the wider financial crisis that followed the banking collapse of 2008, the Bank began to make serious losses; in 2012 it posted a loss of £648 millions, then in June 2013 a capital shortfall of £1.5 billions was discovered, followed by a further £400 millions in March 2014. Two American hedge funds took control and the Group’s share was diluted to 20 percent. Then the Group itself got into trouble, posting a loss for 2013 of £2.6 billions. It had bought a large rival convenience store retailer, but failed to increase its sales and had gone heavily into debt. Happily, the Group did not go bankrupt but under new management and a completely new governance structure it has

survived and is now out of danger, though still with a debt of £700m hanging over it.²⁶

Two reports found serious failings in governance that were at the heart of the crisis. The Kelly Report was scathing about the poor governance of the Bank.²⁷ The Myners Report condemned the Group's governance structure as being completely unfit for purpose, and proposed a new structure based on a 'plc' type board, a larger member representative council and direct elections by members.²⁸ Faced at the time with an ultimatum by the banks that were owed £1.4 billions, the Group's board imposed the new governance structure and then resigned en masse.

This is a very unusual case. Does it have implications for the other very large co-operatives around the world? Fortunately, there are some unique features that make it hard to generalize to other co-operatives, even to other large consumer co-operatives. The Group has its own peculiar history.²⁹ Beginning as the Co-operative Wholesale Society (CWS), it first merged with the Scottish CWS. Then it began to merge regional co-operatives that were themselves the result of many mergers, until in 2000 it merged with another national society, United Co-operatives, turning itself into a national retailer as well as a wholesaler and distributor to the remaining regional co-operatives. Because of compromises that were made in the governance structure to allow as many as possible of the board members of merged co-operatives to continue to have a role, the Group ended up with a three-tier structure of area committees, regional boards and a main board that proved unfit for purpose. In 2014, this was scrapped in favour of a parallel system of a board of directors and a member council, with voting for both being directly by the members as a whole. It is early days for the new system, although the positive signs are that Group is recovering from its financial crisis.

Is there a general problem of co-operative governance?

There are limits to what we can expect from co-operative governance; it is not a cure for all ills. However, recent events have led to questions being asked all over the world by co-operative boards and managers who are wondering if it could happen to them.

Are some co-operatives becoming too big to be governed effectively by a huge and widely dispersed membership? Do their boards need strengthening with the appointment of experts in the business sector as well as people who are elected by the members? Is there a general problem of co-operative governance? Probably not, but we can certainly learn from our mistakes and can do better.

The adoption of up to date governance codes adapted from more general codes is one approach.³⁰ This assumes that co-operative governance is similar to that of any other business organisation, and in many respects it is: the requirement to govern honestly, on behalf of the owners and other stakeholders, to manage the managers, to be accountable, are all common themes. Yet because co-operatives are a different way of doing business, we can expect that their governance will also be different in some important ways. Before we look at the actual governance of large co-operatives, we need to think more carefully about these similarities and differences. The next chapter summarises the approach of conventional economists to co-operatives, showing how inadequate it is. It then proposes a theory of co-operative governance.

Chapter 2: A theory of co-operative governance

When they study co-operatives, economists begin with a set of prejudices derived from conventional economic theory that leads them to expect traditional co-operatives to have built-in disadvantages. Here is a summary of the kinds of problems they expect to encounter.³¹

The conventional critique of co-operative governance

The first problem is that co-operative members have limited ownership rights. There are many members each of whom only owns one share, the value of which is usually fixed at a low level. They cannot share in the growing value of the business through revaluation of shares, as these are not traded.

Sometimes the profits will be returned to them in the form of a dividend, but this is based on the use they make of the business not on their investment. Sometimes there is no return at all, and all the profits go to build up reserves. The less the members feel they own the co-operative, the less likely they are to support it and to take part in governance. The co-operative becomes in practice a kind of non-profit whose board of directors act more like trustees than elected representatives. In contrast, shareholders in investor-owned companies are said to be the clear final owners because they carry the risk. The buck stops with them – they bear the losses when a company performs badly or becomes bankrupt. The duty of the board is to manage this risk on behalf of the shareholders, and to reward them for taking it on.

There is also a *problem of scale and complexity*. Governance systems designed for small, community-based businesses are now being applied to very large national and sometimes international conglomerates. Their complexity partly derives from having subsidiaries and joint ventures that can only be governed indirectly by their members. This is made worse by the trend towards internationalisation, so that the members who continue to live only in

the country of the co-operative's origin cannot easily oversee the whole business. Both the UK Co-operative Bank and OVAG failures are actually a failure effectively to govern subsidiaries, made worse in the latter case because the subsidiary was operating in other countries.

Third, there is a *collective action problem*. When there are many members, and the contribution of each member is likely to have a minimal effect, the rational response is to free ride, letting others do the work. This is true also of widely-held companies that have many small shareholders, but if there are large shareholders such as pension funds and mutual investment funds they will find it more rational to take part and bear some of the costs of governance.

Fourth, there is a *problem of lack of information*. In a conventional business, shareholders have a market signal in the form of the share price that tells them how well the company is doing compared to its competitors. In a co-operative, there are no such signals. Also, in shareholding companies there are rules of disclosure that help the setting of a market price, but in a co-operative managers can often get away with disclosing less information.



“Both the UK Co-operative Bank and OVAG failures are actually a failure effectively to govern subsidiaries.”

Fifth, there is a *problem of managerial capture*. Principal-agent theory says that a board of directors are the principals and the managers are their agents. It predicts that, if they are not stopped, managers will further their own interests rather than those of the board and the shareholders. They will tend to extract more rewards from the business than the board needs to pay to ensure effective management. They will tend to build empires for themselves, avoid risks by building up unnecessarily large reserves, and so on. What stops them is government regulation combined with professional ethics, but the biggest check to managerial self-interest is the threat of takeover. If a company is being run badly – so the theory goes – there will be competition from other managers who persuade shareholders they can run it better – economists call this the ‘market for corporate control’. But by far the most effective way of controlling the ‘agents’ is to align their interests more closely with those of the shareholders by turning them into shareholders themselves, offering share options instead of cash bonuses to reward good performance. From this perspective,

co-operatives have serious disadvantages. They are protected against takeover by the lack of a market for shares, and they cannot offer share options to managers.

Finally, there is a *problem of lack of focus*. Here the argument is that investor-owned companies have one overriding goal – to maximise value for shareholders. By aligning the interests of managers through share options, they make governance much easier. The purpose of the board is to keep it simple! Co-operatives, by having a double or triple bottom line, are too unfocused and so will be less efficient than their competitors.

We might expect that, with all these negative arguments already in their minds, economists who study co-operatives will be critical of their governance. When one eminent economist recently studied European co-operative banks he was surprised to find that their governance was rather good, and that they outperformed their competitors in all the conventional indicators of efficiency, profitability, stability and so on.³² When the evidence refutes it, there must be something wrong with the theory. Why should we try to fit co-operatives into a conventional economic theory that is essentially hostile to them? We can do better and provide our own theoretical framework, one that we might call ‘a theory of member governance’.

Some false starts

However, before we build this theory, first we have to clear away two well-meaning but inadequate theories that get in the way. First, there is a view that the members are not the ‘final owners’ of co-operatives because there is an ‘intergenerational endowment’.

Co-operatives accumulate capital by limiting the distribution of profits to their shareholders, and by limiting the value of each ownership share. Their current members are expected to use the endowment to meet their needs, but to continue to accumulate it and pass it on to the next generation. We would not want to argue too forcefully against this view. In the debate about the merits of demutualisation of UK building societies in the 1990s, it provided a strong justification for them to resist demutualisation, and to create new rules that made sure that if it was demutualised, a society’s assets would go to a good cause. However, if taken too far it undermines the idea that a co-operative has any current owners at all, and it makes the board members more like trustees in a non-profit business. As Fonteyne says

The existence of such an ownerless endowment constitutes a major challenge to the governance systems of a co-operative. It reduces members' incentives to exert effective oversight over management, while at the same time increasing the need for such oversight. ³³

We can agree that the current member-owners have obligations towards future members, without undermining their claim to be the rightful owners.

Second, there is a view that co-operatives are both associations and businesses, and as such they have a dual bottom-line with both economic and social goals. The association looks after the social, the business the economic. This is a mistake; it has no basis in law and it is bad for business. It splits into two the one clear aim of a co-operative – to meet the economic needs of its members. Of course, if a co-operative is well run and ethically sound, there will be public benefits, but these are a by-product of business that should not be the concern of the governors or managers. Like other large businesses, co-operatives have a corporate social responsibility, but theirs is no greater than that of other companies. However, the members can choose to broaden the aims if they want to, and then the governors and managers have a duty to respond.

Brett Fairbairn says

The problem with the dualistic view (social and economic) is that it appears to lay a second set of obligations on co-operatives, over and above those they face in common with competing, non-co-operative enterprises ³⁴

They carry a double burden and so in a competitive market they will fail. Also, the splitting of the social from the economic allows managers to assert the primacy of economic over social goals. Social goals then become costs. Critical activists can then criticise a co-operative for not doing enough to meet its social goals. It gets worse! Boards can leave the 'economic' to the managers and concentrate on the 'social'. The whole idea is too simplistic, suggesting trade-offs where there should be synergies. It is the members that give the co-operative direction, tie the economic and social together, and make its governance possible.

A member governance approach

The most fundamental question those who are running a business can ask is ‘what are we in business for?’ The answer depends on who owns the business. If it is investor-owned, the answer might be ‘to add value for the shareholders’. This is the dominant American business model, in which the firm is seen as a relationship between the owners who are the principals and the managers who are their agents.

Another answer might be ‘to meet the needs of our stakeholders, as well as keeping our investors happy’. This is the dominant European business model, in which the firm is seen as a set of contracts between owners and other stakeholders. In co-operatives, the answer is simple - ‘we are in business to meet the needs of our members’.

Start from the assumption that the members really are the owners, not because they are the ‘residual claimants’ in the case of bankruptcy, but because the business cannot be sold or merged with another co-operative without their permission. In a demutualisation, even when the members do not know they are members, they have to be given a vote. Nobody else has a vote. Past and future members do not have a vote. Therefore they are the owners. The more a co-operative treats its current members as real owners, the simpler its governance task becomes. This approach makes the most of the inherent advantages of co-operative governance, which are:

- High trust relationships, with no profit taking by intermediaries, and a longer-term focus on member needs

- Alignment of the interests of members and elected governors, and inability to reward managers perversely! This can lead to value-based management

- The ability to monitor board and management performance in relation to a clear set of objectives focused on meeting member needs and expectations.

Trust is generated when members see the co-operative focusing on their needs. Fairbairn says bluntly ‘Members support co-operatives because co-operatives are dedicated to making members better off’.³⁵ The co-operative is their agent, promoting their economic wellbeing. Its job is to create products the members need, in convenient locations, sharing success with a patronage refund, and developing the non-

material aspects of the relationship that create greater satisfaction. If it is designed properly, *co-operative* governance has the potential to be as good for members as *corporate* governance is for shareholders. Experiments are needed to find out what are the best governance structures, but the test of whether they are designed properly is whether or not they incentivise managers to pursue goals that improve the livelihood of the members.³⁶

The Indian economist Tushaar Shah has developed a member-centred theory of co-operatives. He challenges the conventional view in India that the reasons why some co-operatives succeed and some fail are: good leadership and management; conformity to co-operative principles; a supportive local culture; and lack of government interference. His startling alternative is that these are all results of success, not causes. He says

*The success of a co-operative... depends upon how effectively it serves the purposes central to its user member; and how effectively the co-operative does this depends critically on how well it gets designed to do so.*³⁷

Successful co-operatives change the economies of their members, so that they become more central to the members than before. They are an 'ever-expanding presence', creating new opportunities for their members to prosper. They seek to become central to their members, and when they expand it is only in order to increase the allegiance of members and potential members. The role of the governance structure is to 'aggregate member preferences and represent this aggregate in formulating goals, policies and decisions pertaining to the patronage interests of the members'.³⁸ Patronage interest is easier to define in relation to farmer co-operatives – it is the return members get from trading with and through the co-operative – but it applies to all co-operatives in one way or another. He goes on to say:

A patronage cohesive board is able to cohere around patronage issues important to members. It evaluates alternative decisions against their impact on overall patronage interests of the members.

Protecting the integrity of the member-co-operative relationship is central to success, and this is the job of the board of directors.

The source of a co-operative's vitality is in its design. One important aspect of design is the governance structure that is a device that owners use to ensure the organisation remains subservient to their goals.

³⁹ The test of whether a governance system is designed properly is whether or not it enables the managers to pursue goals that improve

the livelihoods of the members. What gives co-operatives their drive? It is the constant improvement of their capacity to serve their members.

The design architecture of a co-operative has to foster three sets of relationships: between members and the board, the board and the managers, and the managers and the employees. A successful board finds out what are the members' priorities, turns these into organisational aims, and then holds managers accountable for pursuing these aims. The board energises the managers, making demands but also offering support. Managers, in their turn, energise the employees, making demands on them but also offering support. The circle is complete when the relationship between employees and members becomes mutually reinforcing, with both employees and members gaining energy from each other.



*“What gives co-operatives their drive?
It is the constant
improvement of their capacity
to serve their members.”*

It follows that the board should not be independent, but should include people who are intensive users of the co-operative. They should hear the voice of members, aggregate their priorities, ensure alternative courses of action are evaluated, and when they have decided what to do next, get the members' approval. The board has to meet members' expectations and maintain their trust. But this is not a one-way street. The board has duties towards the members, but the members have duties towards the co-operative. Such duties should be proportional to the size of the benefits, and members should accept the discipline that comes from being a member in return for having a better deal than they could get anywhere else.

Problems with co-operative governance	Solutions based on member centrality
<p>1. Members have <i>limited ownership rights</i>. The less they feel they own the co-operative, the less likely they are to support it and to take part in governance.</p>	<p>A member-central business strategy emphasises the importance of ownership, and member loyalty is visibly rewarded.</p>
<p>2. Co-ops have become <i>too large and complex</i>. Governance systems designed for small, community-based businesses are now being applied to very large international conglomerates.</p>	<p>Governance systems are redesigned to provide opportunities for participation via member councils, advisory groups and social media platforms</p>
<p>3. There is a <i>collective action problem</i>. When there are many members, and the contribution of each member is likely to have a minimal effect, the rational response is to free ride</p>	<p>Specialised member relations staff foster 'member voice', identify potential activists, and provide opportunities for member participation.</p>
<p>4. There is a comparative <i>lack of information</i>. Share prices that indicate performance, and rules of disclosure that make share price more accurate, do not apply.</p>	<p>Boards have a duty to inform members about performance. Members expect a patronage refund or other benefits, and require explanations for poor performance</p>
<p>5. There is a strong likelihood of <i>managerial capture</i>. Boards with a weak mandate will not stop managers furthering their own interests</p>	<p>A representative board with a strong mandate from members will align the interests of managers with those of the members</p>
<p>6. Co-ops suffer from a <i>lack of focus</i>. Investor-owned companies have one overriding goal – to maximise value for shareholders. The social goals of co-ops make governance costly.</p>	<p>Member centrality provides the focus boards need to govern effectively. The business strategy does not divide social from economic goals but focuses on meeting member needs</p>

Table 2.1: Problems with co-operative governance and member-centred solutions

Objections to a member-centred approach

These insights from Shah's work get us a long way in constructing a theory of co-operative governance, but he was analyzing agricultural co-operatives in India that were, by comparison with the largest co-ops, quite small. They just had a conventional board of directors elected directly by the members, with a management team to carry out their wishes and run the business.

In a very large co-operative it is impossible to get all the members together in one place; we have to find other ways of aggregating member preferences so that they can connect up with the governance process. Then we have to design in a structure that enables their representatives effectively to supervise top managers both in the main business and in any number of subsidiaries, sometimes in several different countries. This task is so difficult that there is a strong argument for bringing in expert independent directors on to the board.

Then there is the question of who are the members. They may be the people who have signed up for membership at the moment, but there are other potential members who might benefit. In mutuals, people cannot benefit from the co-operative without being a member. In non-mutual co-operatives there are people who trade with the co-operative but are not members. In producer co-operatives this includes non-member producers. Allowing people to trade without being members is a bad idea, as it undermines the value of membership. It can lead over time to confusion about the value of having a co-operative at all; this is what happened among some Irish dairy co-operatives where the meaning of membership got lost and they opted to become investor-owned.⁴⁰ Contrast this with the practice at Arla Foods, a European dairy co-operative that insists that farmers become members and invest in the business in proportion to the use they make of it.

In worker co-operatives the proportion of workers who are not yet members is crucial; if it is a high proportion then the co-operative is on its way to deforming into a limited partnership. Worker co-operatives have to persuade people to invest in the co-operative so that those who have already invested are not worse off. In order to solve this problem, the Mondragon Group in the Basque region of Spain requires workers who want to become members to serve a qualifying period and then to contribute a significant amount of capital; they have to show their

commitment and then buy into the co-operative. For instance, Eroski, Mondragon's co-operative retailer, has over 33,000 employees of whom only 11,000 are member-owners, though all employees eventually get the opportunity to become members.⁴¹

In consumer co-operatives, it is often impossible to exclude non-members (except in Japan where the law forbids non-members from buying from the co-operative store). Here, if membership is to mean anything the aim must be to increase the proportion of customers who



“In Eroski, seven million customer members account for 76 percent of sales.”

voluntarily sign up as members. In the 1970s, European co-operative banks were given the right to have non-member account holders (whereas in the rest of the world credit unions still insisted in full mutuality). Some of the European banks – notably Rabobank in the Netherlands - are now trying to

regain lost ground by persuading customers to become members. In retail consumer co-operatives this mismatch between member and non-member is easily rectified if members are offered a patronage refund. On the other hand, general discounts on purchases for all customers undermine the idea of membership.

In consumer co-operatives, persuading customers to become members makes sense because it enables the co-operative to build up loyalty and to retain the new customers over time. In Eroski, seven million customer members account for 76 percent of sales. In the Co-operative Group, 4.5 million members account for only 25 percent of sales, but the aim is to take this to 50 percent within five years.

In producer co-operatives the main purpose is *obviously* to meet the needs of members. This may include a variety of needs, not all of which are purely economic. For instance, workers in the field of social care might need the satisfaction that comes from doing a good job in caring for vulnerable people just as much as they need a living wage. In consumer co-operatives, in contrast, it is sometimes tempting to substitute for the members some other target group such as the local community or customers in general. We will see this in chapter 4 when we come to look at the different approaches of four very big retail consumer co-operatives.

Intervening factors

We cannot say for certain that a member-centred approach to governance will always bring success. At least three other factors intervene. First there is the quality of a co-operative's management.

Obviously, if the managers are not up to the job no amount of good governance can compensate. However, as Shah points out in his study of Indian agricultural co-operatives, good governance tends to lead to good management; the governors make sure they get the managers they need and that the managers get the training and support they need.⁴²

Second, there is the *degree of intensity of competition in the market place*. This varies between sectors and between the same sector in different countries, and it limits the amount of room a co-operative has to reward members for their loyalty. European co-operative banks, for instance, are operating in a business where there are now very low margins. On the other hand, the greater the competition the more important it is to establish a business advantage, and membership is one way to do this. We can see the importance of the co-operative advantage by the way in which competitors try to gain the same advantage by developing their own loyalty cards and membership clubs.

Third, *the type of product co-operatives offer* puts limits on their ability to pursue a member-centred strategy. In farmer co-operatives, the product can expand continuously to meet members' needs and aspirations. They can go further into food processing, and backward into supply of raw materials. In worker co-operatives, the safeguarding of people's jobs is so important that member-centredness is virtually guaranteed. In credit unions, there is a natural evolution from savings and loans to bank accounts, credit cards and other financial products. Mutual life insurance is more limited, because once someone has bought a policy it tends to be a one-off investment. It is, however, a long-term one and there is an opportunity for some interaction between governors and members over time. Food retailing co-operatives have often been seen as having a very 'thin' relationship to their members yet, as the Co-operative Group in the UK and SOK in Finland are demonstrating, it is possible to combine members' concern for local community with their interest in a range of ethical consumerist issues at national level. The combination is a potent one that is constantly expanding the 'offer' given to members.

A multi-stakeholder approach to governance

The main alternative to a member-centred approach is multi-stakeholding. There is a view that co-operatives are ‘legal persons’ that transcend the interests of any one group, including their owners. They should be governed on behalf of all the stakeholders, including employees, suppliers, customers, the wider community, the environment, and future generations.

At one level nobody would argue with this; in a consumer co-operative the interests of workers should be taken into account, and vice versa. The local community in which a co-operative is set is also important. Some people would argue that community needs should take priority; this is a strong sentiment in Japan, where co-operatives are sometimes seen as a complement to local authorities in providing public services. The wider environment is also important, not least because we have a duty to leave the world a fitter place for future members!

The problem with this approach is that it is vague and tends to make the task of governance much more complex. It is difficult to see how a board could govern effectively with so many ‘owners’, and how managers could manage with so many competing goals. Supporters of the ‘stakeholder view of the firm’ argue that it is a mindset that involves seeing stakeholder interests as joint rather than opposed.⁴³ Yet they represent different interests that cannot always be maximised together. The stakeholders may co-operate in the production of value, but there will never be a way to maximise the interests of all in its distribution. This means that the costs of governing on behalf of all stakeholders will be higher than for enterprises that have just one owner. By costs we mean not just the time and money spent maintaining complex governance systems, but also the delay in making important decisions, the damaging effect of uncertainty over business strategy, the effect of open conflicts on the morale of employees, and so on. If the costs are too high, the co-operative will go out of business.⁴⁴

The multi-stakeholder approach is important but it should come *second* to a focus on members. Otherwise, we may as well turn the governors into trustees and turn the co-operative into a non-profit charity or foundation. Sometimes this might be a good idea; better a trust that has a broader focus than a co-operative that has lost its sense of purpose. We can see this in cases where a membership-based organisation is set up but the service it provides goes to everyone (what the economists

call 'non-excludability') and there are no reasons to become a member. This is what has happened in the Canadian health co-operatives; not surprisingly they suffer from a lack of member participation.⁴⁵

In large co-operatives that are defending a significant market share, competitive pressures make it difficult for multi-stakeholder governance to work well. The co-operatives' competitors are focused single-mindedly on shareholder value. In such an environment, unless co-operatives are equally single-minded their governance will become too costly and they will be at a competitive disadvantage.⁴⁶ Also, to put the same point more positively, they benefit enormously from a single-minded focus on giving value to members because that is where their business advantage lies.⁴⁷ In smaller co-operatives working in less competitive environments, perhaps a broader focus is possible without making governance more difficult; this is particularly true of social co-operatives where a close relationship between workers, carers, and those cared for, is necessary if a quality service is to be provided.⁴⁸ It is also true that, if the members themselves want other interests than their own to be taken into account, then these become part of the member interest.

The single-minded focus on giving value to members is not as selfish as it sounds, because people often have collective as well as individual incentives. In studies of what motivates members to participate, Birchall and Simmons found that sense of community, shared goals and shared values were much more important motivators than personal gain or satisfaction.⁴⁹ When we know how the members define their community, we can channel benefits to the community through the members. Once we know what goals they share, we can align these with the co-operative's business strategy. Once we know what values they share, we can align these with the co-operative's values.⁵⁰

Design principles for governance

One way of understanding the relationship between governance and organisational purpose is through identifying some underlying principles in the governance system. Think of governance as being like a cake – not a round one but a long, rectangular one. It is cut into three pieces; one piece represents member voice, one representation and one expertise.

These are the three design principles that lie behind all governance systems. Within all the diversity, we can find co-operatives that give a larger slice to one or more of these principles. The exact combination is unique to each co-operative, but using the three principles we can find some common patterns. Some governance systems are designed to be exactly representative of the members, and so the governors cannot bear to give up places on the board to independent experts. Some are expert-driven and the governors do not care about representation at all. Some are expert-driven even though they still have systems of election and representation; their governors just control the selection process for candidates to the board! Some find ways to increase member voice, though the larger the co-operative becomes the more difficult this seems to be.



“We have to listen to the voice of the members, find an effective way of representing them, and find the expert help they need.”

In designing governance structures, whether we realize it or not we are struggling to give some weight to each of these three principles. We have to listen to the voice of the members, find an effective way of representing them, and find the expert help they need. Only when all three types of authority are present can a co-operative be governed effectively.

Member voice is expressed through attendance at annual general meetings, voting for representatives on boards, and other activities that are orchestrated by the co-operative. Representation is achieved through the election of people who become members of boards of directors, but also through regional councils, national assemblies and other intermediate or supervisory bodies. Expertise is something that the board of directors in particular focuses on in order to ensure that it has the necessary skills and knowledge effectively to govern the

co-operative as a business. In some co-operatives, the boards are so concerned about this that they supplement their expertise with that of an expert advisory committee: the giant Japanese insurance mutuals Nippon Life and Sumimoto Life do this.

Up to a point, these three principles can all be *optimised*. We can make sure that they work effectively. Much of the governance literature is concerned with improvements achieved through training, annual appraisals for directors, providing independent sources of advice and so on. Co-operatives UK's Corporate Governance Wheel is a good device for ensuring quality of governance in co-operatives that makes all this systematic.⁵¹ When co-operative governance works well, there are synergies between member voice, representation and expertise that sometimes go beyond our expectations. However, in designing governance structures we soon come to the uncomfortable realisation that these three principles cannot all be *maximised*; there are trade-offs between them.⁵² We cannot have more of one without putting limits on another. They are, in the words of the philosopher, *antinomic* principles.

This does not mean that the governors themselves can be divided neatly into those who are representatives and those that have expertise. Of course, representatives are experts of a sort (though their experience rarely extends to running hundreds of subsidiaries in foreign countries!), and if they are in touch with members they can convey the members' voice to the board. Also, there is a trend towards making sure that representatives pass a test of competence before being allowed to stand for election.⁵³ Conversely, experts who are appointed as independents on the board can also be representative. In the UK Co-operative Group, for instance, people who have been vetted by the nominations committee for their expertise and experience still have to become members and express their loyalty to the co-operative. In some co-operatives – Co-op Swiss for example – people who are encouraged to apply to be on a board because they have the requisite skills still have to submit themselves to election via regional or national assemblies. However, it is more helpful to keep the three principles separate even if, in practice, some people manage to combine them.

Using this simple set of principles, we can identify governance systems that are predominantly representation-based, expertise-based, or more balanced, giving some weight to all the principles. Moving from description to prescription, we have to ask some difficult questions. If you are redesigning your co-operative's governance system, what

size should each piece be? Do you give a big piece to representation or, under pressure from a competitive market place give a bigger piece for expertise? Is the member voice piece of the cake always going to be very small? We will be suggesting some answers to these questions in Chapter 10.

Chapter 3: The agriculture and food industries sector

Twenty years ago, the ownership structure of farmer co-operatives was very traditional. They were organised in two or three tier federal structures with primary co-operatives, and co-operatives of co-operatives at local and regional levels.

The cost of a membership share was low, farmers did not expect to contribute much capital, and returns were based on patronage. The supply side of the business was organized through wholesaling that aggregated demand so as to obtain discounts from manufacturers, and through manufacturing of staple products such as seeds, gasoline and fertilisers. The marketing side consisted of the collection of raw materials and their basic processing to make a product ready for sale. Co-operatives did not need a lot of capital, and what they did need was provided through retained surpluses or short-term borrowing.⁵⁴

Since then, big changes have taken place in the nature of farming, in the relationship between co-operatives and governments, and in the way that companies further along the supply chain do business. The pressures on co-operatives have intensified, externally from their competitors and internally from the demands of their members. In developed countries, the withdrawal of governments from farm subsidy and price maintenance, and the volatility of commodity prices because of increased global competition, have made small farmers vulnerable. They are no longer able to make a full living from farming and have to try to find other ways of generating income. Everywhere the number of farms is dropping; in the USA in the last 50 years farm numbers have dropped by two thirds. Co-operatives are now faced with diverse types of farmer-member who have different needs, which makes it increasingly difficult for multi-purpose co-operatives to govern in such a way that they meet all their members' needs.

At the same time, changes in the market make it more difficult for co-operatives to fulfil their traditional functions. On the supply side, farmers are beginning to use the Internet directly to purchase from manufacturers; this undermines the wholesaling side of the co-operative. Those societies that manufacture basic farm inputs are able to survive if there is sufficient scale and they can keep up with

competitors. However the competitors are themselves going through rapid consolidations and mergers in order to keep up with each other.

On the marketing side, the collection, storage and marketing of products has become less profitable, and those who can do so are investing further down the value chain in processing. The market has become dominated by supermarkets that demand product at a uniformly high quality, sourced all year round from producers that have to enter into contracts guaranteeing future production. Those co-operatives that want to stay in the market have had to develop rapidly to become large, transnational food processors. Their need for large amounts of investment capital has led to a growing diversity of co-operative ownership structures and new, mixed types of farmer and investor-owned business.⁵⁵ This all makes governance more complex.

There are still many *primary co-operatives*, but in the USA and Europe, through hundreds of mergers and takeovers they have outgrown their local roots and become regional, national and (in Europe) even multi-national players. In some countries such as Brazil, a national two-tier system of primary co-operatives and *co-operatives of co-operatives* has remained intact. In the USA there some very large co-operatives that, because of an untidy process of mergers of smaller co-operatives, are a *primary/co-operative of coops mix*, with both individual farmers and primary co-operatives in membership. In Korea and Japan, which until recently have been protected from the rigours of the global market, the system has become integrated into national-level *co-operative groups* that have their own banking and insurance arms, and consolidated accounts in which turnover is calculated for the system as a whole. Finally, some co-operatives have become *investor-owned businesses*, *majority-owned* by either individual farmers or co-operative holding companies.

Name	Turnover	Ownership Type	Governance Type	Experts of the board
1. NH Nonghyup (Korea)	\$63.76bn	Co-operative Group (producer)	Indirect via member council	Yes - 7
2. Zen-Noh (Japan)	\$47.69bn	Co-operative Group (producer)	Indirect via member council	Yes - 2
3. CHS Inc (USA)	\$42.66bn	Primary/co-operative of coops mix (producer)	Indirect via member council	No
4. BayWa (Germany)	\$20.16bn	Majority owned IOB (producer)	Conventional shareholder	No
5. Dairy Farmers of America	\$17.92bn	Primary/co-operative of coops mix (producer)	Indirect via member council	No
6. Fonterra (New Zealand)	\$15.56bn	Primary co-operative (producer)	Direct, with member council	Yes - 4
7. Friesland Campina (Netherlands)	\$15.14bn	Primary co-operative (producer)	Indirect via member council	Yes - 4
8. Land O' Lakes (USA)	\$14.97bn	Primary/co-operative of coops mix (producer)	Direct, via electoral constituencies	Yes - 3
9. Arla Foods (W Europe)	\$13.95bn	Primary co-operative (producer)	Indirect via several member councils	No
10. Hokuren Federation (Japan)	\$13.88bn	Co-operative of coops (producer)	Indirect via member council	?

Table 3.1: the top ten co-operatives in the agriculture and food industries sector

Who are the top ten co-operatives?

The top 10 co-operatives show how diverse the sector has become; all five of the ownership types described above are represented. First, there are two co-operative groups: the National Agricultural Co-operative Federation of Korea (known as Nonghyup) and Zen-Noh in Japan. Nonghyup has 1165 primary societies in membership, with 2.45 million members (more than 80 percent of Korean farmers) and over 15 million associate members.

It aims to provide everything the farmer needs in supply and marketing, and livestock production. It also has its own chain of stores

to help market farm produce locally, produces petroleum products for farmers, provides banking and insurance, and farm extension services. It works closely with local government to provide public services, and has a significant influence on central government policies towards farming and the rural environment.⁵⁶

Zen-Noh would be the world's largest agricultural co-operative by a wide margin, except that one of its regional co-operatives is now listed separately. It is the business arm of the 'JA Group', the national federation that represents farmers throughout Japan. It has 993 unions in membership, and apart from its national office, it has 34 offices in prefectural unions. There are 10.37 million members of the agricultural co-operative association, JA. It is the major importer of farm inputs such as grain and fertiliser, and the main marketing agent for farm products. It supplies 50 percent of fertiliser, 40 percent of agrichemicals, and 29 percent of animal feed. It markets 45 percent of Japan's rice, 34 percent of fruit and vegetables, 15 percent of eggs, and 14 percent of all meat distribution. It also has its own bank and insurance arm, and has research institutes, a chain of supermarkets, supplies farm machinery and buildings, oil and gas, and runs social action programmes to strengthen rural communities.⁵⁷

There is one co-operative of co-operatives in the top 10, Hokuren, the regional co-operative for the island of Hokkaido. It has 127 member co-operatives that between them have 38,000 farmers in membership.⁵⁸ In the top 20 there are four more of these traditional federations, including Growmark (USA), Agravis Raiffeisen (Germany), In Vivo (France), and DMK Deutsches Milch (Germany).

There are three co-operatives with a mixed ownership. They are both primary co-operatives and co-operatives of co-ops, with individual farmers and local and regional co-operative societies in membership. They include CHS, Land o Lakes, and Dairy Farmers of America, all based in the USA. CHS is a giant agribusiness that is listed 69th in the Global 500 listing of the largest firms.⁵⁹ Owned by 75,000 individual farmers and ranchers, and 948 member co-operatives, it is essentially a supply and marketing coop for grain farmers. It is a global company, selling grain in 65 countries. Land o Lakes is a dairy co-operative but with a large farm supply business mainly in animal feed that ranks 215 in the Fortune 500.⁶⁰ Owned by 2079 dairy producers, 964 agricultural producers and 782 member co-operatives, it has gone along the value chain into cheese, butter and other dairy products.⁶¹ Dairy Farmers of America (DFA) is another dairy co-operative that serves around 13,000

farmers and four regional co-operatives, mainly by marketing their milk but also by adding value through its own branded cheeses and joint ventures with food processing companies.⁶²

There are three primary co-operatives in the top 10: Fonterra (New Zealand), Friesland Campina (the Netherlands), and Arla Foods (Denmark/Sweden). They are quite a common type; there are three more in the top 20: Suedzucker (Germany), DLG Group (Denmark), and Sodiaal Union (France). Through steady growth, mergers and acquisitions they have outgrown the old federal systems of which they used to be part, but are still owned by their individual farmer-members. Fonterra is the biggest primary agricultural co-operative in the world and the world's largest dairy exporter, with 10,500 New Zealand dairy farmers in membership.⁶³ It markets dairy products only 10 percent of which are consumed in New Zealand: the other 90 percent are exported to over 100 countries. In fact, it accounts for 25 percent of New Zealand's exports.

Friesland Campina is another very large, transnational dairy co-operative.⁶⁴ It has 18,900 members in the Netherlands, Germany and Belgium, and exports to over 100 countries. Arla Foods is the fifth largest dairy company in the world. It is owned by 12,700 dairy farmers in the UK, Sweden, Denmark, Germany, Belgium and Luxembourg. Like Fonterra, it is not just a supplier of milk and milk produce but a global agrifood business (it has an agreement with Fonterra to share the Lurpak and Anchor butter brands). In the UK it is now the largest milk pool with 2500 farmers in membership.⁶⁵

Finally, there is one investor-owned company, the Baywa Group in Germany. A legacy of the Raiffeisen movement that was founded in the 1850s, it is 35 percent owned by Bavarian co-operatives, and 25 percent by warehouse co-operatives. The Group is based in Germany but has spread over 14 European countries in the agricultural, building and energy sectors. It franchises stores in the building materials and DIY trades and owns 275 petrol stations.⁶⁶ There are several other cases where farmers have opted to put the business at arms-length into an investor-owned company, and to hold a majority of shares in a holding company. The Swiss dairy company Emmi and the Irish dairy company Glanbia are examples. Often the farmers' shareholding becomes diluted over time; Kerry Group is at number 17 in the top 20 but it should not be there at all, as the farmers now own only one per cent of it.

What is their governance structure?

Only two of these co-operatives have a direct system of governance, in which the members elect the board: Fonterra and Land o' Lakes. Fonterra supplements this with a member council, and Land o' Lakes with electoral regions. Their systems are highly representative, but they both include independent experts on their boards.

Fonterra's board includes nine members elected from the 'shareholder base', while four independent members are appointed by the board and approved by the shareholders at the annual meeting. It also has



“Seven of the top 10 have an indirect system in which representatives are elected by the members to a member council.”

a member council consisting of 35 members, each elected to represent a geographical ward. The council organises the elections, and reports on its view of the company's direction, performance and operations. The council meets regularly with the board and management to discuss Fonterra's performance, and each year makes a report to all shareholders. It

runs training programmes for prospective directors and councillors, appoints an independent milk commissioner to deal with any complaints the farmers might have, and it makes two appointments to a milk price panel that sets farm gate milk prices.

Land o' Lakes has 24 directors elected by the members at an annual meeting with voting organised through five agricultural and seven dairy regions. The board also appoints three independent experts, making it a large board of 27 members. Every five years (or less) the company evaluates the boundaries of the regions and number of directors from each region so that the number of directors reflects the proportion of patronage income from each region.

Seven of the top 10 have an *indirect* system in which representatives are elected by the members to a member council which then elects the board. In different ways, they all achieve a very *representative* governance system.

First, let us look at the two co-operative groups. In Nonghyup, primary societies elect people to attend a member council (called a general assembly) that consists of the chairman plus 291 presidents

of member co-operatives. It elects the board of directors, and has the power to amend articles of incorporation, to do business planning and budgeting, and approve the accounts. The board of directors consists of the chairman, four presidents and CEOs, 18 presidents of member co-operatives and seven invited professionals.⁶⁷ Zen-Noh is similar; primary societies elect people to attend a large member council (called a delegates meeting) that elects a board of 20 directors consisting of representatives from all the different businesses, plus a lawyer and an accountant.

Now let us look at the European co-operatives. Friesland Campina has a base level of 21 electoral districts from each of which 10 people are elected to be on a district council. Out of the districts, two central governing bodies are created: the members' council and the co-operative council. All 210 district council members serve on the members' council, which is the highest decision-making body. This is also the 'General Meeting of Shareholders' of the company, and its voting is based on milk quotas; one vote for every 10 million kilos of milk delivered by each council. The chairs of the district councils make up a smaller co-operative council. The co-operative council nominates, and the members' council elects the board of directors, which consists of nine member dairy farmers, along with four external members chosen to supplement the skills of the Board members.

Arla Foods governance is also based on electoral districts (24 in Sweden, 25 in Denmark) from which the members elect representatives to serve on a regional tier (3 regions in Sweden, 4 in Denmark). In parallel with this system, in Germany, Luxembourg, Belgium and the UK there are 'local organisations' that aggregate the members' votes. At the top level is a member council (called the board of representatives), consisting of 169 members plus 10 employee representatives. The members consist of the chairs of each district in Sweden and Denmark, plus other elected members, and representatives from the organisations based in the other four countries (the UK, for instance, has 10 places on the Board). The result is a highly representative board of directors consisting of 24 members, of whom 8 are from Denmark, 7 from Sweden, 3 from Germany and 2 from the UK, along with 4 employee representatives (following the European model of having employee representatives on the board). The rules for apportioning the votes are complex and are based on the volume of milk marketed and the number of members in each country. The member council and the board of directors have a complex relationship, in that both are interested in long-term business strategy. The council decides on

the distribution of the profits for the year, while the board of directors monitors the company's activities more directly, and appoints the management board.

The details vary, but these two co-operatives show just how carefully the European farmer co-operatives achieve a highly representative governance system. Danish Crown featured in the first edition of this study, but has now slipped to eleventh place. It also has a base level of districts, a member council and a board that mainly consists of farmers. What is distinctive about it is the way in which it achieves a careful electoral balance between pig and cattle farmers.

The two US co-operatives that use indirect governance are similar in their emphasis on representation. CHS has eight regions from which a 17-member board of directors is elected (representing the regions plus the chair). In order to run for office, a candidate has to be endorsed by a local producer board and be an active farmer; there are no appointed independent experts on the board. DFA has districts from which members elect representatives to serve on seven area councils. These monitor the marketing of milk and deal with local issues, and elect the board of directors. The board consists of 55 dairy producers, three of whom represent co-operatives that are also corporate members of DFA. It is entirely made up of member representatives, with no appointed experts. Because it is so large, seven board members who are the elected chairs of the Area Councils then go on to serve as an Executive Committee.

Finally, BayWa has a conventional shareholder model of governance. It has a 16-member board of directors that includes the chairs of several Raiffeisen associations plus employee representatives.

How is member centrality ensured?

All but one of the top 10 co-operatives demonstrate member centrality, both in the way their websites portray them and in the way they do business. Zen Noh and Nonghyup have a reputation for being closer to government than to their members, but they certainly maintain a purpose that is central to their members' needs.

In Nonghyup's 2013 Report, the chairman says:

We as an organization exist mainly for the benefit of Korean farmers because they are, after all, at the core of all we strive to achieve.⁶⁸

Nonhyup has made strenuous efforts to streamline its operating system. In 2000 it merged three federations into one, and in 2012 separated its agricultural and banking operations. The ultimate goal is to improve marketing and supply so as to increase farmers' incomes. Zen-Noh's leaders realise that marketing farm produce is not enough; like the big co-operatives in the USA and Europe they need to expand into food processing and sell their own branded products. They have a three-year plan to strengthen sales and expand overseas in order to generate added value, yet they are still committed to providing the comprehensive support service that farmers have grown used to.

Arla has a strong commitment to farmer ownership. For instance, Arla Foods UK began as a shareholding company, but the shares were bought back by Arla Foods a.m.b.a and in 2007 it was delisted from the stock exchange and became a subsidiary. Danish Crown and Friesland Campina have recently become two-tier companies: a public limited company that does all the trading, but still wholly owned by the co-operative society.

Fonterra has maintained a focus on the needs of its farmer members. An innovative share ownership scheme and internal market have enabled the co-operative to bind the members into the business as suppliers and as shareholders; the Fonterra's ownership structure is complex, but it is still a co-operative. It might easily have demutualised but for the insistence of its farmer members on finding other ways to raise capital while remaining in control. There were two reasons why capital was needed. First, there was a need to find large amounts of capital to maintain the dominant market position as a food processor at a global level. Second, the amount of capital farmers had to invest was proportionate to the amount of milk they supplied, but when their supply of milk dropped they were able to withdraw capital, thus causing some instability in the capital base. In 2007, the board of directors announced that they wanted to convert the business to a listed shareholder-owned company, with the co-operative maintaining a controlling interest, but the farmer members turned it down. In 2009 the Board came up with another plan. Farmers can hold twice as many shares as their milk quota demanded, and be able to buy or sell them among themselves at market prices through a farmer-only share trading market. The company lends them the money to invest and provides a market maker to ensure liquidity. Other investors can buy unit trusts, but cannot buy the farmers' shares. Thus, the co-operative remains a co-operative.

Friesland Campina has recently changed its policy so that from 2014 member dairy farmers will receive an annual performance payment amounting to 35 percent of the co-operative's net profit (previously 30 percent). Fixed member bonds are available for members to invest in, and they receive 20 percent of net profit. Thus, in a very straightforward way, farmers are bound into the co-operative through both a patronage refund and investment. Arla binds its farmers into membership, expecting them to contribute capital in proportion to their milk delivery and in return offering to obtain the best price for the milk.

In the last five years, CHS has returned nearly \$2 billions in cash to its members. A portion of the patronage refund is in the form of non-patronage equity certificates that can only be redeemed at the age of 70 or on a member's death. This, combined with non-voting preferred stock, gives a stable equity base. In 2003, CHS issued non-voting stock to the general public that is quoted on the NASDAQ Global Select Market. This means the co-operative has outside shareholders who earn a return on capital of eight percent. However, because they are non-voting this does not really alter the governance structure. In 2012, Land o Lakes returned \$113 millions back to the members in patronage refunds, which brings the five year total to \$551 millions. DFA concentrates on giving a good price for milk, under the traditional two-stage payment system; in 2012 it paid its members \$7.3 billion. Cash returned to members through DFA's various equity retirement programs was \$32 million.

BayWa is the one co-operative in the top 10 that does not demonstrate member centredness. It is impossible to tell from its website that it is owned by co-operatives, and there is nothing to show how it connects with real co-operative members. It is easy to identify co-operatives that have lost their member focus. Compare the website of the Swiss dairy company Emmi (a shareholder company that is majority owned by farmers) with that of Fenaco (which is owned by the Landi group of co-operatives). The difference in ethos is immediately apparent; majority ownership by farmers is not enough to ensure member centrality in governance.⁶⁹

Have there been governance problems?

There has been one major scandal involving Fonterra. In 2008, a Chinese dairy company that was 43 per cent owned by Fonterra, recalled more than 10,000 tonnes of infant milk powder after it was found to be contaminated. An estimated 300,000 Chinese babies were affected, and six died. In the subsequent debate about who was to blame, Fonterra did not come out too badly; it had done what it could as a minority investor to get the products recalled quickly, and had donated to a children's charity in recompense.

There is not much that a transnational company can do to stop criminal contamination, especially as a minority shareholder, but the scandal has made Fonterra more cautious in entering into such partnerships.

In July 2012, Arla Foods was one of several dairy companies blockaded by farmers protesting against falling milk prices. They claimed that they were making a loss and could not continue in business if the supermarkets did not raise their prices. The result was that supermarkets, led by the UK Co-operative Group, raised the price they paid for milk. However, it shows that in a competitive market even the most efficient co-operative cannot always exercise enough market power against the buyers. It was not a governance failure, but it does underline the importance of focusing on the needs of farmer members above all else.



“in a competitive market even the most efficient cooperative cannot always exercise enough market power against the buyers.”

Chapter 4: The wholesale and retail sector

There are two types of co-operative in the wholesale and retail sector. The consumer co-operative offers membership to individual consumers. It is essentially a non-profit enterprise that meets its members' needs by organising the manufacture, wholesaling and distribution of the goods they need without independent wholesalers and retailers taking profits; effectively, they get all the goods at cost price plus expenses.

The producer co-operative offers membership to independent retailers. It provides them with the buying power they need to compete against much larger consumer co-operatives and multiple chains. It restores to the small retailer the profit that the consumer co-operative threatens to eliminate! It is no wonder, then, that at times there has been antagonism between the two types, because their interests are very different, and when they are facing each other on the high street they are direct competitors. However, in the last 60 years in the face of competition from investor-owned multiple chains, they have both had to struggle to maintain their market share. Sometimes they do this through joint buying between the two types of co-operative, which is a sign that their interests are not so different after all.

Consumer co-operatives trace their origins back to the Rochdale Society of 1844. It was not the first consumer co-operative, but it was the first successful one and it invented new ways of governing and managing that gave it a business advantage. One of its innovations was to link primary co-operatives into a federation that provided the advantages of group wholesaling and manufacturing.⁷⁰ However, this two-tier system has undergone many changes. In the last 40 years, because of intense competition from supermarket chains primary co-operatives have regrouped into regional and national level businesses that have grown very large. Some are still two-tier *co-operatives of co-ops*, some have, through mergers, become giant *primary co-operatives*, while one – the UK Co-operative Group – is like the US farmer co-operatives in being a *primary/co-operative of coops mix*.

When independent retailers began to face serious competition from consumer co-operatives and saw the advantages their rivals were gaining from vertical integration, they began to organise their own

wholesale supply. Like the Rochdale co-operatives, they began in a small way: in 1922 in the USA, 15 retailers shared out a carload of soap that they had bought in bulk, thus founding Unified Grocers.⁷¹ This parallel movement has built up a formidable set of retailer-owned businesses that are now trying to match the buying power of the multiple chains such as Tesco and Wal-Mart. Though they often form joint ventures, they are mostly still *primary co-operatives* owned by the retailers.

There are other ways to achieve the integration needed; some wholesalers offer retailers a franchise that imposes the same kind of discipline as a co-operative but without offering the retailers a stake in the wholesale business. Also, some retailer-owned co-operatives have moved away from basing voting rights and rewards on the use made of the business towards shareholder ownership. This is why one of the largest retailer-owned businesses, Intermarche, is not listed in the World Co-operative Monitor.

Name	Turnover	Ownership Type	Governance Type	Experts of the board
1. ACDLEC Leclerc (France)	\$58.4bn	Primary co-operative (producer)	Direct – election of store owners to board	No
2. ReWe Group (Germany)	\$56.4bn	Primary co-operative (producer)	Direct	?
3. Edeka Zentrale (Germany)	\$37.3bn	Primary co-operative (producer)	Direct	?
4. Systeme U (France)	\$31.2bn	Primary co-operative (producer)	Direct	?
5. Coop Swiss (Switzerland)	\$30.8bn	Primary co-operative (consumer)	Indirect via regional constituencies/ member council	Yes - 5
6. Migros (Switzerland)	\$29.8bn	Primary co-operative (consumer)	Indirect via member council	Yes - 9
7. John Lewis Partnership (UK)	\$18bn	Primary co-operative (employee)	Indirect and shared with trustees	Yes - 3
8. Co-operative Group (UK)	\$17.8bn	Primary/co-operative of coops mix (consumer)	Direct, with member council also elected	Yes
9. SOK (Finland)	\$17.1bn	Co-operative of coops (consumer)	Indirect via member council	No
10. Wakefern Food Corp (USA)	\$11.9bn	Primary co-operative (producer)	Direct	?

Table 4.1: The wholesale and retail sector

Who are the top 10 co-operatives?

There are five primary co-operatives of producers in the top ten: ACDLEC (France, more simply known as Leclerc) is in first place, followed by ReWe Group (Germany) Edeka Zentrale (Germany), Systeme U (France), and Wakefern Food Corporation (USA).

It is a common type: there are six more in the top 20, including Astera (France), Sanacorp (Germany), Associated Wholesale Grocers (USA), Superunie (Netherlands), CCA Global Partners (USA), and Foodstuffs North Island (New Zealand).



“The Edeka Group is the largest German supermarket corporation, currently holding a market share of 26 percent.”

Leclerc has a market share of 18 percent in France, and has over 630 stores, including 112 in Spain Italy, Portugal, Poland and Slovenia. It has 474 members, and divides its operations into 16 regions.⁷² REWE Group is one of the leading trading and travel

companies in Europe, and the third largest food retailer in Germany. It has a turnover of nearly €50 billion and 330,000 employees.⁷³ It trades through 22 distinct trade names in trading, 20 in travel and tourism, operating more than 15,000 stores in some 15 European countries including Russia and Ukraine. It also has 2500 travel agency outlets and other food businesses. It has 890 retailers in membership in Germany, operating 1112 stores.⁷⁴ The Edeka Group is the largest German supermarket corporation, currently holding a market share of 26 percent.⁷⁵ It has more than 4000 retailers in membership, supported by seven regional wholesale companies that operate 38 warehouses, and a central based in Hamburg. It has around 11,700 retail outlets, owns a subsidiary discount retailer (Netto Marken-Discount), and has its own Edekabank. Système U is another French retailers’ co-operative, comprising about eight hundred independent hypermarkets and supermarkets. Its members trade under the banners Hyper U, Super U, Marché U and Utile. The Wakefern Food Corporation is largest retailers’ co-operative group of supermarkets in the United States, based in New Jersey and operating in six states. It has 46 members who own and operate ShopRite and PriceRite supermarkets.⁷⁶

Pharmacy co-operatives just miss out on being represented in the top 10, but there are two of them in the top 20: Astera at number 11, and Sanacorp at 18. They proclaim boldly on their websites that they are co-operatives. In 2007, they created a new company, Sanastera

that operates in Belgium, France and Germany and, with over 14,000 members, is the largest pharmacist-owned wholesaler in Europe.⁷⁷

There are two primary co-operatives of consumers in the top 10: Coop Swiss, and Migros. Together they dominate the market in Switzerland, so much so that they have sometimes attracted attention from the European Union regulators for potential monopoly. This is not a common type, as primary co-operatives do not usually grow this big. Coop Swiss has 2476 outlets including the whole range of food outlets: superstores, supermarkets and convenience stores.⁷⁸ It has large chains of department stores, building supplies stores, petrol stations, catering outlets, home furnishings, and pharmacy. Through joint ventures it has a stake in the travel industry (owned with REWE). Unlike the UK's Co-operative Group it still has a substantial investment in manufacturing, with nine companies that include the country's largest grain miller and meat processor. It has recently acquired Transgourmet, Europe's second largest cash and carry and wholesaler. It has 2.5 million members, and 85,000 employees.

Migros is the largest retail trade enterprise in Switzerland and the largest private employer, with 87,000 employees. It has over two million members organised in 10 regional co-operatives, and over 102,000 employees.⁷⁹ The Group includes 569 supermarkets, 221 non-food outlets, 191 M-Restaurants, its own discount and department store chains, 21 industrial companies, several companies specializing in trade, travel and logistics and a bank. Turnover is 52 percent in retail, 23 percent in the merchandise trade, 17 industrial and commercial, with its travel business contributing four percent and finance (it has its own bank) three percent.⁸⁰

The traditional form that national-level consumer co-operatives have taken in the past is the co-operative of co-operatives. There is only one in the top 10: SOK Corporation in Finland, though there are three more in the top 20: Federated Co-operatives (Canada), Kooperativia Forbundet (Sweden), and Coop Norge (Norway). SOK is the national-level apex of the S-Group, owned by 20 independent regional co-operatives and eight local co-operatives.⁸¹ In its core business of the supermarket trade, S Group is now the market leader in Finland; it has nearly 1700 outlets and 37,000 employees. While food retailing is its main focus, it also has 751 restaurant outlets, more than 400 petrol stations, 39 car sales outlets, 89 Agrimarket outlets, and 58 hotels. In 2007 it opened its own S-Bank. The Group has well over two

million members, representing more than 80 percent of the Finnish population.

There is one primary/co-operative of co-operatives mix: The Co-operative Group (UK). This is the third largest consumer co-operative after the two Swiss co-operatives, but it is unique in having this hybrid ownership structure. The Group went through a bad time a few years ago because of huge and unforeseen losses at its bank due to a merge with a building society, and because of indifferent performance in its food business following the purchase of a chain of small supermarkets. A change of management, and a complete redesign of its governance system have led a steady recovery. Its turnover is listed in Table 4.1 as US\$17.8 billion, but these are 2014 figures; in 2016 its turnover was a more modest \$12.5 billion.⁸² It has sold some of its peripheral businesses, and begun to focus on food retailing and funerals; it has 2774 food stores and 1026 funeral homes and is still the market leader in these sectors. It has over 60,000 employees and four million active members. In 2016 its sales grew by more than three per cent, which made it the fastest growing retailer in the UK apart from two discount supermarket chains.⁸³

Finally, there is one primary co-operative of employees in this sector, John Lewis Partnership. It is the only large co-operative of its type. Like another of the primary co-operatives, Migros, it is the result of a deliberate decision by the original owner to give control away; Migros was given to the customers and John Lewis transferred to the employees. The Partnership includes the John Lewis department store chain of 35 stores and 12 'at home' shops, and 352 Waitrose supermarkets. It has 84,000 employees who are referred to as 'partners'.

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What is their governance structure?

It is difficult to find out about the ownership and governance structures of the retailer-owned wholesalers. Very little information is provided on websites, annual reports are not available and press offices have been unresponsive.

They are probably quite conventional, with a direct system in which members elect the board of directors at an annual general meeting. For instance, REWE Group is governed by a 16 member supervisory board, nine of whom also serve on the finance arm, REWE Central Finanz.

The governance of the consumer co-operatives is much more transparent. The two primary co-operatives both have highly *representative, indirect systems*. Coop Swiss has a base level of six electoral regions, consisting of 60 to 120 elected members (the proportions depending on the number of members in each region). Together, they form a member council of several hundred people that has the powers of an AGM, electing the board of directors. The electoral districts appoint a 12-member nominations committee whose job it is to propose people for election to the board. However, their nominations do not go directly to the member council to be voted on, but go to the board for approval first. These procedures must give the board of directors a strong influence over their own re-election and the election of new directors. The board of directors consists of six members nominated by the electoral regions, and a maximum of five more, including a French speaking representative and an employee representative (it has 10 members at the moment). The directors may represent the regions, but are all professional people with formidable skills; the indirect method of proposing and electing them leads to a board that is both representative and expert.

Migros is officially a federation, with 10 regional co-operatives in membership, (though it is more realistic to see it as a primary co-operative with electoral regions). The supreme body is the member council, referred to as the 'Migros Parliament'. It has 111 members, of whom 100 are elected by ballot of the electoral regions and 10 by the regional managers. As in Coop Swiss, the council forms the AGM, electing the board of directors. This is a mix of 10 representatives (one from each of the regions), nine independents chosen for their expertise, two employee representatives, plus the CEO and President.

SOK also has a *representative, indirect* system of governance, which mirrors that of its member co-operatives. It has a member council on which all regional and local co-operatives are represented, and which elects the board of directors. The board has 20 representatives from the regional co-operatives, plus two employee representatives. There are no independent experts on the board.

Co-operative Group used to have an indirect and highly representative system of governance ascending through three levels; area committees, regional boards and a main board. To reach the main board, people had to be elected to the lower levels first, and then stay elected at each level. This was replaced by a more conventional system of a member council and board, but with the difference that it is a *direct*

representative system; both the member council and the board are elected directly by the ordinary members. The council consists of up to 100 members. There are 92 at present (in 2017), including 15 from the 22 member co-operatives, 73 from 13 electoral regions, and four employee representatives. The board consists of four member-nominated directors, five independents, two executives, an independent chairperson and the chief executive.

There are two routes to becoming a board member. You may be appointed as one of the five

independents on the basis of your expertise, with the appointment then ratified by the members at an AGM. Alternatively, you may become one of the four member-nominated directors, directly elected by the members. There has been a lot of competition for these member-nominated places as well as for the member council. The nominations committee is composed of the council president plus two member-nominated directors and the Group chair plus two independent non-executive directors. This ensures that there is some member involvement in the nomination process.

John Lewis has a complex governance system devised by its previous owner when he donated the company to the employees. We might classify it as *indirect via member council, shared with trustees*. The basic principle is that there should be checks and balances, so that no one group of employees can gain control, and so that current employees cannot sell the company for personal gain; the underlying principle is the intergenerational nature of employee ownership. The partnership has three governing authorities: a member council (known as the partnership council), board of directors (partnership board), and a chairman. The members are divided into constituencies, each of which elects one 'partner' as their council member. The council appoints five directors to the board of directors (it also appoints three trustees and the President). The board of directors consists of the five member-elected directors, three external non-executive directors, and five executives appointed by the Chairman. Finally, there are trustees who act as directors of John Lewis Partnership Trust Ltd, the legal entity that holds the company shares in trust for the partners. They appoint the Chairman and distribute the annual 'partnership bonus'.



"John Lewis has a complex governance system devised by its previous owner when he donated the company."

How is member centrality ensured?

The retailer-owned co-operatives align individual and collective interests in a careful balancing act that ensures the loyalty of individual member retailers and the responsiveness of the co-operative to their needs. The basic structure of property rights is the same in all the retailer co-operatives, but the package varies. The membership contract is designed to be medium to long-term, otherwise the co-operative can become unstable with members exiting at will and withdrawing capital. ⁸⁵

Other, non-co-operative wholesalers offer franchising, but this is not the same thing; in the co-operatives, ownership of the store stays with the retailer (though in Rewe the company has a 20 percent stake). The members are tied into the co-operatives through a goods-purchase agreement and a service level contract, and there are rules that prevent them selling to their competitors; in Leclerc, for example, there is a minimal contract term and penalties for premature withdrawal. Leclerc also requires its members to work for the company for two days a week (as does Intermarche), which is quite a commitment. As one researcher sums up: 'The system as it is built, facilitates the alignment of interests between the co-operative and its members'. ⁸⁶

There are two ways in which Coop Swiss meets the needs of members. First, it returns profits not through dividend but through a low price policy (its prices are 0.5 percent lower than those of its competitors). It has regular rounds of price-cutting; in 2012, for example, it passed on profits directly in cuts that meant prices fell by 1.2 percent. Second, it emphasises the sustainability and ethical aspects of its brands. Like CWS, in the 1980s it was a pioneer of honest labelling and it stopped promoting tobacco, and it tried to keep open loss-making shops in remote areas. It launched its own organic and fair trade products and a separate sustainability brand (it is now the world leader in fairly traded organic cotton). It has a family club for member families with discounts, and a Coop Supercard with loyalty points. But the emphasis is on low prices, and on governing more broadly for stakeholders: in the 2012 annual report it says 'it acts to ensure good corporate governance in the interests of its members, customers, employees and other stakeholders'. ⁸⁷

Migros does not set out to meet the needs of members but of the society as a whole. In 1950, when they turned the business into a co-operative, Gottlieb and Adele Duttweiler published 15 propositions,

one of which was that the general interest must be placed higher than that of the co-operative (proposition 10). The main beneficiaries are a directorate of Cultural and Social Affairs that operates 64 leisure centres, and a directorate of Migros Club Schools that operates 50 clubs and is the largest adult education institution in Switzerland. Membership is free, and new members receive a share worth 10 francs, the right to vote, a weekly magazine, and a brochure that provides discounts. In 2012, SFr135 millions were returned – not to members but to the community – in what is called a ‘cultural percentage’.

SOK Group is clearly member-centred. Its policy is to return as much of the profit to members as possible: in 2012 this amounted to €420 million. This included the patronage refund on purchases, plus bonus sales (five percent on purchases), interest on membership fees and a small percentage for using the S-Bank credit card. The S-Etukortti card is a sign of co-operative membership and a key to benefits, and it also provides free banking. This policy of relentlessly pursuing member benefits and using the Bank to orchestrate them shows a total commitment to membership that is unrivalled by any other consumer co-operative.

After going through a period of uncertainty about its goals that was coupled with a near meltdown of its entire business, The Co-operative Group has begun to focus clearly on the benefits of membership. In September 2016 it introduced a five per cent discount for members on co-op brand goods and a one per cent dividend to local community groups. The community dividend has proved very popular, but it is worth noting that it can only be earned through purchases by *members*. Member benefits plus community benefits seems to be a potent combination. In the nine months to June 2017, £50 million has been distributed to members, and £10 million to local causes. By the end of 2018 they aim to give back £100 million a year.⁸⁸ The strategy seems to be working: more than a million new members have been signed up since it began.

Employee-owned businesses have one important advantage, that paid work is already a central concern in people’s lives. In John Lewis Partnership, because of the carefully crafted governance structure, members have plenty of opportunity to make their views known. They also benefit substantially from the business. A ‘partnership bonus’ is paid out each year by the board and is distributed as the same percentage of gross annual pay to all partners. In 2012 to 2013 they received a 17 percent bonus at a total cost of £210.8 millions.

Have there been governance problems?

There are no reported governance problems in any of these co-operatives, with the exception of The Co-operative Group, whose story was told in Chapter 1. This shows just how important it is to design a governance system that is fit for purpose.

Chapter 5: The industry and utilities sector

Industry and utilities are really two sectors that overlap. Industry includes the processing of raw materials and manufacture of goods in factories. Co-operatives are not strong in the industrial sector, except in two concentrations of worker-owned companies in the Basque region of Spain and in North Italy. The Basque co-operatives are tightly organised in one co-operative group, while the Italian ones are in a more loosely organised network that includes both primary co-operatives and co-operatives of co-operatives.

The utilities sector includes the production and distribution of basic amenities such as electricity, gas, and water. The providers do not just have to create the product, they have to invest in expensive distribution networks that, once they are set up may lead to natural monopolies in which consumers have no choice but to rely on one provider. To get over this problem, in the past governments have chosen to provide the utilities themselves, or to promote consumer co-operatives that do not exploit the natural monopoly for private gain. More recently, governments have tended to encourage a competitive market between utility companies, opening up the distribution networks and regulating prices on behalf of consumers.

Consumer-owned electricity co-operatives are strong in the USA. They are part of the system that was created in 1935 when the US government decided to bring electricity to rural areas, and have all retained the same ownership structure. The transmission co-operatives are *co-operatives of co-operatives* owned by local electricity distribution co-operatives. This type is also strong in the Scandinavian countries, but here they tend to be much smaller and mixed in with local authority providers, so they do not appear in the top 20.⁸⁹ In Western Europe, there are large companies owned by local authorities that are classified in the Monitor as co-operatives, though they tend to distribute voting rights on the basis of shareholding and so their inclusion is debatable. We will call them *consortium co-operatives*.⁹⁰

Name	Turnover	Ownership Type	Governance Type	Experts of the board
1. Mondragon Group	\$16.7bn	Co-operative group (mainly producer)**	Direct, then indirect via member council	No
2. National Cable TV Coop (USA)	\$2.8bn	Primary co-operative (producer)	Direct, plus advisory committees	No, but advice
3. Basin Electric Power Co-op (USA)	\$2.2bn	Co-operative of coops (consumer)	Direct, via electoral constituencies	No
4. Publi-T (Belgium)	\$1.9bn	Consortium co-operative	Conventional shareholder	?
5. Eandis (Belgium)	\$1.5bn	Consortium co-operative	Conventional shareholder	No
6. OK Amba (Denmark)	\$1.5bn	Mixed primary/ co-operative of co-ops (producer/consumer)	Indirect, via electoral constituencies	Yes - 2
7. Oglethorp Power Corp (USA)	\$1.4bn	Co-operative of coops (consumer)	Direct, via 5 electoral groups plus advisory member council	Yes - 2
8. Tri-State G&T Association (USA)	\$1.4bn	Co-operative of coops (consumer)	Direct, 1 board member from each coop	No
9. Consorzio Co-operative Construzione (Italy)	\$1.4bn	Co-operative of coops (producer)	Indirect via member council	Yes - 3
10. Central Electric Power Coop (USA)	\$1.3bn	Co-operative of coops (consumer)	Direct, 2 board members from each co-op	No

Table 5.1: The top 10 co-operatives in the industry and utilities sector

**Mondragon Group has mainly worker co-operatives, but also some farmer co-operatives and a consumer/worker co-operative Eroski in membership

Who are the top 10 co-operatives?

The Mondragon Co-operative Corporation (Spain) is a co-operative group that dominates the top 10 listing with a turnover of \$12 billion. ⁹¹

It has grown out of a small group of worker co-operatives in the Basque region of Spain to become the largest concentration of worker-owned businesses in the world. It now has 102 co-operatives in membership,

with another 140 subsidiary companies, and has become Spain's seventh largest industrial company, with a workforce of over 100,000. Around 78 per cent of its employees are members.

Consorzio Co-operative Construzione (CCC, Italy) is a co-operative of co-operatives that has around 300 primary co-operatives in membership, operating in the building, transport, service, industrial, and building materials sectors. With a turnover of \$1.4 billion, it is one of the leading groups in the Italian construction sector, carrying out major building and engineering projects such as high-speed railways, bridges, shopping centres, airports, railway stations, and an Olympic village. It also engages in restoration of public buildings such as theatres and libraries. There are two more Italian industrial co-operatives in the top 20, both of them primary co-operatives. SACMI, a manufacturer of machinery for the Ceramics, Food and Plastics industries, is 13th with a turnover of \$1.2 billion. CMC di Ravenna, a specialist in the large-scale construction industry, is 15th with a turnover of \$1.1 billion.



“Mondragon in the Basque region of Spain has become the largest concentration of worker-owned businesses in the world.”

There are four consumer-owned power utilities, all co-operatives of co-operatives with primary co-operatives in membership: Basin Electric Power Co-operative, Oglethorp Power Co-operative, Tri-State G and T Association, and Central Electric Power Co-operative. This is a common type; there are seven more US utilities in the top 20.

Basin Electric Power Co-operative is one of the largest electric generation and transmission co-operatives in the United States. It provides wholesale power to a consortium of rural electricity co-operatives through a diverse energy portfolio that includes coal, gas, oil, nuclear, distributed, and renewable energy, including wind power, and it delivers these through over 2000 miles of high-voltage transmission. It has 137 member rural electric systems in membership, located in nine states, and indirectly it serves 2.8 million electric consumers. Oglethorp Power has 38 Electric Membership Corporations that provide electricity to more than 4.1 million consumers in Georgia. It is like Basin Electric in having a diverse energy portfolio that includes natural gas, hydroelectric, coal and nuclear generating plants, and it also purchases power from other generators.

Tri-State Generation and Transmission Association is owned by 44 electric co-operatives in Colorado, Nebraska, New Mexico and Wyoming, which serve over one million consumers. Its power is generated through a combination of coal and gas power plants supplemented by purchased power, and it owns 5,056 miles of transmission line. Central Electric Power Co-operative is owned by 20 distribution co-operatives in South Carolina. It serves over 700,000 customers through 70,000 miles of distribution lines.

There are three consortium co-operatives in the top 10. Eandis and Publi-T are both based in Belgium. Eandis is a not for profit company that provides electricity and gas for seven Flemish mixed distribution system operators that are majority owned by 234 local authorities. Publi-T is similar, but with a complicated ownership structure; major shareholders include other affiliated energy companies in which Publi-T also has a stake. Publi-T owns part of Interfin, which is also part owned by 15 local authorities. Another affiliate, SOCOFE, is owned by several provinces, plus five affiliates including Publi-T.

The third consortium co-operative is National Cable Television Co-operative (USA). It is a supply co-operative for producers of cable TV. It negotiates on their behalf with the TV networks that supply programmes, and with hardware suppliers that provide the cabling infrastructure. It also provides its members with support in marketing their products. It has more than 1,000 member companies that serve more than 10 million subscribers, and they range in size from fewer than 100 subscribers to more than 1 million.

Lastly, there is one co-operative that can be classified uniquely as a mixed primary/co-operative of co-operatives of both consumers and producers. OK amba (Denmark) is an energy co-operative owned by 17,000 customers and dealers. It is Denmark's biggest selling petrol brand, with 26 percent of the market. It has two sales centres, a distribution centre, and more than 670 unmanned filling stations, most of which are located alongside co-operative supermarkets. It also supplies consumers with heating oil, natural gas, electricity, and renewable energy equipment.

What is their governance structure?

Being a group, Mondragon has a complex system of both direct and indirect representation. Individual worker members elect their own boards of directors. The primary co-operatives and some specialised co-operatives of co-operatives then elect delegates to a very large 650-member council (called Congress).

It lays down general guidelines and criteria, and is a forum for debate and approval of basic policies. It meets every four years, and calls to account the standing committee; it may be convened by the standing committee or by 15 percent of members of the Congress. The standing committee is equivalent to a board of directors; it elects the president and vice president of congress and the secretary general. Each division has representatives on the standing committee in proportion to worker-members. Then there is a management board (called a general council) that has a president, nine vice presidents responsible for the divisions, and six directors of central departments. Only the president needs to be a member of a co-operative.

CC Construzione has an indirect system of governance. Member co-operatives elect a member council (also called the general assembly) that then elects the board of directors that appoints a management board. The board consists of 25 members, including three independents, plus the president and vice-president.

Governance of the US utilities is designed to make them responsive to their member co-operatives. Three of the four in the top 10 have a direct and highly representative governance system, with no independents on the board. Basin Electric's board of directors is made up of one representative from each of 11 electoral districts. Tri-State's board is made up of one representative from each of its 44 member co-operatives. Central Electric's board is made up of two representatives from each of its 20 member co-operatives.

Oglethorp also has a direct and highly representative system. The 38 member co-operatives are organized into five regional constituencies (called scheduling member groups) from where they elect 10 directors to serve on the board. Each constituency elects one board member and one managing director from the primary co-operatives. The board of directors includes these 10 elected directors, three directors-at-large and up to two outside directors.⁹² The board is supplemented by a member council (called an advisory board) that consists of one elected

representative each from the 38 member co-operatives. It constitutes a nominations committee that organizes the process of identifying potential board members and electing them. Three times a year it receives a report from the board of directors and is expected to give advice.

In contrast, while Eandis and Publi-T may be classified as co-operatives in the World Co-operative Monitor, their governance is identical



“workers have to make a significant investment, and in return receive a share of the profits and a pension.”

to that of any investor-owned company. In Eandis, the member local authorities are referred to as shareholders and the shares are transferable between the partners.⁹³ Voting is by the number of shares held. The board of directors consists of a maximum of 20 people elected by a general meeting of the

shareholders. The board members elect the chairman, and appoint a management committee of up to eight executives. National Cable also has a conventional governance structure. Board members are elected at an annual member’s meeting. The board consists of 14 directors and a president and CEO who is a non-voting member. In addition to the board, other members also serve on a technical advisory board and a marketing advisory group.

OK Amba has an indirect representative system, carefully designed to allow both types of members’ voice to be heard. It has an electoral base made up of 75 representatives elected from 16,000 customer and retailer members divided into three regions of Denmark. They elect six out of 13 member board of directors that also includes two co-operative retailer representatives, three employees and two externally selected directors. Thus, the board balances member representation, the special interest of retailer members and the need for expertise.

How is member centrality ensured?

In the Mondragon system, workers have to make a significant investment, and in return receive a share of the profits and a pension based on their lifetime earnings; over 50 percent of profits are distributed to worker members.

Their democratic structure is complex and allows worker-owners to oversee their co-operative while accepting the right of management to manage and of the Bank and other institutions to influence business strategy. The Mondragon system is tighter than that of North Italy, but the effect is the same - to sustain a complex system of interconnected firms that overcome the weaknesses of worker ownership while building on its strengths. CC Construzione says little about its focus, but through contracts with members it must maintain member centrality.

The US utility co-operatives have long-term wholesale power supply contracts that bind their members into their network, and they operate as non-profits that in effect means they deliver their power at cost price. What more could their members want? Eandis and Publi-T do the same for the end-customers, but much less directly. National Cable declares on its website that it seeks to maximize 'opportunities to ensure the profitability, competitive stature and long term sustainability of its member companies'. As a non-profit it is essentially an agency passing on savings to its members.

Have there been governance problems?

None of these co-operatives have any reported governance problems. However, some critics warn that Mondragon is deforming into a kind of worker capitalism because it does not offer membership rights to workers in other countries.

In 1990 90 percent of workers were members, but this has slipped to 38 percent; four jobs are being created abroad for every one created in Spain.⁹⁴ Also, co-operative leaders are beginning to debate whether elected board members alone can control all these subsidiaries, or whether they also need some expert independent directors.

Chapter 6: The health and social care sector

Seen from a global level, the distribution of co-operatives in health care is very uneven. Opportunities for co-operation in health care depend largely on the role of the state in funding and providing for the sector, which varies greatly between countries. Co-operatives face competition from the investor-owned sector in some countries, and the state sector in others.

In health and social care, as in the wholesale and retail trade sector, there are two basic types of co-operative, of producers and consumers. The producer co-operatives have been set up to provide medical doctors and other health care staff with the opportunity to practice their profession in hospitals and health centres. These are similar to co-operatives owned by other professional groups such as investment brokers, architects, and lawyers. The consumer co-operatives have been set up to provide patients with community-based and hospital care, and with the means to pay for it through health insurance. These are similar to co-operatives owned by consumers in other sectors such as retailing and general insurance. They are a mirror image of the producer co-operatives, and so are potentially rivals.

Occasionally their different interests are brought into the open. In the 1930s in the USA, rural consumer-owned health co-operatives gained government support, but were opposed by the American Medical Association, whose members succeeded in getting legislation passed in 26 states barring consumer controlled health plans.⁹⁵ When Group Health Co-operative first began in the late 1940s, the local medical association opposed it and the co-operative had to win a court case against 'restraint of trade' in order to employ its own doctors. Even in the 1970s, when another small group health co-operative began in Wisconsin, a local medical society opposed it.⁹⁶ This is why, when consumers organise their own health care, they have to design a governance structure that gives the medical profession a lot of autonomy.

The producer-owned health co-operatives could include retailer-owned distributors set up by pharmacists to provide them with inputs to their own businesses. In the World Co-operative Monitor statistics these are found in the wholesale-retail sector. Had they been classified

in the health sector, they would have figured much more largely as their turnover is bigger than that of the biggest health co-operative.

Name	Turnover	Ownership Type	Governance Type	Experts of the board
1. Unimed Confederation (Brazil)	\$22.4bn	Co-operative Group (producer)	Indirect, via member council + forum	Mix of producer/ consumer
2. Health Partners (USA)	\$5.5bn	Primary co-operative (consumer)	Direct + advisory committee	Yes – 2 physicians
3. Group Health Coop (USA)	\$3.7bn	Primary co-operative (consumer)	Direct + advisory committee	No – but advisory
4. Fundacion Espriu (Spain)	\$2.1bn	Co-operative of coops (producer and consumer)	Direct, from the four member coops	Mix of producer/ consumer
5. Saludcoop (Colombia)	\$1.2bn	Co-operative of co-ops (consumer), now liquidated	Direct, but obscure	?
6. Intercommunale de santé publique (Belgium)	\$0.5bn	Consortium co-operative	Direct, reps from member organisations	No
7. Centre hospitalier regional Citadelle (Belgium)	\$0.5bn	Consortium co-operative	Direct, reps from member organisations	No, but separate medical council
8. Cooperativa de Salud do Cartagena (Colombia)	\$0.4bn	Primary co-operative (consumer)	Direct (probably)	?
9. Cooperativa de Salud Comunitaria (Colombia)	\$0.4bn	Primary co-operative (consumer)	Indirect, via member council	No
10. Societe co-operative medicale de Beaulieu (Switz)	\$0.3bn	Primary co-operative (producer)	Direct	No

Table 6.1: The top 10 co-operatives in the health and social care sector

Who are the top 10 co-operatives?

The largest is Unimed Confederation (Brazil), a co-operative group that, with a turnover of \$22.4 billion is more than four times the size of the second on the list. It consists of 372 medical

co-operatives that cover 83 percent of the country, with 110,000 physicians in membership.

It owns over 100 hospitals and has contracts with over 3000, and it even runs its own ambulance and emergency services. It has 19 million customers, which makes it the biggest private healthcare operator in Brazil and the largest network of medical co-operatives in the world.

⁹⁷ It finances medical care by offering health insurance to consumers via a subsidiary called Usimed. In this way, it has captured more than a third of the market for health plans. This Brazilian model has been followed in Chile, Colombia, Costa Rica, Paraguay and Argentina.

There are two consumer-owned primary co-operatives in the listing, Group Health Co-operative and Health Partners, both in the USA. Group Health Co-operative was founded in 1947, explicitly in conformity with 'Rochdale' principles; from the start it was planned as a consumer co-operative in which patients would be in control, though its legal form was that of a non-profit. It has recently been acquired by Kaiser Permanente, but is intended to continue as a separate organisation called Kaiser Permanente Washington.

It provides both health care and health insurance. Based in Washington state and North Idaho, it has 651,000 members, 9000 staff, with one hospital, 25 primary care clinics, six speciality care units, seven behavioural health clinics, 14 eye clinics and so on.

Health Partners was founded in 1957, again explicitly as a consumer co-operative along the same lines as Group Health. ⁹⁸ It provides both health care and health insurance. Based in the Minnesota-Wisconsin region, it has more than 1.8 million medical and dental health plan members nationwide. It has a group practice of 1800 physicians, a wider contract network in Minnesota of more than 15,000 physicians (working in 4000 clinics), and a regional network of 38,000 doctors. It is ranked among the top 30 health insurance plans, and has its own research institute. Together, these two co-operatives are in the top 10 of health maintenance organisations (HMOs) in the USA, but they are the only consumer co-operatives; the others are non-profit foundations.

Then there is the Fundacion Espriu in Spain, a co-operative of co-operatives that includes both producers and consumers. The

“Unimed has 19 million customers, which makes it the biggest private healthcare operator in Brazil.”

Foundation is a non-profit umbrella organisation, designed to promote co-operative healthcare. It employs more than 32,000 professionals and provides healthcare cover for almost two million people. It is the apex body for four organisations: Autogestió Sanitària; Lavínia; Assistencials Sanitaries Interprovincial, Sociedad Anonima (Scias); and Asisa.

Autogestio Sanitaria is a service co-operative based in Barcelona made up of 5500 doctors. It has a majority stake in the insurance company Assistencia Sanitaria (Scias). In fact, the law does not allow it to offer insurance to consumers direct, but it has to do this through Scias, a co-operative of users based in Barcelona. Scias has 200,000 policyholders, owns Barcelona Hospital and can call on the services of 4000 doctors. Lavinia is a co-operative based in Madrid but operating throughout Spain. It has 12,000 doctors in membership, and its purpose is to enable them to be involved in the Asisa Group. Like Scias, Asisa is an insurance company created by the medical doctors. It employs 26,000 healthcare professionals, delivers services at 199 hospitals, 16 of which it owns, and serves 1.8 million people through an agreement with the Civil Service Mutual Association; half of its business is the provision of cover for civil servants.

There are three health insurance co-operatives based in Colombia, Saludcoop, Coosalud and Comparta. Saludcoop is a co-operative of co-operatives owned by primary health care co-operatives. It was taken over by the Colombian government in 2011, and in August 2017 was put into liquidation, while its 4.6 million members were transferred to another health provider, Cafesalud. The context is a health care system that is similar to that of Western European countries: insurance based through mutual health insurers subsidised by government funding, and delivered by a variety of health care providers. However, poor regulation and supervision had allowed widespread insurance fraud, runaway pharmaceutical costs and corruption. It is unclear whether the governance system in Saludcoop contributed to its demise; certainly wider forces are at work and the full story still has not been told.

Coosalud is in complete contrast. It is one of the largest insurers in Colombia, with around 2 million members. It focuses on the subsidised insurance regime for the 'poor and vulnerable', and as such it is the first among eight companies that specialise in this type of insurance, with more than seven per cent of the market. It was founded by civic leaders from the area south east of Cartagena. Comparta began in a small way in one province in 1995, and then through several mergers and rapid growth has become the insurer for more than 1.8 million people.

There are three European health co-operatives, Intercommunale de santé publique du pays de Charleroi (Belgium), Centre hospitalier regional de la Citadelle (Belgium), and Societe co-operative medicale de Beaulieu (Switzerland). Intercommunale de santé publique du pays de Charleroi (ISPCC) is a consortium co-operative, managing five public hospitals, two polyclinics, three nursing homes, a youth support service and a nursery on behalf of its members. They are the Public Social Action Centre of Charleroi, the Free University of Brussels, the province of Hainault, and 11 communes. They subscribe capital in proportion to their populations, and the capital is not transferable, which means this is a true co-operative.⁹⁹

Centre hospitalier regional de la Citadelle (CHR Liege, Belgium) is also a consortium co-operative. It runs a public hospital, the Citadel Regional Hospital Centre that is one of the largest Francophone hospitals. It has more than 3500 employees, and nearly 500 doctors and operates in four sites in the city of Liege. The members are 16 communes, and 10 other interested parties including the Province of Liege and the local university.

The Societe co-operative medicale de Beaulieu (translated as Beaulieu Medical Society, Switzerland) is an association of medical doctors from the Canton of Geneva. Its aim is to support the work of the Clinique Generale de Beaulieu, a private hospital that provides state of the art health care through 600 medical doctors. It does this through collaborating in the hospital's management, providing funding, organising conferences, and taking shares in related businesses. The Society has a 28.7 percent share in the holding company that owns the hospital, but a consortium of 16 private hospitals, known as the Swiss Medical Network, has recently acquired over 70 per cent and would like to buy the rest. Presumably, the Society could sell its shareholding and continue to be a support group for the hospital, but the future is uncertain.

In the first edition of this study, a consortium co-operative, VHA, was described but it has now dropped out of the top 10. It is a US supply co-operative owned by more than 1350 not-for-profit hospitals and 24,000 non-acute health care organisations. The closest parallel may be the retailer-owned wholesalers described in Chapter 4, but in scale VHS rivals the big consortium co-operatives Eandis and Publi-T that supply Belgian local authorities with their energy. This shows that the same basic types of co-operative tend to appear in different industry sectors around the world, doing essentially the same job.

What is their governance structure?

The three-tier co-operative system of Unimed is, like Mondragon, a mix of direct election from local to regional co-operatives followed by an indirect system via a member council (known as a general assembly). It begins with local societies that elect representatives to regional federations that in turn elect representatives to a central confederation, Unimed of Brazil.

There are also specialist organisations that enable consumers to pay for health (Usicred and Usimed), and a Unimed Foundation. The affiliated federations elect a member council (general assembly) that leads to a Unimed deliberative forum, a board of directors (known as the confederative council) and a management board. . Unimed Brazil has recently developed a seal of approval for rewarding those of its 63 affiliated organizations that demonstrate good governance.¹⁰⁰

Health Partners consists of two Health Maintenance Organisations (known as HMOs): HealthPartners and Group Health Plan (not to be confused with Group Health Co-operative!), each with its own board of directors. Health Partners Board consists of fifteen directors, of whom 10 are elected directly by individual members and three by individual Group Health Plan members, and with two physician representatives. The Group Health Board consists of five directors, three elected by the Group Health Plan members, plus the chair of the HealthPartners Board and a physician appointed by the President of Group Health. These are small, representative but also skilled boards.¹⁰¹ In addition, there is an advisory committee (known as the patient council) of 15 people that is a forum for obtaining member and patient feedback on a 'wide range of health plan and clinic topics'. The election of the boards is direct, via the annual general meeting, at which applicants for the boards are proposed by a nominations committee.

The governance structure of Group Health Co-operative has now been subsumed into that of Kaiser. It used to have an 11-member board of directors (known as the Board of Trustees) consisting entirely of elected consumer-members. In addition, there was an advisory board (known as the Co-operative Development Committee). It was a very interesting model, as it combined a conventional board of directors at the apex with a lot of member involvement at the base, linked by a very representative advisory committee.

There is not much information about the governance systems in Colombia. Comparta has a section on governance on its website but

it is empty. Coosalud has a lively website and lists its governance committees but without explaining how they work. It looks to be indirect and representative. Ordinary members elect a large member council (that currently has 97 members) from whom a 13-member board of directors is chosen, along with five principal counsellors and a five person surveillance board.

ISPCC has a direct representative system, in which the members elect the board of directors at an annual general meeting (called the general assembly). The communes always have the majority of votes and the presidency. The board consists of 25 individuals. One fifth of places are reserved for representatives from Charleroi. Of the rest, three quarters are reserved for members of the municipalities and public law partners and a quarter for private law partners. The system is obviously designed to be highly representative.¹⁰²

CHR Liege has a similarly direct, representative system. The member organisations meet in an annual and a half yearly general meeting (called the general assembly), and they elect the board of directors. It is a large board of 29 people that includes one person representing each of eight communes, seven people representing the city of Liege, two people representing the province, two the city of Vise, four the University Hospital, and five representing other member organisations. In addition there is a management board (called a permanent bureau) and an 18 member medical council that represents the doctors. A recent innovation is the formation of a patients' committee to formalise the view of the service users.¹⁰³

The Beaulieu Medical Society also has a direct and representative system, with a general assembly of the members (called partners), who exercise the powers of the annual general meeting, on the basis of one person one vote. They elect a nine member board of directors, all of whom have to be partners, and most of whom should be 'Swiss and domiciled in Switzerland'.¹⁰⁴ It does not need outside expertise. This is the classic form of governance, and it is appropriate for a scientific society whose purpose is not primarily to do business but to support those who do.

How is member centrality ensured?

The problem for Unimed is in meeting the needs of both producer and consumer members; it has to balance representation of the doctors who make a living from the system with fairness to the consumers who pay for it. Unlike Health Partners and Group Health, Unimed is producer-driven and so has a more complex governance structure that aims to balance potentially conflicting interests. It is more like Kaiser Permanente whose health insurance plan is considered in Chapter 8.

Group Health and Health Partners are both non-profits, which means there is no patronage refund, and the benefits from membership have to be incorporated into the price paid and the quality of the care provided. All the non-profit HMOs do this, so the benefits from being in a co-operative are difficult to demonstrate. This is even truer when patients obtain their health insurance collectively through an employer. Health Partners declares its aims as ‘to improve the health of the population served, to improve the experience of individuals and to keep care affordable’. The aims of other HMOs are similar. However, before it was taken over by Kaiser, Group Health Co-operative set a different tone. On its website it explained:

*One of the things that makes Group Health successful is our tradition of member governance and participation. As a health co-operative, we’re patient-powered. Not only do our members play an active role in their health care, they help shape and guide the system that delivers their care. From electing and serving on the Board of Trustees, to approving bylaws and serving on advisory groups, there are many ways you can help govern Group Health*¹⁰⁵

This combination of a conventional board and member involvement expresses the co-operative difference rather effectively, but it is uncertain whether this emphasis on member centrality will continue.

Unusually, the Espriu Fundacion promotes a model of health care in which ‘medical professionals and the users of health services are involved in the co-management of organisations on a co-operative



“The problem for Unimed is in meeting the needs of both producer and consumer members.”

basis'.¹⁰⁶ The philosophy of Dr Espriu who founded the system, is an optimistic one of self-management by doctors and patients without interference from the state. Governance theory would predict that this arrangement will be unstable and that one stakeholder will become dominant, and it is clear that the doctors are in a strong position.¹⁰⁷ Here are two groups of doctors, based in Barcelona and Madrid, who have set up health insurance co-operatives that provide them with work. The health insurance co-ops are described as 'placing doctors and users on an equal footing on decision-making and administrative bodies'. Yet there is a fundamental difference of interest – recognized in law – between doctors offering services on contract and insurance mutuals offering to cover patients' costs.

A cynical view might be that the doctors get round this by having two producer co-operatives that own a controlling interest in the consumer co-operatives. However, the governance structure is transparent and seems to work well. Annual meetings are held in each co-operative, after preparatory area meetings that encourage member participation. Each co-operative has a board consisting of representatives of users and professionals.¹⁰⁸

Of the three Colombian health insurance providers, Saludcoop provides a dramatic example of what goes wrong when a co-operative is no longer member-centred. Here, managers were able to acquire businesses such as golf courses and hotels, and to lose huge amounts of their member co-operatives' money before the co-operative was taken over by government and then wound up. In contrast, Coosalud emphasises its mission to the poor and vulnerable, and has a general assembly made up of ordinary members.

The two European consortium co-operatives look to be member-centred, because their members are all local authorities and related organisations with a direct – and politically sensitive – interest in making them work. Similarly, the members of the Swiss medical doctors' co-operative have a direct interest in its effectiveness in supporting their businesses.

Have there been governance problems?

The main problem in health co-operatives is how to balance the interests of medical doctors with those of patients. Unimed and Espriu are producer-driven, while Group Health and Health Partners are consumer-driven. Yet each has to accommodate the interests of the other party to the relationship. They seem to have found workable solutions, and so there are no noticeable governance problems.

The case of Saludcoop is different. Here the governance of a co-operative of co-operatives must have been defective, to allow the company to be driven into bankruptcy by its managers. We do not know exactly what happened, and Colombian politicians and media commentators give widely different accounts. What we can say is that the governance of the health insurance industry has to be supported by an ethos of professionalism among managers, an effective system of regulation by government, and resistance to corruption in the wider society. The distance between insurance mutuals and their members is too great, and the incentives to participate are too weak, to put all the weight on the governance of the individual co-operative.

Chapter 7: Banking and financial services

Some banks do away with the need for a group of investors-owners; they turn their customers into owners instead. On the one hand, they are not all that different from investor-owned banks; they do the same kind of business, relying on managers and boards of directors to take decisions, using the same technology and providing similar products, but they have different motivations and their definition of business success is very different.

Crucially, they do not have the incentive to take the kind of risks that have brought so many investor-owned banks to ruin and the need for massive government bailouts. However, like other consumer co-operatives they can suffer governance failure if their elected representatives lose touch with the members and cannot control the managers.

Co-operative banking began in Germany in the 1850s, from where it spread to all parts of continental Europe. A second wave of development began in Canada in the late 19th century, where there was a name change to 'credit union'. In the 1970s, co-operative banks began to be allowed to trade with non-members, whereas the credit union movement continues to insist on all customers being members. In both traditions, their movements began with local



“they do not have the incentive to take the kind of risks that have brought so many investor-owned banks to ruin.”

primary co-operatives but quickly established regional and central federations and national banks that gave them the strength to grow without getting into trouble. These group banking systems provided liquidity, sharing of risks, and mutual supervision and inspection, which are crucial in a system that handles vast amounts

of other people's money. Unlike other types of co-operative, the banks have mostly retained these group structures and so they are *co-operative groups*, whose governance is two or three tiered. Some of the co-operative bank groups have a close relationship with the agricultural sector, though they also serve other domestic and business

customers. In this respect they can be classified as *co-operatives of both consumers and producers*.

Two of the banking groups are majority owned by their customers through the local or regional banks that are in membership. They have a minority of shareholders and are listed on the stock exchange. They are still essentially *co-operative groups*, but they can also be classified as *majority-owned IOBs*.

There is a related set of banks sponsored originally by the governments of some countries to meet the needs of farmers. They began as state banks and then sometimes were handed over to the farmers to be run as co-operatives. In the USA they are known as the Farm Credit System, which consists of local farm credit associations, served by four secondary-level banks and one third-level specialised bank that raises capital for them to lend on to the local associations. They can be seen as a combination of *primary co-operatives* and *co-operatives of co-operatives*, serving *producers*. Together they provide more than \$191 billion in loans, leases, and related services to farmers, ranchers, rural homeowners, aquatic producers, timber harvesters, agribusinesses, and agricultural and rural utility co-operatives. The System's website boasts that it 'provides more than one-third of the credit needed by those who live and work in rural America'. Taken as a whole, the System has assets in excess of \$246 billion, nearly 500,000 member-borrowers and more than 12,000 employees.¹⁰⁹

We would not expect many *primary co-operatives* to make it into the top group worldwide, but in this case one American credit union comes in at ninth place. Finally, other types of co-operative often set up their own banks to service their businesses. There is one of these at number 10, and it is simply classified as a *subsidiary*.

Name	Turnover	Ownership Type	Governance Type	Experts of the board
1. Groupe Credit Agricole (France)	\$63.42bn	Majority owned IOB (consumer)	Conventional shareholder	Yes?
2. BVR (Germany)	\$54.07bn	Co-operative Group (consumer)	Indirect, via member council	No
3. Groupe Credit Mutuel (France)	\$35.43bn	Co-operative Group (consumer)	Indirect, three tier system	No
4. Groupe BPCE (France)	\$30.84bn	Co-operative Group (consumer)	Indirect, three tier system	Yes - 4
5. Rabobank (Netherlands)	\$17.05bn	Co-operative Group (consumer)	Direct plus member council	No, but selected for skills
6. Desjardins Group (Canada)	\$13.75bn	Co-operative Group (consumer)	Indirect, via member council	No
7. Raiffeisen ZB (Austria)	\$7.69bn	Majority-owned IOB (consumer)	Conventional shareholder	Yes
8. Federal Farm Credit Banks Funding Corp (USA)	\$7.5bn	Co-operative of coops (producer)	Direct	Yes - 2
9. Navy Federal Credit Union (USA)	\$3.55bn	Primary co-operative (consumer)	Direct plus advisory committee	No
10. Norinchukin Bank (Japan)	\$3.07bn	Subsidiary of Co-operative Group	Subsidiary, board appointed by JA federation	Yes

Table 7.1: The top 10 co-operatives in the banking and financial services sector

Who are the top 10 co-operative banks?

There are six European co-operative bank groups and one Canadian credit union group in the top 10: Groupe Credit Agricole (France), the National Association of German Co-operative Banks (BVR, Germany), Credit Mutuel (France), Groupe BPCE (France), Rabobank (Netherlands), Desjardins Group (Canada), and Raiffeisen ZB (Austria).

There are four more in the top 15: OP Financial Group (Finland), Swiss Union of Raiffeisen Banks (Switzerland), Grupo Cooperativo Cajamar (Spain), and Sicredi (Brazil). This is still the standard business structure for co-operative banks and credit unions.

Credit Agricole has a mixed ownership: 56 percent of the shares in the central bank are owned by 30 regional banks, which are themselves owned by 2512 local banks, which are owned by 9.3 million members.¹¹⁰ In return, the central owns 25 percent of the share capital of the regional banks. Institutional investors own another 27.9 percent, individual shareholders own 11.1 percent, and employee mutual funds own the rest. Seen from below – from the point of view of individual owners - it has 6.9 million ‘mutual’ shareholders and 1.2 million investor shareholders. This is why it can be classified both as a co-operative banking group and a majority-owned IOB. It has 27 million retail customers in France, 52 million customers in all (if we add in Italy and Greece), and 138,000 employees worldwide.¹¹¹ In France, it has 24 percent of deposits, 21 percent of loans and 30 percent of the SME loans market.



“Credit Agricole has 6.9 million ‘mutual’ shareholders and 1.2 million investor shareholders.”

BVR can be translated as the National Association of German Co-operative Banks. It has 972 primary co-operative banks from both the Volksbanks and Raiffeisen banks in membership. It is one of the largest banking groups in Germany, with 30 million customers (of whom 18.4 million are members), 151,000 employees and more than 11,787 branches.¹¹²

Credit Mutuel is the third largest co-operative group in France. It is a three-tiered group, with 2104 local banks organised into 18 regional federations and a national federation and bank. It has over 30 million customers, of whom 7.7 million are members, and in France its market share of deposits is 16 percent, of loans is 17 per cent, and of lending to SMEs is 16 per cent. It has 82,000 employees and 5200 banking outlets.

¹¹³

BPCE is an amalgamation of two banking groups: the Banques Populaires and the Caisses d’Epargne, which merged in 2009 to form France’s second-largest banking group with a market share of 22 percent of deposits and 21 percent of loans. BP is a group of 19 regional co-operative banks. CE consists of consists of 17 regional savings banks that were converted to mutual status in 1999. The group has over 31 million customers and 9 million members. Among its subsidiaries are Natixis, that manages assets of €570 billions (and is the 13th largest asset manager in the world), and a building society, Credit Foncier.¹¹⁴

Rabobank has 147 local banks divided into 12 regions, with 40,000 employees, 8.7 million customer, and 1.9 million members. It specialises in the food and agriculture sectors, and has a market share of 34 percent of deposits and 21 percent of mortgage oans in the Netherlands. It also has 43 percent of loans to SMEs. It also has a huge international presence in the food and agriculture industries, with offices in 47 countries. It is rated 29th largest bank in the world by assets.

Desjardins Group is the leading co-operative financial group in Canada, and sixth largest in the world, so that it stands on a level with the credit union sector in the USA and the biggest European co-operative banking sectors. There are 313 caisses Desjardins, with 5.8 million members, 47,000 employees, and 5400 elected officers.¹¹⁵ The Group is the market leader in the Quebec region for just about everything to do with finance: its market share of residential mortgages is 38 percent, of consumer credit is 22.8 percent, of business credit is 27.9 percent, of agricultural financing is 42.7 percent. In Canada as a whole it is ranked second in the group insurance market, fifth in life and health insurance and seventh for property and casualty insurance. It achieves all of this while having a Tier 1 capital ratio of 17.3 percent, which is much higher than the regulator requires; it is ranked 18th among the 50 safest banks in the world.

Raiffeisen ZB in Austria is a three-tiered system of 541 local banks, eight regional banks and one national. The regional banks do clearing functions for the local banks. Together they have 3.6 million clients and 1.7 million members. It has been listed on the Vienna Stock Exchange since 2005; the regional Raiffeisen banks hold 58.8 percent of the shares, with the rest being held by 41.2 private investors. The Bank is the third largest in Austria; as well as providing services to the local banks it is a large commercial bank in its own right. The group has a 30 percent market share of savings, and 29 percent of loans. Like Credit Agricole, it can be classified as both a co-operative banking group and a majority-owned IOB.¹¹⁶

There is just one of the US farm credit banks in the top 10; the apex for the whole system, Federal Farm Credit Banks Funding Corporation. One of the four regional banks, CoBank, is at number 15. In the first edition of this study, there were two more listed, Agribank at number 9 and Ag First Farm Credit Bank at number 14 but they have now slipped out of the top 15. Federal Farm Credits Funding Corporation acts as a kind of central bank. It issues debt securities to finance the capital

needs of the four banks, manages their relations with investors, and also provides consulting, accounting and financial reporting services.

At the base of the co-operative banking groups are hundreds of local banks that are primary co-operatives and so not expected to become very large. One has made it into our league table at number 9: the Navy Federal Credit Union (USA). Credit unions have a 'common bond' that restricts them to serving an identifiable group of people; they are not allowed to offer membership outside of this group. It can be a geographical community, an affinity group such as a church, or the employees of a particular company or public body. Navy Federal has as its common bond service in all the armed forces of the USA, which explains why it has grown so big. It has over seven million members.¹¹⁷

Norinchukin Bank is the national bank for the Japanese agriculture, fishing and forestry co-operatives. It is a subsidiary of the three apex co-operatives, JA, JF and JForest. We have described JA's business arm, Zen-Noh, in Chapter 3. The Bank's job is to take in deposits from member co-operatives and invest them, and in doing so it has become one of Japan's largest institutional investors, and its largest hedge fund. Deposits total nearly ¥89 billions, of which 88 per cent are invested by agricultural organisations. It has investments of ¥70 trillion (\$616 billion). During the banking crisis it lost money though heavy investment in subprime mortgages, but it was so strong that the losses were made up quickly in only one year. We will discuss below whether this might have indicated a failure of governance.

What is their governance structure?

Credit Agricole has a three-tier, indirect system of governance. The 'mutual shareholders', who are members of the local banks, elect directors to the regionals that then elect members to the board of the national bank. Voting is proportional to their shareholding. They also have a parallel democratic structure in their national federation (Fédération Nationale du Crédit Agricole), where the Group's main 'orientations' are decided.

BVR has an indirect, representative system of governance, with a member council. The member banks have one vote each in the annual general meeting, from where they elect a 50 strong member council that then elects a 12 person board of directors (called the administrative board). It supervises a small management board of three top managers.

Credit Mutuel also has an indirect representative system. Individual members elect a member council (called a general assembly) that then appoints the boards of directors of the local banks. These boards then go on to elect regional boards, who elect the board of the central confederation through a confederal general assembly. It is expensive in time and energy; there are 24,000 volunteer directors on the local, regional, and national boards, and over 200 annual general meetings, one per local bank. The local banks are financially independent; they collect savings, approve loans, and provide all financial services. At the regional level there are 18 groups each consisting of a regional federation and a federal fund that provides banking services (plus an agricultural federation that makes 19 groups). At the national level there are two bodies: the central federation that represents the Group and acts as banking supervisor and inspector, and a central bank, the Caisse Central du Credit Mutuel that manages liquidity and ensures the financial solidarity of the regional groups. The federation board consists of 35 members, all of whom represent a region. In addition there is an honorary president, CEO and two top managers who also participate but there are no independent expert directors.

BPCE is in transition from two co-operative networks to one, and so it has two boards that feed into an 18 member board that includes seven from the BPs, seven from the CEs, and four independent members. In other respects it is typical of the two-tier structure of European co-operative bank groups.

Rabobank has a direct representative system. The 147 local banks jointly make up the annual general meeting of Rabobank Nederland. They are divided into 12 electoral regions, from which they elect a member council that discusses policy. The general meeting appoints the members of the Group's board of directors; it has only 10 members, and they are all experienced professionals selected more for their skills than their ability to represent a region.

Desjardins has a similar structure, though with only two tiers; the caisses network is served by just one central, Desjardins Group that has a unitary board, with a CEO who is also President. It has a democratic structure of regional general meetings, councils and an assembly of representatives.

Raiffeisen ZB is an investor-owned bank that has the conventional board of directors (known as a supervisory board) and management board. Presumably, the directors are elected at an annual meeting of shareholders, after being proposed by a nominations committee

of board members, with voting rights being allocated by the size of shareholding. The approach to governance taken on the bank's website is entirely conventional; it is anxious to show transparency and conformity with the corporate governance code for investor-owned banks.¹¹⁸ The German Central Co-operative Bank, known as DZ, appeared in the first edition of this study but has since slipped out of the top 15. It has a similar ownership and governance structure.

The US farm credit co-operative banks have a three-tier, indirect structure that balances representation with expertise. The local associations elect representatives to the boards of the four banks, and the banks in turn elect the board of the Funding Corporation. The Funding Corporation board of directors has nine members. The Farm Credit banks elect seven members (three members are elected from among the chief executive officers of the Banks and four from among the directors). These seven board members, after receiving recommendations from key government departments, appoint two independent members. The president of the Funding Corporation serves as a nonvoting member. It has audit and disclosure committees that operate on behalf of the whole farm credit system.

Navy Federal Credit Union has a direct representative system. It has a nine-member board of directors, elected at annual meetings, with all members being able to vote. It is supplemented by a four person advisory committee, three of whose members are not on the main board. There are no independent directors. A nominations committee puts up members for election and other nominations can only be received if members get up a petition.¹¹⁹ Members are notified of the nominations along with their regular financial statements, which means the whole system is cost-effective, though it lacks independent member activity at the base.

Norinchukin Bank is like other subsidiaries in having a 20-member board of directors (called a supervisory committee) appointed by the three parent co-operatives. The board then appoints the management board (rather confusingly called the board of directors).

How is member centrality ensured?

The problem for co-operative banks is how to ensure member centrality when they do not return a patronage refund to members. The surpluses are either reinvested in the business or used to adjust prices downwards.

This is a cost price mechanism that ensures the customers benefit, but it is not transparently a benefit to members. One way to engage them is as shareholders. Rabobank has issued new types of non-voting share to its members, so that now over a third of the members have ‘an interest in the bank’s financial performance as well as in its service to customers’.

A more co-operative engagement strategy emphasises the advantages to local economies of having what BPCE calls:

a stable base of co-operative shareholders, individual customers, artisans, self-employed professionals, shopkeepers, entrepreneurs who act as local economic agents.

In order to build on this, the banks (unlike the credit unions which are fully mutual) have to make sure that a high proportion of customers opt into membership. Rabobank is instructive here. At the end of the 20th century, only six percent of its customers were members. However, a drive to recruit new members produced a fourfold increase to 24 percent.

In the farm credit banks, member centrality is not difficult to ensure, because the local associations are providing a financial service focused entirely on the needs of the farmers. Unlike the European banks, there is no facility for taking in savings as well as giving loans, and the whole system relies on funding from the financial markets. In this respect, there is homogeneity of interest between the members.

Credit Agricole shows that it is possible to have a majority shareholding of consumers and a minority of investors. The consumer interest is well organized through the local and regional banks, and it ensures that the consumer voice is well orchestrated in the central bank. The individual shareholders have a shareholders’ club, through which they receive regular information and can attend learning sessions designed



“Credit Agricole shows that it is possible to have a majority shareholding of consumers and a minority of investors.”

specifically for them. The system works because it is well orchestrated. The mutual voice is formed in the local banks, and expressed upwards through the regionals. The voice of individual investors is less formally expressed, through the members' club.

Have there been governance problems?

Norinchukin, Zen-Noh's bank was badly hit during the financial crisis. In response to growing competition the Bank had invested heavily in US asset-backed securities including the now notorious sub-prime mortgages.

When the 2008 crisis broke, much of the paper it was holding proved worthless. It had to raise 1.9 trillion yen (\$20 billions) through share sales to its farmer members, but then it bounced back with a net income for 2009 of ¥29.5 billions.¹²⁰ Was this a governance issue? It was certainly a move into a higher risk strategy, but we can only say this with the benefit of hindsight; at the time the securities were 'triple A rated' by the official rating agencies.

At Credit Mutuel, there has been a recent downgrading by one of the rating agencies but this is due not to governance problems but to a difficult environment; low economic growth, low interest rates, and increased government regulation mean that banking in general has become unprofitable. There is, however, a stable outlook. Rabobank has recently been fined \$1 billion by regulators in the USA, UK and Netherlands, because some of its traders were implicated in the Libor rate-fixing scandal. This would not have been a problem of governance but of fraud, except that the UK's regulator identified 'poor internal controls' as being to blame, and there was a long delay between the board knowing of the problem and taking effective action. BPCE and Credit Agricole have both been fined for involvement in the Libor rate-rigging scandal. Clearly, it is not possible for a co-operative to avoid being caught up in what has been a major failure of professional ethics in banking.

Chapter 8: The insurance sector

It is easy to understand why one of the oldest forms of mutual aid between people is the sharing of risk through insurance. Some people have bad luck; their house burns down, they contract a serious illness, or their crops fail. Others escape these fates but – and this is the crucial point – nobody knows in advance whether it will happen to them. Their efforts have tended to focus on one of three types of risk: illness, accident and old age. These make up the three main forms of insurance: health insurance, general insurance (sometimes called assurance), and life insurance. ¹²¹

Insurance co-operatives are more usually referred to as *mutuals*, since they often consider all their policyholders automatically to be members. The distinction is similar to that between credit unions and co-operative banks. ¹²² They have an inherent advantage over investor-owned businesses in providing insurance. They do not have a separate set of investors who can take surpluses and turn them into profits. All surpluses go back into the business to keep down costs for the customers. There is no conflict of interest between policyholders and investors, something that is particularly serious in relation to long-term contracts for life insurance. However, governments have legislated to protect policyholders from exploitation, and this has created a more level playing field between non-profit and profit-making insurers.

Once an insurance mutual is set up, members have an incentive to encourage its managers to expand the business; the more people are insured, the further the risk is spread and costs are shared. Unlike other consumer-owned businesses such as co-operative banks and retail co-operatives, insurance mutuals can easily grow beyond national borders and become multi-national. Nor do they need the complex federal structures that other types of co-operative have formed, except for reinsurance services to cover unexpected disasters. They are still essentially *primary co-operatives*.

There is another type of insurance co-operative that is owned at one remove by other co-operatives or similar organisations. Consumer co-operatives, co-operative banks, farmer co-operatives and credit unions have often set up insurance *subsidiaries* to meet the needs of

their corporate members, that have then gone on to offer products to individuals as well. As in other industries, some insurance co-operatives have become *majority-owned IOBs*. In these cases, it was not so much a need for investor capital that created these hybrids but a series of mergers and takeovers between different types of owner. The resulting governance structure is a compromise between the affiliated businesses. Some insurers are classed by the ICMIF as *non-profits*; they are not fully mutual or co-operative in their ownership structure but have been judged to be essentially member-centred.

Name	Turnover	Ownership Type	Governance Type	Experts of the board
1. State Farm (USA)	\$63.73bn	Mutual	Direct, members endorse board decisions	Yes - majority
2. Kaiser Foundation Health Plan (USA)	\$62.66bn	Non-profit	Subsidiary - board appointed by main board of KF	Yes, but appointed
3. Zenkyoren (Japan)	\$54.71bn	Subsidiary of Co-operative Group	Subsidiary - board appointed by JA federation	Yes, but appointed
4. Nippon Life (Japan)	\$45.25bn	Mutual	Direct, + member council + advisory committee	Yes – 4 plus advisory
5. Meiji Yasuda Life (Japan)	\$33.91bn	Mutual	Direct, members endorse board decisions	Yes – 6 (a majority)
6. Nationwide (USA)	\$32.32bn	Mutual	Direct, members endorse board decisions	Yes - majority
7. Liberty Mutual (USA)	\$31.87bn	Majority-owned IOB	Direct, members endorse board decisions	Yes - majority
8. Achmea (Netherlands)	\$26.53bn	Majority-owned IOB	Direct – election of 7 board members	Yes - majority
9. New York Life (USA)	\$26.32bn	Mutual	Direct, members endorse board decisions	Yes - majority
10. MAPFRE (Spain)	\$25.85bn	Non-profit	Conventional shareholder	Yes- at least 1/3

Table 8.1: The top 10 co-operatives and mutuals in the insurance sector

Who are the top 10 co-operatives?

There are six mutuals in the top 10: State Farm Group, Nationwide, Liberty Mutual and New York Life (USA), Nippon Life and Meiji Yasuda Life (Japan). They are the most common type: there are seven more in the top 20, including Sumimoto Life (Japan), Covea (France), Co-operative VGZ (Netherlands), Farmers Insurance Group, MassMutual Financial, USAA, and North Western Mutual (USA).¹²³

State Farm Group, based in Illinois, is the leading auto and home insurer in the US, though it offers the full range of other types of insurance as well. It is currently ranked number 43 on the Fortune 500 list of largest companies, with more than 65,000 employees and more than 80 million policies: 61 percent of

its net written premium is in auto, and 35 percent in home insurance.

¹²⁴ Nationwide Mutual, based in Columbus, Ohio, is one of the largest diversified insurance and financial services organizations in the world, ranking 108th on the Fortune 500 list. The company provides a full range of insurance and financial services, including auto, motorcycle, boat, homeowners, life, commercial insurance, administrative services, annuities, mortgages, mutual funds, pensions, long-term savings plans and health and productivity services. Liberty Mutual is based in Boston, and is the third largest property and casualty insurer in the US, offering a full set of insurance products including auto, home and life as well as personal liability. It ranks 81st in the Fortune list of largest US corporations based on 2012 revenue, with more than 50,000 employees and business in 18 countries. ¹²⁵ New York Life is the largest mutual life insurer in the USA, with 11,500 staff offering a range of life insurance, retirement income, investments and long-term care insurance. ¹²⁶

In Japan, Nippon Life is the second largest life insurance company, with over 70,000 employees and 9.2 million policyholders. Meiji Yasuda Life is market leader in the group life insurance sector, with more than 37,500 employees. There is another Japanese mutual in the top 20, Sumimoto Life

There is one insurer in the top 10 that can best be classified as a subsidiary: Zenkyoren, the National Mutual Insurance Federation of



“State Farm Group is the leading auto and home insurer in the US. It is currently ranked number 43 on the Fortune 500 list.”

Agricultural Co-operatives, Japan. There is one more in the top 20, R+V Versicherung, which is owned by the German co-operative banks. Like the Norinchukin Bank, Zenkyoren is a subsidiary of the agricultural co-operative federation, JA. Zenkyoren's first task is to provide life and non-life insurance products for agricultural co-operatives and their members, but it also provides asset and investment fund management. It was hit harder than any other insurer by the Great East Japan Earthquake, paying out over ¥890 billions (approximately US \$8.7 billions) in claims. Remarkably, it was able to meet these losses out of reserves and reinsurance.¹²⁷

There is one majority-owned IOB, Achmea. A holding company, the Achmea Society, holds 65 percent of shares, with every customer automatically becoming a member of the Society. Rabobank holds 29 percent of the shares, and the rest are owned by a grouping called STAK that represents Dutch customers in the Achmea Society. It is a leading insurance company based in the Netherlands, providing the full range of health, life and non-life cover. It serves eight million customers (roughly half of all Dutch households), and has 17,000 employees in the Netherlands and 4000 in other countries.

There are two non-profits in the top 10: Mapfre (Spain) and Kaiser Foundation Health Plan (USA). Mapfre is a stock company majority owned by a non-profit foundation.¹²⁸ It is the leading insurance company in Spain and the largest non-life insurance company in Latin America. It is also has business in USA and Turkey. It covers all types of insurance, and has more than 35,000 employees.

Kaiser Foundation Health Plan is part of an integrated managed care consortium called Kaiser Permanente, consisting of three entities: the Kaiser Foundation Health Plan, KF Hospitals and regional Permanente Medical Groups. Only the health plan is relevant here, as it is a mutual; the hospital group is a non-profit while the medical groups are for-profit companies owned by the medical doctors (otherwise it might feature in Chapter 5 alongside Unimed as a co-operative group). The health plan is based in California, where it has 75 percent of its members, but it also operates in several other states. It has 11.8 million health plan members, more than 80 percent of whom are in 'group health' plans funded by employers.

What is the governance structure?

The mutuals all have a direct, expert governance structure, with the members as a whole electing – or at least endorsing – an expert board. State Farm Mutual has a 12 member board that includes the chairman who is also the CEO. The directors are independents: ‘leaders in business and academia’. Nationwide is similar. It has a conventional 16-member board, including the CEO, chair and vice-chair but consisting mainly of independent directors appointed for their expertise.

Liberty Mutual has a board of directors of 12 members, all expert independents except for the Chair-CEO of the holding company, and the company secretary. New York Life has a 13-member board of directors who are all independents with distinguished careers in business. The policyholders are asked to endorse the board’s choice of directors through mail voting, but as is usual in mutuals they are not given a choice of candidates.¹²⁹

Meiji Yasuda Life is similar to the American mutuals. However, Nippon Life is more interesting; its governors have deliberately constructed a complex governance structure that is designed to foster transparency and member participation. We could call it a direct, expert system with checks and balances. It holds member meetings directly with policyholders every year (about 82,000 people have taken part since it began in 1975). Members receive reports on the business activities and express a broad range of opinions. For instance, in 2012 114 meetings were held around Japan, bringing together 2,486 policyholders.¹³⁰ There used to be an annual general meeting of all members, but this became impractical. In 1962 they set up a member council (called a meeting of representatives) elected from among the policyholders, in what they describe as a deliberate attempt to provide a check on managerial power.

This member council of 200 is equivalent to the general shareholders’ meeting of a stock corporation, and it has the power to amend articles of incorporation, approve proposals for the disposal of surplus and nominate directors and auditors. However, the board members are still elected, or at least endorsed, by the policyholders. They are selected carefully, and members are not able to stand for election without having been selected first. The explanation for this is clear; they aim to balance the independence of representatives with their ability to represent a ‘broad base’ of members while avoiding factionalism. The member council also elects an advisory committee from among

policyholders and academic experts. Central to the governance structure is a board of directors consisting of 18 people, four of whom are outside directors, the rest being top managers. It unites in an unusual way the functions of a board of directors and of management. Sumimoto Life, which has now slipped to 12th place, has a similar structure.

Zen-Noh used to have prefectural insurance federations but in 2000 these were merged with the national body; they still operate but are more like branch offices. There is a 23-member board of directors that is responsible for 'fundamental policies' and supervision of the business operations of the management board. As is normal with subsidiaries, the directors are appointed by the board of directors of the JA federation.

The Kaiser Foundation Health Plan is the mutual part of a triad of businesses that also includes Kaiser Foundation Hospitals (a non-profit) and the Permanente Medical Groups (for-profit partnerships of medical doctors). They are described as an 'integrated managed care consortium', and their governance is intertwined; the health plan invests in the hospitals, while providing a 'tax-exempt shelter' for the medical groups.¹³¹ Each of the three businesses has its own governance structure, although as the website describes it 'all of the structures are interdependent and co-operative to a great extent'. The national-level apex body, Kaiser Permanente, has a 15-member board of directors, two of whom are executives of the Health Plan, with 13 experts representing other organisations. There is also a regional presidents' group of 11 members that includes eight regional presidents and three group presidents. The mutual part of the group, the KF Health Plan, has its own board of directors, five of whom by law have to be members of the Health Plan. However, all these directors are appointed by the main board of Kaiser Permanente (as are the board members of the KF Hospitals), through the work of a governance committee.¹³² The health plan is therefore not a co-operative, nor is it a true mutual and it is questionable whether it should be included in the World Co-operative Monitor listing.

At Achmea, the general meeting of shareholders appoints a 12 member board, seven of whom represent the Achmea Society, four Rabobank and one the other shareholders. As well as representing these groups of shareholders, they are also 'well qualified professional board members'. A member council at the Society regularly meets with the board to discuss the business.

Mapfre SA's governance is complex, because the Group is responsible to shareholders who invest in it, and also to the foundation that is the majority shareholder. It looks both ways, aiming to create value for shareholders and to meet the aims of the foundation that are of a 'general and social nature'. The 15-member board of directors consists mainly of independents chosen for their expertise. It is supplemented by regional councils, and advisory councils for health, corporate and agricultural business areas. However, there is no doubt that the main focus is on governing on behalf of shareholders: the advisory and regional councils are appointed by the board of Mapfre rather than by the policyholders. The board is more like a trust or foundation, and board members themselves decide how large the board should be (between 14 and 30 members). It is self-perpetuating; the board itself appoints new members, and so it is not answerable to anybody but itself.

How member centred are these co-operatives?

State Farm Group consists of State Farm Mutual Automobile Insurance Company that is the parent company of 23 wholly owned subsidiaries in other branches of insurance. It is still, as its website declares 'a mutual company owned by its policyholders', but it provides no information on how it makes sure the business remains member-centred. ¹³³

Liberty Mutual is even less member-centred. In 2002 it converted to a mutual holding company structure, and only members of the four companies within this structure have a vote, while policyholders insured with other companies in the group have no such rights. On its website, it discusses membership as a part of 'investor relations', and only some of its policyholders are members and then at one remove, via a holding company.

"It discusses membership as a part of 'investor relations' and only some of its policyholders are members."

In contrast, Nationwide is much more explicitly member-centred. In 1997 it floated off part of the Group, Nationwide Financial Services (NFS), on the New York Stock Exchange. Then in 2009 it made an offer

to buy out the independent shareholders of NFS and remutualise it. The completion of the transaction set Nationwide apart from the competition in a deliberate marketing strategy that, its website claims, enables the Group to align its entire product and service portfolio around the customer.¹³⁴ On its website it declares:

Nationwide Insurance is made of members and for members. And we put our members first, because we don't have shareholders. That's how we started, how we operate today and what drives our On Your Side® service.

¹³⁵

The resulting advantage for customer-members is clearly set out in this kind of statement:

We can't predict when bad things will happen, but we can help protect you when they do. Last year, we paid \$10.9 billion in total claims. And we paid \$0 to shareholders – because we don't have any.

It emphasizes the advantages of becoming a member not just to the individual but to the collectivity of insurance customers, saying 'every member makes us stronger'. Clearly, Nationwide has a commitment to member centrality.

The Japanese mutuals seem to be firmly focused on the interests of their members. Nippon Life says explicitly that one of its goals is to pay a stable dividend to its policyholders, and it explains at length in its annual report that this is an adjustment made because life insurance contracts are long-term agreements, and it is difficult to estimate in advance what the returns will be. The policyholders are regarded as 'members of the company', and so after surpluses are allocated to reserves all profits should go back to them. |In 2012, they returned a remarkable 96 percent of the surplus to members as dividend. Sumimoto Life has a similar understanding, saying in its annual report that 'each holder of a participating policy is a member of the Company, or in other words, a part owner'. In 2012 it distributed \$0.6 billions to members in dividends, carefully divided between individual and group policyholders.¹³⁶

Achmea is only majority-owned by individual members but through their Achmea Society they do at least get to elect seven board members. In Mapfre SA, despite the policyholders being automatically members of a non-profit Foundation that is the majority corporate shareholder, control over the group is in the hands of a board who are more like trustees. The governance of Kaiser Foundation is even more remote, with just some of the members of an appointed board representing

policyholders. In these companies members can hardly be central to the business. They are not co-operatives but non-profits, with broader aims and much less emphasis on representation of members.

Have there been governance problems?

Governance is sometimes a problem for these large co-operatives; we have noted in chapter 1 the failure of Equitable Life. The connection between the member and the co-operative usually extends no further than an annual premium.

It is difficult for very large numbers of policyholders to hold their boards to account, and easy for them to 'free ride' on the participation of others. For this reason, it may be more accurate to see a large mutual as being not owned by anyone, but held in trust for current and future members by a self-perpetuating board whose directors are expected to act like trustees.¹³⁷

These insurance mutuals and co-operatives all seem to be reasonably well governed. The main issue is who they are being governed for. Some boards see themselves as governing on behalf of shareholders or as a non-profit. When they do this, they neglect to 'touch base' with their policyholders and find ways to circumvent the election process by seeing themselves as trustees. What is remarkable is that some of the largest mutuals – Nationwide in the USA, Nippon Life in Japan - have found ways to involve members, if not in governance, at least in discussions about how well the business is governed. This goes together with a declared commitment to member centrality.

Chapter 9: Findings

What can we learn from the analysis of these six industry sectors for co-operatives as a whole?

Types of ownership

First, there are several different types of ownership in each sector (see Table 9.1). There are nine co-operative groups. Five of them are found in banking (plus two more that have been classified as majority-owned IOBs but are also groups).

This is because the founders of the credit co-operatives in mid-19th century Germany saw clearly the need for the economic strength that federation can bring, and because it is in the nature of finance that higher level organisation is needed for spreading risks, ensuring liquidity, imposing common standards and so on. There are also two groups in agriculture, both in East Asia. They follow the co-operative tradition of federation, whereas the North Americans have preferred to achieve integration via mergers into giant primary co-operatives. There is one group in the industry and utilities sector, and one in health care, but none in insurance or retailing because in these sectors there is no need for such a tightly organised type of ownership; primary co-operatives can simply grow bigger on their own.

There are 10 *co-operatives of co-ops*. Five of them are in the industry and utilities sector, where there is a need for shared services such as electricity power generation, or for collaboration to secure large contracts. There are one or two in every other sector apart from insurance.

The *primary co-operative* is still the largest ownership type. There are 23 of them, and they are predominant in health and social care, wholesale and retail, and insurance.

An interesting variant is the mix of *primary co-operatives/co-operatives of co-ops*. There are five of these: three in agriculture, and two in retailing (though one of these is classed as being in the industry sector). This is an untidy combination that has come about through mergers, and it takes careful governance to make it work.

There are two examples of *subsidiaries*, in banking and insurance. This is a common type, because consumer and producer co-operatives have

often set up their own banking and insurance arms that have then taken on a growth trajectory of their own.

Industry sector	Coop Group	Coop of coops	Primary coop/mutual	Majority-owned IOB	Consortium coop	Subsidiary	Primary/C of Cs mix	Non-profits
Agriculture & food	2	1	3	1			3	
Wholesale & retail		1	8				1	
Industry & utilities	1	5	1		2		1	
Health and care	1	2	5		2			
Banking	5	1	1	2		1		
Insurance			5	2		1		2
TOTAL	9	10	23	5	4	2	5	2

Table 9.1: Industry sector by type of ownership

Three more types have been identified that raise the question of where the boundaries lie between co-operatives and other types of business. There are four *consortium co-operatives*. Set up to support the public sector, they can be organised co-operatively with one vote per owner, or through a conventional investor-owned model, in which case they are not much different from any business set up to provide services to other businesses. The two *non-profits* in insurance have such a limited amount of member voice that it is difficult to see why they are included. The five *majority-owned IOBs* are still member-owned but they have lost their emphasis on membership and now see members as shareholders.

Types of governance

Except in this last example, there is no simple correlation between ownership type and governance type (see Table 9.2). Direct election of members to the board of directors is the norm in exactly half of the top 60, but only in 17 of the 30 cases is it not supplemented in some way; it is difficult to imagine such giant businesses continuing with the simplest of governance systems without some adaptation to boost member voice or representation.

The main adaptations are the introduction of electoral constituencies, a member council or an advisory group. However, there are good reasons for some co-operatives maintaining this simple system. In insurance, mutual boards tend traditionally to be self-appointing, with the members asked to endorse decisions. They are more like non-profit trusts than co-operatives. The same is true of some health care organisations. In retailing, the producer co-operatives have a conventional – and unpublished – system of election to the board, but with member retailers bound into the business through a complex set of mutual expectations that is similar to a franchise.

Industry sector	Direct to board	Direct with advisory group	Direct via electoral constits	Direct with member council	Indirect via member council	Conventional shareholder	Subsidiary – board appointed
Agriculture & food			1	1	7	1	
Wholesale & retail	5			1	4		
Industry & utilities	1	1	2		4	2	
Health and care	4	2	2		2		
Banking	1	1		1	4	2	1
Insurance	6			1		1	2
TOTAL	17	4	5	4	21	6	3

Table 9.2: Industry sector by type of governance

A large minority (21 out of 60) of these giant co-operatives choose to elect their boards indirectly via a member council. This council can be very large (650 in the case of Mondragon, but more usually

around 100 people), and provides a useful way in which boards can be both elected by members and regularly supervised. As we have often noted, the council's powers vary from being purely *advisory* to being strongly *supervisory*. The relationship between council and board is a complex one. Where it works well, it ensures broad representation of members and a certain amount of member voice as a counterweight to an expert board.

Most of the co-operatives are member-centred. The exceptions are those that see members just as shareholders, or have a broader mission to a more generalised 'community'. Here we see co-operation merging at the margins into other types; the investor-owned business on the one hand, and the community benefit society on the other. Some of our 60 have made member-centredness into a clear, confidently expressed business strategy. Others are member-centred but only implicitly, and they would benefit from being made aware of the 'co-operative advantage' that member ownership provides. Co-operatives UK is currently working on a set of guidelines for 'narrative reporting' that should prove very useful in this respect.



"Some of our 60 have made member-centredness into a clear, confidently expressed business strategy."

Chapter 10: Conclusion: design for good governance

Since the 1990s, there have been attempts to reform the governance of large businesses that have put pressure on co-operatives to conform to new expectations. For instance, under corporate governance guidelines companies are expected to have independent non-executive directors on their boards.

Co-operatives are then expected to comply with these guidelines or explain why they do not want to do so. CHS, the giant American agricultural co-operative has explained recently that it does not need independents as the board members are all highly experienced farmers. Other co-operatives such as Land o' Lakes, have appointed some independents. Another instance is the pressure to bring top executives on to the board, making them more responsible for governance as well as management. This has been resisted by many co-operatives as being against their principles, as board members have to be elected from among the membership.

The rash of failures of American companies in the early 2000s, followed by the financial crisis in which previously solid banks crashed have produced strong pressures for the governors of all large businesses to demonstrate their quality. They have to show that their governance system is working well and protecting the owners from risky takeovers, false accounting methods, hidden losses, managerial arrogance and so on. Good governance has become as important as good management. Co-operatives whose members and boards understand this are beginning to include regular reviews of their governance systems in their annual reports. Some go further than this, and attempt to measure the quality of governance. The health co-operative federation, Unimed Brazil, has recently developed a seal of approval for rewarding those of its 63 affiliated organisations that demonstrate good governance. Some give the oversight of the governance process to independent experts: Desjardins in Canada has a standing Corporate Governance Commission of six people whose job is continually to review all aspects of governance.

Also, because of rapid growth some co-operatives are regularly reviewing their rules to make sure new members are represented. For instance, Land o' Lakes regularly reviews its regional representation to

balance changes in the number of members. Arla Foods expands into new European countries, signs up new farmers as members, and then adjusts its governance structure to make sure they are represented.

Granted that there is a growing interest in good governance in co-operatives, what sort

of guidelines can we suggest for its redesign? First, we have to be cautious. Governance is deeply embedded in the daily practice of a business organisation. It has evolved in all sorts of ways, and changing it is risky. It is not just a rational process, and there may be unforeseen consequences. The complete redesign of a governance system is rare. The UK Co-operative Group is a good example, whose regional and main boards voted to end their role, passing an extensively revised set of rules in 2014 in order for a new board to be formed. Happily, in terms of business performance, the redesign seems to have worked and, along with some very good and diligent management, it has brought the Group through the crisis.¹³⁸

An incremental approach is more usual. Co-operative boards add new elements to the existing governance system, making it more representative, bringing in more expertise, or trying to create a more vital connection with the members. This does not mean total redesign but a careful reshaping of the system to make it fit for purpose in the changed circumstances in which a co-operative finds itself.

How to design a highly representative governance system

If you want to make your system highly representative, you interpose between the members and the board of directors some kind of representative council from which the board members are elected.

The member vote can be organised in districts or regions to improve geographical representation. This is a common practice in large co-operatives, and in those that transcend national boundaries the regional structure becomes a national one. The representative council



“Governance is deeply embedded in the daily practice of a business organisation. It has evolved in all sorts of ways, and changing it is risky.”

should have some supervisory powers over the board and report back to members.

There is no need to allow all the members to attend an annual meeting. In an extremely representative system, only the elected representatives can attend. It is democratic, but very indirect, and to retain legitimacy, the governors tend to review their electoral rules regularly to make sure the system remains balanced. The elected representatives are really saying to the members 'Leave it to us - we know best how to govern on your behalf'. The risk is that ordinary members may feel their own voice is excluded. Also, board members who are highly representative may not realise they need help in areas where they do not have the relevant expertise.

How to design a highly expert system

If you want a highly expert system, it is best to start with a traditional system of members attending an annual meeting and electing a board of directors. Then, when the co-operative becomes much bigger, a nominations committee of the board screens potential board members and offers members no choice but to endorse (or not endorse) the board's preferred candidates.

Because the board is self-perpetuating, its members can afford to appoint candidates who have the right set of skills and experience without worrying about how representative they are. Their task at the annual meeting is simply to explain their decisions to the (usually small) group of members who attend.

The resulting system is legitimated by the expert board members saying to the members 'Just give us your approval and leave it to us. After all, we are the experts'. It is common in mutual insurance companies where the members include millions of policyholders who have little incentive to get involved unless something is going badly wrong. It is also common in co-operatives that have adopted a 'shareholder' mentality and the kind of corporate governance that is typical of investor-owned businesses. In some cases, the member ownership shares are kept in a separate organisation that then relates to the company as a major shareholder. In such cases it is difficult to imagine how the members' voice can be heard.

If expert-dominated co-operative boards want to increase member voice, they can organise meetings around the country where they go

to listen to what members have to say. If they want to increase their representativeness, they can set up a national-level member council that is elected at the annual meeting alongside the board. If the board genuinely wants to strengthen representation, it gives the member council some authority over nominations to the board. If it wants to ensure that expertise still has priority over representation, it makes sure that the member council has no powers to nominate board members or, if it does have such powers, it has to send its nominations back to the board for final approval!

How to design a more balanced system with some member voice

If you want to design a more balanced system, you are trying to end up with a small group of people that are both highly representative of the members and experts at running huge, complex businesses. This is an impossible task.

The only way it can be done is to have two top-level groupings. There will be a small board of directors who are mainly independent experts but with some representativeness built in. Then there will be a member council that will be much larger and will be highly representative of the members. This means that, to some extent, board members are freed from the need to prove their representativeness as well as their expertise. It also means that the top executives can become board members rather than just advisers to the board, as their expertise as managers can be recognised.¹³⁹ In such a system, authority is distributed and so the member council and the board of directors can each get on with doing what they do best.

In order not to choke off the voice of ordinary members, both the council and the board will have to submit themselves for election by the members at an annual meeting. Because of the need to ensure a threshold of competency among council members and specific types of expertise among board members, there will be a powerful nominations committee that will vet the candidates for both board and council. However, there should also be a rule allowing 'nomination by petition' whereby members can directly nominate candidates if they are dissatisfied with the performance of their leaders.

Under normal circumstances, it is unlikely that applicants for the *board* will face competition, as their expertise will qualify them and the

members will be asked merely to endorse the board's choice. However, applicants for the *council* will only be qualified if they can persuade the members that they will make good representatives. Here there can be regular competition for places. One interesting variant employed by the new Co-operative Group system goes like this: board members are mainly appointed through the nominations committee and endorsed (without competition for places) by the members. But four places on the board are for 'member-nominated' directors, and here there can be competition among candidates. It is an interesting way to introduce some representatives into a mainly expert board, with member voice exercised in their election.

There should be some tension between the two bodies. The council should have some powers, such as having places on the nominations committee, being able to approve annual accounts, and endorsing strategic plans. Major decisions such as acquisitions of other large businesses may need a vote of the council or even of the members as a whole. In order to stop the board from becoming self-perpetuating, probably the council should have at least half of the places on the nominations committee. Probably the person who chairs the board should also chair the council, as this will stop the tension from becoming destructive.

It used to be expensive for co-operatives to foster member participation. The digital revolution has seen these costs fall almost to zero. Members can 'attend' an annual meeting online and send questions via texts, as they do now in the Co-operative Group. They can organise into any number of interest groups, and can make friends with each other through social media. Those responsible for orchestrating member voice have a wide range of powerful tools for keeping in touch, and for explaining and justifying the co-operative's strategy.

There are dangers inherent in participatory democracy, as single-issue groups can also organise at low cost and potentially disrupt the business. However, the nominations committee will safeguard the expertise of the board, while the competitive election process will safeguard the representativeness of the council. The cost to the co-operative of orchestrating member voice can easily be justified: not only does it foster democracy but it has a clear business advantage in developing trust and loyalty among members. Thanks to the digital revolution, it is also not so costly.

Conclusion

Imagine you invite three guests to a party; it is polite to offer them an equal share of your homemade cake. It is also polite for them to say ‘just a small piece’.

In designing a governance system for a co-operative, the guests are much less polite; member voice, representation and expertise usually insist on a bigger piece for themselves, which means less for the other two. But you are right; it is fairer to try to give a roughly equal share to each, or at least to pay attention to each principle when reviewing the way the governance system is working. The best-governed co-operatives are already showing us how this can be done. Perhaps the task that researchers should now set themselves is to do some detailed case studies of co-operatives that demonstrate ‘best practice’ in governance design and redesign, so we can all learn from them.

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Endnotes

- 1 See Atherton et al (2011)
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- 3 Euricse (2017). Size is measured for most co-operatives in terms of turnover, which is defined as the income generated by the business activities conducted by a company. For mutual and co-operative insurance organisations the turnover is represented by their income on premiums, and for co-operative banks it is net interest income, understood as the difference between interest income and interest expenses.
- 4 Birchall, J (2014a)
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- 14 Wilson, J et al (2013) ps312-3
- 15 Aso (2012) p102
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138 Birchall (2014b). However, some critics would argue that the redesign has privileged expertise over representation, and if so pressures may always build up for further redesign in the future.

139 This issue is discussed well in Jones, P (2017)

This is the second edition, comprehensively revised, of a research study which has been widely recognised as the first thorough research study into how co-operative businesses worldwide operate in terms of their governance.

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The opinions contained in this document are those of the author and do not necessarily represent the formal policy of Co-operatives UK.

Published by:
Co-operatives UK
Holyoake House
Hanover Street
Manchester
M60 0AS
0161 214 1750
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www.uk.coop/advice

Published by Co-operatives UK, 2017.

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