CO-OPERATIVES UK

NEW INSIGHT

The governance of large co-operative businesses

A research study for Co-operatives UK

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"How difficult the task of governance is depends not just on the size and complexity of an organisation, but also on who owns it."

Co-operative enterprises build a better world

This is the first comprehensive research study into how co-operative businesses worldwide operate in terms of their governance. Confronting head on some of the myths around the co-operative way of doing business, *The Governance of Large Co-operative Businesses* reviews the performance and governance structures of sixty of the world's largest co-operative businesses.

The opinions contained in this document are those of the author alone rather than the policy of Co-operatives UK and any errors or omissions remain entirely the responsibility of the author.

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Summary

Experience tells us that governance in member-owned co-operatives is distinct from that in investor-owned businesses, yet we do not understand fully how this operates in practice. This research study of governance in large co-operatives helps to fill the gaps in our knowledge.

The subject of governance has become a hot topic for all types of business, and co-operatives are no exception. The decision in 2013 by Co-operatives UK to commission this research could not be more timely.

Co-operatives are a significant part of the global economy:

- There are 1,465 co-operatives that have over $100 million of annual turnover, showing that the co-operative model is not just for small business.
- These large co-operatives cover many sectors including agriculture and food, wholesale and retail trade, industry and utilities, banking, insurance, and health and social care
- The largest number are found in the USA, followed by France, Japan, Germany, Netherlands, Italy, Spain, Switzerland, UK and Finland.

Co-operatives have a diverse range of governance practice. There is, however, a theory of member governance and a set of principles of 'member centrality' that can explain what works better than can traditional economic theory.

The key principles are that the board of a co-operative should:

1. ensure its purpose is central to its members
2. promote the right operating system to build and sustain competitive advantage
3. align incentives so that governance sits effectively with the wider economic participation of members
4. nurture, secure and retain the allegiance of members.

The report reviews the ownership and governance structure of 60 of the world's largest co-operative enterprises, across key sectors.

- Overall, the governance of large co-operatives is on a par with and probably superior to shareholder companies

- Where there are examples of governance weakness there is encouraging evidence of action to remedy this
- The governance approach of co-operatives is shaped by the ownership model and central purpose of the business. The best model is one that reinforces the economic participation of members
- Two common challenges in co-operative governance are ensuring expertise on the Board and managing the costs of a participative model of governance
- Governance design is all about the effective distribution of different types of authority. The voice of members should underpin that authority and three key groups will shape how this is exercised in terms of governance practice – member representatives, who help to ensure a member focus in governance, outside experts, who bring specialist skills, and lead managers, who put decisions into practice
- Good governance design will adapt in an evolutionary way to the changing circumstances of the business and member needs. Governance systems that do not adjust and adapt are more costly over time than governance systems that do
- Boards who want to redesign their governance structures in a radical way (for example in times of challenge), should do so with care, given that there will also be the risk of unintended consequences
- An open, participative model of governance ought to ensure greater diversity among those involved in decision-making. While there is some evidence of this (such as gender equality in the UK co-operative sector), further research is required to measure the comparative performance of the co-operative model.

The report recommends that co-operatives adhere to a quality code of governance and report on their compliance in an open way to members. The advantage of such a code is that, alongside statutory legislation, it offers a way of articulating good practice. The secret of good governance in co-operatives is to take it seriously, to invest in it, learn how to do it, and over time to test, prove and improve governance and business performance.

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 years. 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'.[1] 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 crucially 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. Since the International Co-operative Alliance started listing them in a 'Global 300', we have learned that there are many and some are very large indeed. For two years, a group of experts based at Euricse in Italy have produced a definitive list that has solved some methodological problems, and we can say with confidence that there is a sound database on which to build.[2] According to the World Co-operative Monitor, there are 1,465 co-operatives across 42 countries with a turnover of more than 100 million USD turnover.[3]

They are divided into business sectors. 31 percent of the total number are in *insurance*, 28 percent in *agriculture and food*, 22 percent in the *wholesale and retail trade*, eight percent in *industry and utilities*, five percent in banking and financial services, four percent in *other services*, two percent in *health and social care*, and another one percent in various services. They can also be divided by country, in which case the USA comes first, followed by France, Japan, Germany, Netherlands, Italy, Spain, Switzerland, UK, Finland and so on. In this report we will examine the top ten co-operatives in each of the six main sectors, 60 in all. [4]

The first task is to describe each co-operative; surprisingly, nobody has yet done this and we simply do not know enough about these large co-operatives. Then we ask why they it has grown so large. Third, we find out more precisely who owns it. Is it a producer co-operative, owned by people who need help in making a living (farmers, small businesses, workers) or a consumer co-operative, owned by people who need help in meeting their own consumption needs (customers, service users, policyholders)? Is it a primary co-operative, owned directly by individual people, or a secondary co-operative, owned by other co-operatives or similar organisations? It may have a mixed ownership, and one of the important tasks is to disentangle this and describe exactly who the owners are. Then we can describe its governance structure. Is it single-tier (governed by a board of directors) or two-tier (governed by a supervisory board and management board)? How does it connect with the huge numbers of members, through a minimal process of an annual meeting or through an intermediate body such as a member assembly or regional boards? How central is the co-operative to the lives of its members, and how central are the members to the co-operative? Finally, have their been governance problems and, if so, what lessons can we learn?

Readers may be surprised to find little mention here of governance codes, audit committees, compliance, and guides to managerial conduct. This is because all the large co-operatives have these now, and they are fairly uncontentious (though in the final chapter we will be asking the important question of how far co-operatives can comply with governance codes that were not written for them but for investor-owned businesses). You may also be surprised to find the emphasis is on structures, when everyone knows that it is the processes of governance – the way they work in practice – that is important. The only way to find this out is to spend a lot of time interviewing people and observing them in the day-to-day business of governing. We hope to do this soon in a follow-on project, but because so little is known about co-operative governance we feel this report is a good start.

What this report is about

Chapter 1 asks what is governance? It provides a background to the subject by describing the ways in which, in the first decade of this century corporate governance in shareholding companies 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. Chapter 2 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 describes some false starts in building such a theory, and then outlines a 'member governance' approach that provides the guidance we need in assessing the current practices of co-operatives.

Chapters 3 to 8 report on the governance practices of large co-operative businesses, divided into the six sectors: agriculture and food; wholesale and retail; industry and utilities; health and social care; insurance; and banking.

The Conclusion sums up what we have learned and tries to make sense of the great diversity in governance traditions in co-operatives. It identifies four key elements – member voice, representation, expertise and effective management – and shows how the diversity is explainable in the way that individual co-operatives have chosen to 'cut the cake' of governance into these four elements. However, it also warns that no change is costless, and it is important not to overload the business with too many governance costs. A redesign of governance structures would involve reassessing the effectiveness of the co-operative in giving weight to these four elements, making sure that member voice is not neglected, making full room for representatives, but also respecting the role of experts and effectively connecting the governors up with the work of management.

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 billion 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 billion in assets and $41 billion 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 the 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 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 percent 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 billion. 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 percent of total milk production and 1,800 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. 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.

Governance failures in consumer co-operatives

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 Co-operative Wholesale Society 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 pay-outs of £5.4 million (as opposed to the anticipated £1.4 million) 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.[17]

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.[18]

Governance problems have also arisen in insurance mutuals, which have large numbers of members who are only weakly incentivised to take part. A recent review of the governance of life insurance mutuals in the UK confirms that in some mutuals this is a serious problem[19] The 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'.[20]

The 2004 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'. [21] 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 cooperatives were competing successfully against investor-owned banks.[22] 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 cooperatives 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. OVAG is the central bank for the Austrian urban co-operative banking sector, and before the crisis it had expanded into Central and Eastern Europe. Losses made in these other countries led to its partial takeover by the Austrian government. 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. The causes will be the subject of a number of reviews, starting with one led by Sir Christopher Kelly at the request of The Co-operative Group. The factors are likely to 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 (broadly speaking) a retail consumer co-operative.[24] 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 (a relatively recent innovation) 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 is now engaged in a review of its governance structures, recognising that there are some fundamental questions to be answered.

Co-operatives are not immune to failures stemming from changes in the culture of the business sector they are in, and from falling 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. It was not the first misselling scandal in which it had been implicated. 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 group BPCE has also been fined, and Credit Agricole is still fighting its case. 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.

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.[26] 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. [27]

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.

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.[28] 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 essential 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 three 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.* [29]

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-cooperative enterprises* [30]

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.

Third, 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. The problem with this 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.[31] 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.

A member governance approach

We 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.

It implies a relationship view of governance – it is all about trust and agency. 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'. [32] 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. The problem is that the larger the co-operative the more difficult it is to maintain the relationship.

In a book called *Making Farmer Co-operatives Work*, the Indian economist Tushaar Shah developed a theory of linkage-dependent co-operatives. He challenged the conventional view in India that good leadership and management, conformity to co-operative principles, a supportive local culture, and lack of government interference between them explained why some co-operatives were successful and others failed. His startling alternative was that these are all results of success, not causes. He said

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.[33]

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'.[34] 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.

In his next book, *Catalysing Co-operation*, Shah continued to develop this theory, exploring the idea that 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.[35] 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 enable the managers to pursue goals that improve the livelihood of the members.

What gives co-operatives their drive? Shah says it is the constant improvement of their capacity to serve their members. The design architecture includes the interrelationship of member-users, the board, and the operating system. The design generates three types of effectiveness – patronage cohesiveness, governance effectiveness, and operating effectiveness. In patronage cohesive co-operatives, the board aggregates the priorities of members, articulates this into the organisational objectives, and holds the operating system (what we would call the management) accountable for pursuing this objective. Governance effectiveness is achieved by a tenacious board that blends various types of rewards to drive and energise the managers, making demands but also offering support in pursuit of high performance. Operating effectiveness is achieved when the employees, who deal directly with the members, have a mutually reinforcing relationship, with both employees and members gaining energy from each other.

There are four design principles:

1. The board should *choose an appropriate purpose central* to members, and then make sure it can achieve it. If the members' priorities change, the co-operative's priorities should change with them.

2. The board should *get the right operating system*, building and sustaining competitive advantage by developing new ways of organising business and serving members. It will not be easy, as competitors will try to copy the innovations the co-operative comes up with, but it will succeed if it roots the competitive advantage in the only thing the competitors cannot replicate – its character as a co-operative.

3. The board needs to *ensure patronage cohesive governance*. The performance of the operating system depends on the demands made on it, and support given in form of incentives. The governance system is the instrument of operationalizing member control over the operating system. It is often the weak link in the design. The skills that board members need include transmitting the preferences of members, while understanding the operating system. The board should not be independent, but should include people who are intensive users of the co-operative. Patronage cohesive governance is not easy to achieve; it includes the ability to aggregate members' priorities, ensure alternative courses of action are evaluated, and take members into confidence before committing to other activities. The board should hear the voice of members, or expect them to exercise their right of exit.

4. The board has to *secure, retain and continually nurture member allegiance*. It does this by meeting their expectations and maintaining their trust. But this is not a one-way street. The board has to evolve and enforce rights of the co-operative on the members, and of the members on the co-operative. Obligations should be imposed in proportion 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.

A member-central governance structure

These insights from Shah's work get us a long way in constructing a theory of co-operative governance, but he was analysing agricultural co-operatives in India that were, by comparison with the largest co-operatives, 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 a way of aggregating member preferences so that they can connect up with the governance process. Then we have to design 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.

Here is a more theoretical way of putting this. In designing governance structures, we struggle to give some weight to each of four different types of authority: voice, representation, expertise and management. We have to listen to the voice of the members, to find an effective way of representing them, to find the expert help they need, and to find effective ways of encouraging and controlling managers. Only when all four types of authority are present can a co-operative be governed effectively. If we were designing a large co-operative from scratch, a logical plan might be to find ways of animating the members' voice, through informal activities that encourage them to be get involved and to take an interest in voting for representatives who will take part in governance on their behalf. Then we might devise a fairly large representative assembly of perhaps 40 or 50 members. It is at this stage that any persistent differences in interests should be identified and designed in, and so we sometimes see representatives coming from regions or from different types of member. The assembly has a supervisory role, with real powers to define the ultimate goals of the business, and call the board of directors and top managers to account. They then appoint a management board of around ten or 12 people that might consist of say five member representatives, four independent non-executive directors, the CEO and one or two top managers. In these ways, the four different types of authority could each be exercised but without being mixed up.

We now have a set of criteria for member-central governance by which to compare the governance arrangements of real life co-operatives. However, though this is all very logical, most co-operatives have never been designed like this. They have evolved, usually over several decades, and their governance structures are the result of initial design, adaptation, mutation and occasional redesign – mixed in with the usual human liking for routines and a certain amount of inertia. When we turn to the task of describing the governance structure of the world's largest co-operative businesses, we can expect a lot of variety.

Chapter 3 The agriculture and food industries sector

Twenty years ago, the ownership structure of farmer co-operatives was very traditional – the cost of a membership share was low, farmers did not expect to contribute much capital, returns were based on patronage, and there was one person, one vote. There was beginning to be a move from three-tier to two-tier federal structures; the cost of governing a system based on primary, regional and national societies was becoming burdensome.[36] The supply side of the business was organised 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. [37]

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 fulfill 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 products 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 lack of capital has led to a growing diversity of co-operative ownership structures and new, mixed types of farmer and investor-owned business. This all makes governance more complex.

The top ten co-operatives show how diverse the sector has become, with four distinct ownership types all represented. There are two traditional federal co-operatives in the top ten: Zen-Noh (Japan), and the National Agricultural Co-operative Federation of Korea (NACF), though in the top 20 there are several more, including Growmark (USA), Agravis Raiffeisen (Germany), In Vivo (France), Fenaco (Switzerland), and DMK Deutsches Milch (Germany). We should not be surprised at this, because the federal model of an apex co-operative owned and controlled by primary co-operatives is the traditional way farmers have organised in most countries. In some countries – notably Brazil – the traditional federal system has remained intact, while in others – the USA, Canada, Scandinavia – it has only partially broken down, with primary societies becoming redundant or creating new 'super-locals', and with regional and national societies growing into transnational food processors.[38] The trend is towards a much looser, more diverse structure that will lower the costs of governance while increasing the challenge.

There are four primary co-operatives in the top ten: Fonterra (New Zealand), Friesland Campina (the Netherlands), Arla Foods (Denmark/Sweden), and Danish Crown (Denmark). They are quite a common type; there are five more in the top 20: Suedzucker (German), DLG Group (Denmark), Metsaliitto (Finland), Sodiaal (France), and Tereos (France). They have grown into transnational businesses that in some cases are still based in one country but with a foothold in several more, and in others are truly multi-national. 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.

In some cases the growth process has led to one complex hybrid organisation owned by both primary co-operatives and individual members. There are three of these in the top ten: CHS, Land O'Lakes, and Dairy Farmers of America, all based in the USA. Finally, there is one investor-owned company that is majority owned by two co-operative investment groups; the Baywa Group in Germany.

Two traditional federal co-operatives

Zen-Noh is the world's largest agricultural co-operative by a wide margin, with a turnover of more than $62 billions. [39] It is the business arm of the JA Group, the national federation that represents farmers throughout Japan.[40] It is the major importer of farm inputs such as grain and fertiliser, and the main marketing agent for farm products. It distributes 50 percent of fertiliser, 40 percent of agrichemicals, and 29 percent of animal feed. It handles 45 percent of Japan's rice, 34 percent of fruit and vegetables, 15 percent of eggs, and 14 percent of all meat distribution. It has research institutes, a chain of supermarkets, supplies farm machinery and buildings, oil and gas, and runs social action programmes to strengthen rural communities. NACF Korea has exactly half the turnover of Zen-Noh ($31 billion), but is still third in the world after CHS. Like the Japanese federation, 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 delivers family support services in rural areas, and has a particular mission to help integrate married women immigrants. Like Zen-Noh, it works closely with local government and has a significant influence on central government policies towards farming and the rural environment.

Why are these co-operatives so large?

Zen-Noh has 1,022 unions in membership, plus 132 secondary unions, with 4.72 million regular members and 4.97 million associate members (of the agricultural co-operative association, JA). NACF has 1165 primary societies in membership, with 2.45 million members (more than 80 percent of Korean farmers) and over 15 million associate members.[41] How did they grow so large? They have been backed by government as well as by farmers, and it has always been assumed that nearly all the farmers would be in membership and that it would provide everything they need. Protectionism has, until recently, ensured that competition has been limited.

What is the ownership and governance structure?

The ownership structure of Zen-Noh is complex but if one sees it from the point of view of the individual farmer member it becomes clearer. At the local level they come together in 703 primary associations. At the prefectural level these associations are grouped together in prefectural JA associations that represent them as farmers, and in Zen-Noh associations that organise the business side of marketing and supply. Also at this level they group together in Credit Federations that provide savings and loans. At the national level there are the JA national federation, Zen-Noh national federation, a central co-operative bank that services the credit federations, a national mutual insurance federation (Zenkyoren that features in Chapter 8) and a central union for auditing, supervision and agricultural policy issues. The structure of NACF is less complex as it only has two levels, and there is only one national federation that is both a business and a trade association. It also has its own bank. In addition, the co-operative's website lists a staggering 125 subsidiaries, and eight affiliate companies, and governing them all must be quite a task.

How do these giant federal co-operatives govern themselves? In Zen-Noh, the primary societies elect people to attend a delegates meeting (in which a quorum of 235 is needed). This appoints the 20 members of a supervisory board that consists of representatives from all the different businesses, plus a lawyer and an accountant (there are no other expert appointed directors). The supervisory board then appoints an 11-member board of directors. This is really an executive management board, as it consists of the president and all the managing directors. NCAF is similar. The primary societies elect people to attend a general assembly that is roughly equal to Zen-Noh's delegates meeting; it consists of the chairman of NACF 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 is roughly equivalent to Zen-Noh's supervisory board. It consists of the chairman, four presidents and CEOs, 18 presidents of member co-operatives and seven invited professionals. Then there is an executive of the chairman, four CEOs, and executive officers.[42]

How is member centrality ensured?

These co-operatives certainly maintain a purpose that is central to the needs of their members.

In NCAF's 2013 Report, the chairman, Choi Won Byung 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.* [43]

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. The NACF 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. Again, the ultimate goal is to improve marketing and supply so as to increase farmers' incomes.

Four primary co-operatives

Fonterra is the biggest primary agricultural co-operative in the world, with 10,600 New Zealand dairy farmers in membership. It is, as its own website describes, a 'global co-operatively owned company', marketing dairy products only ten percent of which are consumed in New Zealand: the other 90 percent are exported to over 100 countries. It is the world's largest dairy exporter, and fourth in the global top dairy processors listing after Nestle. There are two aspects to the business; the collection and sale of milk and the processing and sale of branded milk products. In 2011 it collected 14.5 billion litres of milk in

New Zealand (plus some from Australia and Latin America to ensure a constant supply), but its consumer brands contribute 55 percent of its earnings.

Friesland Campina is another very large, transnational dairy co-operative. It has 19,487 member dairy farmers[44] in the Netherlands, Germany and Belgium. The co-operative has a two-tier ownership structure; the co-operative Zuivelcoöperatie Friesland Campina is 100 percent owner of the Friesland Campina Company, which is responsible for the milk processing, product manufacturing and sales. The company has offices in 28 countries, and exports to over 100 countries.

Arla Foods AmbA is the world's sixth largest dairy company owned by 12,256 dairy farmers in the UK, Sweden, Denmark, Germany, Belgium and Luxembourg.[45] 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 3,200 farmers in membership.

Danish Crown is Europe's largest meat processing company. More specifically, it is the world's second largest, and Europe's largest pig slaughtering business. It also has a major stake in the pig industry in Britain; 7,000 of its 25,000 employees are now employed by its UK subsidiary, Tulip. It has 8,552 farmer members. 58 percent of its revenue comes from slaughtering and sale of pork and beef related raw materials, six percent from sale of casings, natural ingredients and packagings, and 36 percent from processing and sale of processed meat products.[46]

Why are these co-operatives so large?

What made these co-operatives grow so fast? New Zealand farmers were always orientated towards export, first to the UK and then (when the UK entered the European Common Market) to Asia. There had been over 400 primary co-operatives, but by 1995 there were just 12 serving the whole industry. By 2000, 95 percent of the industry was organised in two groups – the Dairy Group and Kiwi Co-operative Dairies (the remaining five percent were represented by two small co-operatives). In 2001 farmers voted to merge the two into Fonterra.[47] Similarly, in the 1960s smaller co-operatives in the Netherlands began to join together to create national brands, and the regional co-operatives that resulted were big enough to buy up some of their competitors. Then they began to merge with co-operatives in the Belgian province of Antwerp and in the west of Germany. After many mergers, by the end of the 1990s there were just two giant co-operatives, Campina and Friesland, which merged together in 2008.

Arla is the result of a transnational merger in 2000 between the Danish dairy co-operative, MD Foods and the Swedish co-operative Arla. The Danish co-operative had been buying up UK dairies since 1990, and the new company continued this strategy, in 2003 merging with Express Dairies to form Arla

Foods UK. In 2010 it entered a joint venture with the UK dairy co-operative Milk Link, and two years later they merged. In 2012, an Arla Foods Milk Partnership, by which UK farmers were able to supply milk to Arla, was also taken into full co-operative ownership when the farmers were offered, and overwhelmingly accepted, membership. The same year, Arla merged with a German milk union. Similar acquisitions and mergers in other countries have led to its rapid growth. It is perhaps better described as a multi-national rather than a transnational co-operative, because farmers in each country relate to it via a national level subsidiary. Danish Crown began in 1970 out of a merger, and after more mergers it now has every major slaughterhouse in Denmark.

What is the ownership and governance structure?

It is not surprising that at this level there have been pressures for these co-operatives to convert to conventional investor-owned companies. 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 could hold twice as many shares as their milk quota demanded, and were able to buy or sell them among themselves at market prices through a farmer-only share trading market. The company lent them the money to invest and provided a market maker to ensure liquidity. Other investors could buy unit trusts, but could not buy the farmers' shares. Thus, the co-operative remained a co-operative.

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 AmbA 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 wholly owned by the cooperative society.

At its base level, Fonterra has a shareholders' council consisting of 35 members, each elected to represent a geographical ward. The council 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.[48] 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. The council organises the election process for the director elections, and some of its members sit on sub-committees of the board. In this way, the farmer voice is ensured. There is a board of directors with up to 13 members – nine elected from the 'shareholder base' and four independent members appointed by the board (and approved by the shareholders at the annual meeting).

Friesland Campina has a base level of 21 electoral districts. Ten council members are elected from each district to be on a district council. The company website explains that

> *The District Council forms the bridge between the members and the co-operative, holding members' meetings at which the councillors report back. 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 a supervisory board, which consists of nine member dairy farmers, along with four external members chosen to supplement the skills of the Board members. They then appoint a management-led Executive Board. However, the Supervisory Board is responsible for audit and remuneration and appointments, via two sub-committees.*

Arla Foods' base level in Denmark and Sweden is also electoral districts (24 in Sweden, 25 in Denmark).[49] Here the members elect representatives to serve on a regional tier (three regions in Sweden, four in Denmark). In parallel with this system, in Germany, Luxembourg, Belgium and the UK there are 'local organisations' that raise national issues and aggregate the members' votes. At the top level is a board of representatives, consisting of 169 members plus ten 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 ten places on the Board). Then there is a board of directors consisting of 24 members, of whom eight are from Denmark, seven from Sweden, three from Germany and two from the UK, along with four employee representatives (following the European model of having employee representatives on the board). The rules for apportioning the numbers are complex and are based on the volume of milk marketed and the number of members in each country. The board of representatives and the board of directors have a complex relationship, in that both are interested in long-term business strategy. The board of representatives 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 (which consists of the CEO and Vice CEOs).

Danish Crown also has a base level of districts: the pig supplying members are divided into 15 local districts and three electoral districts, while the cattle suppliers are divided into nine local districts and one electoral district. From these, the members elect a board of representatives, which keeps in touch with the members by meetings in the electoral districts. It elects the board of directors; there are ten members of the board, all of whom are farmers, plus three employee representatives. However, because of the challenges faced by internationalisation, in the last year two new independent members were appointed to the board. The board of representatives focuses on supplier and ownership issues, while the board of directors focuses on business operations. It is the latter board that has an audit committee and a nominations committee that recommends new candidates for the board and fixes remuneration. There is also a small executive board consisting of the top three managers.[50]

How is member centrality ensured?

Are the needs of the members central to the co-operative? Fonterra has maintained a focus on the needs of its farmer members. It has a governance system in which the shareholder council has a strong supervisory role over the board of directors. 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 Board aims to pay out 65 to 75 percent of adjusted net profit after tax each year. 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 cooperative'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. Danish Crown keeps its centrality to members through the traditional two-stage system of a first payment and then a supplementary payment that represents a share in the profits. It is also now beginning to demand capital contributions from farmers for the cost of new buildings.

Three mixed membership co-operatives

CHS is a giant agribusiness that is listed 69th in the Global 500 listing of the largest firms in the USA.[51] If it were not for the much more extensive business of Zen-Noh in Japan it would be the largest agricultural co-operative in the world by a big margin. It is essentially a supply and marketing coop for grain farmers, supplying inputs such as petroleum products, seeds, crop nutrients and animal feed, marketing grains and other crops, and processing soy beans and sunflowers into higher value products. It also provides farm insurance, financial and risk management services. It is a global company, selling grain in 65 countries. Land O'Lakes is the second largest agricultural co-operative in the USA after CHS. It is essentially a dairy co-operative but with a large farm supply business mainly in animal feed; it derives from a secondary co-operative set up in 1921 in Minnesota by 320 primary creamery co-operatives that in 1929 branched out into feed for hogs, chickens and cattle.[52] Like other dairy co-operatives it has gone along the value chain into cheese, butter and other dairy products. Dairy Farmers of America (DFA) is another dairy co-operative that serves nearly 13,000 farmers, mainly by marketing their milk but also by adding value through its own branded cheeses and joint ventures with food processing companies.

Why are these co-operatives so large?

They are the result of many mergers between both primary and secondary co-operatives and so they have a dual structure. CHS is owned by 77,000 individual farmers and ranchers, and 1,100 member co-operatives, Land O'Lakes by 4,000 farmers and 900 member co-operatives.[53] DFA derives from mergers between nine regionals, with another, Dairylea, becoming a partner in a joint venture. It has 14,200 farmers plus four regional co-operatives in membership.[54]

What is their ownership and governance structure?

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. The board oversees an eight member executive board led by the President and CEO. Land O'Lakes has five agricultural regions and seven dairy regions, from each of which the members elect 12 directors, making 24 in all. The board of directors also appoints three independent experts, making it a large board of 27 members. Directors are elected to four-year terms at the annual meeting by voting 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. The board then relates to a rather large senior strategy team of 14 executives. 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 members of the board of directors. The board consists of 51 dairy producers who (in the words of the company website) 'guide the Cooperative and establish policies and business direction'. Three of these members 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.

How is member centrality ensured?

In 2013, CHS returned nearly $600 million in cash to its owners, bringing the amount returned over five years to $1.8 billion. 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 million back to the members in patronage refunds, which brings the five year total to $551 million. 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.

One investor-owned business with majority co-operative shareholding

Baywa Group is a conventional shareholder-owned company that is classed as a co-operative in the World Co-operative Monitor, because it is majority owned by two holding companies: 34.9 percent by Bavarian co-operatives, and 25.1 percent by warehouse co-operatives. It is a legacy of the Raiffeisen movement that was founded in the 1850s, and developed both credit co-operatives and farm supply co-operatives. The Group is based in Germany but 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. The agricultural sector provides half its revenue, with building and energy each contributing 25 percent.[55]

Baywa has a 16 member supervisory board that includes the chairs of several Raiffeisen associations and employee representatives from the works council. They appoint a board of management that is led by the CEO. 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. Does it have a purpose central to members, and does the board ensure patronage cohesive governance? It is not possible to say. 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. Compare Emmi's website with that of Fenaco (owned by the Landi group of co-operatives), and the difference in ethos is immediately apparent; majority ownership by farmers is not enough to ensure member centrality in governance.

Have there been governance problems?

In the traditional secondary co-operatives there is no evidence of governance problems, except at Norinchukin, Zen-Noh's bank. In response to growing competition the Bank 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 USD) through share sales to its farmer members, but then it bounced back with a net income for 2009 of 29.5 billion yen.[56] 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.

There has been one major scandal involving Fonterra. In 2008, a Chinese dairy company, the Sanlu Group that was 43% 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.

Chapter 4 The wholesale and retail sector

In the list of the top ten co-operatives in the wholesale and retail sector, we might be surprised to find that the top three are not consumer co-operatives. They are all retailer-owned wholesale distribution co-operatives. 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: Unified Grocers in the USA was founded in 1922 by 15 retailers who shared out a carload of soap.[57] 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.

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 from further up the supply chain. 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.

There are five retailer-owned co-operatives in the top ten: ReWe Group (Germany) is the largest, followed by Leclerc (France), Edeka Zentrale (Germany), Systeme U (France), and Wakefern Food Corporation (USA). It is a common type: there are five more in the top 20, including Associated Wholesale Grocers (USA), Superunie (Netherlands), Astera (France), Sanacorp (Germany), and Noweda (Germany).

There are four consumer co-operatives in the top ten; that is, companies owned ultimately by individual consumer-members. Like the agricultural co-operatives, the consumer co-operatives grew at first by linking primary co-operatives into federations that provided the advantages of group wholesaling and manufacturing.[58] By going back in the value chain from the end-consumer, they were able to eliminate profit and sell goods at cost to the consumer-members (or to sell at market prices then distribute the surplus as a patronage refund, which amounts to the same thing). In the last 40 years, because of intense competition from supermarket chains they have regrouped into more ad hoc structures that have enabled them to grow very large, though unlike the farmers they have not become multi-national, mostly preferring to stay within country borders.

The top two are primary level consumer co-operatives: 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. There is only one more in the top 20 – Eroski (Spain) at number 11. However, Eroski is unique in being a hybrid of consumer and employee ownership.

The traditional form that national-level consumer co-operatives have taken in the past is the large federal wholesaler owned by primary co-operatives. This is the organisational equivalent of the retailer-owned wholesaler. There is only one in the top ten: SOK Corporation in Finland, though there are four more in the top 20: Federated Co-operatives (Canada), KF (Sweden), JCCU (Japan), and Coop Norge (Norway). There is one consumer co-operative conglomerate owned by both primary co-operatives and individual customer-members; 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.

Finally, there is one employee-owned co-operative in this sector, John Lewis Partnership. Apart from Eroski that has 50 percent employee ownership, it is the only large co-operative of its type. Like one of the primary co-operatives, Migros, it is the result of a deliberate decision by the original owner to give it away; Migros was given to the customers and John Lewis to the employees. Though the types of co-operative are very different, they sometimes work together. For instance, in 2006 Leclerc and Rewe formed a joint buying group with Co-op Swiss.

Five retailer-owned wholesale distributors

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 euros and over 327,000 employees. 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 (about 10,900 in Germany), including Russia and Ukraine. It also has 2500 travel agency outlets and other food businesses. It has 890 retailers in membership in Germany, operating 1,112 stores.[59] 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. The Edeka Group is the largest German supermarket corporation, currently holding a market share of 26 percent. It has more than 4,000 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' cooperative, comprising about 800 independent hypermarkets and supermarkets. It owns the trademarks Hyper U, Super U, Marché U and Utile, which are used by its members. 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 retail supermarkets under the ShopRite and PriceRite banners.

Why are these co-operatives so large?

The co-operatives have grown organically as their members' businesses have grown, acquiring other companies as the opportunity arose to consolidate their market position, and moving into other countries (in the case of Wakefern, other US states). In some cases, there has also been the kind of consolidation familiar to other types of co-operative. For instance, Rewe Group used to be owned partly by wholesalers in a three-tier structure but in 1990 it moved to a more efficient two-tier model with four regional wholesalers transferring their business operations to REWE-Zentral AG. Also, one of the rules of Leclerc is that members have a duty to propose new members, who are set up in business with loans guaranteed by their sponsors. The expectation is then that the sponsors will monitor the progress of their protégés.

What is the ownership and governance structure?

It is difficult to find out about the ownership and governance structures of these companies. Very little information is provided on websites, annual reports are not available and press offices have been unresponsive. They are probably quite conventional. For instance, a 16 member supervisory board governs Rewe Group, nine of whom also serve on the finance arm, REWE Central Finanz.

How is member centrality ensured?

These 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.[60] Other, non-cooperative 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 it members'.[61]

Two primary consumer cooperatives

Coop Swiss[62] is a giant co-operative retailer, the second largest in Switzerland after the other co-operative, Migros.[63] It has over 2000 retail outlets including the whole range of food outlets: superstores, supermarkets and convenience stores. 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 nearly three million members, and 75,000 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 ten regional co-operatives. 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. [64]

Why are these co-operatives so large?

In the postwar period, the consumer co-operative sector in Switzerland faced similar challenges to that in the UK, with a move to regional warehousing, closure of 500 small shops, resistance to mergers and a switch to discount stamps and a low price policy. However, the National Union of Swiss Consumer Co-operatives took a tougher line than did the UK Co-operative Union, threatening weaker societies with expulsion from the Union and the wholesale society if they did not merge: by 1983 it had succeeded in its aim of reducing the number from over 400 down to 40. Also in contrast to the UK the group was disciplined, as early as 1960 adopting a single logo, placing its members' stores under the Coop brand and using television-advertising campaigns. From the mid-1970s, in contrast to other countries, it began a period of strong growth, increasing its market share from nine percent to 12 percent. The Union continued to reorganise its distribution and purchasing operations into a centralized structure, and changed its name to Coop Swiss.

Migros was started in 1925 by Gottlieb Duttweiler who, though he was a talented solo entrepreneur, admired co-operative values (his father had been a co-operative store manager). He built a large retail chain then turned it into a non-profit, and then in 1940 into 12 regional co-operatives grouped into a federation. His business strategy was to provide products at the lowest possible price, and by the 1960s Migros had become a massive conglomerate, with own manufacturing production, a bank, and an insurance company. Although it did not give the traditional co-operative dividend, through its M-Budget range it continued the low prices strategy, and gave back profits through extensive adult education activities. Unlike consumer co-operatives in other countries that were struggling with the need to restructure from a decentralised system to a unified retailer, Migros simply continued to grow and to diversify into other types of retailing.

What is their ownership and governance structure?

Coop Swiss is complicated. At the base level, there are six regional councils, consisting of 60 to 120 elected members (the proportions depending on the total number of co-operative members in each region). Together, these elected councillors make up a delegate assembly of several hundred people. The assembly has the powers of an AGM, electing (and having the power to dismiss) the Board and auditors. The regional councils appoint a 12-member nominations committee whose job it is to propose people for election to the board of directors. However, their nominations do not go directly to the general assembly to be voted on, but go to the board that then sends them back to the delegate assembly for election. If elected, the board member also becomes president of the regional council and its nominations committee. 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 regions, and a maximum of five more, including a French speaking representative and an employee representative (it has ten members at the moment). The board is 'self-constituting', appointing its own chairman and vice-chairman, and it has its own audit committee. The directors may represent the regions, but they all seem to be professional directors with formidable skills; the rather indirect method of proposing and electing them leads to a more professional board.

Migros is officially a federation, with ten regional co-operatives in membership, (though it is more realistic to see it as a primary co-operative with regions). The supreme body is the delegate assembly, referred to as the 'Migros Parliament'. It has 111 members, of whom 100 are elected by ballot of the regional co-operatives and ten are from the regional administrations; an independent president chairs it. It decides on the business policy and bylaws, approves the annual report and financial statements, and appoints the auditors and top management. Then there is a management board consisting of ten representatives (one from each of the regional co-operatives), two employee representatives, nine external directors, plus the CEO and President. It is a large board of 23 people.

How is member centrality ensured?

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 the Co-operative Wholesale Society (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'.[65]

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 million were returned – not to members but to the community – in what is called a 'cultural percentage'.[66]

One secondary consumer co-operative

SOK is the national-level apex of the S-Group, owned by 20 independent regional co-operatives and eight local co-operatives. In its core business of the supermarket trade, S Group is now the market leader in Finland; it has nearly 1700 outlets and 43,000 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 two million members, representing more than 80 percent of the Finnish population.

Why is the co-operative so large?

From the 1960s onwards, co-operative retailing in Finland was in trouble, with most primary societies making losses and having to be subsidised out of the SOK Federation's reserves. The numbers in membership of SOK fell through merger from 178 to 32. Then in 2002 the biggest primary society, Elanto merged with SOK to form the 'S-Group', which immediately gave it around 40 percent of the grocery market.

What is the ownership and governance structure?

SOK is the 'central' for the co-operatives, providing expert and support services and developing the various chains while the regional co-operatives manage the supermarkets. Regional co-operatives are governed in this way. Members can stand for election in the council of representatives that is the highest decision-making body. It decides on the annual distribution of profits, on changes in the rules and any possible decisions concerning mergers or the closing down of the co-operative's operations, and it appoints the auditors. It chooses the supervisory board. The election for the council of representatives is organised every four years as a postal election. One interesting rule is that anyone who is 15 years old or older the year before the election has the right to vote. The supervisory board focuses on supervision-related questions, representing the owners and selecting the members of the regional executive board.

SOK also has its own separate governance structure. Its highest decision-making body is the co-operative meeting, on which all regional and local co-operatives are represented. Its tasks include approval of financial statements, discharge from liability and election of supervisory board members and auditors. SOK's supervisory board 'answers for the co-operation principles' relating to S-Group's operations, decides on large-scale policies, supervises the interests of co-operative members and does long-term planning. It has 20 representatives from the regional co-operatives, plus two employee representatives. There are no independent experts on the board. The Supervisory Board oversees the executive board.

How is member centrality ensured?

The 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.

One mixed membership consumer co-operative

The Co-operative Group is a huge 'family of businesses' that, as well as its supermarket chain, includes a bank and insurance arm, funerals, travel and farming that together turnover $23 billion.[67] It is owned by nearly eight million members, with 4,500 retail outlets and nearly 90,000 employees. It is the UK's fifth biggest food retailer operating across the country with almost 2,800 local, convenience and medium-sized stores. Amongst its other wholly-owned businesses are the UK's largest funeral services provider, and the third largest pharmacy chain. [68] One feature of this co-operative is that in 1997 a decision was made to get out of the superstore business and focus on smaller supermarkets and convenience store trading, in which it is now pre-eminent.

Why is the co-operative so large?

The origins of The Co-operative Group are in the Co-operative Wholesale Society (CWS); the oldest in the world, being founded in 1863. The Group results from a long series of mergers, first with the Scottish CWS (in 1973), and from 1973 onwards with the takeover of ailing retail societies; by 1990 it had acquired 41 societies. This was never meant to happen. The 'ambulance service' of the co-operative sector was Co-operative Retail Services that by the mid 1970s had taken over 162 societies. But it could not absorb the losses, and CWS had to help out, evolving into the curious mix of a primary society and a secondary. From the 1990s, several large societies joined, sometimes from a position of strength.[69] In 2009, the Group bought the 750 stores of a retailer called Somerfield, at one stroke leaping from a market share of 4.5 percent to 7.2 percent of the retail food market, and into fifth place behind the big four supermarket chains.

What is its ownership and governance structure?

The Group used to be dominated by societies in membership, but more and more societies merged making it important to seek a new voice for individual as well as corporate members. A constitutional review board reported in 2001. Eight regional boards were set up, with significant powers of scrutiny of business operations, approval of capital expenditure in the region, and approval of branch closures. 45 area committees were set up, 'championing co-operative values and principles in local communities'.[70] They were elected by postal and internet voting. A group board level values and principles committee was formed, with equal status with other committees. This meant that for the first time member relations was mainstreamed in the governance structure of the Group. In 2007, for the first time a chairman was elected from the individual members rather than from the – previously powerful – corporate members.

The three-tier system is complex, but as one historian puts it, provides 'a more transparent and appropriate governance model for the combined business'. [71] It has been altered slightly, consisting now of 48 area committees and seven regions. There are 21 directors on the Group board, 15 of whom are regional board members. There are also five elected representatives from independent co-operative societies that are members of The Co-operative Group. This is a large board – in contrast the average board size of UK consumer co-operative societies is 12. How well does it work? Chief executives have from time to time criticised the lack of expertise on the Group Board. Now, with governance problems surfacing, the question of appointed expert directors is being considered.

How is member centrality ensured?

Since the ending of the 'dividend' (patronage refund to members based on purchases) in the late 1960s, the consumer co-operative sector has struggled to make itself central again to members. In 2005, the Group brought back the dividend in the form of an electronic card. At that time membership was just over a million but is now close to eight million. There is a growing cohort of dedicated members who are active on and around area committees, and who are attracted to the Group's ethical stance on a whole range of issues. The question is whether the Group can capitalise on this to turn customers with a very 'thin' relationship into loyal, long-term members.[72]

One employee-owned co-operative

The John Lewis Partnership includes the John Lewis department store chain of 30 stores and nine 'at home' shops, 255 Waitrose supermarkets and 35 Waitrose convenience stores. It has 84,700 partners who are also its employees.

Why is this co-operative so large?

The answer is quite simple. John Lewis inherited a thriving business from his father, and then built it up, in 1937 buying the Waitrose chain, and then in 1940 the Selfridge provincial chain. He practiced profit sharing with his employees, and then in 1950 handed the business over to them via a trust. Since then, the business has simply grown, building on the sound work of its founders.

What is its ownership and governance structure?

In contrast to the lack of information about the retailer-owned wholesale co-operatives, John Lewis provides a transparent picture of its governance structure. 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: the partnership council, the partnership board, and the chairman. The partners directly elect the partnership council, whose job is to hold the chairman and executives to account and appoint five directors to the partnership board (it also appoints three trustees and the President). The council has the power to discuss, to ask questions, and to make recommendations on any subject, and if it is completely dissatisfied, to dismiss the chairman. The chairman appears before the council twice a year to report and answer questions.

The business is divided into constituencies, which elect one partner as their council member. The chairman has personal responsibility for ensuring that the partnership retains its distinctive character and democratic vitality. He or she is also ultimately accountable for the commercial performance and is responsible for developing a business strategy that ensures the long-term sustainability of the partnership. The partnership board has five directors appointed by the council, three external non-executive directors that provide a broader base of skills and experience, 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 and officially appoints the Chairman and distributes the partnership bonus.

How is member centrality ensured?

Employee-owned businesses have one important advantage, that paid work is already a central concern in people's lives. Also, because of the elaborate and 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 partnership 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 million. There have been no governance problems.

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, which used to be knows as CWS. In 1995 a CWS executive took a bribe from the company that had bought the CWS manufacturing business, to continue a three-year deal to supply CWS for another two years. Board members were only informed in 1997 (£2.4 million had been paid into an offshore bank to facilitate the deal). In 1997 came a hostile takeover bid from the owner of the company, and again bribery was involved, but the Group board led a heroic stand against the takeover and won. Commentators agree that co-operative values were not just saved but strengthened by the ordeal.[73] In 2009, The Co-operative Bank merged with Britannia, the second largest building society in the UK. It seemed like a good idea at the time; the society had over 250 outlets, and assets of over £37 billion. The Bank then bid for over 600 branches of Lloyds in an attempt to become a serious alternative to the big investor-owned banks. Despite having government support, in 2013 the Group withdrew because a very large hole had appeared in the Bank's capital. Loans made by Britannia had turned into losses, the pursuit of the Lloyds deal had been costly, and money had been wasted on a failed new computer system. Now the Bank has to be floated on the stock exchange, and the Group will be a minority owner.

A review of the governance of the Group is currently being carried out by Lord Myners, and so it will not be discussed further in this report. However, this case raises more general questions that will be addressed here, about whether independent directors should be appointed to co-operative boards, and whether their sometimes-elaborate democratic structures are fit for purpose.

Chapter 5 The industry and utilities sector

As in every sector in which we find co-operatives, the industry and utilities sectors contain large businesses that are owned by primary societies. Here, they have not been so affected by structural changes as in the agriculture and retail sectors, and so we do not come across any giant primary co-operatives or hybrids of individual and corporate membership. In the industry sector there are four secondary co-operatives owned by primary co-operatives: Mondragon (Spain), Copersucar (Brazil), National Cable TV Co-op (USA), and Consorzio Cooperative Construzione (Italy). There are no primary co-operatives owned directly by employees. Fagor Electrodomesticos has sadly had to be omitted as it is in liquidation (a victim of the downturn in the Spanish economy since the Euro crisis, rather than of any governance problems). The Sacmi Group, an Italian manufacturer of machinery for the Ceramics, Food and Plastics industries, is now the largest primary co-operative, listed at number 13 with a turnover of $1.1 billions. [74]

There are five consumer-owned power utilities, all at secondary level. Four are part of the same system in the USA: Basin Electric Power, Oglethorp Power, Seminole Electric Co-operative and Tri-State G and T Association. This is quite a common type; there are two more US utilities in the top 15. Utility co-operatives are also quite common in Europe and Scandinavia, but they are often quite small.[75] There is one in the top ten: Eandis (Belgium).[76] Finally, there is one utility that is a primary co-operative: OK AmbA in Denmark.

Four secondary co-operatives in the industry sector

The Mondragon Co-operative Corporation (Spain) dominates the sector with a turnover of more than $19 billion in 2011. 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 264 companies in membership, and has become Spain's seventh largest industrial company, with a workforce of over 100,000. Copersucar is the world's largest sugar and ethanol companies and one of the most important exporters worldwide. Based in Brazil, it manages all the links in the supply chain, from the marketing of crops to end markets, including storage, transport and processing. It receives all the product of 47 sugar producers who are members of the co-operative, and also buys from another 50 non-members. It produces 12 percent of the world's ethanol and 10 percent of sugar. Among its customers are the world's main petroleum companies, sugar refineries and food industries. [77] National Cable TV Co-op (USA, NCTC) 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. The Consorzio Cooperative Costruzioni 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. It has around 300 primary co-operatives in membership, operating in building, transport, service, industrial, and building materials sectors. Between them, they have a total of over 20,000 employees.

Why are these co-operatives so large?

In different ways, they have grown by participating in the growth, diversification and globalisation of the industries they started in. Mondragon's corporate structure is famous for its ability to spin off new primary co-operative. Its bank, the Caja Laboral, uses the savings invested by local people to finance new ventures, so individual co-operatives are not short of capital. In return, they bind themselves to the discipline of the group. A heavy investment in institution building has meant the group meets its own needs for technical and university training, research and development and business planning, and so its human capital is the best available. Copersucar has grown by participating in the modernization and internationalization of the sugar cane industry. In 2011, Copersucar and another refiner created their own shipping line. In 2012 it bought a US biofuel trading company, created a subsidiary to open up the Asia region, and joined with other big companies to invest in pipelines. NCTC has grown by adding cable operators to its list of members: starting with twelve cable operators, it has grown to serve over 1,000 cable companies across the United States. CC Construzione has grown through four subsidiaries that focus on different market sectors.

What is the ownership and governance structure?

In Mondragon at the base level is Congress, with 650 elected delegates from the primary and secondary co-operatives. [78] 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. The general council is the equivalent of a management board. It 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. The president is responsible for development and implementation of the decisions of the congress and standing committee. It meets monthly, administers a central inter-cooperative fund (ten percent of the gross profits of the coops), and an education fund (two percent of gross profits).

Copersucar has 47 ‘partner’ mills in membership, owned by 24 ‘economic groups’. In 2008 it converted into an investor-owned company, so that the sugar and ethanol producers are members of a Sao Paulo producer co-operative and also shareholders of a holding company that controls Copersucar. The company’s board of directors is made up of 11 members, two of whom are independent. The president is also independent and has no relationship with the partner mills. The board has the usual sub-committees for audit and risk management, sustainability and so on. In addition, in 2012, the office of corporate governance secretary was created, to ensure good governance practices. Then there is an executive board of four: the president and three executives. Since 2009 the company has had a comprehensive code of conduct that sets out the ethical principles guiding employees’ behaviour.

NCTC has a conventional governance structure. Board members are elected at an annual member’s meeting. The board consists of 14 voting directors and a president and CEO who is a non-voting member. In addition to the board, other NCTC members also serve on a technical advisory board and a marketing advisory group. CC Construzione has a general assembly that elects a supervisory council that appoints a board of management. The supervisory council consists of 25 members, including three independents, plus the president and vice-president. It also appoints the company auditors.

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.

In Copersucar, the members may be central but the company website emphasises the duty to them as shareholders rather than as users. Also, the type of business that has shown most growth recently is buying from non-partner mills. Does this mean it is evolving into a conventional business? The question is whether it can turn the non-partners into partners, as Arla Foods has done. Also, it is committed to a stakeholder view of governance that distracts from its focus on members. NCTC 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. CC Construzione says little about its focus, but through contracts with members it must maintain member centrality.

Five secondary co-operatives in the utility sector

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 2,000 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 Georgia citizens. 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. Seminole Electric Co-operative is a wholesale co-operative with nine primary co-operatives in membership. Based in Florida, it has two generating stations, and serves approximately 1.4 million people and businesses in parts of 41 Florida counties. It also owns and maintains more than 350 miles of transmission line. 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. Eandis SCRL 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.

Why are these co-operatives so big?

The US utility co-operatives have benefitted from having been given a good start; in 1935, the government decided to bring electricity to rural communities through the formation of electric co-operatives, and in the rural areas they now have a virtual monopoly. The four co-operatives in the top ten have grown naturally as their member co-operatives have grown, providing them with electricity at cost. This has given them a clear market advantage over investor-owned competitors. The Belgian co-operative was created by local authorities that needed its services, while the Danish co-operative is an offshoot of a vibrant consumer co-operative sector.

What is the ownership and governance structure?

Governance of the US utilities is designed to make them responsive to their member co-operatives. In Basin Electric, directors are elected by and represent one of 11 districts. They serve on the boards of Basin Electric Power Cooperative and four subsidiaries. There are no independent members on the board, just 11 people who represent one district each. Seminole's board of directors (called board of trustees) consists of 27 people, three each from the nine member co-operatives. Each co-operative sends its managing director, a voting member and an alternate member, from who a president and vice-president are selected. An executive of 11 managers then relate to this board. Tri-State's board of directors is made up of one representative from each of its 44 member co-operatives.

Oglethorp is more complicated, but in interesting ways. Each of the 38 member co-operatives appoints a representative to attend an annual meeting. The 38 members of the meeting also form an advisory board that has no real powers but three times a year receives a report from the board of directors and management and gives advice. They also form a nominations committee that organizes the process of identifying potential board members and electing them. [79] The 38 member co-operatives are brought together again in five 'scheduling member' groups whose purpose is to elect ten directors to serve on the board; these include five who are also directors of their own co-operative, and five who are managing directors. The board of directors includes the ten member group directors, three directors-at-large and up to two outside directors.

In contrast, while Eandis may be classified as a co-operative its governance is identical to that of any investor-owned company. The member local authorities are referred to as shareholders and the shares are transferable between the partners.[80] 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.

How is member centrality ensured?

The US 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 does the same, but much less directly.

One primary utility co-operative

OK AmbA 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. 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.

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. [81]

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. Here, as in other sectors, 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, rural health co-operatives in the USA gained government support, but were opposed by the American Medical Association, whose members succeeded in getting legislation in 26 states barring consumer controlled health plans.[82] 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.[83] 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. Although they are not in the top ten, Astera (France) is at number 15, Sanacorp (Germany) at number 19 and Noweda (Germany) at 20. 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.

There are two consumer-owned primary co-operatives in the listing, Health Partners and Group Health Co-operative, both in the USA. There is one secondary consumer supply co-operative, VHA (formerly, Voluntary Hospitals of America), again in the USA. Then there are six producer-owned primary co-operatives, all regional societies of Unimed in Brazil. Finally, there is Fundacion Espriu in Spain, a secondary federation of co-operatives of both producers and consumers that is really dominated by the producers.

Two consumer-owned primary co-operatives

Health Partners is one of two 'consumer-governed, non-profit' health co-operatives in the USA, the other being Group Health Co-operative in Seattle.[84] It was founded in 1957 explicitly as a co-operative, along the same lines as Group Health that was set up in 1947. It provides both health care and health insurance. Based in the Minnesota-Wisconsin region, it has more than 1.5 million medical and dental health plan members nationwide. It has a group practice of 1,700 physicians, a wider contract network in Minnesota of more than 15,000 physicians (working in 4,000 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.

Group Health Co-operative is of roughly equal size with Health Partners. It also provides both health care and health insurance. Based in Washington state and North Idaho, it has 628,000 members who are covered by health plans offered by Group Health Cooperative or its subsidiaries, Group Health Options, Inc., and KPS Health Plans. It has 9,000 staff, with one hospital, 25 primary care clinics, six speciality care units, seven behavioural health clinics, 14 eye clinics and so on. Nearly two-thirds of members receive care at Group Health Medical Centers, and the rest at, a network of nearly 9,000 community clinicians and 41 hospitals. It also has its own institute, plus a foundation. 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.

Why are these co-operatives so large?

It is no accident that they are both in the USA, where most citizens need to buy private health insurance and the state only provides residual funding for people on low incomes and retired people. Both co-operatives have benefitted from the growth of employer-based health plans that bring large numbers of patients into membership. Health Partners has grown by expanding its ownership of hospitals and clinics, but also in the last ten years by taking into membership existing non-profit hospitals. Group Health has grown by being very good at the business it is in, but recently it insurance arm has also expanded nationwide through a partnership with another non-profit, Kaiser Foundation Health Plan.

What is their ownership and governance structure?

Health Partners consists of two 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 15 members, of whom ten are elected by the members, three by the Group Health members, and two physician representatives. The Group Health Board consists of five members, three elected by the Group Health members, plus the chair of the HealthPartners Board and a physician appointed by the President of Group Health. The Chief Executive Officer is a nonvoting member of the boards. These are small, representative but also skilled boards.[85] However, the role of members in governance is not emphasised. They have a 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' but the election of the boards must be by the normal device of an annual general meeting, at which new members are proposed by the board's nominations committee.

Group Health Cooperative has an 11-member Board of Trustees consisting entirely of elected consumer-members. The board 'hires the organization's chief executive officer and sets the strategy, policy, and direction for the organization'. There is a careful selection process for board members that culminates in a conventional annual membership meeting. What is unconventional is the amount of information provided on the website; there is a lot of detail about the board and it sub-committees, and its compensation fees for board members are published. There is also a 15-16 member Co-operative Development Committee. It is chaired by a trustee, but has a mixed membership of 3-4 trustees, a management representative, the chairs of two advisory groups (the senior caucus, and the advisory group assembly), the chair of the nominating committee, chairs of four medical centre advisory groups, the chair of one district advisory group and three members appointed by the board. It looks very much like a supervisory board, but it acts in an advisory capacity. Underpinning this committee are several advisory groupings; some of these are geographically based, some based on interest groups such as older people or those with individual health plans. This is a very interesting model, as it combines a conventional board of directors at the apex with a lot of member involvement at the base, linked by a very representative advisory committee.

How is member centrality ensured?

These health co-operatives 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, Group Health sets a different tone. On its website it explains:

> *One of the things that makes Group Health successful is our tradition of member governance and participation. As a health cooperative, 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* [86]

This combination of conventional trusteeship and member involvement expresses the co-operative difference rather effectively.

One secondary-level supply co-operative

VHA used to be called 'Voluntary Hospitals of America'. It has shortened the name but the longer name makes its purpose clearer; it is a supply co-operative, working at the secondary level as a co-operative owned by other businesses and supplying them with whatever they need to do that business. In this case, the owners are more than 1,350 not-for-profit hospitals and 24,000 non-acute health care organisations in 47 of the US states. The closest parallel may be the utility co-operative, Eandis, which is owned mainly by local authorities. It provides supply chain management services and promotes and supports the formation of regional member networks that enable health care organizations to collaborate. Is it a consumer or a producer co-operative? It is described as 'a nationwide network of leading community-owned health care organizations and physicians', which makes it something of a hybrid.

What is the ownership and governance structure?

VHA is split into 12 regions. It has a 20-member board of directors that includes managers and physicians from 'member and non-member organizations and health systems of varying sizes'. Mostly it consists of the CEO/Presidents of companies but it also includes three medical doctors. It aims to bring both professional experience and geographical representation on to the board. It is a conventional board, following good practice as recommended by the National Association of Corporate Directors. It has the usual sub-committees, including a nominations committee that, presumably, orchestrates elections to the board from a conventional annual meeting of members. What is unusual is that it also has a dedicated member/shareholder evaluation committee that evaluates and makes recommendations to the board about whether to admit new members. It also develops policy in relation to members, monitors member expectations, and undertakes member-related activities.

How is member centrality ensured?

As in other consortium co-operatives that exist to supply their corporate members, the co-operative does not have to do much to ensure member centrality. This is built into its business model. However, the inclusion of a member relations sub-committee indicates that the board recognises the need more actively to ensure member centrality.

Six producer-owned primary co-operatives (regional societies of Unimed)

The Brazilian co-operative, Unimed, 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 3,000, 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 cooperatives in the world. 87 Like the co-operatives in membership of the Espriu foundation, it finds a way to finance 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.

Why is it so large?

The history of medicine shows that doctors do not like working for someone else, whether it be a co-operative owned by consumers or the government; with some honourable exceptions, they have insisted on remaining as independent practitioners.[88] This is all very well if there is a health care system to contract one's services to, but in Brazil the lack of basic infrastructure meant doctors were unable to find work, and so in 1967 the joined together in the city of Santos to found Unimed. In 1975 they founded a national federation, in 1983 they opened their first hospital and then the system just continued to grow.

What is the ownership and governance structure?

The three-tier co-operative system of Unimed begins with local societies that are federated in regional federations and 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 have a general assembly that has its own independent auditor and a 'fiscal council'. The general assembly leads to a Unimed deliberative forum, a confederative council (equivalent of a supervisory board), and an executive board. Unimed Brazil has recently developed a seal of approval for rewarding those of its 63 affiliated organizations that demonstrate good governance. [89]

How is member centrality ensured?

The problem for large health co-operatives is in meeting the needs of producer and consumer members. They have 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.

A secondary federation of producer co-operatives

The Espriu 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 5,500 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 4,000 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).

What is the ownership and governance structure?

Unusually, the 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 basis'. [90] 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. [91] 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 governing council consisting of representatives of users and professionals. [92]

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.

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 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 their governance is two or three tiered.

There are five European co-operative bank groups and one Canadian credit union group in the top ten: Groupe BPCE (France), Credit Mutuel (France), Rabobank (Netherlands), DZ Bank Group (Germany), Raiffeisen ZB (Austria), and Desjardins Group (Canada). There are three more in the top 15: OP Bank Group (Finland), Swiss Union of Raiffeisen Banks and L'Alliance des caisses populaires, Ontario (Canada), which suggests that this is still the standard model for co-operative banks and credit unions. At the base of these 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 ten: the Navy Federal Credit Union (USA).

Some of the co-operative bank groups (notably Rabobank and Desjardins) have a close relationship with the agricultural sector, though they also serve other domestic and business customers. 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, this system consists of local farm credit associations, served by four secondary-level banks and one specialised bank that raises capital for them to lend on to the local associations. This specialist bank (Federal Farm Credit Banks Funding Corporation) is at number six, and one of the four banks (Agribank) comes in at number nine. Two more are listed at numbers 13 (CoBank) and 14 (Ag First Farm Credit Bank). Finally, there is one French co-operative bank that started out as a state-sponsored agricultural bank but has undergone several transformations: Credit Agricole. This is the only bank in this category because it has its own peculiar history in which ownership types have changed. It has individual and corporate members and also a minority of investor-owners, and has expanded into several other countries.

Six co-operative banking groups

BPCE is the second largest banking group after Credit Agricole. It is an amalgamation of two mutual 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 23 percent of real estate 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 36 million customers and 8.8 million members. Among its subsidiaries are Natixis, that manages assets of €570 billion (and is the 13th largest asset manager in the world), and a building society, Credit Foncier. 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 7.3 million are members, and in France its market share of deposits is 15 percent, and of loans is 17.1 percent and it has 79,000 employees and and nearly 6,000 banking outlets.

Rabobank is similar, with 147 local banks divided into 12 regions, and 1.7 million members. It specialises in the food and agriculture sectors, and has a market share of 43 percent of deposits and 30 percent of loans, and 39 percent of loans to SMEs in the Netherlands. It also has a huge international presence in the food and agriculture industries, with offices in 47 countries. It is rated 29th in the world by assets. DZ Bank (an acronym for German Central Co-operative Bank) is a two-tiered group with more than 900 banks in membership. It has 30 million customers of whom 17.3 million are members. It is the fourth largest bank in Germany, with a 19.4 percent share of the market in deposits and a 16.9 percent share in loans, and it provides 28 percent of all loans to SMEs. It is ranked 46th in the world.

Raiffeisen ZB is a three-tiered system of 541 local banks, eight regional banks and one national. Together they have 3.6 million clients and 1.7 million members. The regional banks do clearing functions for the local banks. Their national bank, RZB is the third largest bank 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 29.3 percent market share of savings, 25.5 percent of loans, and a 39 percent market share of loans to SMEs. There is also a parallel structure of co-operative associations that provide consultancy and auditing services to the local banks. Desjardins Group is the leading cooperative 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 397 caisses Desjardins (377 in Quebec and 20 in Ontario), with 5.8 million members, 42,500 employees, and 5400 elected officers.[93] 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.

Why are these co-operatives so large?

There are three fundamental reasons. First, the five European co-operative groups are the inheritors of two extensive networks that began in the 1850s in Germany and spread rapidly throughout Europe; these were the Raiffeisen system of rural co-operative banks and the Schulze-Delitsch system of town banks.[94] Second, during the 1970s, the law was changed in several countries to allow them to trade with non-members. This enabled the sector to grow further, though it also obscured its co-operative nature. Third, once they reached a certain size these groups were able to expand internationally (though sometimes making losses in the process) and to expand into other areas of banking and insurance by acquiring existing companies.

Credit Mutuel (CM) is typical. It represents the Raiffeisen legacy of rural co-operative banks in France that began in 1882 in Alsace and then grew rapidly throughout France. In 1960 it began to diversify into insurance, then in 1998 the takeover of CIC bank meant a change of scale to a really big bank. While most of CM's business was rural, CIC was based in Paris and brought five new regions. Since then there have been several more acquisitions, a number of specialist subsidiaries have been created, and offices opened abroad. Rabobank and DZ are both the result of the merger in the 1970s of two rival federations that gave them national coverage (though there is still one other small federation in Germany). BP and CE both grew quickly by acquiring the asset manager, Natixis, and then by joining together in one co-operative group. Desjardins has grown through the steady growth of its network of 'caisses' and through diversification into many areas of banking, property and insurance.

RZB has grow through expansion into Central and Eastern Europe, through Raiffeisen International, a company listed on the stock market but majority owned by RZB. This means that many customers in other countries are banking with a co-operative bank that is not giving them the membership rights customers have in Austria, and it carries the risk of making large losses if the economies of these countries takes a downturn. OVAG, the central bank for a parallel system that grew out of the Schulze-Delitsch inspired town banks, has made serious losses in Eastern Europe. It is the only European co-operative banks that has had to be bailed out by its government, which has taken a large ownership stake in return.[95]

The Desjardins Group grew out of a network of rural credit unions in Quebec inspired by the same vision as animated the Europeans (its founder, Alphonse Desjardins, was following Friedrich Raiffeisen). It has also grown recently through acquisitions of businesses that have enabled it to diversify into all areas of financial services, including insurance.

What is the ownership and governance structure?

Credit Mutuel is typical of the European co-operative governance model. It has three levels – local, regional and national – operating on the principle of subsidiarity whereby each level cedes a certain amount of control to the next, but only if it is necessary to the efficient running of the business. The members elect the local boards, who elect the regionals, who elect 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. At the local level, the general assembly of each bank appoints the board of directors, and it has to approve the accounts. 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.

Rabobank is similar. The 147 local banks jointly make up a general meeting of Rabobank Nederland that adopts the financial statements and approves amendments to the articles of association. They are divided into 12 regions called local committees. Each local committee elects a board of directors whose members also make up a central delegates assembly that discusses policy.

However, it is the general meeting that appoints the members of the Group's supervisory board. This board 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. BPCE is in transition from two co-operative networks to one, and so it has two boards that feed into an 18 member supervisory 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. DZ Bank is organised as a joint stock corporation, with most of its shares held by the local cooperatives. It is interesting to note that it refers to them as shareholders and provides no information at all on its governance, preferring to focus on 'investor relations'.

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. DZ is a stock bank, owned mainly by the local banks, and it refers to 'investor relations' rather than membership. 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.

One very large primary-level credit union

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

Credit Union has as its common bond service in all the armed forces of the USA. This gives it a huge group of potential members. It has over four million members, and 223 branches located throughout the USA and abroad.

Why has it grown so large?

It began in 1933, and gradually it expanded its membership criteria from the navy to include all military personnel, and from one district to the whole of the USA. By 1962 it was the biggest credit union in the world and had become reliant on professional staff rather than volunteers. It has also grown by merging with several smaller unions such as USA Federal. Recently, it expanded its common bond further by taking in military contractors and the coastguard.

What is its governance structure?

Navy has a conventional structure of a nine-member board of directors, elected at annual meetings, but it is supplemented by a four person supervisory 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.[96] 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.

Two agricultural co-operative banks

The Farm Credit System is a nationwide network of borrower-owned lending institutions and specialized service organizations. It provides 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 cooperatives. 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', has assets in excess of $246 billion, nearly 500,000 member-borrowers and more than 12,000 employees.[97] 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, it manages their relations with investors, and also provides consulting, accounting and financial reporting services. Agribank is the largest of the four banks, serving around 238,000 farmers, ranchers and other rural borrowers through 17 farm credit associations in 15 states. Its district covers over 40 percent of all the farmland and more than half of the cropland in the USA.

Why are these co-operatives so large?

Being government-sponsored, the system was big right from the start, covering the whole of the USA and lending not just to farmers but also to ranchers, timber harvesters and utility co-o-operatives. It was established in 1916 by federal law as a system of 'borrower-owned lending institutions'; 12 land banks were set up and $125 million provided by the government to get it started, then in 1933, a Farm Credit Administration was created to provide regulatory oversight. By the early 1980s, there were 37 banks and more than 1,000 local lending associations, but now after considerable consolidation there are only four banks and 78 local lending associations.

What is the ownership and governance structure?

Because of their close association with government, these co-operative banks may be regarded as quasi-public bodies, though they are genuine co-operatives. They have the same kind of three-tier structure as the European co-operative banks, with the local associations electing representatives to the boards of the four banks, and the banks in turn electing the board of the Funding Corporation. Agribank has a board of directors with 18 members, 16 of whom are farmers elected by the associations, plus two appointed directors. The Funding Corporation board of directors consists of nine voting members and one nonvoting member. The Farm Credit banks elect seven members (three members are elected from among the chief executive officers of the Banks and four members 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.

How is member centrality ensured?

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.

One mixed membership co-operative

Credit Agricole (CA) can just about be called a co-operative bank as it is majority-owned by local banks. It 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 6.9 million members. It has 54 million customers, many of whom are in Italy and Greece. In France, it has 24 percent of deposits, 22 percent of loans and 25 percent of the SME loans market[98]. It is ranked seventh largest bank in the world by assets. [99]

Why is this co-operative so large?

Though it has the typical three-tier structure of a co-operative bank group, CA was founded by the state and has until recently had a protected environment. It was founded in the 19th century by government as a state bank to meet the needs of farmers, but in 1988 it was converted to a mutual, and then recently at the national level it was converted again into a joint stock company. Having recently expanded into wholesale banking, asset management and insurance, and having bought Credit Lyonnais in 2003, it has become a major player.

What is the ownership and governance structure?

CA's central and regionals are listed on the stock exchange, but 30 regional banks own 56.3 percent of its shares through their holding company, SAS Rule La Boetie (in return, the central owns 25 percent of the share capital of the regionals). Institutional investors own another 27.9 percent, individual shareholders own 11.1 percent, and employee mutual funds own the rest. The regionals are themselves owned by 2512 local banks. Seen from below – from the point of view of individual owners – it has 6.9 million 'mutual' shareholders and 1.2 million investor shareholders. The mutual shareholders, or members of the local banks, elect directors to the regionals and own most of their share capital. They also have a parallel democratic structure in their national federation (Fédération Nationale du Crédit Agricole), where the Group's main 'orientations' are decided.

How is member centrality ensured?

CA 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 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?

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. In 2010, BPCE was fined for colluding with ten other banks in charging unjustified fees for cheque processing. Credit Agricole has been caught up in the Libor rate-rigging scandal, but is refusing to settle with the regulators and is fighting its case. 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. For people who are particularly at risk – those on low or uncertain incomes, and farmers who are at the mercy of the weather – it makes perfect sense to find ways of sharing it. 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) against personal accidents, house fires and so on, and life insurance that provides pensions and death benefits. They have also, through the democratic process, set up welfare states that spread the risk even further to whole populations. However, these are never able to cover everyone all the time, and so mutual insurance is often called upon to fill the gaps, particularly in health care and pensions.

Once a mutual is set up, members have an incentive to encourage its managers to expand it indefinitely; the more people are insured, the further the risk is spread and the cheaper the cost. Unlike other consumer-owned businesses such as co-operative banks and retail co-operatives, it can easily grow beyond national borders and become multi-national; the connection between the member and the co-operative usually extends no further than an annual premium. This is because actuarial science has enabled premiums to be calculated to cover known risks and because the insurers have created a reinsurance market to even out the risk from large-scale disasters. This, however, causes problems in governance since 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 members act like trustees. [100]

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. Agricultural co-operatives in particular have created some giant insurers to meet the needs of their members. Insurance and banking are similar, in that there is no real need for a separate group of investors provided the business can be self-financing in the long run. Just as banks recycle money, insurance mutuals recycle – or rather spread – risks, so that the idea of member-ownership becomes not just a statement of value but a real business advantage.

The largest insurance co-operative is Zenkyoren (Japan), a secondary co-operative owned by the agricultural co-operative federation, JA. There is one more secondary in the top 15: R+V Versicherung AG (Germany), which is part of the DZ Bank Group. There are seven primary co-operatives, often just called mutuals. Three of them are in Japan – Nippon Life, Meiji Yasuda Life, and Sumitomo Life – and four in the USA – State Farm Group, Kaiser Permanente, Nationwide Mutual, and Liberty Mutual. Despite the trend to demutualisation in the USA, the American mutuals are still significant players in the sector. This is the most common type of insurance co-operative, and there are four more in the top 15: Groupama and Covea in France, and Farmers' Insurance Group and New York Life in the USA. There are two co-operatives that are majority-owned by individual policyholders but part owned by other companies. Achmea (Netherlands) is majority owned by its customer-members through a holding company, though Rabobank also owns a minority stake. Mapfre (Spain) is similar, though it is quoted on the stock exchange and has a minority of investor owners.

One secondary level insurance co-operative

The National Mutual Insurance Federation of Agricultural Cooperatives (Zenkyoren) is a subsidiary of the JA Group that also includes the agricultural co-operative Zen-Noh (described in Chapter 3). It operates at the national level of the three-tier JA system. Its first task is to provide life and non-life insurance products for agricultural cooperatives 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 Y890 billions (approximately US $8.7 billion) in claims which it met out of reserves and reinsurance.[101]

Why is it so large?

Zenkyoren is a subsidiary of the biggest agricultural co-operative in the world, and so we can expect it to be big. It began in 1951 with fire and building insurance for farmers, then added children's, life, auto, medical and several other types of insurance. It grew with the system of which it was part.

What is its ownership and governance structure?

It 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. The local agricultural co-operatives liaise with members, deal with claims, and administer the policies. The prefectural bodies also deal with claims and 'support various activities carried out by the primary societies' but they are not as important as they were. At the national level, there is a 23 member supervisory board that is responsible for 'fundamental policies' and supervision of the business operations of the board of directors on behalf of the agricultural cooperatives. Then there is a board of directors (really a management board), consisting of nine people including the president, three senior managing directors and five managing directors. There is a standing audit committee of three people plus two auditors. This is what we can expect of an organization that is a subsidiary of an even bigger co-operative system. It does not in itself ensure member centrality, but it is part of a bigger system that does.

Three Japanese insurance mutuals

Nippon Life is the second largest Japanese 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. Sumitomo Life offers individual and group life policies and medical insurance and also does asset management. It has over 30,000 full time sales reps and seven million policyholders. In response to the growing need for nursing care to support a rapidly aging society, the Both Sumitomo and Meiji Yasuda are now nursing care insurance for Japan's ageing population.

Why are they so large?

They are all very well established businesses. Meiji Yasuda was founded in 1880, Nippon Life in 1889, and Sumitomo in 1907. In common with other insurance companies, they have grown through making strategic investments in companies around the world. Nippon Life, for instance, has recently entered into alliances with Allianz Group, one of the leading integrated financial services providers in the world; Reliance Group, one of the largest business houses in India; and the AIA Group, the largest life insurer in the Asia-Oceania region. In 1985 Meiji Yasuda became the first Japanese insurer to own a life insurance company in the USA. Through acquiring shares and making alliances, it has expanded into Poland, China, Indonesia and now Thailand. [102] Sumimoto Life has recently entered joint ventures that have enabled it to enter the market in China and Vietnam. They have also sometimes grown through merger: Meiji Yasuda, for instance, is the result of a merger in 2004 between Meiji Mutual and Yasuda Mutual.

What is their ownership and governance structure?

These mutuals have a variety of ways of keeping in touch with their large numbers of policyholder members. Nippon Life's governors have deliberately constructed a complex governance structure that is designed explicitly to foster transparency, member participation and a check on managerial power. They hold 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.[103] There used to be an annual general meeting of all members, but this became impractical (presumably because of the huge numbers who might turn up). Instead, in 1962 they moved to 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 group 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.

The representatives are put forward by a nomination sub-committee and elected 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 meeting of representatives elects a group of trustees from among policyholders and academic experts to act as an advisory body to the representatives and to management. 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 has a similar structure. It holds annual policyholder dialogues to put managers directly in touch with members (88 in 2012). It has a large policyholder representatives meeting, where 180 representatives have exactly the same powers to allocate surpluses, change the articles of association and appoint directors and auditors. It also has the same offshoot from this meeting of an expert panel of academics and policyholders called a board of councillors. The board of directors consists of 14 people, 11 of whom are managers and three outside directors, with sub-committees in which the outside directors are in the majority. Meiji Yasuda Life looks more conventional. It has a board of directors consisting of 11 members, including the chairman, four insiders and six outside directors. It has adopted the "company-with-committees" system to strengthen its management supervision functions and increase transparency. The logic of this is carried through into the Nominating, Audit, and Compensation Committees, each of which has a majority of outside directors.

Member centrality?

These mutuals remain 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 billion to members in dividends, carefully divided between individual and group policyholders. [104]

Four US insurance mutuals

State Farm Group is based in Illinois, and offers property and casualty insurance, life and health, annuities, mutual funds and banking products. It is the leading auto and home insurer in the U.S., and one of the leading insurers in Canada (though currently selling this business to Desjardins). 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.[105] Kaiser Permanente is an integrated managed care consortium, consisting of three entities: the Kaiser Foundation Health Plan (a health insurance mutual), 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 an integrated co-operative system). 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 over 9 million health plan members, more than 80 percent of whom are in 'group health' plans funded by employers.

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. [106]

Why are they so large?

State Farm Group was founded in 1922 by a retired farmer and insurance salesman. Originally a single line auto insurance company, it has diversified so it now offers nearly 100 products and services, in five different lines of business. Nationwide was founded in 1925 in a similar way, to provide auto insurance for farmers. Initially called the Farm Bureau Mutual, it relied on farm bureaus to help it gain business.107 By 1955 it had expanded so much it changed its name to Nationwide. It grew through an ambitious programme of acquisitions to become a 'family' of over 100 businesses, and in 2007 opened its own bank. Liberty Mutual was founded 1912 after the Massachusetts legislature passed a law requiring employers to protect their employees with workers compensation insurance. Quickly it went into auto and fire insurance and from 1964 life insurance. By the 1990s it had gone international in Spain and Latin America.

Kaiser Permanente was started in 1933 through a partnership between a medical doctor and the owner of a shipbuilding and construction company, to provide health insurance for construction workers employed on large engineering projects. From 1945 onwards, it began to employ doctors to run its own hospital. After a federal law was passed in 1973 encouraging integrated health maintenance organizations (HMOs) it became a full HMO and was able to expand beyond California. Its fortunes have fluctuated with those of the HMO business model. Its membership peaked in 1998 with around nine million health plan members and then fell back. Now, with the integrated health model finding favour again, it has recovered to about the same level.

What is the ownership and governance structure?

The three general insurance companies all have complex ownership structures with groups of companies under the umbrella name of the parent. They have relatively small boards of directors dominated by independent, professional directors appointed for their expertise rather than representativeness. Nationwide has always been a mutual but in 1997 it floated off part of the Group, Nationwide Financial Services, 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.[108] Nationwide has a conventional 16-member board, including the CEO, chair and vice-chair but consisting mainly of independent directors appointed for their expertise.

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. Yet it is still, as its website declares 'a mutual company owned by its policyholders'. The board has 12 members including the chairman who is also the CEO. The directors are independents: 'leaders in business and academia'. Liberty Mutual is a different story. 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. It also has a conventional board of directors of 12 members, all expert independents except for the Chair/CEO of the holding company, and the company secretary.

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 intertwined; the health plans provide infrastructure for and invest in the hospitals, while providing a 'tax-exempt shelter' for the medical groups [109] Each of the three businesses has its own governance structure, although as the website describes it 'all of the structures are interdependent and cooperative to a great extent'. The national-level apex body 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.[110] 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.

How is member centrality ensured?

Liberty Mutual 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. Kaiser Foundation Health Plan provides no way for its policyholders to have a vote. State Farm Group is still a 'mutual owned by its policyholders' but it provides no information on how they relate to the board of directors. [111] Nationwide, on the other hand, is interesting. 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.* [112]

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.

Two European mutuals with mixed ownership

Achmea 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 Netherlands and 4,000 in other countries. Mapfre 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. It is the leading insurance company in Spain and the largest non-life insurance company in Latin America. It is focused mainly in Spain, Europe and Latin America but also has a presence in USA and Turkey. It covers all types of insurance, and has more than 35,000 employees.

Why are they so large?

Achmea traces its roots back to 1811 with the founding of a mutual providing fire insurance to farmers. Through merger with 'like-minded insurers sharing the same co-operative background' in 1995 it emerged as an umbrella group, and then grew further when other insurers such as Interpolis (the Dutch insurance subsidiary of Rabobank) and Agis (the health insurer) joined. Mapfre is similar, growing through merger with smaller mutuals, and through buying businesses that has enabled it to expand into other countries. For instance, in 2007 it purchased a US motor insurer, and in 2010 a British travel insurer.

What is their ownership and governance structure?

Achmea is mainly customer-owned, but the merger with Interpolis brought Rabobank in as a minor shareholder. 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. The general meeting of shareholders appoints a 12 member supervisory 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'. The supervisory board oversees a five person executive board. A members' council at the Society regularly meet with the supervisory and executive boards to discuss the business.

Mapfre SA is a holding company whose shares are traded on the Barcelona stock exchange. It holds all the subsidiary companies that form the system, while a non-profit Mapfre Foundation owns the majority of shares.[113] 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'. Mapfre SA has a board of directors, and conventional sub-committees for audit, compliance and appointments and remuneration. It also has a committee representing insured customers in Spain, which listens to and resolves complaints (something they are attempting to replicate in other countries). There are regional councils, and advisory councils for health, corporate and agricultural business areas. However, there is no doubt that the main focus of boards of the 'system' is on governing on behalf of shareholders. The advisory and regional councils are appointed by the board of Mapfre rather than by the policyholders.

Each of the group's companies has a general meeting of shareholders, and their boards of directors can choose whether to have external directors. Mapfre SA's own board has a rule that the executives should not exceed one third of the directors, and at least one third should be independents. There is a long list of requirements that must be met by external directors; these are serious independent professionals. However, they are more like trustees, 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 is member centrality ensured?

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. There are probably enough checks and balances and there is an enviable attention to good governance, but the members are seen just as a group of shareholders, and the board members of Mapfre SA are self-appointing. In both these companies members can hardly be central to the business. These are more like non-profits with broader aims and more diffuse loyalties.

Have there been governance problems?

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 and Sumimoto Life in Japan – have found ways to involve members, if not in governance, at least in discussions about how well the business is governed. It goes together with a declared commitment to member centrality.

Conclusion

Academics often complain about the fact that their findings are too diverse and difficult to interpret. Usually this means they do not have an adequate theory with which to make sense of their data. The findings in this report are much more diverse than expected and they do not fall into neat patterns, but we will now attempt to make sense of them using the theory of co-operative governance outlined in Chapter 2.

The question of ownership

First, who owns these 60 largest co-operatives? Producers own 25 of them, consumers 35.[114] 22 of the 60 are secondary co-operatives (owned by primary co-operatives that are owned by individual members). 22 are primary societies owned by individual members, five have a mixed membership of both individual and corporate members, while six co-operative banks can best be described as groups consisting of both primary and secondary (and sometimes tertiary) co-operatives. This is a surprise; in a tightly organised system the distinction between primary and secondary breaks down. There are five that are majority owned by primary co-operative members through a holding company, which stretches the definition of ownership almost to breaking point.

The question of governance

Second, how are they governed? The variety in governance structures shows that there never was a single blueprint for good governance, and that co-operatives have adopted structures that they borrowed from others and then adapted over time. They have evolved, adapting to changed circumstances, mutating (perhaps with mistakes that have proved useful, as in biological evolution) and occasionally being redesigned. In some cases, one suspects, inertia has set in. The terminology is confusing, partly because of poor translation into English, partly because even the English-speaking co-operatives adopt different names for the component parts of their governance systems. The term 'supervisory board' which is often used in European co-operatives turns out to be just the same as 'board of directors' or even 'board of trustees' in the US context.

There are no neat divisions into two or three governance systems, such as the European two-tier model, or the US unitary board. Instead, imagine that you have to cut up a cake that in British culture would be called a 'Swiss roll' (or Yule

Log) – it is round and long, covered in chocolate and easy to cut into four pieces. The first piece is member voice, the base level of engagement with members that can be quite informal but is necessary in order to involve at least some members in governance. The second piece is representation, the channelling of the energy that comes from member involvement into a smaller set of elected representatives who can carry the members' voice into the governance structure. The third is expertise, which is needed to ensure that the business does not take unacceptable risks and works effectively on behalf of members, and the fourth is management, that puts all of this into practice. The problem is that the cake can be cut unevenly into the four pieces so that some are small and some larger; sometimes after three pieces have been cut there is no cake left – this is sometimes what happens to member voice that gets left out altogether.

Member voice is orchestrated by some of these co-operatives in innovative ways that are not too costly and work well – informal meetings that encourage exchange of views and information, and that motivate members to vote for their representatives. Without it, boards tend to be self-selecting and to engage in circular routines with nomination committees and complex rule-governed behaviour that ensures nothing but oligarchy. Representation is not difficult to organise, provided the members are divided into natural constituencies by geographical area or interest group. It tends to result in large, unwieldy boards and is better funnelled into an even larger representative assembly where, provided they have real powers, representatives can keep an eye on the board of directors.

Expertise is achieved by having a small, mixed board of representatives and appointed experts. Around half of the 60 boards have independent appointed experts on them, and we can expect more to follow. Most boards achieve some balance between representativeness and expertise by controlling the appointment of new board members through nomination committees. This can become undemocratic, particularly when they neglect member voice and make sure only their recommended candidates get elected. It is better to open up elections of representatives to competition while ensuring expertise through appointing extra independent board members. What should be the place of management? Most co-operatives have an executive board or committee of top managers that relates to a separate board of directors, but among our 60 co-operatives there are some interesting permutations. Having a large assembly of representatives enables some co-operatives to have a smaller, mixed board of directors and managers that seems to work well. It is all about the effective distribution of different types of authority.

The secret of good governance

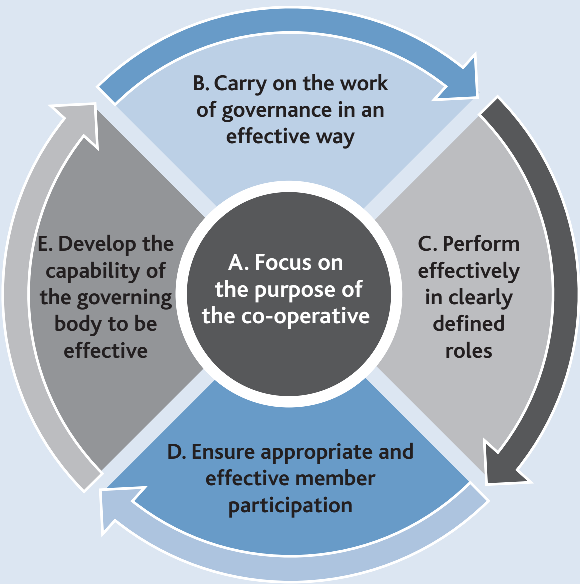
The first priority of boards of directors must be to ensure good governance in their existing system by adopting codes of governance. The co-operatives that impress are the ones that supplement these with ethical guidelines that go further than the codes, or introduce a rating system that grades the performance of different parts of their group, or state boldly the reasons why they do not comply with a particular code if this is out of line with their co-operative identity. From their websites, it is clear that some co-operatives have grabbed hold of the opportunity to improve their governance processes, and do not mind boasting about them. They have defined what governance quality looks like in practice. For co-operatives that want to go down this road there is plenty of guidance, not least that provided by Co-operatives UK (see below).

Corporate Governance Wheel

Co-operatives UK operates a number of quality standards, to guide co-operatives in relation to good governance. These include the Code of Governance for Consumer Co-operative Societies, the Worker Co-operative Code of Governance and a standard currently under development for agricultural co-operatives.

While there are significant differences across the three codes, there is also a recognition of shared elements that underpin each of these, in line with internationally agreed co-operative values and principles. These underlying components of the Co-operatives UK codes of governance are articulated in the Co-operative Governance Wheel.

Co-operatives UK
Corporate Governance Wheel



Those boards that want to redesign their governance structures should tread carefully. All governance is costly, but some is more costly than others, and there is good evidence that if it becomes too costly the co-operative will go out of business or convert to a different ownership type. 115 Sometimes doing nothing is more costly than redesigning the governance structure, and several of the largest co-operatives regularly adjust their representation to ensure fairness between regions and different types of member. This is particularly important in producer co-operatives, whose members are sensitive to any perceived unfairness.

Where should the four pieces of the Swiss roll be cut? There should be a piece reserved for member voice, because without this boards become oligarchic and complacent and members lose interest. Another piece should be reserved for representatives, because those who bring forward member voice into decision-making have the crucial task of keeping the business member-centred. A third piece should be reserved for outside experts who can bring both expertise and scepticism to the board, and who are not habitually inclined to trust the chief executive. A fourth piece has to be reserved for top managers, whose involvement in governance is crucial because their values have to be aligned with those of the members if the co-operative is to remain member-centred in practice. After this, exactly how the cake is cut is a question of judgement based on experience and mutual learning. The 60 large co-operatives worldwide cut it in slightly different ways, each intended to align governance with the core purpose and business model of the co-operative.

A diverse range of governance practices have emerged across the co-operative sector worldwide, reflecting different cultures and societies and giving expression in creative ways to the spirit of participation that infuses the co-operative model. There is a long way to go before we can provide a definitive account (see box: The need for more research). What we do know is that many co-operatives are striving to put into practice the four guiding principles of member governance outlined in Chapter 2.

The secret of good governance in co-operatives is to take it seriously, to invest in it, learn how to do it, and over time to test, prove and improve governance and business performance.

The need for more research

This report has begun to explore issues that need further research. We need to learn more about the relationship between governance and performance; are there ways of governing that bring business success? We need to learn from those co-operatives that have invented new ways of governing; are there innovations that can be spread widely to good effect? We need to ask the uncomfortable question about why some co-operatives may be unrepresentative of some types of member. In the UK, women's participation at Board level is reported to be around twice the level that holds for leading shareholder companies. But why, internationally, when we look up boards of directors on co-operatives' websites, are there are so many more photographs of older men and so many less of women, younger people and minority ethnic groups? The way to answer these questions is with a study that goes deeper into the routines and taken-for-granted worldviews of the participants and for this we need a series of in-depth case studies. Above all, we need to engage in some serious mutual learning on the question of how to ensure member-centred governance in very large co-operatives. I hope you agree that this report has been a good start.

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Endnotes

1 OECD (2004) p11

2 Euricse is the European Research Institute on Co-operative and Social Enterprises, based in Trento.

3 World Co-operative Monitor (2013). 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 The 'other services' and 'various services' categories will not be used

5 Aglietta and Reverioux (2005) ch.8

6 Stiglitz, J (2010) ch.5

7 See Birchall (2013a) ch.4

8 see Stout (2012)

9 Birchall (1996) p195-6

10 See Fulton and and Larson (2012)

11 Environment, Food and Rural Affairs Committee (2010)

12 see Birchall (1994) and Schediwy (1989)

13 These are personal recollections; I was the chair of the Education Committee of the York Co-operative Society between 1984 and 1987.

14 Wilson, J et al (2013) ps312-3

15 Aso (2012) p102

16 As above, p107

17 see for instance the new study of CWS

18 Birchall (2013a) ch.4

19 Myners (2004)

20 Penrose, quoted in Myners, 2004 p113

21 Myners, 2004, p102)

22 Birchall (2013b)

23 Birchall (2013a) ch.6

24 The Group is difficult to describe as it is the successor both to the old Co-operative Wholesale Society and many retail societies that merged in order to survive in the 1980s. It has a dual membership of other regional co-operatives and its own individual customer-members.

25 FCA quotation

26 Co-operatives UK has just launched its new code of governance for consumer co-operatives, and is developing one for agricultural co-ops

27 See Fonteyne (2007)

28 Personal communication from Professor David Llewellyn

29 Fonteyne (2007) p4

30 Fairbairn (2003) p2

31 Freeman et al (2007)

32 Fairbairn (2003) p7

33 Shah (1995) p25

34 Shah (1995) p62

35 Shah (1996) p25

36 Korea had moved from three to two tiers in 1981, Switzerland in 1983, but in others (Japan, several developing countries) the three tiers remained.

37 See Birchall (2010) ch.8

38 Hogeland (2002)

39 Turnover figures are all from the *World Co-operative Monitor* (2013) using 2011 statistics

40 Zen-Noh (2013) Annual Report, found at www.zennoh.or.jhp

41 Non-farmers who have invested some capital in the co-operative

42 NCAF Annual Report 2012, accessed at www.nonghyup.com

43 As above p9

44 At year end 2012

45 It is growing so fast that it is hard to keep up; on its UK website it says it is owned by 13,500 farmers and it may well be by now.

46 Danish Crown (2013) Annual Report 2012-2013.

47 Fonterra website, www.fonterra.com

48 As above.

49 The website is inconsistent, elsewhere quoting slightly different numbers

50 As above p19

51 2013 figures

52 it was called Minnesota Co-operative Creameries Association, but its brand of butter became so popular that in 1926 the association itself changed its name to ‘Land O’Lakes

53 Figures from the Annual Report for 2012.The website gives different figures – 3200 members and 1000 co-operatives.

54 This includes Dairylea, whose members have voted to merge with DFA in April 2014.

55 Baywa website, www.baywa.com

56 See Birchall (2010) ch.6
57 See Birchall (2010) ch.8
58 As above, ch.3
59 Information from Reuters
60 Baron (2007)
61 As above, p307
62 Suisse in French, Schweiz in German
63 In the World Co-operative Monitor for 2013 it comes first. It is difficult to estimate total turnover in co-operatives that spill over into several other countries
64 From Migros Faits et Chiffres, 2012: found at www.migros.ch
65 Coop Swiss Annual Report for 2012, p46
66 This includes SFr125 millions from the food business, and another SFr10 from the non-food businesses.
67 World Co-operative Monitor for 2013
68 Co-operative Group website
69 North Eastern and United societies were notable
70 Wilson et al (2013), p348
71 As above, p350
72 See Birchall and Simmons (??) Co-op group findings
73 See Birchall (2000) and Wilson et al (2013)
74 Here, Fagor is deleted and the ordering adjusted
75 See Birchall (2009)
76 In the World Co-operative Monitor listing, a Swiss village co-operative Elektra Rapperswil is listed, but this must be a mistake.
77 Copersucar website, www.copersucar.com.br
78 Bakaikoa et al, 2004. There is one delegate per 30 worker-members plus the standing committee members elected by the sub-group councils
79 Oglethorp Power Corporation bylaws, 2008
80 Eandis Articles of Association
81 MacLeod and Reed, 2009
82 See Birchall (2010) ch.8
83 www.ghcscw.com page on history
84 There is also a much smaller co-operative, confusingly also known as Group Health, of South Central Wisconsin that provides health insurance plans
85 HealthPartners, Inc. and Group Health Plan, Inc. (2006) Principles of Corporate Governance

86 Group Health website – see note 2
87 Information provided by Ana Alves
88 See Birchall (2010) ch.7
89 Language difficulties have prevented a clear exposition of this, but it should be better known.
90 Fundacion Espriu website
91 Hansmann (1996)
92 Information provided by Jose Perez of Espriu Foundation
93 Desjardins Group, 2012a
94 See Birchall (2013a)
95 As above
96 Information provided by Adam deSanctis of Navy Federal
97 Farm Credit System website
98 2009 figures. These were not updated in the ECBA statistics for 2010
99 Global Finance (2012)
100 Hansmann (1996)
101 Zenkyoren Annual Report, 2012
102 Meiji Yasuda Annual Report, 2012
103 Nippon Life Annual Report, 2013
104 Meiji Yasuda provides no information on which to judge its attitude in this respect
105 State Farm Group website
106 Liberty Mutual Annual Report, 2012
107 It is still promoted by nine farm bureaus that give discounts to members
108 Nationwide website
109 Kaiser Foundation website
110 Information provided by Beth Roemer, Senior Director of Kaiser Permanente Institute for Health Policy
111 State Farm Group website
112 Nationwide Mutual website
113 Sistema Mapfre Code of Governance
114 The two health co-operative groups – Unimed and Epriu – whose ownership is shared by both producers (medical doctors) and consumers (health plan policyholders) might more accurately be classified as producer-owned because the doctors own a majority of the shares
115 Hansmann (1996)

About the author

Johnston Birchall is Professor of Social Policy at Stirling University and Co-operatives UK Advisor on International Co-operative Governance. His focus is on member-owned businesses and public service agencies that involve users in their governance. He has written several books on these subjects (with translations into seven other languages), including *People-centred Businesses: Co-operatives, Mutuals and the Idea of Membership* (Palgrave Macmillan, 2010) and *Finance in an Age of Austerity: the Power of Customer-owned Banks* (Edward Elgar, 2013). He has advised the UK government on governance of mutual insurance and hospital trusts, and UN Agencies on cooperatives, poverty reduction and responses to the global economic crisis. His most recent report, for the International Labour Organisation, is called *Resilience in a Downturn: the Power of Financial Co-operatives*. This report and research builds on his 2013 report for Co-operatives UK, *Good governance in minority investor-owned co-operatives*.

Co-operatives UK

Co-operatives UK works to promote, develop and unite co-operative enterprises. It has a unique role as a trade association for co-operatives and its campaigns for co-operation, such as Co-operatives Fortnight, bring together all those with a passion and interest in co-operative action.

Any organisation supportive of co-operation and mutuality can join and there are many opportunities online for individuals to connect to the latest co-operative news, innovations and campaigns. All members benefit from specialist services and the chance to network with other co-operatives.

www.uk.coop

The subject of governance has become a hot topic for all types of business, and co-operatives are no exception. Governance in member-owned co-operatives is distinct from that in investor-owned businesses and this research helps us understand how this operates in practice.

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