The Forward March of Co-operation Halted?

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first published in The Spokesman (for the Bertrand Russell Peace Foundation) in 2014

2012 was a great year for the Co-operative Movement. The United Nations gad designated it as International Year of the Co-operatives. Dame Pauline Green President of the International Co-operative Alliance addressed the United Nations and UN Secretary-General Ban Ki-moon told the world that,

> 'Co-operatives are a reminder to the international community that it is possible to pursue both economic viability and social responsibility.'

Co-ops UK and the Co-op Group rose to the occasion with a major conference and exhibition in Manchester called Co-ops United' (apologies to City fans!) Even David Cameron was swept along by 'Big Society' rhetoric and agreed to support one of the objectives of the year, governments' consolidation of co-op legislation through a new Co-operatives and Community Benefits Societies Act. Corporate capitalism was on the ropes; the co-operative and mutual sector had weathered the banking crisis and and was growing. Entering 2013, Co-ops had never had a more favourable press; in the public's eyes we were 'a good thing'.

Then the sky fell in; 9th May 2013 was the day of reckoning, when the ratings agency Moodys's downgraded the Co-operative Bank's debt rating to 'junk' status. It said the bank was vulnerable to potential losses and warned that it may need 'external support' if it could not strengthen its balance sheet. The Bank said it was 'disappointed'; chief executive Barry Tootell resigned, and Project Verde, the bid to buy 631 branches from Lloyds bank, collapsed.

The enemy was inside the gates; US hedge funds (described as 'vulture funds') Silver Point Capital and Aurelius Capital management now had significant stakes in the Co-op Bank. They had their chance to do to the Co-op what they usually did with the distressed assets of developing economies. Moody's, ever helpful in these matters, said that the Bank will be forced have to 'take the axe' to costs. For banks this is not new. Other banks have had to be recapitalised, some even taken into public ownership.

But the banking environment had dramatically worsened; ultra low interest rates having destroyed the margins in retail banking.

Aspects of this crisis, of course, had been caused by the bankers themselves, by their ridiculous growth strategies, reckless lending, and taking risks on products they did not understand, in a mad, greed-driven feeding frenzy. That is not to offer an excuse. The Co-operative Bank was supposed to be different; we had encouraged people who had an ounce of ethics to 'switch their money'. Now, thanks to the effective demutualisation of the bank, and the exposure of the private life of its chair, the 'Crystal Methodist' Paul Flowers, that switching was going in the wrong direction.

As Professor Johnston Birchall has said,

> 'when a conventional investor owned company fails people ask why it has failed. When a co-operative fails, people ask whether co-operatives can ever be made to work.'

This débâcle created a new 'investigation' industry. Externally the Co-op Group is now subject to to regulatory investigations by the Financial Conduct Authority, The Prudential Regulation Authority, and the Financial Reporting Council. The failure of the Bank has also been the subject of Treasury Select Committee hearings, and then there is the independent review by Sir Christopher Kelly, commissioned by the Group itself. Before any of these bodies could report, we found ourselves in the Alice in Wonderland position of 'verdict first, evidence later'.

Since the collapse of the Co-op Bank and its recapitalisation, there has been a clean sweep of the management following the retirement of Group Chief Executive Officer, Peter Marks, who was replace by former Kingfisher plc Chief Operating Officer, Euan Sutherland. He quickly recruited a completely new management team who wasted no time in calling for a review of the organisation's governance. In the process, they appealed over the heads of the board and elected members to individual members through a strange opinion poll run by YouGov, inviting customers and members to 'Have Your Say'. Pundits and activists alike soon saw through this crude polling.

Sutherland's view seemed to be there was no time to waste, and the governance of the Group was at fault and had to be reformed. Lord Myners was made a Senior Independent Director of the Group, and asked to lead 'an independent review of the Group's governance'. Myners had previously lead a review of the governance of life mutuals (to which, incidentally, the Co-operative Insurance Society had submitted evidence – pointing out that 'the co-operative model of trading is particularly conducive to strong corporate governance in that it involves democratic participation by customers'.)

There is no doubt that governance in large organisations is a concept with several strands. Clearly there is the question of the structure of the organisation; is there something inherent in large-scale co-operatives that makes them difficult to govern? Was there a healthy culture at the group, i.e. was there an open and respectful relationship between those who represented the interests of the members and the professional management?

Finally, what of the qualities of the key personnel, the senior executives of the Group and the Bank, and the lay chairs of the Bank and the Co-op Group?

It seems odd that Myners should begin his work before Sir Christopher Kelly, former chair of the Committee for Standards in Public Life, had concluded his report, as his job was to look at the trail of poor decisions that led us to this situation:

> 'to look at management structure and culture in which those decisions were taken; lines of accountability which governed those decisions; and the processes which led to them … To identify lessons which can be learnt to strengthen the Co-operative Bank and the wider Co-operative Group, ad the co-operative business model generally.'

It seemed like putting the cart before the horse.

During the year all this was going on, the Co-operative Wholesale Society (CWS) celebrated its 150th birthday, and the occasion was marked by a splendid book entitled Building Co-operation . This first business history of the Group is an impressive piece of scholarship, as the CWS is one of the best documented businesses anywhere in the world.

In all those 150 years, there has never been anything quite as extraordinary as the current crisis. Yet, like all long history, if you look carefully, as Marx pointed out, it does tend to repeat itself.

The obvious precursor was the collapse of the Scottish Co-operative Bank in 1973. The bank had been investing in what were called Sterling Certificates of Deposit without the full knowledge of the board of Scottish Co-operative Wholesale Society (SCWS). When it was clear that it could not meet its obligations, and no other bank would lend to it, a quick marriage between the SCWS and the CWS was arranged, and more than 100 years of independent trading came to an end in just a few weeks. Prior to the collapse of the Scottish Bank, the SCWS marked its centenary with an new headquarters building opened in 1968 by Her Majesty the Queen. Today the building houses Glasgow Council Offices.

Many of us attending recent Co-op Group annual and half-yearly meetings have been watching the construction of 1, Angel Square, the Co-op Group's new palatial headquarters in Manchester, with some trepidation. Was such aggrandisement a sign of hubris on the part of a Chief Executive, which almost always spelled disaster? Also to be opened by the Queen, Angel Square became subject to a sale and lease back, which was described by lord Myners as an expensive addiction. Yet, even the most cynical could not imaging the disaster that was to come.

Today's crisis is the biggest since 1997 when the Lanica Trust attempted to take-over and demutualise the CWS, backed by such City luminaries as Hambros, Schroders, amd Nomura. That time we fought them off and, in so doing, learned lessons that sparked a revival based on two things: a common brand, and a degree of consolidation. The branding was effective, meaning that travel, pharmacy, funerals, food, insurance and banking were all clearly part of the same business. The idea was to encourage cross selling and reduce marketing costs.

Consolidation was another story. If any one individual is associated with this drive, it is Peter Marks, who argues for a single national co-operative society. His climb to the top was thanks to a series of society mergers rising from Chief Executive Officer of Yorkshire Society, via a merger with United Co-operatives, to CEO of the Group, when United in turn merged with the Co-operative Wholesale Society.

Many people had misgivings about the way elected members had been persuaded to support these mergers with large pay-offs for loss of office. Grudgingly, most commentators felt that the Co-op was at least back on the map. Mergers had brought some efficiency savings, but Marks thought that the Group was still too small to compete effectively with its rivals.

Building Co-operation has a section on Marks and the 'Renaissance'. In retrospect, the word is quite rightly in inverted commas. Len Wardle became group chair in 2007, and Marks CEO in 2008. the authors argue that Wardle offered Marks 'constructive criticism'. It is hard to see anything constructive about this partnership.

Absorbing retail co-op societies into the Group was one thing, but now the target was non co-op businesses. Marks' predecessor, Martin Beaumont, had looked at the acquisition of the Somerfield Group (also an aggregation of other businesses, including Kwik save) and ruled it out as too difficult to absorb. Marks and Wardle had no such fears and, in March 2009, they paid £1.57 billion to make the purchase.

Euan Sutherland, before he left (after his exorbitant pay had been revealed), had told us that this year the Co-op group will lose over £2billion. Mostly, it would appear, this is from ill judged acquisitions which, according to Myners, are 'breathtakingly value destructive'; one of those acquisitions was the purchase of Somerfield.

The biggest act of value destruction, however, was the Co-op Bank's merger with the Britannia Building Society. The public pillorying of the elected chair, Paul Flowers, has masked a key issue in that failure – the role of the managers and the independent non-executive directors (IPNEDs), favoured by Mynors.

The Co-op Bank has never been a co-operative. It began life as the Loan and Deposit Department of the Co-operative Wholesale Society, back in 1872, and 99 years later it became a public limited company (PLC) and a subsidiary of the Co-op Group. The Directors have never been elected. They were appointed by the main Group board and, to overcome any skills gaps, in recent years they have included independent non-executive directors from the financial services and banking industry. Of the appointments, there was a minority of elected members. The 2012 annual report states:

> 'Of the 11 Non-Executive Directors four are elected members of the Co-operative Group Board, two are Co-operative Group Executives and five are independent and recruited for their specific financial services experience and expertise.'

All the key roles on the operational sub-committees of the board were taken by banking professionals of some standing. The chair of the risk committee, which had responsibility for 'the management and control of all significant risks, including technical, operational, business model and external risks', was Merlyn Lowther. Her name may be familiar; as chief cashier of the Bank of England her signature was on our bank notes for four years.

Other board members included Peter Harvey, ex-chief executive of UK Business Banking at Barclay's, and William Hewitt ex-Group finance Director of the RAC, who was chair of the audit committee.

Then there are the external auditors, KPMG, who gave the Co-op Bank a clean audit, including a review of its corporate governance statements by Andrew Walker, an Audit and Transactions Services partner in KPMG's Financial Services practice.

The man who facilitated the merger with Britannia was Tim Webb of J.P. Morgan Cazenove. Mr Webb is an exceptional banker, according to Cazenove's website. He represents 'the stability of our management team and the depth of talent that allows us to maintain consistent service to clients year after year'.

That Britannia deal was a disaster. Whatever political pressure there was, it was clear that now something needed to be done about Britannia, and Nationwide could not swallow any more failing building societies. The Co-op Bank was a prudently run, fairly boring bank; indeed there was a time when the board had consisted solely of completely risk averse elected members.

Britannia was loaded with all sorts of toxic debts in both residential and commercial property. The new Chief Executive Officer of the combined business was Neville Richardson, the former CEO of Britannia, making it a sort of reverse takeover. Peter Marks, the Co-op Group CEO, determined to grow the business by acquisition.

The stage was set for the step-too-far, which finally brought the Co-op group to its knees: Project Verde. Collectively, these bad debts have left the Group carrying far too much debt. The dander is the Group would no longer be owned by its members but by the banks or, worse, the same bond-holders who prized open the bank. Reducing the debt is the key challenge.

Academics attribute Co-op failures to three key factors, ‘badly thought out business strategies, paying too much for acquisitions, and boards being out of their depth’. They rarely point to the ‘over weaning CEO’ or non-co-operative managers. That is what I think is the real problem here. Co-operative governance relies on mutual respect and understanding between professional managers and representatives of the members and a common set of values.

Sir Graham Melmoth, an earlier chief executive of the Co-operative Wholesale Society, publicly stated that Peter Marks would not know a co-operative principle if it crept up and hit him in the face. As a former President of the International Co-operative Alliance, he was in a particularly strong position to make that statement. Whilst he was CEO, he instigated a co-operative values and principles programme – developed and run by the Co-operative College – for all senior managers. Sadly, that programme was allowed to lapse when leadership in the CWS changed. Surely such training in co-operative identity should be mandatory for all in leadership positions – be they managers or elected representatives of the membership. This gap is perhaps one of the factors in the governance failure.

I would argue that there has, indeed, been a failure of governance at the Co-op Group, but it is not as simple as the one put forward by Lord Myners. The failure is much more comprehensive and systemic. It includes the whole purpose of the business, the relationship with members and their representatives, and the management.

There is a critical crisis of co-operative education, which has failed to produce elected directors or managers with the qualities to run a large scale *co-operative* business. This argument was best expressed by Peter Davis in his work on Co-operative Management.

When the Co-operative Bank was under the leadership of Terry Thomas, with his 'Inclusive Partnership plus Sustainability' model of management, he was offering us a model of a co-operative, value-based management. His philosophy focussed on membership as the key. He recognised the social mission at the heart of what being a co-operative really means and demonstrated how, with good market research, it could be re-interpreted for the modern age. In so doing, the bank's advertising and branding did not simply reflect what the members wanted, it enlarged what they wanted, it educated them. This is the key point. All the surveys that put the Co-op at the top of any ethics survey are a legacy of this period. Not only did this recreate the co-operative brand, it also generated record surpluses to the CWS/Group, keeping the whole retail movement afloat at a critical time.

One Thomas went, however, the rot set in. The ethos faded. We had lost the *Co-operative Bank* long before the hedge funds got their talons into it. This is the real tragedy. The Co-operative Bank, the only real post war success the movement had, has been wiped out by a combination of charlatans and poorly educated idealists.

Is the situation recoverable? Mondragon in the Basque region of Spain, which until recently was roughly the same size as the Co-op Group, has its own University. Across Europe there are institutions delivering the new co-operators as far apart as Italy and Finland.

This year the Co-operative College will be incorporated and able to redevelop itself. The mission we have is to rebuild co-operative education; this will not be cheap, but it is a vital investment.
Without the necessary skills, firmly rooted in co-operative values, we will be doomed to repeat this cycle. We have to do this ourselves; build a co-operative organisational culture, as there is no one else to do it. Otherwise, we will simply keep re-infecting ourselves with the same alien and fundamentally non-co-operative culture.

The last generation of co-op managers to come from the old home of the College at Stanford Hall in Leicestershire included Ursula Lidbetter of Lincolnshire Co-operative Society, and current Group chair. Maybe that is a small glimmer of light.

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Black Country Bloke @ Large

In May 2014, the Co-op Congress in Birmingham could have been a very miserable gathering, given the events around the Co-operative Group. Ironically, if it had not been for that crisis around our biggest member, this would have been one of our best years ever. There are more than 15 million memberships in over six thousand co-ops in the UK and, despite the travails of the Co-op Group, turnover in the sector is up to £37 billion.

I was particularly delighted that Yorkshire based Suma, the wholefoods distributor, was named co-operative of the year. Suma is a worker co-operative with 140 owner/members, no hierarchy, no chief executive officer, and a radical commitment to equal pay. It turns over £34 million a year, and has doubled sales in the last decade. Last year it was able to pay a well deserved bonus of £4,750 to each and every owner/member. To celebrate, they received a visit by current TUC President, Mohammad Taj of UNITE, to mark Employee Ownership Day on 4th July 2014.

There were other bright spots at Congress, too. On the Friday before, we went down the Pershore Road in Birmingham with International Co-operative Alliance President, Pauline Green to launch Britain's first ever student housing co-op. If any section of society has been shafted by austerity it is young people. The Students Co-operative Movement grew out of the anti-fees movement. They argue that students have been led up a cul-de-sac by student union politics as a training ground for New Labour apparatchiks. Rather than passing resolutions and waiting, they decided to get on and do things for themselves. They began with student food co-ops and bike co-ops, and now they are trying to challenge the dreadful blight of poor quality housing and exorbitant rents. This new housing co-op has received substantial financial support from the Phone Co-op and technical support from Birmingham Co-operative Housing Services, a very good example of Co-op Principle Six in action – Co-operation amongst Co-operatives.

Whilst there was no escaping the shadow of the Co-op Group, there was a confidence and vibrancy at congress this year. Sensibly, we had changed the format to make the whole event as participatory as possible under the theme ‘Co-operation How?’

The debates focussed on two main issues: how do we promote the co-operative message and secure our identity? How do we take participation in Co-operatives to the next level? BBC business news reporter Steph Mcgovern, who acted as facilitator, commented that it was the best conference format she had ever experienced. Hopefully, we have begun the process of making Co-operatives UK an open, democratic, participatory learning organisation, truly practising what we preach.

The sponsor of this years’ congress was symbolic of a new, deepening relationship between co-operative and trade union movements. It was Unity Trust Bank, itself a result of such a partnership, and now marketing itself as ‘Proud to Bank Co-operatives’. Also involved were the Musicians’ Union, who are working to develop worker co-operatives to protect musicians who work in entertainment and in music education.

One of the best and most articulate contributions to the weekend’s discussions came from Patrick Roach, Deputy General Secretary of the National Association of Schoolmasters Union of Women Teachers (NASUWT), who spoke at the annual meeting of the Co-op college about the challenges in education and the opportunity that Co-operative Schools present. The rate of Co-op Schools development has been incredible, and we are now working on a proposal to get the law changed so that they can be formed as Co-ops on a proper legal basis.

Other success stories included the work done by Peter Couchman and the Plunkett Foundation, who have worked tirelessly to protect pubs for their communities. They have estimated that community ownership has so far helped to save 4,000 years of pub history.

Of course, we could not have a party without an end of the pier show. Except, rather than an end, this was a new beginning, as Simon Opie explained how Community Ownership had raised some £600,000 to save Hastings Pier. He explained that the previous owners had not understood that the pier was vulnerable to the sea (!), and they had been required to rescue it from the dead hand of private ownership. Clearly the home of Robert Tressell still has some Ragged Trousered Philanthropists working to make a better world. There is a lot of work to be done and we are not out of the woods with the Co-op Group yet, but the event does give us some space for quiet optimism.

Nick Matthews
2014