

# Employees as Stakeholders within Co-operatives

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## Introduction

The success of any enterprise depends on harnessing the skills and interests of all the stakeholders. Co-operatives will have an advantage in that respect if stakeholder interests can be built into their legal constitutions. In theory, it is a matter of building in the appropriate interests for the job in hand. In practice, finding the right balance has led to much debate. In particular, the competing claims of employees and consumers to control the co-operative enterprises in which they work or from which they buy and to share surplus from the enterprise has been controversial throughout co-operative history. This paper considers: how the polarisation between "consumer" and "worker" co-operatives developed in the UK; how certain "co-partnership" societies survived; the constitutional position of employees in UK consumer co-operatives during the last century; some international "Co-partnership" examples; the application of these international and historical cases to the new thinking about the role of employees crystallised in the Co-operative Commission Report; and their relevance application of the bona fide co-operative test by the UK regulator.

## The path to polarisation

The Rochdale Pioneers initially operated their Toad Lane store with voluntary labour and had no need to address the issue of employee representation or profit sharing in their first rules. The consumer "divi" alone prevailed. However, as soon as the pioneers extended into productive activity, founding the Rochdale Co-operative Manufacturing Society, employees received a proportion of the profits equal to that received by the holders of capital. Success with a first cotton mill led to acclaim for the system but also to plans for a new mill. Capital for that was raised but the many new shareholders sought to abandon the employees' profit share to improve investment return. That pressure prevailed and the enterprise became a traditional joint stock company returning profits to capital holders only.

The pioneer co-operators were shocked at this outcome. Abraham Greenwood (inter alia first President of CWS, founder of CIS) observed that despite this outcome, "The original promoters

never lost confidence in the principle of profit sharing". Another pioneer, William Cooper (later first secretary of CWS and CIS) declared - with a feeling that would resonate with today's opponents of de-mutualisation - "It appears to me wrong for persons to enter a society with whose principles they disagree, and then destroy its constitution."<sup>1</sup>

It is significant that the original Chairman of the Manufacturing Society was J T W Mitchell. Later as Chairman of CWS he was the champion of exclusive consumer control and consumer dividend as the only safeguard of co-operative enterprise - driven with a zeal that could probably be traced back to his experience in his pioneer days at the hands of the "little capitalists".

Some new productive societies were set up in various trades, with employees sharing in the profit as shareholders. Others continued from Owenite foundations. However, the experience of the Pioneers led them to secure production and other services through the organisation that was to become the CWS. With the development of productive capacity in CWS factories and Parliamentary lobbying for appropriate legislation to allow it to extend into new fields (literally with its farming interests), opinion in the co-operative movement polarised between advocates of exclusively consumer-based models and proponents of the right of workers to a share.

For a while CWS paid a worker bonus out of profit in its factories. In the Scottish CWS, employees in the mills could take a real stake through the "Employees Investment Society" which used employee bonuses to buy shares in the SEWS which, jointly held, also carried the right to employee representation at SCWS general meetings. (An approach clearly well ahead of its time and echoed in some modern stakeholder and ESOPs schemes.)

These schemes show that the law allowed such participation, but they did not survive. CWS, led by Chairman J T W Mitchell, ceased the employee bonus, opting for an exclusively consumer co-operative model and won the theoretical argument of the time with the assistance of Beatrice Potter (later Webb), who captured the intellectual high ground through her writings, notably *The Co-operative Movement* published in 1889. She gave examples of practical problems and condemned worker models as self-help organisations which created a myriad of small worker capitalists. This, she concluded, would not "moralize" business and was not the road to socialism. A century later, the arguments for self help and wider share ownership are seen in a positive light by a wide range of business theorists and politicians. But her analysis carried the day and consumer co-operation, driven by the rapid commercial success of CWS at its heart, dominated UK co-operative thinking in the 20th century.

## Co-partnership societies

Despite the dominance of consumer control, some societies recognised both consumers and employees in their constitutions. A survey by Ben Jones in his book *Co-operative Production* (published in 1894) gives many examples.

After the general polarisation outlined above there still remained strong advocates of joint control, including Edward Vansittart Neale (General Secretary of the Co-operative Union), George Jacob Holyoake, (co-operative historian and propagandist) and Edward Owen Greening, (active in many co-operative initiatives and prominent in founding the International Co-operative Alliance). The involvement of such figures demonstrates that the joint model satisfied the test of being legitimately co-operative in law and practice. E V Neale was closely involved with initial I&P legislation in the 1852 Act and virtually drafted the consolidating Act of 1876. As an advocate of co-partnership, he presumably had a feel for how inclusive the I&P legislation was intended to be.

To promote and help such organisations, Greening and others, mostly from a Christian Socialist background, formed the Co-operative Productive Federation. The founders also drew inspiration and method from the work in France of J B Godin, who had built on work of Philippe Buchez (whose models for worker co-operatives predated the Rochdale Pioneers), and Louis Blanc, who had secured state aid for worker co-operatives after the 1848 revolution.

In framing rules for the British societies - such as those devised for the Leicester Co-operative Boot and Shoe Manufacturing Society Ltd (Equity Shoes) - Greening and his committee tried to follow the principle that "every element in production ought to participate in the results, in the proportion of the services which it renders".<sup>2</sup> The logic was to ensure that every stakeholder would have real interest in the success of the enterprise. In the Leicester example they apportioned profit: 40 per cent for employees; 20 per cent to customers; 12 per cent to directors; 10 per cent to holders of share capital and the balance into a selection of their provident and educational funds.

Although never a large sector, the co-partnership societies sustained themselves into the 20<sup>th</sup> century principally in the clothing, footwear, and printing trades. These co-partnership societies, with their mix of consumer and employee control and share of profit provide a helpful precedent. They were registered as co-operatives under the Industrial & Provident Societies Acts, already in substantially the same form as current legislation.

In 1935, forty-two such societies existed. Forty per cent of their total membership was employees. The proportion of employee

board members was even greater. In 31 societies providing details, 179 out of a total 294 board members were employees. Regardless of the ideological and practical issues, neither the law nor the regulator inhibited employee representation.<sup>3</sup>

### **The co-partnership legacy - current UK experience**

Societies on the co-partnership model have not disappeared from the UK co-operative scene. The Productive Board, administered by the Co-operative Union, represents a number of them, including, for example, Queen Eleanor Ltd, which supplies work wear and other clothing.

Their 1994 rules provide for a board of "the president, manager, secretary and seven directors, four of whom shall directly be employed by the society, one not employed by the society and the remaining two shall be representatives of shareholding societies". Payments from surplus go to: "the workers employed by the society in proportion to their wages or salaries during the period to which the surplus relates"; to customers of the society "in proportion to their purchases during the period to which profits relate"; and to "the holders of share capital interest, in proportion the amounts paid up on their shares" (with a 7.5 per cent limit).<sup>4</sup>

### **The consumer movement legacy**

For the consumer movement, the role of employees on boards and in profit sharing remains problematical. After the ideological split and polarisation into separate consumer and worker movements, the consumer movement was unsure how to give recognition to employees without ceding power. Co-operative Congress commissioned studies and a 1919 Survey Committee Report suggested that societies experiment with employee representation on boards. Some societies introduced rules to allow this.

By 1939 around 80 societies allowed employees to stand for election and in 60 they had successfully done so. But in that year the Co-operative Union suggested that "Whilst there may be exceptional cases, in the majority of instances it is not to the advantage of co-operative societies to permit employees to occupy seats on management committees." If it were permitted there should be a limit of two candidates elected by employees who would not be able to vote for any other candidate. In suggesting limits, the Union pointed out that compared with their counterparts in other retailers, co-operative employees enjoyed higher wages, shorter working hours, and better job security.

In the second half of the 20<sup>th</sup> century, retail co-ops suffered intense competition and their pre-eminence as employers was

eroded, but employee representation on boards varied from society to society. It often exceeded the limits suggested earlier and the combination of employees with retired employee board members (whose director numbers were often unlimited) could exert considerable influence on society affairs. That tendency led many societies and, latterly, the Registry of Friendly Societies to impose tight limits in the rules.

Currently many societies aspire to "empower" employees. To date this has typically involved providing courses to imbue them with the cooperative ethic and encouraging them to become consumer members and to take part like other members - subject to the limits on board representation. It has not meant building them back into the constitution as separate stakeholders.

However, the issue is now being reconsidered in some societies. Since the law tends to follow rather than lead cultural change this desire for new models, even in traditional established co-operatives, is an encouraging sign.

### **The Co-operative Commission**

The Co-operative Commission<sup>5</sup> deals with employee members and employee directors in consumer co-operatives directly in Recommendation 31.2.:

Employees should be recognised as important stakeholders and should be encouraged to participate actively in the Society's internal democracy via a reserved employee member constituency with at least two seats on the Board. Employees may continue to stand as consumer representatives but the total number of employees on the Board (in any capacity) should not exceed one third.

Since the Co-operative Union stance of 1939, the movement has progressed from conceding a maximum of two to suggesting a minimum of two. The one third ceiling prevents the recommendation from seriously affecting the legal position of employees in the constitution. Nevertheless, it is, potentially, an important change in the culture of retail co-operatives when taken with the other Commission recommendations. It will be for individual societies implementing the report to determine whether this change will represent enlightenment or tokenism.

### **International experience**

There are examples of multi-stakeholder co-operatives in a number of countries particularly in the emerging health/social welfare sector

in Japan, Sweden, Latin America, France, Spain, and Italy. However, co-operatives in that sector generally continue to follow a national single stakeholder model with a government agency or a mutual insurer as the additional stakeholder. Some models integrating employees and consumers exist. For example, the April 2000 *Journal* of the Society for Co-operative Studies, describes the combined worker and consumer ownership of Weaver Street Market, a natural foods co-operative in North Carolina, USA.<sup>6</sup>

The experience of the Spanish Mondragon organisation is recognised as a paradigm for modern co-operation. In 1968 Eroski was formed under the Mondragon umbrella to bring together existing consumer co-operatives within a single organisation. Membership is in two categories - the employees who operate the supermarkets and other outlets and the consumers who buy from them. Rather than a traditional "divi", consumers receive a discount. The Governing Council has equal employee and consumer representation, although the chair is held by a consumer member.

Mondragon has expanded taking in other consumer co-operatives, dual membership has not always been pursued but, failing that, new workers are offered membership of a separate co-operative, owned 50 per cent by Eroski and 50 per cent by the employees to provide similar benefits to employee members who elect half of the governing council.

The strong worker co-op tradition in Spain and different legal structure from the UK prevent an easy assumption that such success can easily be transplanted. But this example demonstrates that dual membership and control can operate legitimately within ICA principles - the favoured registration criterion of our regulator, the Registrar - and with commercial effectiveness.

## **Conclusion**

Even outside the classic worker co-operative and common ownership movement, representation by employees on co-operative boards has a long tradition and examples of "mixed" boards currently exist both in the UK and elsewhere.

In the UK consumer movement employees have not taken board places as stakeholders. They have occupied board seats via the inappropriate consumer membership route. Fear of dominance by employees through that route has then provoked limitations by rule on employee board places. Might this experience of the traditional consumer movement inhibit draftsmen and regulators in developing models for new co-operatives for joint initiatives of consumers and employees, for example, in social care or utilities?

This need not be so. Work by bodies such as the UKCC and

Co-operative College and recent closer liaison of the Co-operative Union, ICOM and the UKCC provide opportunities to improve understanding and generate new ideas. The Co-operative Commission has set the scene for cultural changes from which legal changes may flow. The development of new mutual structures under the existing legislation opens up other opportunities to recognise employees as stakeholders. The new openness of national and local government bodies to participative and mutual forms of service provision enhances the positive climate.

The representation of employees on boards has generally been determined by opinion and pragmatism rather than law. Given the new positive climate of opinion, the Industrial & Provident Societies Acts can accommodate both consumers and employees as stakeholders in various proportions. Modern overseas examples also demonstrate that mixed board representation can satisfy the ICA Principles. They provide the main criterion used by the Registrar of Friendly Societies and the Financial Services Authority in defining a bona fide co-operative under UK industrial and provident society law.

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#### **References**

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#### **Notes**

- 1 Bonner, Arnold *British Co-operation* Co-operative Union, 1961 p54.
- 2 Greening, E O A *Pioneer in Co-Partnership - The History of the Leicester Co-operative Boot and Shoe Manufacturing Society*, 1923.
- 3 Co-operative Co-Partnership Propaganda Committee *Co-operative Co-Partnership*, 1935.
- 4 Queen Eleanor Limited 1994 *Rules* nos 45 and 77.
- 5 Co-operative Commission, *The Co-operative Advantage: The Report of the Co-operative Commission*, Co-operative Commission, London, 2001.
- 6 Coleman, Daniel A *Combining Worker and Consumer Ownership: The Experience of Weaver Street Market Journal of Co-operative Studies*, 33.1, April 2000 pp7-14.