Co-operative Opportunities and Co-operative Advantages

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This paper considers how co-operative and mutual organisations can be structured to include excluded groups; to focus directors' legal duties on issues *other than maximisation of shareholder value; and* so *operate successfully in circumstances in which investor-controlled companies may fail. Conclusions are drawn about the role of employees in consumer co-operatives and the opportunities available to those societies in developing new relations with their employees and the wider application of the Co-operative Advantage advocated in the Co-operative Commission Report.*[1]

Setting the Scene

The origin of the two statutory forms of industrial and provident society currently recognised - the bona fide co-operative and the community benefit society - was not a carefully thought out approach to the effective registration of co-ops and other mutual organisations. They arose from the need to resolve a problem with share-pushing in the company sector. The prospectus laws for companies were being circumvented, and so the definitions for registration as an industrial and provident society were changed.[2] It is disappointing that this key part of co-operative legislation does not owe its origins to careful analysis and policy development.

However, this understanding of the origin of the current definition helpfully demonstrates that both structures were intended to allow co-operative and mutual businesses to exist, and that registration as a bona fide co-operative is not the only legitimate route to a mutual structure. The Industrial and Provident Societies Act 1965 (IPSA) is intended to permit a broad spectrum of structures to facilitate different forms of business ownership and control rather than to inhibit them.

Similar benefits arise from understanding the history of employee and consumer roles in co-operative society constitutions. Worker models were feared a century ago as self help organisations that would create a myriad of small capitalists rather than moralising business. These were powerful arguments at that time, but how do they stand today?

A number of factors point to the need to rethink traditional positions. One is the opportunity now open to consumer co-operatives to use All Employee Share Ownership Schemes to

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involve employees in the business. Another is the report of the Co-operative Commission which has at its heart the need to re-establish the co-operative advantage. The report refers to the virtuous circle - the attainment of social goals provides a competitive advantage leading to commercial success, which then reinforces the ability to meet the social goals.

This is what the Pioneers were doing - setting out clear social and commercial objectives and achieving them. The pioneers of the co-operative and mutual movement were also fulfilling a vital social need and meeting a real demand in pursuing their clear vision. That also features in the Commission's recommendation that new areas be explored and a new body - a New Ventures Working Group - be established to work on new projects which demonstrate a co-operative advantage.

What are the co-operative opportunities?

One big contrast with the nineteenth century is that instead of a small group trying to moralise business, many people are now crying out for an alternative to the company model. They seek a model focused on service rather than profit-making which does not put shareholders ahead of safety, the environment, or the interests of future generations. The company model has failed in some applications.

Consider some of the prominent topics in current news. The railway industry is in a terrible state, and with no clear way forward; the water industry can no longer afford to fund its business with equity share capital; nobody is keen to have air traffic control in a structure earning profits for investors; there are endless arguments about which of model should be used for the London Underground. An obvious conclusion to draw is that the company model does not work in certain circumstances; but why not?

The company model has two flaws: the exclusion of certain key groups; and the operation of the legal fiduciary duties of the board.

Excluded groups

A typical company is founded and owned by member shareholders. Under the constitution, they appoint a board of directors to be responsible for running the business. The company constitution and Company Law in general are mainly concerned with the shareholders and the directors - the two groups of people with a recognised function or role within the constitution. Two key groups, without which no business can survive, are excluded from a company structure - customers and employees. Their legal relationship with the company is contractual. They are outside the organisation, looking in. They do not have a role within the constitution of the company.

This exclusion can lead to mistreatment by companies of both customers and employees. The exclusion of customers played its part in the growth of co-operatives to empower customers as members. Trade unions developed partly to respond to the exclusion of employees from the company structure. Unions did not give them a constitutional role, but they gave greater collective power.

Despite those developments, the exclusion of customers and employees from company structures is still a problem. Thus, legislation to protect consumers and employees - consumer credit, health and safety, employment protection legislation - is needed. Statutory regulators protect consumers of food, energy, telecommunications, and water and deal with society's wider environmental and health concerns.

Co-operative and mutual organisations are radically different from companies in this respect. They allow customers and employees to be part of the structure and to have a role within the constitution. Their interests play an important part in the major decisions taken at the highest level. Such organisations show how a corporate structure can involve interest groups other than investor shareholders in the decision-making process.

Directors' fiduciary duties

But structure alone is not enough. The duty of a company director is to act at all times in the best interests of the company. That means acting to maximise shareholder value - the profits or underlying capital value of the company.

This legal obligation to achieve shareholder value is both the strength of the company model and its weakness. Investors want to make money. Business success brings a return. Companies strive to be successful to attract further investment and to enhance the rewards to executives if they have share options. But the focus on shareholder value can be damaging when long-term investment is needed, when safety ought to be a high priority, or where longer term environmental or health issues arise. In these situations, the company model breaks down, the service provided deteriorates, or a vulnerable party suffers.

Here, once again, a co-operative or mutual organisation can provide a more appropriate answer than a company. The structure can align the legal duties of directors with a purpose other than the drive to produce shareholder value. The IPSA requires registered societies either to adhere to the co-operative principles, or to conduct business for the benefit of the community. Directors of such organisations can have a subtly different outlook from company directors and should make decisions in the interests of the user members or the community rather than those of the investors.

This provides a legal and structural co-operative advantage. Co-operative and mutual organisations can prioritise, in structures and decision-making processes, the interests of groups such as customers and employees and can serve community interests. The fiduciary duties of directors making the key decisions can be different in such organisations because the "default setting" is not in favour of making profits for investors.

Of course, co-operative and mutual enterprises, like companies, are driven by the ambition to succeed commercially. The difference is that co-operative and mutual organisations want to succeed to provide a better service to their customers and communities, not to reward shareholders.

Which factors make the company model unsuitable? Monopoly, dependence, public or community services, and community assets do not fit well with a company structure. They may conflict in a damaging way with a structure designed to generate profits for investors. These are some of the areas where the company is unsuitable. These areas are co-operative opportunities.

There are other examples. Local authorities under best value reviews, seek options for local or community services. There are often effective monopolies or a dependence on the service by a vulnerable group who may be open to exploitation. Should our elderly citizens have to be accommodated in care homes run to make profits for investors? Is housing best held by housing associations which are not necessarily democratic? Should leisure and other services only be provided through a company model?

These are areas where co-operative and mutual structures can provide answers, and they are areas where there are clear co-operative advantages. More than that, these are areas where there is a real social need for an alternative form of ownership.

New developments: expanding mutuality

Have these opportunities emerged in reality? Some years ago, Cobbetts was approached to develop a co-operative or mutual solution in the water industry. From that we developed a community mutual model in which the members are the customers but represent the community served by the organisation. The business is conducted for the benefit of the community, and any surplus must be used to build reserves, to reinvest in the business, or to provide the community with cheaper or higher quality service. This model attracted great interest and has been fully discussed with the Registry of Friendly Societies.

Following this, we developed a mutual structure for football club fans to pool their interests and develop democratic involvement in their club. Six clubs have taken up this initiative, with the support of the Government through Supporters Direct. Another six clubs hope to do the same and there is a model for clubs owned through a listed PLC. Supporting new mutual organisations can provide real opportunities for co-operative societies to promote their· own business and participate in new ways in local communities. Lincoln City, with support from Lincoln Co-operative Society, may become the first football club to pass into fully mutual ownership. This is the Co-operative Commission's virtuous circle at work.

An important initiative involves the development of a co-operative or mutual model for residential care homes for a North West local authority. This is particularly relevant to the issue of multi-stakeholder representation and the use of a community benefit model. When creating a society in which elderly or frail residents are members, a family member or close friend supporting the resident can be a joint member. Families whose elderly are cared for in such homes are also the recipients of the service.

Because successful care homes require the commitment of staff, employees should also be members - given the staff to resident ratio, there will be similar numbers of employees and residents. Board members can be elected from the joint members and also from the employees. In addition, the board will contain representation from the local authority, a local minister or religious leader who is providing support within the local community, a local general practitioner, and members of the local business community.

What is challenging about this model is the participation of employees in the structure. This model harks back to some of the earlier ideas of the involvement of workers in co-operatives.[3] Where local authority employees face an uncertain future in the best value review process, the community mutual model provides a structure in which they are involved in determining their future and the future of service provision. This can help win trade union support, in the interests of members threatened by possible privatisation. A transfer into a community mutual model allows union and employee participation in the best value process and it enables a key community service to be owned by the community it serves - the essence of mutuality. Care home collaboration between co-operatives and trade unions came from the work of the Co-operative Commission.

Employee empowerment in consumer co-operatives

Developments such as the care home model reflect a contemporary reappraisal of the employees' role and the route taken by consumer co-operatives a century ago. That raises the Co-operative Commission's recommendation of a reserved constituency for consumer co-operative employees. This will *affect* the debate in the consumer co-operative movement on a constitutional role for employees through the Commission's "reserved constituency".[4]

What of Mrs Webb's concerns[5]? The "little capitalists" fear has been effectively eliminated because societies' rule books provide that on a solvent dissolution, members only get back their share capital, not a surplus from underlying assets. The enforcement of one member one vote by the Registry of Friendly Societies further ensures the equality of all members.

What of concerns to maintain a balance between consumers and employees in the interests of good governance? The Commission recommend a one third maximum for employee directors and many societies already have this enshrined in their rules. That aspect is therefore relatively uncontroversial and not difficult to achieve.

With the availability of All Employee Share Schemes for societies, the wider practice of employee involvement and empowerment of which the election of employee directors is a part becomes a practical proposition and opens the way to an important cultural shift.

Conclusions

Let us conclude with the Commission's proposed mission. Whatever one's view of mission statements, the proposed statement is very relevant to the argument developed here:

> To challenge conventional UK enterprise - by building a commercially successful family of businesses that offer a clear Co-operative advantage.

There are some real underlying advantages in co-operative and mutual structures. They do challenge the conventional UK company solution and provide opportunities for the sector. We need to make a noise about this and educate people about the potential for industrial and provident society structures and why they can have advantages over companies.

This paper concludes with three thoughts for the consumer co-operative movement:

- Be open-minded about structures. Be flexible within the industrial and provident society legislation.
- Hear and debate the Commission's ideas on the position of employees in the light of the bigger picture - see a chance to claim another Co-operative advantage.
- Be open to initiatives in new areas where mutual and co-operative structures can be established. You can benefit from new co-operative and mutual businesses in your region - with shared values, you may be a supplier of first choice..

The movement as a whole faces huge opportunities. Seize those Co-operative opportunities; seize the Co-operative advantage.

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Notes

1 Co-operative Commission, *The Co-operative Advantage: The Report of the Co-operative Commission,* Co-operative Commission, London, 2001.
2 Snaith, Ian, "What is an Industrial and Provident Society?" supra pages 39-42.
3 Jones, Roger, "Employees as Stakeholders within Co-operatives" supra pages 43-49.
4 Co-operative Commission, *The Co-operative Advantage: The Report of the Co-operative Commission,* Co-operative Commission, London, 2001 recommendation 31.2.
5 Jones, Roger, "Employees as Stakeholders within Co-operatives" supra page 44.