Learning from the Past: the Distress and Resuscitation of PSIS, 1979-2003

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The Public Service Investment Society (PSIS) was placed under statutory management in 1979 after a period of growth and diversification. Over the next eight years, the statutory manager restructured the Society's administration and systems, divested assets, freed up the frozen deposits, and restored member confidence. PSIS was released from statutory management in September 1987, and subsequently completed the rest of its restructuring programme. The co-operative refocused its operations on the core savings and loan operation and subsequently emerged as the largest New Zealand–owned co-operative financial services provider. PSIS's brush with failure and its subsequent revival highlight five key balances that must be managed carefully in order to maintain stability and enhance performance. They are (1) diversity and homogeneity of the membership, (2) democratic processes and strong leadership, (3) mutuality and commercial orientation, (4) preserving continuity with past practice and adapting to changing conditions within the business environment, and (5) effective administrative control and flexible capabilities.

The Public Service Investment Society (PSIS) was founded in 1928 to provide savings and loan services to members of the Public Service Association, the largest union of New Zealand civil servants. The co-operative grew rapidly from a small base during the rest of the inter-war period, but following the Second World War it expanded dramatically and developed into a widely diversified business. After 1945, PSIS accumulated a large property portfolio, a chain of general retail stores, liquor outlets, travel agencies, and other businesses. By the late 1970s, the Society had a membership of more than 182,000 and held deposits worth almost $112,000,000. (Boyce, 2005, Appendix a1)

Although signs of impending trouble had been apparent to some observers for several months, PSIS members and employees were shocked to awake on 29 June 1979 and learn that over night PSIS had been placed under statutory management to protect it from imminent collapse. Members could not access their deposits, and those with outstanding loans still had to make repayments, although the Society took steps to relieve financial stress. Over the next eight years, the statutory manager, Robert W (Bob) Stannard, restructured the Society's administration and systems, divested assets, freed up the frozen deposits, and restored member confidence. PSIS was released from statutory management in September 1987, and subsequently completed the rest of its restructuring program. The co-operative refocused its operations on the core savings and loan operation and subsequently emerged as the largest New Zealand–owned co-operative financial services provider. Today, it has over 130,000 members and controls assets worth $1.074 billion. (information provided by Collin Hicks, 18 September 2007) The history of this major co-operative offers a rare learning resource because few enterprises that reach the precipice of collapse actually survive, let alone undergo the type of renaissance that enables them to achieve a leading position within their business sector.

Background

Alfred D Chandler Jr's (1962, 1978, and 1990) study of large-scale enterprise reveals that long-term success depends on management aligning internal structures and systems in a way that supports their strategic inter-action with the external business environment. Thus, major single-product companies adopted a centralised administration to capture economies of scale by exerting close co-ordination over related functions such as purchasing, production, and sales. This strategy suited business environments that were relatively stable in terms of growth rates, government regulation, and technology. Alternatively, corporations pursued diversification when they faced less certain business conditions. Those firms that succeeded in more turbulent environments installed decentralised structures that enabled divisions to develop the responsive capabilities required to take advantage of the specific markets they served. Building these divisions from core capabilities ensured that economies of scope and scale could be secured. The efficient operation of the centralised structure and the decentralised framework required differently configured accounting and information handling systems (Johnson, 1975 and 1978). In addition to these two main organisational forms, others, such as network-based constructs and matrix structures, have their own efficiency properties and distinctive systems. However, the main point of Chandler's work is that strategies, structures, and systems need to be aligned to ensure corporate stability and profitability.

Chandler's framework focuses mainly on the formal elements of organisational design. In addition, there are 'soft' variables that can be included in his construct in order to explain more fully the subtleties of institutional efficiency. (Boyce and Ville, 2002) One of the most important of these elements is leadership, which plays a key role in articulating strategy and communicating to stakeholders. Other 'soft' factors include organisational culture, incentives, and broader social and cultural forces. While these elements are important in explaining the performance of privately-owned enterprises, they are perhaps even more salient considerations for user-owned entities.

Co-operatives are distinctive in terms of their governance and the conspicuous place that values play in motivating management and members. Leadership is a vital element in communicating values and linking them with governance structures, enterprise strategy, and the supporting administrative framework and systems. In working out an appropriate configuration of these elements, user-owned businesses must achieve balance between conflicting forces that privately-owned firms do not encounter to the same degree or in a similar way.

PSIS's brush with failure and its subsequent revival highlight five key balances that must be managed carefully in order to maintain stability and enhance performance. Leaders of co-operatives need to balance:

1. Diversity and homogeneity of the membership.
2. Democratic processes and strong leadership.
3. Mutuality and commercial orientation.
4. Preserving continuity with past practice and adapting to changing conditions within the business environment.
5. Effective administrative control and flexible capabilities.

The following sections chart PSIS's shifting fortunes in light of these five elements of equipoise (the following account is based on Boyce, 2005).

Underlying Weaknesses

Composition of membership

From 1945 to 1979, the PSIS membership grew enormously, from 4,144 to 182,262 individuals. (Boyce 2005 Appendix a1) Moreover, the membership became far more diverse, in terms of the number and range of unions allied to the Society, during this period. Whereas members of only two groups outside the PSA were admitted before the Second World War (the Railway Officers' Institute and the Post & Telegraph Officers' Guild), eighty-nine other unions became affiliated with PSIS. (Boyce, 2005, 164-6) Many of the new groups were small and had a specialised occupational base. The two largest were the New Zealand Education Institute (NZEI, affiliated in 1953) and the New Zealand Post Primary Teachers' Association (PPTA, joined 1954). By 1978, these two organisations represented 18.5% of the PSIS membership, while the PSA constituted approximately one-third.

The growing diversity of a co-operative's membership is a mixed blessing. Generally, greater plurality can either erode solidarity as members from various backgrounds fail to maintain a sense of commonality, or it may promote stability in that people from different social, economic, and cultural backgrounds bring a different outlook and new ideas. Moreover, the distribution of a co-operative's membership is important. For example, if members are equally distributed across different social or economic groups, democratic decision-making processes, free from parochial interest, may arise and persist over the long-term. In contrast, should 'membership blocs' appear and articulate goals that are self-serving, stability may be threatened. In PSIS's case, greater plurality did create scope for factions to develop and pursue their own agendas. Indeed, open conflict between a group of PSA members and groups affiliated with other unions during June and July 1978 undermined its stability.

Internal discord within any co-operative is a matter of considerable concern, but it is especially worrisome for financial co-operatives for which member confidence is of the utmost importance. Whereas a purchasing co-operative affected by dissension-induced resignations will experience a decline in its purchasing power and profitability, it will be fatally undermined only in extreme cases. In contrast, a financial co-operative will be more directly threatened if internal disagreement causes member defection. The danger here lies in the psychology of financial 'runs' wherein deteriorating confidence may lead to stampede of withdrawals as members rush to pull out their money while the institution can still pay them. Unless the run is halted, at some point the financial institution will use up its liquid resources and become insolvent. Thus, for a trading co-operative deteriorating confidence may cause losses, but for financial user-owned entities it drains away its very resource base. In the event, PSIS was exposed to **both** of these outcomes.

The key to preventing an erosion of confidence or the emergence of parochial interest groups is clear communication and effective leadership. Enunciating inclusive goals of broad resonance helps to prevent factions with specific agendas from developing. Transparent disclosure of financial performance is necessary to maintain confidence among members of trading co-ops and more especially those who deposit funds in a financial mutual. Management should keep members informed of business conditions and the performance of their cooperative, and it should proactively assure members by drawing attention to the systemic and procedural safeguards that it has put in place to prevent or give advanced warning of adverse developments. More broadly, those who lead user-owned businesses need to actively manage diversity and educate member perceptions to reinforce mutuality.

Leadership and democratic processes

From the inception of co-operation it has been necessary to balance democratic processes with strong leadership. The efficiency of user-owned entities may be undermined by overly-cumbersome decision-making procedures. Indeed, this was a factor that weakened the British co-operative stores. (Birchall, 1994) PSIS's governance was characterised by a Board made up of two PSA-appointed members, plus four PSA representatives elected by members of the same union. These six members of the Board then voted to appoint up to four people nominated by members of other unions. Thus, the PSA controlled the Board of PSIS. Because the system of representation was not democratic it had the potential to generate tension and mistrust since the interests of non-PSA members were not upheld by a Board member elected directly by them. Moreover, the structure of the Board had a natural fault line that in extreme circumstances could divide the PSA members from representatives of other unions. This arrangement was formulated back in 1965 when Keith Menzies, PSIS's Chairman, resolved a schism between the PSA and members of the PSIS Board over whether local government employee groups should be allowed to join the co-operative. In the end, Menzies displayed considerable statesmanship in brokering an agreement that prevented dissension from undermining member confidence. While Menzies' compromise worked well for over twenty years, by 1978 the growing heterogeneity of the membership made further adjustment necessary. That year, the PSIS Board was unable to exert leadership of the type needed to forestall open conflict between members who sought a democratic voting system and those who wished to preserve the PSA's control.

Mutuality and commercial orientation

The confrontation of 1978, which arose when a large faction within the PSA confronted a group consisting of other PSA officials and members of the PPTA and NZEI, was precipitated by disagreement over the PSIS's interest rate and store rebate policies, as well as the existing voting system. The contest highlighted a serious potential weakness inherent in co-operative enterprise: the ownership structure of co-operatives can undermine the necessary equipoise between pursuing mutuality and maintaining commercial orientation. One of the strengths of consumer co-operatives is that owners are customers and therefore have an incentive to patronise the enterprise. In contrast, usually only a fraction of the owners or shareholders of private businesses are also customers. The potential problem arises from the divergent objectives of owners and customers, while the difference sizes of these two constituencies give them varying degrees of influence over management. Thus, owners are primarily interested in the profits earned by the enterprise, while customers seek the best deal. In co-operative enterprises, short-sighted owner/customers may have the constitutional means to appoint managers who will set prices at favourable levels without regard for the long-term stability of the business. Shareholders in private firms seldom have this power.

In 1978, the balance between mutuality and the pursuit of commercial objectives broke down at PSIS. A report dated 9 June showed that the results for the year ending 31 March 1978 would record a serious loss ($767,058), and projections for the coming year foretold of an even more dramatic loss ($1,731,000). The General Manager, Jim Lawrence, suggested that the Society should reduce the interest it paid on members' deposits, cut the store rebate, and increase the interest charged on loans. The Board decided to change the interest rates along the lines recommended by Lawrence, but it left the rebates at their existing level.

The new policy provoked strong opposition from a group of PSA members who wanted more generous member benefits. This faction contested the Annual General Meeting held on 31 July and succeeded in winning control of the Board. From the time the conflict broke out (12 June) until the end of July when the AGM was held, PSIS members withdrew deposits amounting to over $9.5 million, or roughly 8.5% of members' total contributions. The drain continued during early August, no doubt fuelled in part by the resignation of PPTA members who no longer had Board representation. Deteriorating confidence stemmed from a failure to balance the benefits of mutuality with commercial principles. In the event, the new Board did not succeed in establishing a new equilibrium.

Preserving continuity and adaptability

On 23 August, the new Board announced that it would increase interest on deposits, lower the rates on loans, and reduce the rebate slightly, from 12.5% to 11%. As a result, deposits increased during September and October. However, on November 15, the Board learned that the first six months of the financial year would produce a larger than expected loss of over $1.5 million. In response, expenses were pared, and most saliently, store rebates would in future be paid as profits allowed, not at the time purchases were made as had been the previous practice. Information about the new rebate policy was leaked to the press before the Board could announce the change. Many members construed the move to be a complete cancellation of the rebate. Withdrawals resumed and store sales fell precipitously just as the peak Christmas buying season began.

In the eyes of many members, all of these changes occurred abruptly. Neither the old Board nor the one that took office at the end of July implemented an effective communication strategy. A series of leaks of Board-level information were followed by hastily drawn up statements aimed at controlling damage. More broadly, the Boards did not communicate proactively to shape members' perceptions and safe guard confidence. As a result, members were confused, and the Board's actions appeared to be inconsistent if not crisis prone. For the membership, the shifts in policy did not appear to have any continuity with past practice and did not reflect adaptive capacity. Without a sound communication policy, confidence eroded.

Effective management controls and flexible capabilities

Before 1978, PSIS's management was unable to control operations precisely and the enterprise lacked flexible capabilities. These deficiencies stemmed from the policies enunciated by its founders and the way the business was initially set up. As the business grew, succeeding managers did not remedy the underlying flaws; indeed, in some ways they accentuated them.

The first weakness was structural. PSIS had grown rapidly by acquiring a wide range of diversified businesses, but its Board had not made the necessary administrative adjustments. In 1979, it displayed a mix of centralised and decentralised features, along with holding company type elements and various committees left over from its original Board-dominated set up. The most logical structure would have been a divisional one, wherein individual business operations (for example, financial services, retail, liquor, and travel) would be placed under a single manager who ran the unit as a separate profit centre. The Board could then monitor the performance of each division and allocate investment to those that achieved the best returns.

As PSIS's structure stood at the time, under General Manager, Jim Lawrence, who reported to the Board, three executives called Directors oversaw Retail, Administration, and Finance. The unit that came closest to representing a real division was Retail. Here, Barry Peace controlled centralised purchasing and store display, and each of the twenty-seven store managers reported to him. The next unit, Finance, essentially a staff or advisory element, had the weakest capabilities for two key positions in it were vacant: Accounting Manager and Finance Director. The most cluttered unit was Administration which consisted of both staff and operating areas. Its Director, Ian Reid, supervised staff units such as training and administration as well as operating units including Retail Travel, Wholesale Travel, Property, and twenty-six savings and loan branches. A better set up would have been to have Travel and Property as separate divisions under their own managers. Then Reid could run the savings and loan operation with its supporting administration and training elements.

Another structural anomaly was TV Hire which was run by the Retail manager largely because it had grown out of the shopkeeping operation, but submitted separate financial reports that included with those of the Associated Companies (see below). A more logical structure would have had the rental business as a separate division. PSIS did not have an Investment division run by specialist managers. Instead, this function was run by a holding company, PUBVEST, that reported to the Board. PUBVEST controlled six subsidiaries: the four liquor companies and two travel companies (separate from Retail and Wholesale Travel). Appending a holding company to the emerging hierarchy was a telling indicator of an organisation in transition. Overall, this mixed structure had developed 'naturally' as the enterprise expanded and diversified. While trying to keep up with rapid growth, it appears that the Board had not have time to put together a coherent framework that would allow it to exert precise control and enable the separate businesses to develop the flexible capabilities that divisions exhibit.

In addition to these structural flaws, the Society had a number of financial weaknesses. For example, it did not have a long-term capital base. PSIS's founders required each member to subscribe to one £1 share (later converted to $2), but the amount had never been called up. In any event, the amount that could have been raised would have come to $364,000 a paltry sum next to the Society's liabilities of $131 million. Thus, the co-operative relied overwhelmingly on short term deposits – that is member's contributions – that were repayable on demand. Even though PSIS attracted money by offering term deposits in the 1970s, the sum raised was tiny in comparison with the amount of callable funds.

This heavy reliance on transient money was unwise, but it would not have been such a serious matter had the Society offered only callable loans. Instead, PSIS lent significant amounts on a long-term basis, chiefly mortgages, and as a result it faced very serious levels of risk. The danger was that if substantial withdrawals occurred, the co-operative could not call in the mortgages to meet the demand for funds and it would quickly become illiquid. Moreover, management did not set aside reserves as banks do to create a protective liquidity buffer. To make matters worse, the Board deployed ready money in fixed assets, principally real estate, which could not be sold quickly to raise cash. The practice of borrowing money (accepting deposits) 'short' while lending (or investing) 'long' is a recipe for disaster of the type that befell Securitibank. Back in September 1978, Jim Lawrence suggested that the Society increase its liquidity ratios, but the Board did not heed his call, and PSIS had no safety net to meet a surge of withdrawals.

How did the Society come to be in this position? It seems that management mistakenly thought it was prudent to pay cash for property. It would have been safer to borrow to buy some real estate and keep more cash in reserve. In addition, because the government taxed all amounts co-operatives retained as reserves, PSIS management was encouraged to distribute nearly all of its surpluses. It would have been safer to take the tax hit and build up strong reserves. The policy that the Board followed was also conditioned by the belief that members should be rewarded fully in the form of rebates and favourable interest rates. The Society's leaders did not communicate to change member expectations. The Board probably believed that past trends in business would continue into the future and saw no need to change policy.

Managerial weaknesses helped to bring the co-operative to the dangerous position it faced in 1978. The Board was made up of civil servants, not one of them had commercial experience. None of the senior executives had formal training in finance, there were vacancies in critical positions in this area, and deficiencies in the Society's accounting system prevented management from gaining a precise impression of the co-operative's true position (see below).

Without adequate controls, PSIS had been haemorrhaging cash since 1973. In his close analysis of the Society's accounts, Alan Robb found that it had accumulated a cash deficit of nearly $7 million by 1978. Even though the co-operative had reported profits in all but two years during the 1973-8 period, it had been drained of cash as the Board purchased real estate and paid excessive rebates. In 1979, the cash deficit increased again and PSIS was running an overdraft of over $11 million. It is not clear whether the Board was familiar with cash flow analysis – it was a new financial technique at the time – but the burgeoning overdraft should have alarmed the leadership. The real danger was that being heavily indebted and lacking a cash reserve, the Society was acutely exposed to deposit withdrawals. Why the Board did not act is something of a mystery; perhaps its members thought that PSIS would trade its way out of trouble, if indeed they recognised that it was in difficulty.

To conclude this section, the Society lacked strong managerial controls. Its structure was cumbersome, it lacked accounting systems that enabled the Board to accurately gauge performance, and it needed stronger executive capabilities. The co-operative did not have the capacity to respond flexibly and quickly to changing circumstances. Indeed, the Board had backed the entire enterprise into a corner by draining it of cash, purchasing illiquid assets, and accumulating a large overdraft.

The Sequence of Events

With imbalances between the pairs of elements identified above, PSIS was exposed to adverse incidents that began to unfold in June 1978 and ended with the passage of the Statutory Management Act one year later. We have already analysed the impact of the shifts in interest rate and rebate policies and the proxy fight of June and July 1978. The next shock came in February 1979, when Jim Lawrence furnished the Board with a memo describing the position of the Society as ‘perilous’. A large loss for the year was looming and would have to be disclosed to the membership before the AGM was held in July. Lawrence recommended that the Board inform members and reveal the steps it was taking to remedy the situation. Before any action could be taken, J F Turner resigned as PSIS Chairman to take up an overseas posting. In light of previous events, the membership was disturbed by this development.

Turner’s replacement, W E B (Berrie) Tucker, took office on 28 February and began studying the Society’s affairs. He immediately recognised the liquidity problem and began selling PSIS’s share investments. Tucker also identified a number of other problem areas, including some of the Society’s real estate holdings that were generating losses, a large investment in a new computer that was not operating efficiently, an overpayment of texes, and structural weakness.

On the positive side, Tucker began to communicate directly to the membership. He outlined the favourable results of measures he had taken to improve efficiency and competitiveness. In April, he announced an attractive new “Spend ‘n’ Save”. Most significantly, the same month Tucker reintroduced the rebate at 7.5% fixed and payable at the time of purchase with additional variable amounts paid as profits allowed. By June the rate of withdrawals slowed noticeably and member confidence improved.

Just as it began to look as if the enterprise might right itself, the situation unravelled completely. On Friday 22 June, PSIS’s auditors informed the Board that the accounts had led them to conclude that the Society might not be viable, and they called for a meeting with the Board the following Monday. On that same day, the Government tabled the PSA Withdrawal of Recognition Bill as a way of pressuring striking electrical workers. This legislation meant that the government did not have to recognise the union as the bargaining agent for public servants, and it could sequester the PSA’s funds and place them in the care of the Public Trustee. The Bill led to an unstoppable run on PSIS.

The details of the downward spiral have been recounted elsewhere. (Boyce 2005, pp192-6) By Wednesday 27 June, Brian McLay, Assistant Secretary of the Ministry of Justice’s Commercial Affairs Division, concluded that PSIS could not survive the run on its deposits. Back in January he had become suspicious of PSIS’s viability and arranged with Bob Stannard to move in as Statutory Manager if needed. McLay now contacted Stannard and instructed his staff to prepare legislation to save the institution. The PSIS Management Bill was passed by Parliament on Thursday night. The following morning, members awoke to discover that their deposits were frozen, that is the funds could not be withdrawn, and those who had taken out loans still had to make payments. PSIS staff, many of whom had placed all their money with the Society and also had outstanding mortgages, wondered whether they would still have a job.

How can PSIS’s collapse be explained? We have outlined how the previous Board’s failure to achieve vital internal balances made PSIS vulnerable to adverse developments. The poor result for 1978 and the growing overdraft were surely warning signs of trouble ahead, but management did not respond until Tucker became Chairman. The immediate catalyst for the destructive run on deposits was the Withdrawal of Recognition Bill. An event such as this can seldom be foreseen, and so the PSIS story provides two valuable lessons. The most obvious is the need for those who lead co-operatives to balance the forces identified above. Second, managers need to develop an aptitude for anticipatory risk management. (Boyce and Barnes 2007) These capabilities are developed by mentally placing oneself outside the organisation and searching for critical vulnerabilities. The next step is to imagine what types of events might impact on each point of vulnerability. The final task is to set up some form of system that monitors these potentially destructive variables and can detect when they approach a critical state. Such an anticipatory risk management system may not prevent disaster, but it may save some organisations or mitigate the impact of hostile developments.[1]

Statutory Management: Recovery and Rebalancing

After Bob Standard became Statutory Manager, the most fundamentally important thing he did was to employ effective communication methods to restore confidence and to build workable balances between the five sets of elements discussed above. He informed the membership about the challenges ahead and made it clear that their support was vital to PSIS's recovery. He had to move quickly to correct the financial weaknesses, and he was anxious to 'thaw' the frozen accounts. However, he recognised that the pace of the changes he envisioned could not strain the confidence of the members, employees, and the BNZ which held PSIS's massive overdraft. He had to be firm in decision-making and fair to all stakeholders.

Effective management and flexible capabilities

The first task Stannard undertook was to build effective controls and organisational flexibility. He quickly discovered that PSIS's accounting system did not account for all costs, goodwill amortisation, and obsolete retail stock. More fundamentally, the system did not allocate interest and administrative charges to PSIS's various businesses so that real performance was masked by cross-subsidies. Nor did the system provide financial information in a timely manner to support responsive decision-making. Moreover, the Society's computer could not provide members with up-to-the-minute account balance information. Stannard at once saw this deficiency as a threat to member confidence, especially in the delicate circumstances of Statutory Management. Linked to these systemic weaknesses were deficiencies in the administrative structure. The organisation needed to be reformed and vacancies in key accounting and financial posts had to be filled to create accurate cost control systems, budgets, and planning procedures.

The PSIS Management Act dismissed the previous Board and replaced it with an Statutory Advisory Committee whose members were appointed by the Minister of Justice. It is evident that Stannard had some influence on these appointments and the Committee as a whole consisted of highly regarded political, legal, and business figures with extensive commercial experience. This governance overhaul did much to enhance morale.

The next confidence-boosting move fell to the computer staff who worked over the weekend of 30 June to 1 July to set up new, unfrozen accounts which were credited with any payments made since the passage of the Act. Members could draw upon these funds, but the money in their frozen accounts they could not use. Next, Stannard implemented his forthright communication policy on 3 July, when he disclosed the financial results for 1978 and 1979. He explained that the heavy losses stemmed from excessive distributions, and he outlined the corrective measures he would take. He also told members that the level of their support would determine how soon he could thaw the frozen accounts. Both moves established Stannard's credibility.

True to his word, Stannard prepared for the first thaw. He began selling real estate, commercial mortgages, and share investments to free up funds. By August he had sufficient cash to resume paying a 5% rebate on shop purchases and to thaw the first 20% of the frozen funds. This he did on 13 August, and only minor withdrawals followed. One month later, he released a further 30% and 25% more in early November. Therefore, within only 19 weeks of the passage of the Act, three-quarters of the frozen funds had been released. Moving quickly helped to rebuild member confidence.

Showing anticipatory instincts Stannard set up a simple paper-based system to monitoring the Society's cash position. This was the so-called Red Book in which he recorded movements in funds, and it enabled him to obtain a 'feel' for the pulse of the membership. Later a more advanced system was introduced based on ratios and projections.

The Statutory Manager and newly-appointed financial officers also devised improved accounting systems to assess the performance of PSIS's businesses. They introduced new reporting processes wherein managers of each operating unit submitted monthly statements to the SAC. In early 1980, Stannard overhauled the organisational so that it more closely resembled a modern multidivisional structure. Spheres of authority and responsibility were also clarified. Later the same year, Stannard and his colleagues made further refinements, including a new planning process, but by early 1980 PSIS had effective internal controls and greater capacity to respond to change.

Preserving continuity and adaptability

By March 1980, Stannard had determined the future shape of PSIS. He recognised that operating in an increasingly competitive environment the Society could no longer rely on a 'captive market' provided by the membership. Increasingly, it would have to offer superior service and prices. The Statutory Manager realised that the co-operative would have to down size, but to do this while retaining member confidence, he would have to achieve a balance between adapting to new business conditions and maintaining continuity with past practice.

For the future, he believed that the Society should focus on its core savings and loan business, and sell unrelated operations. The retail shops would have to go at some point, but this had to be handled carefully because members attached great importance to the rebate. In the short term, he would try to make the operation profitable. The Travel and Liquor businesses faced increasing competition and would be sold. Concern for member perceptions would also shape how these divestments were made. The sale of commercial mortgages, financial investments, and real estate was Stannard's first priority because he needed funds to reduce the overdraft and lend to membership. However, he refused to conduct a 'fire sale' and therefore had to tread a thin line between raising funds, controlling the overdraft, and obtaining fair prices.

Showing the fragility of member confidence, a crisis unfolded between August 1980 and May 1981. The problem began when Stannard released a further 10% of the frozen funds in late July 1980 – unlike the earlier thaws for unknown reasons this one induced withdrawals. PSIS's overdraft exceeded the limit set by the BNZ, and Stannard was compelled to pledge more real estate as security. Nevertheless, he continued with his policy of prudent divestment. At the same time, the Society launched a member recruitment drive, new savings products, advertising campaigns, and shop upgrades. By April 1981 the situation had stabilised.

Mutuality and commercial orientation

The promotional campaigns that PSIS ran at this time and those that followed showed a new professional approach. Unlike the pre-Statutory Management Board's initiatives, which were not founded on any concrete basis, the new ones were developed from hard market data, outside economic forecasts, as well as realistic cost and income projections. The new campaigns were also supported by staff training and the use of outside experts as required. The accompanying advertisements projected a sophisticated image of the Society and signalled a strong commercial focus to the membership. In the shops a more competitive ethos emerged as Stannard and a new Retail Manager cut costs, eliminated unwanted stock, introduced more attractive goods, and enhanced service. Significantly, purchases by non-members grew to 15% of total sales. While these developments improved the performance of the shops they still recorded losses although by 1983-4 the operation had almost broken even.

After 1984, PSIS's recovery accelerated. Stannard disposed of all but five of the Society's real estate investments (the total was 48 when he took office). He also divested the Liquor and Travel businesses on favourable financial terms, and in keeping with the principle of mutuality he ensured that the new owners of these businesses gave PSIS members rebates and special terms. Although the retail operation was still not consistently profitable, Stannard retained it because he knew that it was a tangible manifestation of shared benefit.

These moves, supported by the new structures and systems, as well as the increasingly professional management approaches he introduced bore fruit. The Society generated a profit of over $1 in 1985, and while it recorded a small deficit the next year, surpluses of $4.97 million and $5.31 million were earned in 1986 and 1987. The time had come to release PSIS from Statutory Management. Before he did so, however, Stannard had to address the final two balances.

Leadership and democratic processes/ composition of membership

In framing these new alignments through reformation of the Society's governance structure, Bob Stannard sought to preserve the loyalty of the unions that had supported the co-operative from its inception while ensuring that decisive leadership would guide it in the future. He also wanted to revise the voting rules so that again union interests were safeguarded, but new groups of members would be attracted in order to sustain growth. The result was a two class system of membership. Members of public service unions could vote in members of an Electoral Council which in turn elected four people, who were affiliated with public service unions, to serve on the Board of Management. Account holders, who were members of other labour groups, and their spouses could not vote. However, their interests were safeguarded by Board nominees put forward by the New Zealand Society of Accountants (after consultation with the New Zealand Law Society). From a list of candidates supplied by these bodies, the four Board members elected by the unions then appointed four additional Board members. Although the arrangement was not completely democratic it ensured that PSIS would be led by union representatives and people of proven commercial experience.

Stannard's achievement rested on his ability to communicate, consult, and prepare stakeholders for changes that were needed to balance critical elements. Further, he had to gauge the pace of adjustment carefully. He had to temper decisive movement with regard to member confidence and stakeholder expectations that were malleable but only within unknown limits. In retrospect, he felt that he had thawed the frozen funds too quickly, but at the time he was anxious to restore the faith of account holders (interview 17 January 2003). Further, while he wanted to abandon retail, he knew that PSIS's balance sheet would need to be strengthened before it could bear the shock and that the membership was not ready to accept this step. Overall, he set a pace of change that restored the Society to viability, but the balances he established proved to be temporary. In the years that followed succeeding management had to cope with new conditions that compelled them to make modifications. Perhaps, Stannard's most noteworthy achievements were to alert future leaders to the importance of these balances and to demonstrate how they could be adjusted.

Rebirth

After Statutory Management came to an end, PSIS completed a full circle by returning to its original core financial services business. TV Hire was sold off, the real estate holdings were reduced to just one building, PSIS's headquarters, and the retail shops were divested. The strategy was a continuation of the direction set by Stannard, of course, but it was executed in a business environment characterised by increasing turbulence. Demutualisation, mergers, incentives to develop 'one-stop' financial services provision, and the computer revolution shaped the specific course of PSIS's development. More broadly, government reforms that weakened the union movement, an aging population, and new customer expectations demanded strategic responses.

Mutuality and commercial orientation

The new management coped with these forces by promoting 'a conceptual shift' among PSIS stakeholders. These constituents were encouraged to think not only of the benefits the Society could deliver, but also the necessity of its earning 'profits'. Surplus earnings did not detract from the principle of mutuality; rather they strengthened it by supporting investment in facilities and services that would enhance the future stream of benefits. Moreover, profits reflected the competitive efficiency of PSIS and thereby concentrated attention on commercially sound practices.

In 1990, a Strategic Review created a new focus on customer service. The Society sought to attract 'active' customers who used several of its products and thus secured a wider range of price and value based benefits. PSIS differentiated itself from the major banks, which at the time were pushing customers to use ATMs through the use of fee payments, by offering customers a choice of face-to-face interaction or computerised transactions. It gained a major competitive advantage by advertising that its no-fee policy meant that "customers did not have to pay to use their own money." (When rising costs later forced PSIS to introduce some fees, albeit at low levels, following Stannard's precedent it communicated intensively to justify the move on the grounds that it promoted fairness by removing cross-subsidies and mobilised incentives for marginal customers to become active members who paid no fees.) Moreover, PSIS's investment in advanced IT systems kept it on abreast of best practice in non-branch service provision. As foreign banks absorbed local rivals and as a growing number of user-owned insurance and financial services organisations de-mutualised, PSIS stood out as a New Zealand owned, co-operative that was up to date technologically and offered personalised service. PSIS was creating a distinctive and durable niche for itself in an increasingly turbulent environment.

Shifting competitive currents also shaped the way in which management completed the last task left on the Statutory Manager's agenda, selling the shops. The appearance of specialist retailers and big discounters together with locational shifts caused by urban growth left PSIS's stores struggling. A series of initiatives were implemented to find a new market position for the operation, but as PSIS's balance sheet was now strong enough a two-step withdrawal plan was outlined to the membership. First, the shops would be spun off into a separate stand-alone unit, and second if member support was not forthcoming the business would be sold. The Board stressed that through their purchasing behaviour the members needed to tell management whether they still valued the operation. When the hoped for response from the membership was not forthcoming, the unit was sold in 1994. With retail no longer holding it back, PSIS could continue developing its financial services.

Effective control and flexible capabilities

Following the restructuring efforts of the post-Statutory Management years and the sale of the retail operation, PSIS did not need to make any major organisational changes. Management did undertake two important steps to maintain effective control and flexible capabilities. First, the financial position was strengthened. In 1993, the Board issued a Trust Deed in which it set prudent financial ratios that would be monitored by an outside authority. The document supported a very successful float of capital notes that provided a large capital base beyond that founded only on current balances and term deposits. The co-operative also adopted the guidelines set out by the Basle Committee for minimum capital adequacy ratios. These measures linked various types of loans attended by different levels of risk to elements within the capital base of financial institutions (for example reserves and subordinated debt). The ratios are designed to protect depositors, and changes within them provide automatically send signals regarding the financial health of the organisation. Throughout most of the 1990s PSIS had ratios of twice the levels recommended by the Reserve Bank for registered banks.

Second, from the mid-1990s, management conducted a series of strategic reviews and used the findings to guide the future development of its capabilities. Enhancing further the levels of professionalism that Stannard built to guide planning, budgeting, and promotion, PSIS's refined its competitive strategy in an on-going manner. The co-operative strengthened its market niche by emphasising personal lending and providing an alternative type of 'one-stop' financial service proposition. Instead of going head to head with the major banks which focused on offering wealthy customers mortgage lending, overdrafts, and credit cards, the Society specialised in providing 'average' New Zealanders with innovative forms of personal loans and a range of insurance products under the 'Care' brand. (Some of these were linked; for example, car loans and insurance.) Increasingly, PSIS formed alliances with other service providers. Thus, it used the leverage provided by its large membership to team up with firms with strong capabilities in the provision of particular insurance products, for example automobile, home and contents, and life. By building a flexible web of co-operative relationships, PSIS generated further benefits for its members. Thus, the Board concentrated on building up PSIS's core capabilities, while carefully avoided risky businesses such as funds management where it lacked expertise, and adapted these key strengths to changing business conditions.

Leadership and democratic processes/ Composition of membership

While it enhanced and focused its operations, PSIS also adjusted two other balances to maintain alignment with its evolving environment. First, the Board enunciated new guidelines to govern its actions. Interestingly, these were a combination of rule- and behaviour-based principles. Thus, long before the Enron and Worldcom debacles sparked debate about the superior efficacy of either of these governance approaches, PSIS mobilised **both** of them to foreclose avenues for opportunism. Second, the

Board won the support members to give the union elected Directors the power to choose the appointed Directors instead of making selections from the list provided by the Accounting and Law Societies. This step enabled the Society to consider a wider range of talent, and it signalled that PSIS was in a position to stand on its own feet in determining the type of leadership it needed. Third, the Society relaxed its membership criteria. This was accomplished in a two-step manner to allow time for educating existing members about the commercial need for these changes. Initially, PSIS allowed a member of any union to become a full member with voting rights, and then it opened up membership to any one who observed its rules (however non-union members could not vote). In the process the Society was careful to preserve its links with the union movement, for recognised unions still had the right to nominate candidates for election as Board members. As a result the Society preserved continuity with the past and a measure of homogeneity within the membership. However, it needed to attract a wider membership since the Employment Contracts Act had seriously eroded the traditional union membership base. Although the governance framework was not completely democratic, it was more appropriately aligned than it had been and the basis of mutuality had been extended. The way was now open to recruit more widely in order to address demographic and employment conditions that constrained growth.

Preserving continuity and adaptation

While PSIS continued to be shaped by co-operative values and the principle of mutuality, the Board placed particular attention on commercial performance after 1987. Ten years later, successful recovery and growing financial strength provided a platform for shifting this balance slightly by emphasising more strongly the spirit of co-operation. In 1997, the Board adopted a Statement of Co-operative Values that directed the co-operative to help members through every stage of life by providing personal loans to those starting their careers, mortgage finance when they began families, and an array of savings products as they approached retirement. PSIS adopted a long-term view of its relations with members, who were more than just customers and distinct from shareholders. Under a new CEO, Girol Karacaoglu, the first to be recruited from outside the organisation, from 2003 PSIS developed a strategy to build even closer bonds with members. The Board had detected a broadly felt desire for people to support institutions that were responsible commercial citizens. The backlash to the financial debacles of the later 1990s produced a call for greater corporate social responsibility and ethical investment policies. In this environment PSIS's leaders recognised that the enterprise's co-operative values had a new and very relevant resonance. While the co-opeative continued developing new products and services and strengthened its unique niche position as a New Zealand-owned co-operative that operated a nation-wide network of branches and provided a full-range of consumer financial services, its values-driven orientation provided further distinction. The new approach signalled a strong desire to preserve continuity with the past – indeed to articulate a new connection with previous experience- and to communicate this goal in new ways to a new audience. (PSIS has recently introduced services specially designed to assist young people and small business owners.) Recognising, as the Rochedale Pioneers had over a century earlier that co-operative must operate in a market economy, but according to distinctive co-operative principles, PSIS's leaders articulated a new series of balances between the critical variables identified at the beginning of this article. This focus reflected knowledge of the past and a determination born of having stared into the abyss of failure.

Conclusion

This article has identified distinctive elements that shape the performance of co-operatives. From the past we can learn valuable lessons about how co-ops' internal attributes can be successfully aligned with the external business environment to promote efficiency and mutuality. Two salient points emerge. First, it is evident that leaders need to achieve workable balances between five sets of forces. However, it is also apparent that these positions of equipoise are related; each equilibria will affect the others. Second, the key to striking appropriate balances is effective communication. Leaders of co-operative businesses need to transmit in imaginative ways messages that retain the support members wish to give to such highly values-driven institutions.

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Notes

1 For example, the CEO of the Continental Bank of Canada recognised that the failure of two trust companies might induce a run on his company which, being the smallest of the country's chartered banks, was the most vulnerable to such contagion effects. He arranged standby lines of credit from the major banks just in case, and when the run did eventuate Continental could meet the withdrawals which quickly subsided once it became apparent that the bank had constructed in-depth defences.