

The Forward March of Co-operation Halted?

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Anyone familiar with recent labour history in the UK will be aware of the seminal essay by Eric Hobsbawm, *The Forward March of Labour Halted*, the 1978 Marx Memorial Lecture. In it he attempted to outline the economic, social and political changes that were taking place in society that meant that the idea that the left had a monopoly on the future was open to question. In this essay the author attempts to do something similar for the UK retail co-operative movement. It highlights the fact that for co-operatives to succeed at scale the need effective co-operative managers and member representatives and links the crisis at the Co-operative Bank and the Co-operative Group to a failure of co-operative education.

2012 was a great year for the co-operative movement. The United Nations had designated it as the International Year of Co-operatives, Dame Pauline Green President of the International Co-operative Alliance addressed the United Nations and UN Secretary-General Ban Ki-moon reminded 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-operatives UK and the Co-operative Group rose to the occasion with a major conference and Expo in Manchester called Co-operatives 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, government's consolidation of co-operative legislation through a new Co-operatives and Community Benefit Societies Act. Corporate capitalism was on the ropes, the co-operative and mutual sector had weathered the banking crisis and was growing. Entering 2013 co-operatives had never had a more favourable press in the public's eyes we were a 'good thing'.

Then the sky caved in. 9 May 2013 was the day of reckoning. That day, ratings agency Moody downgraded the Co-operative Bank's debt rating to "junk" status. It said the Bank was vulnerable to potential losses and warned it may need "external support" if it could not strengthen its balance sheet.

The Bank said it was "disappointed". As the Bank's chief executive, Barry Tootell, resigned and Project Verde, the bid to buy 631 branches from Lloyds, 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 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 would be forced to "take the axe" to costs. For a bank this was not new. The rest of the 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.

Some of this crisis had of course been caused by the bankers themselves, by their ridiculous growth strategies, reckless lending and of their taking risks on products they did not understand, in a mad greed driven feeding frenzy. That is not to offer an excuse. We were 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 failed. When a co-operative fails, people ask whether co-operatives can ever be made to work (Birchall, 2014).

This debacle created a new industry — an investigation industry. Externally, the Co-operative Group is now subject 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.

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 Bank and its recapitalisation there had been a clean sweep of the management following the retirement of Group CEO Peter Marks who was replaced 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 appealing over the heads of the board and elected members to individual members through a strange opinion poll run by You Gov asking customers and members to “Have your Say”. This was such a crude piece of polling that it was quickly seen through by pundits and activists alike.

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”. Now this is not completely ridiculous as Myners had previously led a review of the governance of life mutuals (to which incidentally the Co-operative Insurance Society had submitted evidence — pointing out: “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 ie 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-operative Group?

It seems odd that Myners should begin 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 the management structure and culture in which those decisions were taken; lines of accountability which governed those decisions; and the processes which led to them” and “To identify lessons which can be learnt to strengthen the Co-operative Bank and the wider Co-operative Group, and the co-operative business model generally”.

Seems like cart before horse to me.

The year all this was going on, the Co-operative Wholesale Society (CWS) had celebrated its 150th birthday and the occasion was marked by a splendid book *Building Co-operation* (Wilson et al, 2013). The 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 that time 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 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 over 100 years of independent trading came to an end in just a few weeks.

Needless to say prior to the collapse of the Scottish Bank the SCWS marked its centenary with a new headquarters building opened in 1968 by Her Majesty the Queen. Today the building houses Glasgow Council Offices.

Many of us attending recent Co-operative Group Annual and Half Yearly meetings had been watching the construction of 1, Angel Square, the Co-operative Group's new palatial headquarters, with a degree of trepidation. Such aggrandisement was a sign of hubris by a Chief Executive and almost always spelled disaster. Also to be opened by the Queen it became subject to a sale and lease back described by Lord Myners as an expensive addiction. Yet even the most cynical of us could not imagine the disaster that was to come.

Today's crisis is the biggest since 1997 when the Lancia Trust attempted to take-over and demutualise the CWS backed by such City luminaries as Hambros, Schroders and 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 was the former CEO Peter Marks who argued for a single national co-operative society. His climb to the top was thanks to a series of society mergers rising from CEO of Yorkshire Society via a merger with United Co-operatives to CEO of the Group when United in turn merged with the CWS.

Many people had misgivings in the way elected members had been persuaded to support these mergers with large pay-offs for loss of office. Grudgingly most commentators felt that at least the Co-op was back on the map. Mergers had bought some efficiency savings but Marks thought 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 hedged. Len Wardle became Group chair in 2007 and Marks CEO in 2008. The authors argue that Wardle offered Marks 'constructive criticism'. It is hard now to see anything constructive about this partnership.

Absorbing retail co-operative societies into the Group was one thing but now the target was non-co-operative businesses. His 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 in huff after his exorbitant pay had been revealed told us that this year the Group will lose over £2 billion. Mostly it would appear from ill judged acquisitions which according to Paul Myners are "breathtakingly value destructive" one of those was the purchase of Somerfield.

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

The Co-operative Bank has never been a co-operative, it began life as the Loan and Deposit Department of the CWS back in 1872 and ninety-nine years later it became a plc and a subsidiary of the Co-operative Group. The Directors had never been elected. They were appointed by the main Group board and to overcome any skills gaps in recent years they have included IPNEDs from the financial services and banking industry. Of the appointments, there was a minority of elected members. The annual report for 2012 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 maybe familiar, you may have her signature in your wallet. 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 Barclays 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 Bank a clean audit including a review of their 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. Tim is an exceptional banker it says on their 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 deal was a disaster. What ever political pressure there was it is clear now that something needed to be done about Britannia and the Nationwide could not swallow any more failing building societies. The Co-operative 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 CEO of the combined business was Neville Richardson the former CEO of Britannia making it a sort of reverse takeover. Peter Marks the Co-operative Group CEO determined to grow the business by acquisition at apparently any price.

With both the Bank chair and the Group chair captured, the stage was set for the step too far that finally bought the Group to its knees: Project Verde. Collectively these bad deals have left the Group carrying far too much debt. The danger 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. But 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 CEO of CWS 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-operative 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 or of the quality to run a large scale *co-operative* business.

This argument has been best expressed by Peter Davis in his work on Co-operative Management (Davis and Donaldson, 1998). 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 focused 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 banks advertising and branding did not simply reflect what members wanted and this is the key point — it enlarged what they wanted, it educated them.

All the surveys that put the Co-op at the top of any ethics survey are the legacy of this period. Not only did this recreate the co-operative brand it generated record surpluses to the CWS/ Group keeping the whole retail movement afloat at a critical time. Once he 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 mixture of charlatans and poorly educated idealists.

Is the situation recoverable? Mondragon which until recently was roughly the same size as the Co-operative 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, build a co-operative organisational culture ourselves 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-operative managers to come from the old home of the College at Stanford Hall included Ursula Lidbetter of Lincolnshire Co-operative Society and current Co-operative Group chair. Maybe that is a small glimmer of light.

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