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Co-operatives and the 'Conversion Syndrome' Abroad

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This paper attempts to describe the experiences of co-operatives in other countries as they decide to become investor, rather than member, owned businesses. It will look at the reasons for such conversions, the forms they take and attempt to assess what lessons might be learned from them. The extent of these conversions naturally varies from country to country but Australian co-operators have been sufficiently concerned by it to refer to it as the "Conversion Syndrome".[1] Hence, the title of this paper.

The paper has been approached from two angles, the geographical and that of experiences in different co-operative sectors. Examination of these has been assisted by information sent by a number of co-operative organisations which is acknowledged with thanks. Such information was necessarily diverse and has not permitted a scientific or exhaustive survey. However, it appears to suggest that the conditions and impetus for conversion occur in many countries, and that some types of co-operative are more prone to it than others. Prominent among these are co-operatives in the agricultural sector where, for more than a decade, a combination of the need for more capital and the desire of some members to increase their personal returns has led to structural changes.

Privatisation describes not only those co-operatives demutualising but also the state co-operatives in central and eastern Europe, Russia and elsewhere which are becoming companies or voluntary co-operatives under programmes of liberalisation or restructuring. These have been excluded because, although collective, they were not voluntary and therefore mutual in the sense that we use the term in free market economies. Moreover, their conversions are occurring in a phase that is temporary and unlikely to be repeated. Excluded also have been mutual organisations which are not specifically co-operatives such as other friendly societies in this country and mutual insurance businesses elsewhere. A problem throughout this paper has been one of definition. Terms such as "mutuals" and "co-operatives" can change under different countries' legislation which sometimes provides that co-operatives be registered as companies. At the outset we should also note a number of background factors.

Background to present situation

A number of world-wide common factors are creating a favourable climate for conversion. One is increased privatisation, illustrated by events in this country over the last 15 years, and followed to a greater or lesser extent in many other countries. Accompanying this have often been measures of deregulation aimed at increasing competition. The result has been that competition is now occurring more frequently on a global scale. In some countries deregulation has involved the lifting of import barriers which have left certain industries, and the co-operatives operating within them, more vulnerable. Alongside such developments new patterns of trade are resulting from the growth of large trading areas, such as the Americas, Europe, and the Pacific rim.

All these factors - privatisation, deregulation, and increased competition - create a climate in which privatisation becomes more popular and mutuality less so. Each will be seen at play in the following surveys.

Geographical survey

Moving from east to west, we are told that in Japan there have been few, if any examples of demutualisation. On the other hand there is increasing pressure from competitors who are challenging Japanese co-operatives' success on the basis of their special characteristics or advantages. There are also changes in the Japanese economy which are prompting co-operatives to reorient themselves. For example, the agricultural co-operative insurance business, having noted that Japan's "socio-economic environment is drastically changing ... due to the liberalisation and globalisation of financial business, deregulation, development of information-oriented society, the greying of the population etc", has decided to try to secure its position in two ways. One is to give priority to promoting members' interests. The other is to strengthen the links between primary societies and federations so as to be able to strengthen the technical ability of staff and to rationalise business operations.[2]

By contrast, in Australia conversions are already more advanced. Australian concern about conversions appears to lie more in the size and strategic nature of the societies involved rather than in their number. Only 49 co-operatives, out of over 2,300 were listed as having converted, but they represented "hundreds of millions of dollars (Australian) of annual turnover". Of these, nine were building societies, one an insurance co-operative, and another a credit society. The rest, termed "general co-operatives", included a number related to agriculture: sugar milling, dairy, ginger growers, citrus, egg, butter, abattoirs and fruit juices. Worse still, a report suggests that, "In the past two years there ... is hardly a significant co-operative that hasn't considered its corporate structure or the adequacy of its capital structure". It is thus feared that if the trend continues, a "critical mass" will be lost from the co-operative sector. The exception to this trend has apparently been among credit unions which have built strong representative and commercial structures, together with a good record of serving and assisting their members. They are held to have proved successful in a highly competitive industry and one that has been subject to deregulation.

A thread running through the arguments that other co-operatives used for conversion is that it is difficult to reconcile the co-operatives' de-emphasising of the role of capital with the need to obtain sufficient funds to remain competitive. Competition has undoubtedly increased as the Australian economy tries to strengthen its position in a region containing a number of "tiger" economies. Consequently, State and Federal governments have lifted regulatory restrictions on financial and rural industries which had already been adversely affected by relaxed import restrictions. Australian co-operatives claim that to be able to compete more effectively in this heightened competition, they require greater flexibility in their funding.

An interesting element in their situation is that, unlike co-operatives in many other countries, Australian societies have not developed second or third tier co-operative structures. Cronan suggests that had they done so - and particularly a co-operative bank - some of their structural weaknesses could have been remedied. Experience elsewhere suggests that he is right. In this context we have already noted the moves by the Japanese agricultural co-operative insurance group to strengthen links between primary societies and federations. Cronan also brings out in his survey the importance of appropriate co-operative legislation and, linked to that, the role of members. These are two constant features throughout the rest of this paper but they are perhaps seen most clearly in an Indian case. It concerned the Development Co-op Bank of Bombay whose attempt to convert also illustrates the fact that reasons, other than access to capital, can prompt changes in business form.

At a special General Body meeting in January 1995, the bank decided to convert into a Joint Stock (Banking) Company. Two members subsequently challenged this decision in court. They wanted it "declared illegal, null and void" on the grounds that the General Meeting had been illegal because insufficient notice had been given and over 90 per cent of the members had not received the notice. They also asserted that the bank should first have been dissolved as a co-operative before its status was changed, and asked that the bank should continue under the Maharastra Co-operatives Society Act 1960 and Multi-State Co-operative Societies Act 1984. The Judge found for them.[4]

The Indian press quoted one of the two members who brought the case as saying that the move to change the bank to a Joint Stock (Banking) Company, "had been done by the president of the Co-operative Bank to retain power in his own hands." If correct, it suggests that some conversions could be driven by officials anticipating advantages for themselves, either in terms of status or financial reward. In the context of this paper, though, the significance of the Indian case is that members were aware of what was happening, they were prepared to challenge it, and their position was strengthened by co-operative legislation.

Another factor at play in India is the continuing liberalisation of the economy under which many co-operatives are able to move away from their earlier close relationship with government. This is giving them greater freedom to face increasing competition and to consider other forms or organisation. Over the last few years, some large co-operatives, including dairy and sugar societies, have campaigned for "company" status. The idea of "co-operative companies" has gained ground. Shah suggests:[5]

> The idea of a co-operative company is an ideal response to this need to promote member-first model of co-operatives which has greater chances to survive and compete in an economic environment which is increasingly throwing farmers and their organisations to compete with private and multi-national enterprises.

Supporters of this idea urge that special provision be made in companies' legislation for the registration of Multi-state Co-operative Companies which would facilitate the business of large co-operatives operating in more than one Indian State. They also claim that Co-operative companies would differ from ordinary companies inasmuch as only their users could enrol as members at a fixed membership fee. Equity capital, however, could be contributed by non-members but these would not have the right to vote or seek election to the board. Another advantage claimed for co-operative companies is that they would have more flexible and less bureaucratic audit procedures than co-operatives because they would come under the Companies Act.

From the above it would appear that a hybrid organisation would be created. Elsewhere it seems that clear cut conversions do not always occur. Ambiguities can arise from the legislation under which they take place, or the form they ultimately take. For example, in some countries, co-operatives can register under co-operative, or companies' legislation. In Kenya and Zimbabwe, the more commercial agricultural co-operative enterprises can register under either. However, in Kenya, the Kenya Planters Co-operative Union, the Kenya Creameries Company and the Kenya Farmers Association, have opted to come fully under the Co-operative Societies Act. In Zimbabwe though, co-operatives with dual registration have decided to operate only under the companies Act.[6] A further confusion can arise when co-operatives decide that part of their operations will take the form of shareholding company. Such examples can be found among agricultural co-operatives in Scandinavia and Ireland.

In Denmark, changes in milk quotas and other regulations, as well as the growing internationalisation of food processing, have increased pressures on Danish agricultural co-operatives. Their resulting dilemma has been summed up thus:

> To secure the future development of the food processing co-operatives and the internationalisation of co-operative activities, it is important to establish models for providing risk-bearing capital which will ensure that co-operative members, as well as institutional investors, are able to protect their interests, and these models must preclude the possibility of members losing total control of the co-operative.[7]

They have evolved three ways of providing risk-bearing capital. One has been to take external capital but not to allow its providers internal influence in the co-operative which retains its existing structures. A second way has been the outright conversion of a co-operative into a shareholding company of the type we have seen in Australia. In this the original co-operative members may, or may not, hold the majority of shares. Even where they do, as we shall shortly see in Ireland, they may not continue to do so in the long run. A third way attempted by two large organisations in Danish co-operative food processing has been to place "particular aspects of the organisation under the control of a special shareholding company, thus allocating certain co-operative activities to the control and aims of the total group of investors, co-operative as well as institutional".

In Ireland, where agricultural co-operatives are to be found in the dairying, cereal and meat sectors, a not dissimilar situation has arisen. However, its problems were compounded in the late 1980s by predators, including the now discredited Goodman International. To try to improve the co-operative position, the Irish Co-operative Organisation Society (ICOS) urged mergers among societies in an attempt to reduce their fragmentation. ICOS also advised and gave assistance to co-operatives which wished to consider going down the plc route as a means of attracting necessary additional capital. Its main concern was to ensure the survival and development of "farmer-controlled" businesses. To do this, ICOS urged that 51 per cent of equity should remain in a co-operative's hands.[8]

A number of large Irish co-operatives have since gone down this route, including the Irish Agricultural Wholesale Society. Safeguards were built into their new rules requiring that if a co-operative's shareholding was to be allowed to drop below the 51 per cent level, at least 75 per cent of members present at a Special General Meeting should have to vote in favour of this. A second Special General Meeting would then have to be held within 28 days at which the Resolution passed at the first meeting would have to be ratified, again with 75 per cent of those present voting in favour. Despite such safeguards it is understood that two of the large co-operatives which went down the plc route are currently considering reducing their societies' holding to below 51 per cent.

Reducing co-operative fragmentation, and improving market share and profitability, have not been the only issues in the Irish situation. Another motive shown to exist in conversions is the widespread perception that money invested in co-operatives is "dead money" because co-operative shares cannot be traded. This also seems to be a factor in American conversions.

These can be typified by the cases in the late 1980s of six agricultural co-operatives; poultry marketing, rice milling and marketing, milk producers, cotton growers, a poultry marketing and purchasing co-operative, and a farmers' marketing and purchasing co-operative. These restructured in various ways. Three became companies, one was "acquired" by another co-operative, while the other two offered shares of their subsidiary corporations to the public. Schrader shows that each case had different features but summarised their underlying motives as being a "combination of financial pressures on farmers, a bull market in corporate equities, and lack of means for patrons to capture appreciation in the value of a co-operative as a going business".[9] He notes an important tension in such co-operatives which occurs when a co-operative that "produces net earnings in excess of the opportunity cost of equity capital may be worth more to investors as an ordinary corporation than it is to many co-operative patrons". To some extent this could be offset if farmers viewed their business as a family operation that would be passed down the generations, and if membership of a co-operative was based on the ownership of land which enabled a successful co-operative's performance to be eventually capitalised in the value of the land. "Thus, the patron does receive a price reflecting the value of the co-operative as a going business when he ceases farming as part of the price for or rent from the land associated with membership."

Sectoral survey

In comparison with agricultural and food processing co-operatives, there is no great movement towards conversion among workers' and housing co-operatives and credit unions abroad. Among consumer and financial co-operatives, however, the picture was somewhat different.

Consumer co-operatives show that, besides outright conversion, partial demutualisation can result from gradual changes. If two defining features of mutuality are taken to be the trading of members with each other to provide goods or services, and reliance on their own capital to do so, then we must conclude that some modern consumer movements are no longer fully mutual. Indeed, the Industrial Common Ownership Movement (ICOM), suggests that, because large retail societies trade extensively with non-members, they are not mutual organisations. On the other hand, ICOM classifies smaller food co-operatives which buy from wholesalers and distribute solely to their members, as mutuals.[10]

Perhaps this is over-simplifying because a movement as old as the British consumer movement is mutual in other ways such as through the transfer of assets from generation to generation and through the links of our federated system. Nevertheless, we have to admit that there have been massive changes among overseas consumer movements. Only two of these, the Dutch, and a large part of the German, have converted outright; even so this did not save them. Finnish experience is more mixed. In 1983, under company legislation, one of the country's two largest co-operative groupings, comprising 39 regional societies and their wholesale, merged to form the Eka Corporation. By the early 1990s, with a downturn in trade, accentuated by recession and the collapse of the USSR, as well as poor performances in building and insurance subsidiaries, a loss of confidence occurred. In 1993 business creditors brought bankruptcy proceedings which resulted in a restructuring and the creation of a slimmed down holding company. Today that concentrates on the retail and hotel trades and still considers itself a co-operative.[11]

As far as Austria is concerned, Konsum Osterreich's problems and weaknesses were not solved by its merger with the more successful Swiss MIGROS. Its bankruptcy was delayed, not prevented.

The Swedish consumer co-operative movement has also been forced to make major changes[13] but, like its Finnish counterpart, these are perhaps too recent to allow conclusions to be drawn.

We can note that conversions of the kind we have seen elsewhere have played little part in the decline of consumer co-operative movements. We should observe also that, in part, changes in retailing are the other side of the coin of what is happening in the food processing industries and to the producer co-operatives operating within them. In retail societies these changes have necessitated considerable rationalisation and distribution through larger outlets. In turn these have made it necessary to find new sources of capital, causing members' share capital to decline as a proportion of a society's total capital. Consequently, members' mutuality based on capital, has been weakened at a time when their mutuality based on trade has also declined through the need to increase sales to non-members.

The effects of a changing environment can also be seen among co-operatives in the financial sector. Insurance societies seem particularly worried by demutualisation threats. These are occurring as a result of governments' new policies and regulations, the effect of which has been to harmonise far more the capital requirements and taxation policies relating to insurance and financial services. As a result the capital requirements of co-operative insurers have been increased, so reducing their earlier competitive advantage. To some extent that had resulted from their being mutual insurers within the social economy and thus being allowed lower capitalisation. However, changes to this requirement are necessitating increased capital and that is leading some of them to consider demutualising.

The International Co-operative and Mutual Insurance Federation (ICMIF) has been sufficiently concerned to try to monitor the changing situation and to "identify means for financing co-operative and mutual insurance activities which reflect their values and principles". The Federation is also attempting to suggest "modern interpretations of co-operative principles that - while upholding the spirit of self-help organisations - encourage and support popularly based insurance companies to successfully operate in a competitive environment."[14] In a recent report, it noted the distinctive situation in Japan where co-operative insurance is more closely tied in with other co-operative activity than is commonly the case elsewhere:

> Every co-operative federation is made up of primary co-operatives that join the federation and have individual members that possibly become "mutual" insurance policyholders. A large part of a co-operative federation's capital is composed of share capital from the primary co-operatives, and the co-operative federations are not to raise capital from the market.

Earlier, reference was made to moves by the Japanese agricultural co-operative insurers to prepare for changes in the Japanese economy. Their proposals can now be placed in a structural context where they will perhaps lend weight to the view expressed by Cronan that Australian co-operatives suffered from not having second and third tier organisations. British co-operative history and theory illustrates the truth of this and the benefits that can arise from federal mutuality.

The ICMIF report asserted that, "Demutualisation may not be the best and most practical option to raise capital, but it is the most emphasised in literature." This points up the need to develop counter arguments which could usefully build on the views of Schrader and Conran touched upon earlier. Schrader suggested that, in agricultural co-operatives at least, other returns than the short-term financial should be emphasised. Moreover, both he and Cronan felt that co-operatives had insufficiently explored the ways in which their members might be encouraged to contribute more capital, and the terms on which they would do so. Such possibilities should be kept in mind when we come to consider future strategies.

In doing so we should take into account reasons for conversions suggested above. Important among these were changes in the overall environment, particularly in the nature of markets as in food processing industries and in countries where protectionism has been reduced. Increased competition has necessitated increased capital. Consequently co-operatives have been more ready to rationalise structures or to consider going down the plc route as a means of raising external capital. Conversions are also more likely to arise in economies that are restructuring and liberalising. They could occur when interest groups, such as co-operative officials, anticipated personal benefits, or result in a blurring of the co-operative form, as with the idea of "co-operative companies" in India.

Elsewhere interaction with the wider economy could be a predisposing factor. We noted Schrader's view that conversions were likely to increase if financial pressures on co-operative members occurred when there was a bull market in corporate equities but co-operative members were unable to benefit from the appreciation of their society's assets. The problem could worsen when a co-operative producing net earnings in excess of the opportunity cost of equity capital could be worth more to investors as an ordinary corporation than it was to its members.

The problem of meeting the need for increased capital was exacerbated by members being either unable, or unwilling, to contribute more. An inhibiting factor was considered to be co-operatives' traditional preoccupation with service to members rather than return on capital. This view strengthened where rules laid down that collective or inalienable reserves should be held, giving rise to the belief that money put into a co-operative became "dead money".

With these issues in mind we should now consider strategies to counter the apparent trend towards conversions.

Strategies

This trend cannot be quantified. Indeed, it may not exist. For example, the conversions that are occurring could be offset by the formation of new co-operatives: the extent, shape and nature of the co-operative sector is always changing. However, the above evidence suggests that there is a trend, particularly in some types of co-operative. Moreover, that the current climate is likely to encourage it to continue.

Given the central importance of the question of capital, the study commissioned by the UKCC, and undertaken by the Plunkett Foundation into the Financing and Taxation of Co-operatives, will be eagerly awaited. We cannot yet know what that will say. Nevertheless, it seems reasonable to suggest that it could usefully be augmented by other lines of research.

One would be to examine Schrader's assertion that "Demutualisation may not be the best and most practical option to raise capital, but it is the one most emphasised in literature."

If he is found to be right we will need to reshape the literature with counter-arguments. One might build on Schrader and Cronan's view that members could be enouraged to contribute more capital. We have perhaps been over influenced by co-operative officials' concern that members' share capital is easily withdrawable. We have therefore been slow to consider other forms of members' funding, particularly forms that allow members to benefit from any appreciation of a society's assets. The question of member benefits is central. History shows that co-operatives have been most successful when they have conferred tangible member benefits. That success has been reinforced when there has been a clear link between the money members put in to a co-operative enterprise and the benefits their enterprise provides in goods or services. History has also shown that self-financing has been the most economic form of capitalisation in co-operatives, also that if members are sufficiently motivated, they will save in order to make high initial contributions. Rochdale and Mondragon are the classic examples.

We should recognise, however, that different types of co-operative need different levels of funding which suggests a second and related line of enquiry. This should be into the question of whether capital problems could be more easily handled if each type of co-operative had its own set of working practices like the original Rochdale Principles. These undoubtedly helped the growth of consumer co-operatives by providing a formula for success but they have proved less relevant to other types of co-operative. The ICA's reviews of Co-operative Principles in the 1930s, 1960s and 1990s, have been complicated by the aim of producing a statement to encompass all types of co-operative. Unity should be valued but we should perhaps recognise that it is more likely to occur in the movement's underlying philosophy than in the working practices of its different sectors. Capital is an obvious example but, historically, there have been other difficulties. For example, open membership has always been easier in consumer, thrift and credit societies. Initially retail co-operatives advocated no credit trading but this soon became impracticable in the wholesales they created and later in agricultural and industrial producer societies. The present spate of conversions highlights the different capital needs of different types of co-operative. It therefore raises the question of whether there might be merit in encouraging different types of co-operative to have their own sets of working practices in the way that credit unions have devised theirs. All would be brought together, though, through a shared philosophy.

This brings us onto the third line of possible enquiry, namely how best to deploy an important part of that philosophy, co-operative economy: it should become a central plank in counter-arguments against demutualisation. It would go beyond the economic argument so far used in the debate which has been that members of privatising mutuals may receive an apparently generous one-off payment but their changed economic status will not necessarily be to their long-term economic advantage. Philip Ireland, in a recent article in this Journal,[15] touched on this and had resonance with the long-held co-operative view that economic activity undertaken on a mutual basis can produce economies which are unlikely if the same activities are undertaken for profit in a share-holding company.

Co-operative economic theory needs to be revised and redeployed in face of threats of demutualisation.[16]

Making the best use of counter arguments requires that you have a clear picture of what is happening in the conversion scene. Australia seems to have been the only country, and the International Co-operative and Mutual Insurance Federation the only co-operative sector organisation, to have carried out detailed surveys. A similar survey should be conducted in this country. In the meantime I hope that this paper will have helped to set the scene by showing what has been happening abroad.

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Notes

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