

The Renaissance of Mutuality: Britannia Building Society

Gerald Gregory

There was a time - say a year to 18 months ago - when any speech with the title "The future of mutuality" was due to attract wisecracks from the media and commentators. Bound to be a very short speech, they may have said. Don't use mutuality and future in the same sentence, they could well have added.

Mutuality is enjoying a renaissance. The debate continues, but I think it's fair to say that today mutuality is recognised as a viable, sustainable means of conducting financial services business now and in the long term. What has shifted opinion? Those major building societies which have rejected the headlong rush to conversion and plc status have re-committed to mutuality and used their creativity to modernise and adopt it. Societies are proving that modern mutuality is alive, kicking and relevant to the current and future needs of their members. I hope you will not call me immodest if we at Britannia claim that we are playing a leading role in this renaissance. We emphasised our commitment to mutuality by becoming the first building society to introduce a Members' Loyalty Bonus Scheme. It is the only Scheme which gives building society members a direct share in the profits. No dedicated commercial man should waste an opportunity to pitch for business, so I will save for later a more comprehensive explanation of our Scheme, how it works and how it is being received by our members. First, I'd like to explain to you why we felt it necessary to take this step, and I'll close by sharing some thoughts on how Britannia may continue to develop its mutuality, and indeed how mutuality itself may develop.

The great Mutuality v plc will run and run. You will all, I suspect, have heard the arguments for and against. Sadly, the debate has often come down to the quick buck issue. Many speculators have invested a few hundred pounds in building society membership in the hope that the society (or societies) they've joined will convert to a plc. They hope for a windfall payment from distribution or reserves, but where has this money

come from? A society's reserves have been built up by its members over generations to provide savers with security for their savings and protect borrowers from the worst effects of the interest rate cycle. No one has an individual right to those reserves. They are there for all members, present and future; this is not just a legal issue, it is a moral issue too. Do we really believe that someone who has held a few hundred pounds in an account for a year or two should be able to walk away with funds built up over many years by thousands of others? Clearly this is nonsense, reserves are just not up for grabs. The 'give us the money and we'll run' brigade see a commitment to mutuality as nothing more than a barrier to a fast buck. They clearly think it is a good thing that some societies have decided to become plcs purely on the basis that they'll get their windfall. It's very interesting to note how many self-confessed speculators fully intend to put any windfall profits back into a building society. Even those people who are attracted by the prospect of getting something for little or nothing seem to realise, in their heart of hearts, that there's always a price to pay. Our view is that this price is simply too high.

It is easy for mutuals like Britannia to appeal to the emotions and say: we're not converting because we're not selling our birthright. Frankly, that is not enough and it provides ammunition to those who, quite wrongly, attack mutuals as being quaint anachronisms. The acid test in the Mutuality v plc debate is: what is in the best interests of our members now and in the future? Level-headed commercial logic has to be applied. Indeed, the board of any building society is charged with doing so. It is their statutory duty. What matters, what really matters, is this: how should our business be constituted so that we can best meet our members' needs? At Britannia, our board examined in incredible depth all the options available for the development of the business, as any organisation worth its salt needs to. Continuous improvement is a fact of business life.

When the Halifax announced its conversion plans most society boards would have re-examined their strategy to ensure they were not missing a trick - if the largest mutual is giving up there must be a reason for it. The commercial logic runs that the mortgage market is commoditised and therefore only the most efficient can survive and cost efficiency = scale. The only problem is that there is no connection between scale and efficiency. The

board looked at conversion and rejected it, unanimously, in favour of a modern form of mutuality. The core of our argument is that as a mutual society, we exist solely to serve the interests of our owners - the members. There is a perfect alignment of interests when members are both owners of the society and valued customers. Our 1.6 million members own Britannia and they have a direct say in how we operate on a one person, one vote principle. It is direct accountability. Our competitors who are intent on becoming plcs are placing themselves in the unenviable position of having to mediate between customers and shareholders, whose interests will almost inevitably conflict.

If I can move outside the financial services arena for a minute, there is an interesting comparison to be drawn between plcs in the very competitive, consumer orientated financial services market and some of the more recent developments in supermarket retailing. Efforts are being made by some of the larger supermarket chains to make us all feel like valued members of a club. Affinity cards offering long term benefits of one sort or another are everywhere, and very welcome they are, too. But in this rush to lock customers in with special deals, quoted retailers run the risk of narrowing their profit margins to such an extent that the City loses interest. In fact, supermarket chains have historically been lacklustre stocks for precisely this reason - the fight to keep customers has left shareholders looking elsewhere for better returns.

It is a matter of record that banks have historically offered a poorer deal to their customers than have building societies. This is reflected both in interest rates charged and offered, and in levels of service. The July issue of *Which?* featured an article on "How to cut the cost of your mortgage" which explained how lenders can offer such large cashbacks and discount deals "because they have a huge book of existing customers paying the standard variable rate" and so existing borrowers subsidise new business. In contrast the article promoted Britannia stating "a few lenders including Britannia offer loyalty bonuses to long term borrowers". Clearly we are adding value to all members without penalising our existing members. I cannot believe that there is no connection between this and a desire to keep shareholders happy with ever higher profits and dividends. With the privatisation of water board, British Gas and other utilities, the philosophy of short term gains has become increasingly

apparent from a shareholder point of view, where they are interested in the profit margin of the company.

My point is that plcs in competitive consumer industries inevitably have to juggle between customers' and shareholders' needs. One group can easily be disappointed. It remains to be seen who the losers will be when the rash of building society conversions has died down, but if I were a member of a converting society, I would be asking my managers some very hard questions about where they anticipate their loyalties will lie. Unless they are content to be seen as an under performing stock, these managers will inevitably find themselves listening carefully to the demands of City institutions whose financial muscle will easily outweigh the interests of ordinary shareholder, let alone customer. Would the average plc shareholder-customer really be able to influence the future direction of their chosen financial institution if their interests clashed with those of a major pension fund or corporate investor?

At Britannia, we encourage members to nominate directors to our board so that we can be sure we are representing their interests fully and properly. This year there was a 60% increase in members voting. If anyone wants to change the direction that Britannia is taking, they can do it by persuasion, not by flexing financial muscle. I believe this is a valuable way of making sure that we continue to serve the interests of our members, rather than those of some external body more interested in short term profit than long term service. Nevertheless, we still have to be competitive and we have to offer our customers the services they demand. According to plc enthusiasts, this requirement presents us with grave problems.

The argument is that building societies are so constrained by the legal framework that has grown up around mutuality that they can't develop away from their core of mortgages and retail services. Not only are they forbidden by law from moving into new areas, but they can't borrow the funds they need to provide the necessary infrastructure. Our customers, we are told, are crying out for ever newer and more sophisticated products that can only be provided by plcs. I don't accept this for one minute. The average customer in the street would be hard pressed today to tell the difference between the range of personal finance products being offered by any top ten bank and those offered by any top ten building society. It wasn't always like this. You only

have to go back ten years to find a market in which the breadth of choice available to customers was nothing like what it is today. Then, you went to your mutual building society for a mortgage and a savings account, and to your publicly-quoted bank for a current account and possibly a personal loan. Your insurance would probably have been arranged for you by a broker who you went to see independently of your bank or building society. Leaving aside the endowment policy bought when you took out your mortgage, any other life cover would probably be set up the same way.

Compare this with today's world and it's simply not credible to claim that mutual societies cannot expand into new areas. Current accounts, unsecured lending and insurance are now everyday products for building societies. We are fully accepted by the public as mainstream providers of these services, and they contribute a healthy slice of our revenue. Even those restrictions which were written into the 1986 Building Societies Act have been steadily relaxed by successive Government reviews. The Government has now decided to move away from a legislative regime which prescribes in detail the activities which societies may undertake. Instead, societies will, in future, be free to pursue any activity not explicitly ruled out by the legislation - provided we retain, as our main purpose, lending secured on residential property, funded in the main by our retail customers. Only the most gung-ho of building society chiefs could see that as a serious constraint on the business. Certainly, we at Britannia now see no obstacles at all to providing our members with virtually all the personal financial services they could possibly need. Having said that, those building societies which have become banks haven't yet shown any signs of seriously expanding the range of service they offer. In fact, as a building society, the Cheltenham & Gloucester made a distinct virtue of confining themselves to their core business of mortgages and savings.

The only area which mutuals are still largely barred from is lending to companies, and that, perhaps, is a good thing. Certainly, Abbey National has shown no inclination to move into corporate lending, and its standing in the market, by comparison with the other major banks, has benefited immeasurably from this restraint. So if mutuals aren't constrained by law from providing the services their members are

demanding, are they stopped by lack of capital? This question is tied very closely to the issue of providing the owners of the organisation with value. All too often it's the people who say that mutuals must convert so they can tap the equity markets for capital, who then criticise us for not distributing retained profits to our members. You can't have it both ways. Either we don't have the funds we need to expand, in which case we don't have any retained profits to distribute, or we do have massive reserves, in which case investing some of them in the business to provide more and better services for our members is a perfectly reasonable way to provide them with value. The way in which building societies behave is driven by our members, not by external shareholders and their day to day requirements. Building societies have strong reserves to protect savers and our record in the industry of no saver losing capital is a proud one. Compare this with the BCCI or Barings collapse or the plc casualties like Polly Peck and Maxwell.

Our Members' Loyalty Bonus Scheme gives us a visible point of difference from other societies as our scheme awards our loyal customers with an annual one-off payment. We believe it is a first class example of modern mutuality in action. The Nationwide and Bradford and Bingley have chosen to demonstrate their commitment to mutuality through shaving percentage points off rates. We believe that straightforward changes in mortgage and savings rates are not enough to show that a society is fully committed to serving its members. Customers are already used to rates rapidly changing in the marketplace, and the effect of another rate change would have little impact in comparison to an annual bonus. Having made that point, there's clearly a strong case for recognising customer loyalty with some form of special concession or reward, and that is what we are doing with our Member's Loyalty Bonus Scheme. This shouldn't be confused with a shareholders' dividend. Rewarding our members for their membership has little in common with rewarding shareholders for their equity holding in a company; a dividend, as I understand it, is a reward for risk capital, which is paid as a distribution of profit.

Given that generally speaking our members have no invested capital in their society, the concept of dividend as a reward for risk is nonsense. However, the profits of the Society's business are generated by the behaviour of our members, and it is entirely

appropriate that profits in excess of those required to maintain the capital base of the society should be returned to the members. The manner of distribution should ideally reflect the contribution that the member has made to the profit. We didn't come to this conclusion without checking it with our customers; the development of the Scheme - which has taken 18 months - has been the most heavily researched strategic development the Society has ever undertaken and what's more it has been the most enthusiastically received strategy welcomed both by staff and customers; our Scheme has been designed to be fair and equitable to all our members and was introduced to specifically reward long-standing members for their loyalty and to add value to membership. It offers annual cash payments to members with qualifying mortgage or investment accounts. In the first year, we expect to pay out around £35 million - around a third of our profits. The payments will come from the profits made over and above those we need to support and develop Britannia's business and will not dilute the society's capital strength. We see it as a classic virtuous circle because the better the society does the more our members will get.

Members earn points each year depending on the size of their monthly mortgage payment, the amount they have invested in qualifying accounts and how long they have been with Britannia. Those who have been members for between five and nine years will have their total points multiplied by 1.5. From year 10 onwards, their points will be doubled. At the end of each year, we will declare a value per point depending on our profits. Each member will receive a loyalty bonus depending on how many points they have earned during the year. A typical customer will receive £49, during February and every subsequent February - it is also within the power of customers to increase their payment by changing behaviour - buy more of our products and your bonus will increase. Our research has shown that consumers will change their behaviour to receive payments of £50 - remember a typical new mortgage advance would qualify for an annual bonus of approximately £100.

Our Loyalty Bonus Scheme is not an alternative to competitive, innovative products and service - members will get these as well. We set out to make our Scheme fair and transparent and before we launched it earlier in 1996, we market tested it extensively among our members. It has been received with

enthusiasm. Currently, we are in the process of registration. So far, of 1.6 million members mailed with the details, 700,000 have registered. The more products our owner-members have with us, the more they get. What we have said to our members is that after the first year we are prepared to adjust the Scheme if there are some features that could be improved. Any responsive members' organisation should behave this way.

So where do we go next? One virtue of being a mutual organisation with a long term view is that we don't have to follow every fashion and run off down every blind alley for fear of falling behind our competitors in the race for short term profits. We can take a more measured view of what our members really will find helpful. Our corporate objective has been changed from volume and profit targets to an objective of maximising profits for eligible members. In the past, new customers tended to benefit from new mortgage deals at the cost of existing members but our aim is to take out the cross subsidy element between new and existing members. This will become more and more visible in our product design. In effect we're less interested in volume and more concerned with membership and profit.

As a modern mutual building society with no external shareholders to consider, it is very important that we get our message across and details of our Members' Loyalty Bonus Scheme to as many people as possible. Hence our decision to be the first society to make mutuality and our Scheme the centrepiece of an advertising campaign. The advertisement asks: "What kind of society do you want to be part of?" and outlines what makes mutual societies different from banks. To emphasise Britannia's commitment to mutuality we also changed our company branding to read Britannia - The Sharing Society. This is tangible evidence that we are a modern mutual determined to remain a successful member organisation.

Registration packs for the Members' Loyalty Bonus Scheme have now been sent to members, who are being asked to complete and return their forms. The enthusiasm with which the Scheme has been received has been extremely encouraging. It has also given Britannia an excellent opportunity to segment the database and build up a product picture of each customer across all their holdings. By storing information in this way, future product development and marketing campaigns can be planned with even greater knowledge of the existing customer base and

requirements. Understanding our customer base is vital to sustaining mutuality in the future and as a mutual organisation we are dominated by members' interest rather than the short term needs of shareholders. Compiling customer information in this way shows further evidence of Britannia's commitment to mutuality and effort to maintain a competitive edge for its members.

The explicit benefits of mutuality and members' ownership of the society must be visible. Our Scheme goes beyond simple pricing and represents an unequivocal commitment to visibly rewarding members for their continued, long term support. The key point is that we will remain a mutual. Touche Ross, in their recent study of the future of building societies, concluded "Mutuality is, and can continue to be, a valid and viable form of business entity. Indeed, it seems to have a number of highly desirable aspects. Despite this, its continuation is far from assured and depends very much upon the building societies' own determination to survive." Touche Ross clearly think, as I do, that mutuality is not a soft option. If we are to continue in business, we will have to be as good as the best, and deliver value to our members that is at least comparable to what they could expect from the best plc. At Britannia, we are determined to survive and prosper as a well managed, mutual organisation. We have far more to offer than the prospect of a quick buck. We want our customers to be able to enjoy the tried, tested and trusted benefits of mutuality for a long time to come.

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