21st Century Pioneers

The Co-operative Group Constitutional Review

Part 2

December 2007

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Acknowledgement

This report has been produced by Mutuo for the Co-operative Group's Constitutional Review Board. The report's purpose is to provide an evidence and information base upon which all stakeholders can draw in considering their contribution to the ongoing constitutional review.

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Peter Hunt
Mutuo, *December 2007*

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Part 2
The wider landscape: Key Source Documentation

This part of the report looks in greater depth at key sources used in the compilation of part one of the report.

Many of the arguments deployed are based on the findings of the research work and academic studies undertaken by Mutuo and its partners. For the benefit of this publication, some of the source documentation has been summarised and abridged. All original documents have been deposited with the Co-operative Group in their entirety.

1. The Current Structure of the Society

Overview

Co-operative Group Limited (the Co-operative) is an industrial and provident society, registered as a bona fide co-operative at the Financial Services Authority. It exists to serve its members as a co-operative, both as a primary society serving individual members, and a federal society serving its corporate members.

It is the UK's largest co-operative, and the parent corporate entity of a group of corporate entities which trade in food retail, financial services, pharmacy, travel, funerals, and other specialist services.

The Co-operative Group is owned and controlled by its Individual and Corporate Members. Representatives of Individual and Corporate Members populate a Board of Directors which is responsible for determining the vision and strategy, appointing and removing the Chief Executive and Secretary, and overseeing the Chief Executive and the executive team in their day-to-day management of the business.

The Chief Executive, who is not a member of the Board, is responsible for the day to day management of the business.

Individual Members are grouped by geographical area, and elect the members of their local Area Committee. Area Committees are grouped together into geographical Regions, there being currently nine Regions. One of these Regions is the United Region, being the geographical area covered by the former United Co-operatives, and this overlaps three of the other eight Regions. The United Region has four Regional Councils (rather than Area Committees), and a number of separate Member Relations Committees.

Area Committee members elect representatives from amongst their number onto Regional Boards. Area Committee members also elect representatives from Regional Boards onto the Board of Directors.

Any change to the Rules requires a majority of two-thirds of the votes cast on a card system at a Special General Meeting.

The rest of this section will set out the structures and arrangements in more detail, in the following order:

- Members
- Members Meetings
- Area Committees
- Regional Boards
- Board of Directors
- Board Committees
- Executive
- Values and Principles Committees
- United Region structures
- Secretary and Secretariat
- Alterations to Rules

Members

The Co-operative Group has two categories of members, Corporate and Individual Members.

Corporate membership is open to a "society or company or corporation" making an application for membership as a Corporate Member. Such an applicant has to apply for corporate shares, and the number of shares is in proportion to the number of members of the applicant[1]. Apart from this, there are no other eligibility criteria for Corporate Members, but the obligations of membership (purchasing from the Society such goods and services as the Society is able to provide)[2] plus the requirement to apply for substantial numbers of shares effectively means that only other retail societies are likely to wish to become members. The Board has an absolute discretion to grant or refuse an application for membership[3].

Individual membership is open to any person making an application for membership as an Individual Member. There are no eligibility criteria for Individual Members, though the Board has an absolute discretion to grant or

1 What is the current requirement under rule 8, and do societies regularly have to adjust their holding of corporate shares to reflect changes to the number of their members?
2 Rule 15
3 Rule 7

refuse membership. The UK is divided into 9 geographical regions (including the United Region) which are themselves divided into 45 Areas (and 4 United sub-regions). Each Individual Member appears on the register of members for the Area in which they reside[4].

Members Meetings

The Co-operative Group has General Meetings (Ordinary General Meetings, which are the Annual General Meeting and the Half Yearly Meeting, and Special General Meetings)[5] .

It also has Members' meetings for Individual Members registered in each Region, which normally take place just before the Society's Annual General Meeting[6] , and Members' meetings for Individual Members registered in each Area, which normally take place just before the Half Yearly Meeting[7]. The purpose of these Members meetings is to receive a report from the Regional Board or Area Committee (as appropriate), and to enable Individual Members to raise issues to be considered by the Society's constitutional bodies.

In the United Region, meetings are now held twice a year and have a broadly similar format to the Area level Members' meetings which are held in the other Group regions. Across the United region, approximately 20 meetings are held twice a year – significantly more than in comparable Group regions.

Individual Members have the right to attend the Members meeting in their Region, and the Members meeting in their Area. However, they do not have a right to attend the Society's General Meetings. Instead, they are represented at General Meetings of the Society via delegates from their Region, who must be members of the Regional Board, or of an Area Committee (Regional Council in the United Region). The number of delegates which a Region is entitled to send to General Meetings, and the voting strength at such meetings is based upon purchases by the Region from the Society. There is no direct link between Members meetings in Regions and Areas, and General Meetings.

4 Regional Regulation 6
5 Rules 67 and 72
6 Regional Regulation 8
7 Regional Regulation 9

According to the rules, the Regional Boards have the right to appoint the delegations to General Meetings (subject to the right of each Area Committee to nominate a delegate[8]), to "mandate" delegations, to submit motions, put questions to and cast the Region's vote[9]. (Identical provisions apply to the United Region[10].) In other words, it is formally for the Regional Boards to determine how votes are cast at General Meetings. In practice however, it is commonly the case that they leave the decision about how votes are to be cast to the delegates at the meeting, thus enabling wider participation (from Area Committees) in how the votes are cast. Votes are cast as a block, and not split.

Corporate Members attend General Meetings of the Society via delegates, and the number of delegates they are permitted to send is based on their purchases from the Society[11]. On any vote at a General Meeting which is either a card vote or a referendum, the number of votes for each Corporate Member is based upon purchases. "Purchases" for the purposes of determining both the number of delegates and voting strength at meetings are determined by provisions contained in the rules[12].

Area Committees

Currently the size and composition of the Area Committees is fixed at their current membership pending this Constitutional Review, but historically the number was between 12 and 16 members[13]. Individual Members may be nominated and elected (by Individual Members in each case)[14] onto Area Committees, subject to qualification criteria, for a three-year term of office.

Members are elected to serve on Area

8 Rule 23 (a)
9 Rule 22 (a)
10 Rules appendix 2 paragraph 3 (a)
11 Rule 82
12 Rules 86 and 87
13 The old provisions on size were deleted in the rule changes introduced to enable the transfer of engagements with United to take place.
14 Regional Regulations, Appendix 4 paragraphs 2 - 19

Committees by postal and internet voting. With the re-launch of the Membership Proposition, the practice in relation to determining who should receive a ballot paper automatically has been changing. When elections are coming up, posters always appear in stores notifying members of the fact. This information also appears on the website. If elections had taken place in September 2007, information would have been included in the general mailing to members in July, which goes to approximately one million people. The Single Transferable Vote (STV) is used for elections. Results of ballots are declared at the Area Members Meetings.

There are provisions to prevent more than two people from any family serving at the same time on an Area Committee; to limit the number of employees serving at any one time to one third; and to provide that employees and members of their families together should always be less than 50% of the total members.

There is currently an age rule requiring a person to retire from an Area Committee at 70.

Area Committees have a number of functions in terms of the links between members and the Board/Executive. In particular, they

- may appoint one of their number as a member of the delegation from the Region at General Meetings;
- may nominate one or more of their own number (who qualify) for election as a member of the Board[15];
- may nominate one or more of their own number (who qualify) for election as a member of the Regional Board[16];
- select by secret ballot their own representatives to the Regional Board[17].

Area Committee members have the right to vote in (Regional) elections to the Board[18]. Rule 23 states that Area Committee members have this right "on behalf of their Area", though it is assumed that individuals exercise their voting rights individually, rather than on a mandated basis.

As well as these and various other appointing functions, Area Committees have a number of functions in relation to trading in their Area, including receive trading reports, raising matters relating to the business, making recommendations, being consulted about closures, disposals and new developments, providing local intelligence and knowledge to management, and conducting store visits. In relation to membership, the Area Committees plan and deliver a range of events and activities in the Area, plan the allocation of the membership budget, develop and monitor the activities of informal local Members' groups, and allocate Community Dividend awards. The full roles and responsibilities of Area Committees are set out in the Regional Regulations[19].
Area Committees meet monthly. Area Committee members also have the opportunity to attend at least one, and not more than two annual Regional Conferences, the purpose of which is to act as a forum for them to receive or exchange information, best practice, or engage in the training opportunities.

Regional Boards

Currently the size and composition of the Regional Boards is fixed at their current membership pending this Constitutional Review, but historically the number was between 12 and 16 members[20]. Having served on an Area Committee for 24 months, an Individual Member may then be elected onto a Regional Board. As with Area Committees, there are provisions to prevent more than two people from any family serving at the same time; to limit the number of employees serving at any one time to one third; and to provide that employees and members of their families together should always be less than 50% of the total members.

Different electoral processes apply in different Regions, but broadly every Area has a seat on a Regional Board, and as explained above, it is the Area Committees who nominate representatives and Area Committee members who select by secret ballot their representatives

15 Rule 23 (b)
16 Rule 23 (c)
17 Regional Regulations, Appendix 4 paragraph 26
18 Rule 23, and Rule 110

19 Regional Regulations, Appendix 7
20 The old provisions on size were deleted in the rule changes introduced to enable the transfer of engagements with United to take place.

to the Regional Board.
The roles and responsibilities of the Regional Boards are set out in Appendix 6 of the Regional Regulations under two headings, Commercial, and Constitutional and membership. The first heading includes the following:

- Reviewing management proposals in respect of the regional revenue and capital expenditure budgets and making recommendations to the Board
- Receiving and monitoring sales and profitability of the Region against budget and previous year to ensure improved performance and growth
- Receiving and monitoring performance of the Region against KPIs
- Making recommendations in respect of the development of the Region
- Considering capital expenditure proposals for the Region, authorising those between £50,000 and £3m, noting those below that limit, and reviewing those above and making recommendations to the Board
- Approving proposals for the closure and disposal of core trading units in the Region
- Receiving national sales and profitability information on the Society's trading operations

Under the Constitutional and membership heading, the following are included:

- Appointing and mandating delegations, submitting motions, putting questions to and casting the Region's vote at General Meetings and other meetings
- Laying before Members meetings in the Region reports detailing the trading and financial performance
- Considering the wishes of Members as expressed via resolutions at meetings
- Overseeing the work of the Regional Values and Principles Committee
- Engaging with local and regional government on Society interests and Co-operative values and principles

Regional Boards meet monthly. There is also an annual national conference of Regional Boards. In addition, from time to time, the chairs of Regional Boards meet with the Chair and Chief Executive.
Each Regional Board establishes its own Regional Values and Principles Committee[21] (see further below under Board Committees – Co-operative Values and Principles Committee).

Board of Directors

Currently the size and composition of the Board is fixed at its current membership pending this Constitutional Review[22]. The Board currently comprises the twenty-five individuals in office at the Amalgamation date, plus eight Directors appointed by and from the United Board. The twenty-five comprise seventeen Regional Directors, representing Regions as per Rule 100 (b), and eight Corporate Directors elected via corporate elections[23] (there were previously eleven, but one vacancy arose and was not filled, and two seats where held by United as a Corporate Member).

Historically, as described above, Regional Board members are nominated as candidates for the Board by Area Committees, and they are then elected in regional elections by Area Committee members individually from within their Region. The number of votes cast by individual Area Committee members is based on the volume of trade within their area, equally divided between members of each Committee. The Area Committee members only vote in the election of the Directors standing for the Board in their own Region – they are regional not national elections.

Corporate Members elect their representatives directly via a (national) corporate election. To be eligible for election in a corporate election, an individual must be either a member of the governing body, or the chief executive, secretary or senior manager reporting directly to the chief executive of the relevant Corporate Member[24]. Voting strength in corporate elections is also determined by purchases[25].

21 Regulation 30
22 Rule 95(a)
23 Rule 117
24 Rule 118 (a)
25 Rule 102

The Board's duties are set out in rule 144, and in summary comprise the following:

- ensuring that Society's affairs are conducted in accordance with its purpose and objects, and the best interests of Corporate and Individual Members;
- determining the vision and strategy of the Society in consultation with the Chief Executive and the Executive;
- overseeing the Chief Executive and the Executive in the day-to-day management of the business.

The Board's rights and powers are set out in rule 145 and in summary comprise the following:

- exercising all the powers of the Society (residuary powers);
- appointing, removing and fixing the terms of office of the Chief Executive, Deputy Chief Executive and the Secretary;
- being able to call for reports on any aspect of the Society's business;
- determining those transactions which require approval by the Board;
- approving use of the seal;
- the power to delegate, subject to certain specific and some general limitations.

The Board meets monthly. In addition, it usually meets twice a year to discuss and approve forward strategy.

Board Committees

Rule 146 requires the Board to appoint four committees.

The **Audit and Risk Committee** oversees the preparation of the Society's accounts, monitors the Society's financial performance and control systems and co-ordinates the work of any
corresponding committees appointed by any other member of the Group. There are approved terms of reference (September 2007), which set out the membership. There are to be not less than six members. The Chair of CFS Audit & Regulatory Compliance Committee is a member, and the Group Chair may not be a member. The Chair of the Committee is to be appointed by the Board and is to be one of the Society's Deputy Chairs.

The **Remuneration and Appointments Committee** makes recommendations as to the remuneration of the Society's senior employees, and as to the plans to be made for the continuity and development of the Society's business, and co-ordinates the work of any corresponding committees appointed by any other member of the Group. There are approved terms of reference (September 2007) which set out the membership. There are to be not less than eleven members, including the Chairs of the Group, CFS, CIS and the Bank, one of the Group Deputy Chairs, and other directors from the Group Board including two from the United representatives.

The **Co-operative Values and Principles Committee** monitors the implementation of the Society's membership, political, community and co-operative strategies, and co-ordinates the work of any corresponding committees appointed by any other member of the Group. The latest terms of reference are from 2006, revised to accommodate United, and new terms of reference are needed. The committee comprises one of the Deputy Chairs who is to chair the committee, one Director from each Region, three from the United Region, up to three Corporate Directors and one Director from the CFS Board (to be nominated by the CFS Board). The Group Chair is to be an ex officio member.

Each Region also has its own Values and Principles Committee, appointed by the Regional Board[26]. Terms of reference for the Regional Values and Principles Committees are set out in Appendix 11 of the Regional Regulations. These provide that the membership is normally to comprise three representatives of the Regional Board, one of who is to be the Chair or Deputy Chair, and one representative from each Area Committee. The aim of the Regional Values and Principles Committee is to work with members and officials to ensure that the national membership strategy is put into effect. It reports directly to the Regional Board on progress of this

26 Regulation 30

implementation. The members of the Regional Values and Principles Committees are entitled to attend the annual national conference convened by the Board Committee.

Chair's Committee

This Committee is provided for the purpose of the functions set out in rule 147 (b), under which the membership of the Chair's Committee is to comprise the Chair, the Deputy Chairs, the Chief Executive and such other persons as they may from time to time determine. This Committee is authorised to deal with matters where (i) the Chief Executive is unable to act on account of some limit or restriction on delegated authority imposed by the Rules or the Board, and (ii) it being impractical in the judgement of the Secretary to convene a Board meeting, or to obtain a written resolution under rule 150.

Executive

As follows from the description of the Board above, the Chief Executive is not a member of the Board, or any other part of the democratic structure. The Chief Executive is appointed, and can be removed by the Board.

Rule 147 (a) provides that the Chief Executive is responsible, assisted by the Executive, for the day-to-day management of the business of the Society. In so doing, the Chief Executive has full power to act for and in the name of the Society. It is for the Chief Executive to appoint the Executive, in consultation with the Board. The Chief Executive may delegate powers to any member or members of the Executive, each of who reports directly to the Chief Executive.

United Region structures

At the time of the transfer of engagements of United, it was agreed that pending this Constitutional Review, the existing democratic structures of United would be preserved, and continue to operate, so far as possible.

The former board of United Co-operatives elected eight of its members to the Board of the Co-operative. The former board of United has itself effectively become the Regional Board for the United Region. It comprises sixteen individuals, four elected by each of four Regional Councils (Northern, Southern, Central and Yorkshire). Its functions are set out in what is now Appendix 2 of the Regional Regulations for the United Region, which basically mirror the functions of the other Regional Boards, with some exceptions.

The functions of the Regional Councils are set out in the Regional Regulations[27], and are as follows:

- to appoint representatives to fill any vacancies on the Regional Board;
- to perform the roles and responsibilities set out in Appendix 3 to the Regional Regulations; and
- to co-opt a minimum of 1 and up to a maximum of 4 of their members onto the Members Relations Committee(s) within their Region.

Appendix 3 sets out a number of functions in relation to trading in their area which broadly mirrors the functions of Area Committees in the other eight regions, including receiving trading reports, raising matters relating to the business, making recommendations, providing local intelligence and knowledge to management, and conducting store visits. The one role which they do not have compared to Area Committees is being consulted about closures, disposals and new developments.

Individual members of United directly elect the members of the Regional Councils. In addition, individual members directly elect members of Member Relations Committees (which have no direct parallel within the democratic structures of the Co-operative), of which there are ten such committees. Voting takes place at members' meetings. Members are able to request a postal vote if they are unable to attend the meeting. In addition to directly elected members, Member Relations Committees also include the co-opted Regional Council Members referred to above.

The functions of Member Relations Committees are as follows[28]:

- encourage the highest level of member participation within the Society's trading and democratic activities and structures;

27 Regional Regulation 26
28 Regional Regulation 29

- develop and support a range of social, cultural and educational activities for members, their families and the wider community which promotes both co-operation and the Society as a co-operative organisation;
- ensure such education of members, their families and the wider community in the principles and practices of co-operation and in furtherance of their interests as consumers as will promote the interests of the Society as a trading and social organisation;
- subject to control by the Regional Board, be responsible for the budgeting and administration of such funds as may be allocated for the work of the committees as specified under paragraph 13 of Appendix 2 of the rules;
- develop Co-operative Members' Groups and/or other similar organisations which will be charged with the task of encouraging member involvement in the Society in the area they cover; and
- publish such material, arrange such events, make such grants and pay such expenses as may be conducive to the success of the foregoing endeavours.

This list of functions reflects those set out in the rules of the former United Co-operatives, which itself reflects a different heritage. There is considerable overlap with the list of comparable constitutional and membership functions carried out by Area Committees. It remains to be seen in practice how much overlap there is.

Secretary and Secretariat

The Secretary is appointed and removed by the Board[29]. The Secretary has the functions set out in the Rules, is returning officer at and otherwise responsible for the conduct of all elections and referenda, and has such other functions as the Board may from time to time assign[30].

The Society's Secretariat has a substantial role to play in servicing the various democratic structures. Each Region has a Regional Secretary, appointed by the Secretary, subject to the approval of the Regional Board Chair and the Board of the Society. Similar powers exist regarding the appointment of a Food Retail Chief Officer. The Regional Secretary appoints an Area Committee Secretary to administer the operation of area committees and other key democratic practices within the region. Each region also has Co-operative Affairs Officers who are also charged with maintaining a working relationship with area committees and the regional values & principles committee . In practice, the Secretariat plays a significant role in running and managing the various meetings within the democratic structures.

Alteration of Rules

Any change to the Rules requires a majority of two-thirds of the votes cast on a card vote at a Special General Meeting. This means that any changes to the Rules are decided by Regional Boards, unless they leave that decision to the Region's delegates as set out above.

29 Rules 145 (b) and 174
30 Rule 174

2. Published Literature Review

Private sector theories of corporate governance

There have been a number of theories developed to explain the issues and problems of governance in the private sector. Each of these suggests a different model of the principle governance problems faced by companies, as well as the different functions that their boards are seen as serving.

Until now, the dominant theory of the corporation and corporate governance arrangements has been agency theory. This assumes the separation between the ownership and control of firms, and that while shareholders may own large corporations; control tends to reside with the management. The interests of managers and owners can diverge, which can lead to firms being run in the interests of managers rather than shareholders. Whilst under this model, free markets are seen as the best restraint on managerial discretion, corporate governance arrangements are also seen as another means to ensure that the management acts in the best interests of its shareholders. It therefore suggests the main function of the board is one of control, to ensure that firms are run for the benefit of its owners, rather than its management. This requires that a majority of board members should be independent of management, and that their primary role is that of ensuring compliance[31].

By contrast, stewardship theory suggests an entirely different role for the board in the governance of a firm. It assumes that management will want to do a good job, and will act as an effective steward for the corporation's resources. Instead of seeing a conflict of interests between senior managers and shareholders, it sees these interests as complementary. This means that the main function of the board is not to ensure compliance, but strategic; in short, to work with management and help them to 'add value' to key decisions. It therefore suggests that board members should be selected on the basis of their expertise and skill so that they are in a position to improve strategy and decision making within the organisation[32].

Resource dependency theory suggests that organisations are highly reliant on their external environment for their success, depending crucially on other actors and institutions for their resources. As a result, it is proposed that they need to find ways to manage this dependence to ensure that they get the information and resources that they need to survive. This theory suggests that the principal role of the board is to maintain good relations with the key external stakeholders that the organisation is most reliant on[33].

Stakeholder theory is based on the idea that organisations should be responsible to a range of groups, outside of its immediate owners, all of which have a 'stake' in how the organisation is run. It suggests that the representation of a broad range of stakeholders is necessary to ensure that it is likely to respond to the needs of all those that have an interest in its success, not just its owners. This sees the primary role of governance as playing a political role, negotiating and resolving the potentially conflicting interests of different stakeholder groups in order

31 Keasey K, , Thompson S and Wright M (1997) 'The corporate governance problem – competing diagnoses and solution,' in Corporate Governance: Economic and Financial Issues, Oxford University Press, Oxford; Berle, A and Means, G (1932) The Modern Corporation and Private Property, Macmillan, London; Demsetz, H, (1982), 'The Structure of Corporate Ownership and the Theory of the Firm,' Journal of Law and Economics, 26:375-389; Mace, M (1971) Directors: Myth and Reality, Harvard University Press, Cambridge MA; Cadbury Committee Report (1992) Report of the Cadbury Committee on the Financial Aspect of Corporate Governance, Gee, London, Jensen M and Meckling W (1976), 'Theory of the Firm,' Journal of Financial Economics., 3: 305-360; Fama E and Jensen M (1983), 'Agency Problems and Residual Claims,' Journal of Law and Economics, 26, 2:327-349; Shleifer A and Vishny R (1989), 'Management entrenchment: the case of manager specific investments,' Journal of Financial Economics, 25, 123-139

32 Davis J H, Schoorman F D and Donaldson L (1997) 'Toward a stewardship theory of management,' Academy of Management Review, 22: 20-47 Muth M M, and Donaldson L (1998), 'Stewardship theory and board structure: a contingency approach,' Corporate Governance, 6, 1: 5-28; Hung H (1998), 'A typology or theories of the roles of governing boards,' Corporate Governance, 6, 2: 101-111, Kay J and Silberston A (1995), 'Corporate governance,' National Institute Economic Review, 153: 84-98

33 Pfeffer J and Salancik G R (1978), The External Control of Organisations: a resource dependence perspective, Harper and Row, New York

to determine a strategy that will benefit them all.[34]

However the problem with all of these approaches is that they tend to be rather one dimensional, and ignore the complexities involved in the governance of modern organisations. One way of addressing this problem is to take a multi-faceted approach to these governance issues, and explore the tensions and differences between these models than arguing the differences between them. An example of this is the work of Sundaramurthy and Lewis who argue that in order to understand governance performance it is necessary to develop an approach that combines both control (agency) and collaborative (stewardship) perspectives. They state that while 'a control approach helps curb human limitations through vigilance and discipline…a collaborative approach taps individuals' aspirations via co-operation and empowerment. Yet if one approach becomes overemphasised, perils of groupthink or distrust can fuel reinforcing cycles[35].'

One can suggest that the same case can be made for all of these governance models, especially if they are to be applied to co-operative models. Any attempt to design an 'ideal' system of governance will need to encompass all of these approaches, and find ways in which it can minimise the tensions inherent in these contrasting models.

Co-operative Governance

Theories of Degeneration

Whilst many theories of co-operative governance have been shaped largely from the perspectives of these governance approaches to investor owned companies (see later), there is also an independent literature that exists on the role of governance in co-operative and mutual organisations. Perhaps the most influential of these has been the degeneration thesis, which although first outlined as a potential danger by the Webbs[36] , has been more recently developed by Meister. Meister's theory is loosely based on Michels' study of political parties in the early twentieth century. Examining the increasing size and complexity of these organisations, it concluded that they would need 'professional' leaders that would accumulate the decision making powers within the organisation. For Michels this was part of the 'iron law of oligarchy' in which he stated that democracy requires organisation, but that all organisations have a tendency to oligarchy[37].

The work of Meister extends this theory into democratic organisations that carry out economic activities. It identifies four stages of internal transformation (or degeneration) of association or co-operatives into managerial enterprises, during which the powers of the management grow, due to their growing technical, economic and organisational complexity. These powers are seen as eventually becoming hegemonic as economic goals begin to predominate over the social and self managing goals of an organisation[38]. This thesis has been extended to from a membership perspective by Vierhaller, who suggests that as size and economic complexity grow, membership apathy increases proportionately, leading to a change in the aims of its members as they become less ideologically motivated[39].

The different stands of degeneration theory has been categorised by Cornforth et al into three types. The first, formal or constitutional degeneration is seen as ocurring when cooperatives revert to a capitalist form, with some members losing democratic rights which were originally exercised by all of them. The second category is defined as goal

34 Kimberly J, Norling R and Weiss J A (1983), 'Pondering the Performance Puzzle: Effectiveness in Interorganisational Settings,' in Hall R H, and Quinn R E (eds.), Organisation and Public Policy, Sage London; Freeman R E (1984), Strategic Management: A Stakeholder Approach, Pitman Press, Boston; Wheeler D and Sillanpää, M (1997), The Stakeholder Corporation: A Blueprint for Maximising Stakeholder Value, Pitman, London

35 Sundaramurthy C and Lewis M (2003), 'Control and Collaboration: Paradoxes of Governance,' Academy of Management Review, 28, 3:397-415

36 Webb S and Webb B (1921), The Consumers' Co-operative Movement, Longman, London

37 Michels R (1962), Political Parties: A sociological study of the oligarchical tendencies of modern democracy , The Free Press, NY

38 Meister A (1984), Participation, Associations, Development and Change, New Brunswick, NJ

39 Vierhaller (1994), 'Oligarchy in co-operatives,' in Dulfer E (ed.), International Handbook of Co-operative Organisations, Vandenhoeck and Ruprecht, Göttingen, pp. 647-651

degeneration, which occurs when co-operative goals are replaced by capitalist goals of profit seeking. The final is that of organisational degeneration, where (as Michels and Meister both argue) control becomes concentrated in the hands of an elite. Unlike Meister though, whilst they recognise the degree to which internal and external forces constrain the degree to which democratic control and alternative priorities can be maintained in co-operatives, they do not see these as determining factors[40]. Indeed, as Batstone has shown, there also remains the possibility of co-operative regeneration, which 'breath life back into co-operatives' ideals.'[41]

An alternative view of the life cycle of co-operatives can be seen in the work of Malo and Vezina[42] , who see the evolution of collective enterprises in three stages. The first stage is that of its emergence, which is played out largely as a pioneering experiment. This is then followed by its spread through replication, which is linked to standardization and the spread of a federal structure. The third stage is felt to be critical, where tension develops between local innovation and the driving of standards across the wider body.

This is seen as leading to three options for the development of large scale co-operatives. The first, standardization, conforms largely to the degeneration thesis, in which instead of remaining a distinct co-operative business, the organisation seeks to position itself much like any other company in the mass market. The co-operative views its members as clients, and by the same token the clients tend to view the co-operative in the same consumerist way. Drives to make the enterprise economically efficient result in centralisation, with governance only operating at a national level and management becoming technical and mechanistic. This is also seen as an open door to degeneration, as the need for expansion requires the sale of equity, opening the door to demutualisation.

Yet it stresses that there are other paths for the large scale co-operative enterprise. The first is that of balanced growth through focusing, which brings the enterprise down the path of innovation. Instead of seeking to expand its market to new customers, it targets its existing members for whom the co-operative's services were originally targeted. The latter, and more attractive approach, is that of balanced growth through hybridization, where the big collective enterprise recognises the diversity of its membership, and differentiates between individuals as groups or networks of relationships based on some sort of common bond. Internal stakeholders are involved and roles are reaffirmed in the strategic process, which orchestrates pilot experiments to allow new strategies to evolve. While integration in governance is required to hold the complex organisation together, the global strategic apex plays a unifying role.

A third thesis on degeneration looks to the costs involved with sustaining democracy in large scale co-operative enterprises. The work of Hansmann[43] explains the development of different forms of ownership as the result of 'lowest cost assignment,' and suggests that in certain situations these costs are minimised if ownership is assigned to the class of patrons for whom the problems of market contracting are most severe. Collective ownership is also seen as involving 'governance costs,' and it is argued that degeneration occurs when these become too high as a result of a lack of homogeneity and conflicting interests among owner members. However, one can make the criticism that this study is based on case studies derived solely from the USA, and does not include the large consumer, worker and agricultural co-operatives that can be found in Europe[44].

40 Cornforth C, Thomas A, Lewis R and Spear R (1988) Developing Successful Working Co-operatives, Sage, London.
41 Batstone E (1983), 'Organization and orientation: a life cycle model of French cooperatives,' Economic and Industrial Democracy, 4
42 Malo M, Vézina M (2004), Governance and management of collective user-based enterprises: value creation strategies and organisational configurations, Annals of Public and Co-operative Economics, 75, 1:1-166

43 Hansmann H (1996), The Ownership of Enterprise, Harvard University Press, Cambridge MA
44 Shaw L (2006), Overview of governance issues for Co-operatives, Global Corporate Governance Forum

Co-operative manifestations of the corporate governance debate

Much of the work on co-operative governance is grounded in the theories that have informed the wider corporate governance debate. One can certainly suggest that there are a number of agency conflicts inherent in the system of co-operative governance, with members replacing shareholders as principles. It is a feature of the literature on co-operative governance that managers are even more powerful in member based organisations than they are in shareholder based ones. In agency theory, it is assumed that the major interests of shareholders is to maximize profitability and that the price signals of share prices, along with pressure from major shareholders and the threat of takeover will tend to keep managers aligned to this goal.

However this situation is very different from that faced by a co-operative enterprise. Firstly, co-operatives exist to serve the interests of their members, and profitability is therefore a means to an end rather than an end in itself. Given that shares are not tradable or revalued, there is a likelihood that members do not have an interest in profitability or the return on capital. For consumer members, lower prices and higher quality are likely to be far more important which means that there are greater difficulties in defining the goals of the organisation. A second and related point is that the lack of tradability of co-operative shares means that there are not the same external pressures on managers to perform.
Mergers and acquisitions are considered an important institutional mechanism for waking up cosy managers and cosy board relations in the private sector, but without demutualisation there is no substitute for this in co-operative enterprises. Indeed, the lack of institutional investors, difficulties in forming coalitions, and dispersed influence of members weakens this form of control still further. Thus, not only do the board of co-operatives have complex goals and targets, which do not fit into traditional measures of business performance; the actions of their managers will also be less constrained by market forces. This means that boards are the most important means that co-operatives and mutuals have to control managerial behaviour, but at the same time they are faced with circumstances in which it is even more difficult to make their influence felt[45].
The work of Chaves and Sajardo-Moreno has specifically looked at the actions that social economy managers can take to increase their margin of discretion vis-à-vis their boards. Using Shleifer and Vishny's work on managerial entrenchment[46], they have identified three specific strategies for social economy managers to 'entrench' their position within a firm. The first, in common with private sector managers, involves the progressive accumulation of intangible assets such as strategic information and assets, as well as know-how and company experience. This places them in a position of information asymmetry compared to the other assets of the firm, increasing their value and cost.

Yet they also point to other ways more specific to social economy firms that managers can enhance their position still further. Institutional entrenchment is one method, where the management pursues policies to weaken the democratic governance of the organisation; either through changing the articles of association of the enterprise, or building a network of subsidiaries of considerable financial and business worth that are not under the same democratic control. Another way in which managers can attempt to improve their position is through political entrenchment, an attempt to change the 'active ownership' of the organisation. This can take two forms. One way of doing this is by modifying its ownership, diluting it with new owner-actors (eg by bringing in capital from outside) and enhancing the role

45 Cornforth C (2004), 'The Governance of Co-operatives and Mutual Associations: A Paradox Perspective,' Spear R (2004), 'Governance in Democratic Member-Based Organisations,' Annals of Public and Co-operative Economics, 75, 1:1-166; Holstrom B (1999), 'Future of Co-operatives: A Corporate Perspective,' The Finnish Journal Of Business Economics, 404-417; Mills C and Snaith I (1997), The Governance of Consumer Co-operatives: Rules and Realities, Journal of Co-operative Studies, 30, 2:70-95; Global Corporate Governance Forum (2007), Corporate Governance and Co-operatives, Peer Review Workshop, Proceedings Report, February 2007; O'Sullivan N and Diacon S R (2003), 'Board Composition and performance in life insurance companies,' British Journal of Management, 14, 115-129

46 Shleifer A and Vishny R (1989), 'Management entrenchment: the case of manager specific investments,' Journal of Financial Economics, 25:123-139

of management, which can then add arbiter to its list of responsibilities. A second, which has been far more common in the UK co-operative movement, is by de facto 'capturing' the elected representatives[47].

If one takes the contrasting stewardship approach, there are also a number of problems that arise for co-operatives in this regard. For those co-operatives with 'traditional' democratic boards, it is impossible to guarantee that those members will have the skills necessary to make the board effective, and 'add value' to decision making and strategy. This has been pointed out in an article by Sivertsen who has stated that 'whereas board members in major private companies are elected within the business environment, board members in co-ops are elected among what we would call everyday people. Very often solid, earnest people with good judgment, but without the necessary background to make strategic decisions in the business world.[48]' A similar problem faces us when we take the resource dependency approach, as the opportunities for co-operatives to use their board to manage external relationships are limited by their elected nature. Thus, whether through adding value to decision making, or managing relations with the outside world; the democratic nature of co-operative boards makes it difficult for them to fulfill these roles, as there can be no guarantee that those with the right skills or contacts will be elected.

One could certainly suggest that consumer co-operatives would be better placed to perform with regards to stakeholder perspectives on corporate governance, especially given that their ownership structure integrates the interests of a key stakeholder group. However this approach does leave a number of unanswered questions about whether other stakeholder groups should be integrated into their governance, and in which format this would take place. Fairbairn suggests that employees in co-operatives have an additional importance beyond the ways in which they are important to other enterprises, and suggests that integrating their needs is vital to co-operative success[49]. However a true stakeholder approach may lead to wider issues of governance, and also include ways in which co-operative governance incorporates the wider local, national and international community.

Whilst there are implicit tensions between all these models in an investor owned company, particularly between an agency and partnership approach, it has been argued that the ownership structure of co-operatives heightens these tensions in one particular dynamic. This, as Cornforth suggests, is the tension between representative and expert boards. Whilst stewardship theory suggests that board members should have expertise and experience that adds value to the performance of the organisation, stakeholder theory suggests that board members are there to serve the constituency that they represent[50]. An emphasis on the stakeholder role has often meant that co-operatives, unlike companies, have been unable to search for particular skill sets, leaving gaps in the expertise of their boards.[51]' This is perhaps the key issue that is faced in co-operative governance today, the conflict between democracy and expertise.

Yet issues of governance and representation are not limited to what goes on in the boardroom. There are also a number of agency conflicts inherent in the relationship between members and their boards. Examples of this can include directors becoming rent-seekers, and taking steps to ensure that members cannot participate, such that they become self perpetuating groups. This can take the form of holding meetings without telling members, or the possibility of 'capture' by well organised

47 Chaves R and Sajardo-Moreno A (2004), 'Social Economy Managers: Between values and retrenchment,' Annals of Public and Co-operative Economics, 75, 1:1-166

48 Sivertsen S (1996), 'Governance issues seen from a management perspective,' Review of International Co-operation, 84, 4:34-36 cited in Cornforth C (2004), 'The Governance of Co-operatives and Mutual Associations: A Paradox Perspective,' Annals of Public and Co-operative Economics, 75, 1:1-166

49 Fairbairn, B (2003), Three Strategic Concepts for the Guidance of Co-operatives: Linkage, Transparency and Cognition, University of Saskatchewan

50 Cornforth C (2004), 'The Governance of Co-operatives and Mutual Associations: A Paradox Perspective,' Annals of Public and Co-operative Economics, 75, 1:1-166

51 Wilson (1998), 'Developing leaders in consumer co-operatives – contemporary issues in the training of directors and members,' The World of Co-operative Enterprise 1998, Plunkett Foundation, Oxford

factions[52].
There is also a wider representative issue in this relationship. In some retail co-operatives, all the customers are members, and this is the same in most financial mutuals, in other words, there is an identity principle. However many consumer co-operatives have lost this principle, so that there are some members that are not consumers, and many more consumers who are not members, either because they lack the interest or the opportunity to join. Where the identity principle does apply, this can often lead to complacency, as seen with the building society movement in the UK before the wave of demutualisations in the 1990s[53].

Where the identity principle does not apply, two issues arise. The first is concerned with the relative number of customers who are members. The lower the proportion is, the less representative the members are of the customer base. Secondly, the proportion of members who are not customers is also of concern, as this can give a false impression of the scale of membership, as well as a minor risk of entryism[54].

Membership issues

However a far larger problem is that of member participation. Whilst the most recent academic research conducted on election turnout in consumer co-operatives took place six years ago, its findings show a range of 0-5% of members participating in board elections, a range which is still likely to be found today[55]. These low
participation rates have the effect of reducing both the legitimacy of, and trust in the representative nature of the board. Moreover, as Spear argues there are issues in terms of how well this 1-5% actually represents the wider membership, a concern flagged up in the Co-operative Commission Report, as well as research conducted by the Co-operative Group. What in practice this means, is that the vast majority of members, and an even larger proportion of consumers, have absolutely no influence on the board or the management, which raises issues of legitimacy for its democratic mandate[56].

However it has been suggested that this may not be a particular issue of concern for co-operative enterprises. Whilst the Co-operative Commission stated that 'successful co-operative businesses require… the participation of an active, informed and representative elected membership,' it accepted that 'those members participating in the democratic process will always be a small minority.' For Birchall and Simmonds, it is an accepted view that large scale mutuals do not need 'mass' participation. Whilst they need to mobilise a wider cross section of their members, this does not mean that everyone, or even a majority, need to be involved. What is required is 'a small group of a few hundred active members who emerge from the membership…to represent members in general.' In addition, co-operatives need 'a much larger group to know about the organisation…to vote intelligently for their representatives, and to influence the co-operative's policies.' It is then felt that co-operatives need to keep in touch with the mass of members through market research type methods, but also by asking them to democratically endorse important decisions[57].

Management and culture

Whilst there is recognition across the literature of the relative agency and stewardship problems implicit in the democratic structure of co-operatives, there is a considerable body of literature that critiques the viewpoint that the boardroom is where the principal governance

52 Corporate Governance and Co-operatives, Peer Review Workshop, Proceedings Report, February 2007
53 Cook J, Deakin S, Hughes A (2001), Mutuality and Corporate Governance: the evolution of UK building societies following deregulation, Working paper 205 ESRC Centre for Business Research, Cambridge
54 Spear R (2004), 'Governance in Democratic Member-Based Organisations,' Annals of Public and Co-operative Economics, 75, 1:1-166
55 Davis P and Donaldson J (2001), Survey of Retail Co-operatives, LUMC, Leicester
56 Co-operative Commission Report (2001), London; Co-operative College (2003), Membership Review Group Report to Congress, Manchester; Spear R (2004), 'Governance in Democratic Member-Based Organisations,' Annals of Public and Co-operative Economics, 75, 1:1-166
57 Co-operative Commission (2001), London; Birchall J and Simmonds R (2004), 'The involvement of members in the governance of large scale co-operative and mutual businesses: A formative evaluation of the Co-operative Group, Review of the Social Economy, 62, 4

problems of co-operatives lie. These works tend to emphasise the role of management and organisational culture as the most important factor in ensuring co-operative purpose, rather than those of democratic structures or boards. For Stephenson the underlying dynamics of managerial control are not exclusive to co-operative societies, but 'exists in all organisations where there are elected representatives of the voters.' Whilst he sees management as increasingly in control, he feels that addressing structures is not the answer, as one 'cannot legislate for the dynamic nature of the relationship between the board and its Chief Executive[58].

Davis goes further in this regard, and critiques the viewpoint that democratic structures are an effective mechanism for governance. For him, the problem of the co-operative governance debate is that it is informed by process and structure rather than purpose and culture. He sees good governance more a problem of management culture than it is a problem of democratic structures. This can be seen in the statement that 'we must recognise that the purpose of governance is the preservation of the integrity of the organisation to fulfill the purpose for which it was founded…Co-operatives…were formed in response to the market economy to give workers, small farmers and consumers better leverage in a market that would otherwise exploit and even ruin them. Issues of democracy are issues of process; they are secondary issues concerned with means.' He explores the option of developing professional management as the guardians of co-operative values and principles, not to replace democratic governance structures, but to support and supplement them. He suggests that in today's market place 'co-operatives simply cannot afford to be appointing non-co-operative managers' believing that their survival depends on having a committed management that can use co-operative purpose and values to leverage an advantage in the market place[59].

This viewpoint is supported by the work of Munkner, whose work on Co-op Dortmund shows that a legalistic approach relying on structural processes can be no guarantee of co-operative success. He states that 'Co-op Dortmund had established an elaborate multi-tier democratic system…in which a total of over 9,500 elected member representatives participated.' Despite this, the new managers, hired and operated on the 'civil service' model of co-operative management were able to continue with policies that ruined the co-operative while still operating within the rules[60].

For Fairbairn, the problem lies with the traditional 'dualistic' (social and economic) view of co-operatives, which appear to lay a second set of obligations on them, over and above those they face in common with competing, non co-operative enterprises. Whilst this can be seen as useful for certain types of managers in that 'it encourages them to concentrate on "their" job, and leave social goals for others to worry about,' the perspective can lead to a 'primacy of economic goals over social ones… the co-op has to first make money before any of it can be spent on good causes. Economic goals become money making and sustaining goals, social goals become costs.' This can sometimes mean that economic goals are often left to the CEO and the senior management, with lay boards only taking an interest in 'their' areas, those of member relations, education, democracy and community relations[61].

The Co-operative Advantage: a model for good governance

Whilst individual works address the problems faced by co-operatives with regards to their board structures, membership issues or management culture as separate issues; the majority of these tend to work on the presumption that the fundamental purpose of co-operative governance should be to enable

58 Stephenson T (1994), 'Power in Governance,' Journal of Co-operative Studies, 81:51-54
59 Davis P (2001), 'The governance of co-operative under competitive conditions: Issues, processes and culture,' Corporate Governance, 1, 4:28-39; Davis P and Donaldson J (1998), Co-operative Management: A philosophy for business, New Harmony Press, Cheltenham; Davis P (2005), 'Co-operative Management. The Missing element for success in membership based organisations,' International Journal of Decision Ethics, 1, 2:155-206.
60 Munkner, H (2000), 'Corporate governance in German co-operatives – what happened to Co-op Dortmund?' Review of International Co-operation, 92-93, 4:99
61 Fairbairn, B (2003), Three Strategic Concepts for the Guidance of Co-operatives: Linkage, Transparency and Cognition, University of Saskatchewan

enterprises to leverage their 'co-operative advantage.' [62]

This premise is based on the idea that all co-operatives have a competitive advantage as a result of their ownership structure. Being member-owned sets co-operatives apart from competitors owned by profit orientated shareholders, as this ownership structure focuses the business on the values and needs of the user.

However, 'co-operative advantage' is only seen to exist when co-operatives are focused on their members' values and needs, as well as in sound financial health. If a co-operative moves away from this structure and focuses only on profits, it cannot claim a co-operative advantage.

As set out by John Monks in the Co-operative Commission Report, 'in successful co-operatives, the ethical values of honest, openness, social responsibility and caring for others, can give an edge over businesses driven simply by the profit motive…Where co-operatives have failed to match their potential this virtuous circle has been broken; the way the business has been conducted has not always reflected the ethical values and the links between members and their co-operatively owned businesses have not functioned effectively.[63]'

At the heart of this proposition is the idea that owner members in consumer co-operatives are seen as looking to it for access to products and services, fair prices, excellent customer service, trustworthiness, community support, co-operative values and ethical business practices[64]. The role that governance plays in this situation is seen as making sure that the co-operative delivers these, and functions in performing its core purpose.

Core purpose and values

A key component of this viewpoint is the importance of strong and clear organisational values. As Paton and Cornforth make abundantly clear, 'without values these organisations would not exist.[65]' Without the profit maximization bottom line of investor-owned companies, organisational values are felt most acutely, as one has to ask the question 'what's the bottom line when there is no bottom line?[66]'

However, there is a debate as to how a core mission or purpose can best be inculcated through an organisation. The Co-operative Commission states that the mission of the UK Co-operative Movement should be 'to challenge conventional UK enterprise by building a commercially successful family of businesses that offer a clear co-operative advantage.' It maintains that it should seek to implement this mission in a consistent, committed and co-ordinated manner, relying primarily on ensuring that all employee and director training starts from this premise[67]. By contrast, Fairbairn suggests that shared organisational goals can only come out of a thinking or cognitive process that involves 'more than just the mind of the CEO.' He states that the co-operative 'will be stronger and more cohesive is managers, members, elected leaders, staff and other stakeholders buy into similar or shared visions[68].' This view is shared

62 Co-operative Commission Report (2001), London; Pritchard D and Tinsley I (2000) 'Corporate Governance in a multi-stakeholder environment,' Co-operative Commission; Webb T, Benander L, Cirillo and Lagier C (2005), Marketing our co-operative advantage: Do marketing and membership programs featuring a co-operative advantage drive successful business outcomes? Co-operative Development Institute; Fairbairn, B (2003), Three Strategic Concepts for the Guidance of Co-operatives: Linkage, Transparency and Cognition, University of Saskatchewan; Gill R (2007), Relaunching the Co-operative Group's membership proposition (master's thesis); Novkovic S (2006), 'Co-operative business: the role of co-operative principles and values,' Journal of Co-operative Studies, 39, 1; Davis P and Donaldson J (1998), Co-operative Management: A philosophy for business, New Harmony Press, Cheltenham; Spear R (2000), 'Membership strategy for Co-operative Advantage, Journal of Co-operative Studies, 33, 2; Côté D (2005), 'Loyalty and Co-operative Identity: Introducing a new co-operative paradigm,' Revue Internationale de l'Économie Sociale, 295:50-69, and many others previously cited

63 Monks J (2001), Preface, Co-operative Commission Report, London

64 Webb T, Benander L, Cirillo and Lagier C (2005), Marketing our co-operative advantage: Do marketing and membership programs featuring a co-operative advantage drive successful business outcomes? Co-operative Development Institute

65 Paton R and Cornforth C (1992), 'What's different about managing in voluntary and non-profit organisations' in Batsleer J and Cornforth C (eds.) Issues in Voluntary and Non-Profit Management, Addison-Wesley, Wokingham

66 Drucker P (1994), Managing the non-profit organisation: practices and principles, Butterworth Heinemann, Oxford

67 Co-operative Commission Report (2001), London

68 Fairbairn, B (2003), Three Strategic Concepts for the Guidance of Co-operatives: Linkage, Transparency and Cognition,

by Aiken, who suggests that there is a danger that 'values are seen as objects possessed by an organisation, controlled and inscribed from above, captured easily in mission statements and transmitted to new recruits.[69]'

There is also a significant debate as to what the core purpose and values of a co-operative should be. Whilst the ICA principles[70] should certainly be a starting point for any organisation, Birchall suggests that these lack a degree of philosophical coherence, rank in order of purpose, as well as a connection with co-operative business practice. For him, 'the co-operative difference has to be based on the core principles rather than the values,' which he states as being member ownership, control and benefit.[71] He also suggests that environmental preservation and the rights of employees may be principles currently missing from the currently stated values.

The work of Parnell, by contrast, suggests that the problems that co-operatives have faced have been as a result of their failure to focus on the provision of benefits to members, and the loss of control of the cardinal stakeholder group to other stakeholders. He proposes that co-operatives be defined by their narrow business objectives, and that the sole purpose of a co-operative is that of 'benefits to members.[72]' This idea has been critiqued by Davis, who suggests that this is too general a concept, and could, after all, include the rights of members to dispose of the assets of the organisation, which in the short run may provide them with the greatest benefit. For him, 'co-operatives are not just about the membership and the benefits of membership in abstraction' but 'about the benefits of membership in association.' This means that social justice and community are central to an understanding of co-operative purpose, and in understanding the propriety of those activities, products and services providing benefits to members[73].

For Fairbairn, the key to co-operative purpose is the relationship that it cultivates and embodies. The most important of these is the one between the co-operative and its members, but relationships among its members, or among and between employees and other stakeholder groups may also be important. Whilst this is the same in any business, the difference in a co-operative is 'the closeness and multidimensionality of the relationship with members; they are customers as well as owners. This relationship model highlights the importance of issues such as trust and agency, with the most important questions being 'how much and in what ways do members trust the co-operative' and 'to what extent is it efficient in acting as an agent of their interests.' He suggests that if one is to see co-operatives as relationship based, this means that relations with members are paramount. This has implications for both governance and operations. When member relations concentrates only on the governance aspect of the organisation. It is argued that these are wider than and different conceptually from investor relations, because they are not just a source of capital and control, but also of sales and the use of the co-operative[74].

Linkage with members

A key part of this is establishing an active membership that is representative of its members, so that the co-operative is accountable to its members through its governance. Perhaps the most comprehensive examination of what motivates members to participate can be seen in two studies by Birchall and Simmonds, which examined the motivating factors amongst members of area committees in the West Midlands and the Co-operative Group. They develop a model for

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69 Aiken M (2002), Keeping Close to your values: Lessons from a study examining how voluntary and co-operative organisations reproduce their organisational values, NCVO paper, Open University

70 ICA Statement on the Co-operative Identity, http://www.ica.coop/coop/principles.html

71 Birchall J (2005), Co-operative Principles ten years on, http://www.ica.coop/calendar/ga2005/birchallkey.pdf

72 Parnell E (1995), Reinventing the Co-operative: Enterprises for the 21st Century, Plunkett Foundation for Co-operative Studies, Oxford

73 Davis P (2005), 'Co-operative Management: The Missing element for success in membership based organisations,' International Journal of Decision Ethics, Department of Educational Studies, Oxford, 1, 2:155-206.

74 Fairbairn, B (2003), Three Strategic Concepts for the Guidance of Co-operatives: Linkage, Transparency and Cognition, University of Saskatchewan

participation called 'the participation chain.' In this model, there are a number of levels or 'links' which affect the degree to which members will be prepared to participate in a co-operative society or a mutual.

The first is concerned with the resources and capacities of potential participants, with the degree of time, money, skill and confidence seen as a crucial determinant as to whether an individual will participate. Of these, time constraint are seen as important, but money less so, as many participants on low incomes tending to participate. Skills and confidence are seen as perhaps the most determining factor, with 75% of participants having been active in other organisations.

The second level is concerned with the mobilisation of participants, for which their research identified a number of factors. Issues are seen as an important catalyst, as well as the creation and promotion of opportunities to participate that are timely, relevant and attractive. Recruitment is also a key determinant on this level, with 'being asked' raised as perhaps the most important factor.

The third level is concerned with motivation, and uses mutual incentives theory to suggest that both individual and collective factors affect participation on this level. Individually, these take the form of rewards and punishments, whereas motivation can also been seen as collectively dependent on the degree to which there is a notion of shared goals and values, as well as a sense of community. Of these, collectivist incentives were seen as the most important, with non financial incentives such as 'feeling good about themselves,' and 'a social life' seen as the most important individual incentives.

The final level is that of dynamics, which is dependent on the style and strategies employed by participants. The work suggests that in consumer co-operatives, the attitudes of managers and organizers are key to this, as the style of their interaction with members may act either to facilitate or repress meaningful participation. People who feel like they are listened to and able to make a difference are the most likely to continue to participate, with 'intimidation and backstabbing, 'hierarchies within the organisation' and time wasting meetings cited as factors that turn people off.[75]

Yet there is an acceptance throughout the literature that the majority of members in a consumer co-operative are unlikely to participate through the governance structure, and that the relationship with members needs to be forged in other, informal ways[76]. For Côté, the co-operative advantage (or his new co-operative paradigm) needs to be based on loyalty. He demonstrates that loyalty and co-operative identity have common foundations, and that loyalty management can be the cornerstone of co-operative success. This requires the co-operative to have a high degree of consistency, seen on a daily basis, with its co-operative values. He stresses the importance of winning employees over first, as customers will be loyal to individual employees before the enterprise itself[77].

A similar viewpoint is put forward by Webb, who suggests that 'co-operatives are all about relationships based on mutual respect… Co-operatives have the potential to construct powerful relationships characterized by incredible loyalty.' He feels that this powerful differentiator is helpful when considering the wider competitive environment. In creating this relationship, marketing is seen as playing a key role, as 'the nature of a consumer co-operative lends itself to combine relationship and socially responsible marketing. Members ought to trust the store they own in a way they cannot trust any other business.[78]'

For Gill, while the majority of consumers will join a large co-operative because of the service provided, for some 'the decision to trade with a co-operative is precisely because of whom we are and what we stand for.' For others, 'values

75 Ibid.; Birchall J and Simmonds R (2004), 'Creating and supporting co-operative members in the West Midlands, Journal of Co-operative Studies, 37, 1
76 Spear R (2000), Membership strategy for Co-operative Advantage, Journal of Co-operative Studies, 33, 2
77 Côté D (2005), 'Loyalty and Co-operative Identity: Introducing a new co-operative paradigm, Revue Internationale de l'Économie Sociale, 295:50-69
78 Webb T (2005), MOCA course materials

and principles act as a tie breaker between as co-operative business and another service provider – in other words if price, service and quality are equal, co-operative values are a potential tipping point.[79]'

Fairbairn states that the reason that members invest time and loyalty with a co-operative is 'because they trust that doing so will be in their own interest as well as the interests of other members.' He suggests that members trust the co-operative when they perceive them to be dedicated to their needs, not the needs of any other organisation or group. There are two parts to this relationship, not only must the co-operative be an efficient agent for what its members need and want, but it must be perceived as such. This means that it needs to find ways of 'adding value' to meet member needs. This can be done through sharing operating success (dividends), offering products and services that meet specific members' needs, as well as developing nonmaterial aspects of the relationship between the co-operative and the member. Yet it is not only important to perform in this regard, but also to communicate these benefits to its 'mass' membership. This means that a successful co-operative not only needs its marketing to engage with how it is delivering to members, but also needs to undertake research in an organized way to analyse changes in its membership and environment, connected to the way it regularly revisits its identity and purpose.[80] A similar approach has been taken by both the Co-operative Commission and Gill, who demonstrate how these can be practically applied to the UK Co-operative Movement[81].

Impact on Management and Board Leadership

As the work of Webb et al affirms, if the board and management are not aligned with the needs of their members, they can fail to deliver what their members and customers are looking for. This is where good governance, both in terms of having an effective board, as well as a competent, purpose driven management team have a distinct role to play. It is suggested that a co-operative's advantage is strengthened or weakened by the degree of alignment among the values and needs of members and owners and the actions of its board and management, with failure to deliver resulting in no co-operative advantage[82].

A large part of this responsibility has to fall to management. The work of Chaves and Sajardo-Moredo suggests that there are two 'ideal' models of managers in co-operatives, one of which is the 'business school' manager, and the other which is the 'social economy' manager. 'Business school' managers are sharers and carriers of the managerial culture of the major capitalist companies, not just in policy objectives, but in the methods that they employ. They often possess serious deficiencies in their training and skill sets need to run a co-operative, particularly that of an understanding of the social economy and the different families of organisations within it. They tend to share the value system of the major business institutions; idealising the market and hierarchy, underrating values such as democracy, and tend to be unreceptive to the social needs of the organisation. Managers of this type are felt to avoid the participative styles of management and the institutionalized mechanisms of democracy and distribution that characterise the social economy, considering them 'burdens.' This view is contrasted with 'social economy' managers, who are seen as precise opposites, and have the skills and motivation to lead the co-operative not just as a successful business, but in line with its true co-operative purpose[83].

This view is shared by Davis and Donaldson, who suggest that the primary role of the

79 Gill R (2007), Relaunching the Co-operative Group's membership proposition , Master's Thesis
80 Fairbairn, B (2003), Three Strategic Concepts for the Guidance of Co-operatives: Linkage, Transparency and Cognition, University of Saskatchewan
81 Co-operative Commission Report (2001), London; Gill R (2007), Relaunching the Co-operative Group's membership proposition , Master's Thesis
82 Webb T, Benander L, Cirillo and Lagier C (2005), Marketing our co-operative advantage: Do marketing and membership programs featuring a co-operative advantage drive successful business outcomes? Co-operative Development Institute
83 Chaves R and Sajardo-Moreno A (2004), 'Social Economy Managers: Between values and retrenchment,' Annals of Public and Co-operative Economics, 75, 1:1-166

co-operative manager is to use the 'co-operative difference' and purpose to determine the appropriate strategic response to the demands of the business environment. In this role, professional management bears responsibility for the overall leadership of the co-operative, including the functioning of membership, democracy and governance. This requires them to create a responsive framework for members and other constituents, and a participative framework for employees to overcome the problems of remoteness between management and their members. For them, 'developing professional value based co-operative managers is ultimately the best basis for ensuring good governance.[84]'

Yet other works suggest that the Board of Directors have an important role to play in ensuring that such management is in place. While both Spear and Cornforth also believes that good professional manager development has a role to play, he also maintains the importance of lively, competent boards. These can be maintained either through increasing member participation and training, or through the recruitment of independent non-executive directors[85]. Other suggestions have included bringing executives on to the Board of Directors, or the creation of European style supervisory boards[86].

Yet a number of works suggest that competent boards are only part of the answer to ensuring high quality co-operative management, but also mechanisms for incentive and control. Spear tends to concentrate on incentives, stating that these should largely concentrate on adequate remuneration, linked to measures of performance that match the aspirations of the co-operative, as well as those of its members and stakeholders. He also suggests that better reporting systems, such as social audit, will ensure an information system that provides well founded measures of performance, allowing managers to target their activities.[87]

While Chaves and Sajardo–Moreno also believe that there is a role for the better setting of and measurement of social performance, they see control mechanisms as more important than incentives. These include the introduction of neutral external councils, or bodies to oversee the correct performance of the corporate governance function, as well as the introduction of explicit detailed definitions of co-operative performance objectives or indicators that must be assessed periodically on the basis of modern social balance sheet and social audit mechanisms. It is felt that through the application of these measures, managers will focus on the co-operative purpose in its entirety, rather than merely the financial objectives, which are felt to be easier to recognise.

84 Davis P and Donaldson J (1998), Co-operative Management: A philosophy for business, New Harmony Press, Cheltenham

85 Cornforth C (2004), 'The Governance of Co-operatives and Mutual Associations: A Paradox Perspective,' Spear R (2004), 'Governance in Democratic Member-Based Organisations,' Annals of Public and Co-operative Economics, 75, 1:1-166;

86 Co-operative Commission (2001), London; Pritchard D and Tinsley I (2000) 'Corporate Governance in a multi-stakeholder environment, Co-operative Commission; Bracey W (2000), 'Presentation to the Co-operative Commission: Structural issues,' Co-operative Commission Papers

87 Spear R (2004), 'Governance in Democratic Member-Based Organisations,' Annals of Public and Co-operative Economics, 75, 1:1-166

3. Standards in corporate governance: the key issues in the developing corporate governance agenda in the UK

The purpose of this paper is to consider the broader context of corporate governance. It outlines in detail what developments have occured in the UK in relation to the developing corporate governance agenda. It is essential that this Review is informed of the key issues that are at play across the whole of UK industry and commerce, in addition to those that are particular to the co-operative sector.

Summary

The present corporate governance regime in the UK is an elegantly regulated system, principally concerned with listed companies, which operates primarily through unofficial rather than official regulation. It was instigated in its present form through official concerns about economic stability and managerial probity, but has been implemented and sustained primarily by the private interests of the financial investment community. It has functioned successfully, within its terms of reference, since 1992, with periodic reviews to ensure its continued relevance. One of its greatest achievements is to have gained almost universal acceptance for its premises among British managers and investors. The key issues henceforth are not so much how the system should be maintained – although further vigilance in the light of changing circumstances is clearly necessary - but whether it covers all the aspects that it should and whether the concept of corporate governance, in a UK environment, can in practice be extended to cover more than its current scope.

The Financial Reporting Council ('FRC') summarised its view of UK corporate governance in a document entitled 'The UK approach to corporate governance', published in November 2006:

The UK approach combines high standards of corporate governance with relatively low associated costs. Comparative studies consistently show that the UK outperforms other countries in terms of governance standards, while compliance costs are estimated to be lower than in other countries with comparable standards. It is proportionate and capable of dealing with a wide variety of circumstances. There is a relative lack of prescription as to how the company's board organises itself and exercises its responsibilities. The Combined Code on Corporate Governance identifies good governance practices, but companies can choose to adopt a different approach if that is more appropriate to their circumstances. The key relationship is between the company and its shareholders, not between the company and the regulator. Boards and shareholders are encouraged to engage in dialogue on corporate governance matters. Shareholders have voting rights and rights to information, set out in company law and the Listing Rules, which enable them to hold the board to account (FRC, 2006).

This suggests a well-established and deeply institutionalised system of corporate governance. In one sense, it is true that awareness of how companies should properly be run has a long tradition in the UK and the Cadbury Report that laid the foundations for the Combined Code stressed that it drew upon existing best practice for its ideas:

The basic system of corporate governance in Britain is sound. The principles are well known and widely followed. Indeed the Code closely reflects existing best practice. This sets the standard which all listed companies need to match (Cadbury, 1992, 1.7).

However, awareness of 'corporate governance' as a concept of debate has a relatively shallow history in the UK[88] and the Combined Code itself is a fairly recent innovation; the FRC, later in the same document quoted above, traces this awareness specifically to events of the late 1980s and early 1990s. This

88 Tricker had specifically discussed 'corporate governance' in relation to British corporate practices in the early 1980s (Tricker, 1984) but widespread use came only after the publication of the Cadbury Report in 1992. As late as 1990, when the National Association of Pension Funds in the U.K. issued a collection of essays on relationships between the management of public companies and institutional investors, some of the contributors discussed this topic without using the expression 'corporate governance' at all (Leigh-Pemberton, 1990).

awareness of corporate governance as a valid focus of concern was driven by scandals which demonstrated that financial irregularities were being tolerated or actively perpetrated at some large companies operating in the UK. When the collapses of Polly Peck and Coloroll in 1990 provided evidence of inadequate controls and lack of transparency, the Committee on the Financial Aspects of Corporate Governance was instituted in May 1991 to produce what came to be known as the "Cadbury Report", published in late 1992. While the Committee was still studying the situation, other and in some ways more serious scandals came to light at BCCI in 1991 and at the Maxwell companies in 1992. Further studies have followed on specific or general aspects of U.K. corporate governance, all of which consciously seek to build upon and augment the code of conduct originated by the Cadbury Report.

Consequently, British interest in the concept of corporate governance was initially the product of official unease at corporate scandal, leading to an officially inspired but still essentially private sector response. Thereafter, there has been an emphasis more on unofficial regulation or 'soft law', than on formal regulation, and this characteristic has been sustained and effectively institutionalised as a key element of the UK system. A distinction is often observed between this approach and that of the US, where there is felt to be a greater emphasis on specific regulation. Awareness of this distinction and of the choices facing the UK can be observed in the Cadbury Report, which states:
We believe that our approach, based on compliance with a voluntary code coupled with disclosure, will prove more effective than a statutory code. It is directed at establishing best practice, at encouraging pressure from shareholders to hasten its widespread adoption, and at allowing some flexibility in implementation. We recognise, however, that if companies do not back our recommendations, it is probable that legislation and external regulation will be sought to deal with some of the underlying problems which the report identifies. Statutory measures would impose a minimum standard and there would be a greater risk of boards complying with the letter, rather than with the spirit, of their requirements (Cadbury, 1992, 1.10).

This approach has been preserved as an article of faith in subsequent officially commissioned reviews on corporate governance matters. In the introduction to his 'Review of the role and effectiveness of non-executive directors', issued in January 2003, Higgs wrote:
I do not believe, however, that legislation is the way forward. Instead, this Review builds on the "comply or explain" approach established by Sir Adrian Cadbury a decade ago (Higgs, 2003, 1.14).

Nevertheless, despite this important divergence, the UK has been influenced by the older and continuing debate surrounding corporate governance in the USA. Starting with the expression 'corporate governance' itself, the British debate has drawn on US ideas for much of its vocabulary and concepts. It is common to talk of 'Anglo-American' corporate governance, and although the validity of this term is often questioned – one of the greatest differences being the British preference for unofficial regulation rather than legislation - there are certainly some similarities in the way that governance is conducted in both countries, as well as a tendency to draw on the same set of defining terms, many of which derive from the USA. One great similarity between the USA and UK in corporate governance is that in both countries the strongest private sector driver of concern has been and remains the institutional investment sector. In many ways, the format of British corporate governance has been created to satisfy this audience.

Before the early 1990s, directors of British listed companies performed a number of different roles. Some were executives with managerial responsibilities. Others were there as nominees of large shareholders, such as family interests, or main suppliers or customers. Very rarely might there be employee representatives. Non-executive directors provided advice to senior management and their presence gave reassurance to investors. There were few mandatory rules of company law governing the membership, structure and operation of boards, and the listing rules of the London Stock Exchange were not much more prescriptive. Often this meant that the constitution of boards and the way they functioned were determined by the chief executive, who was also, in many cases, the chairman. The AGM was an occasion for reporting by the management, and shareholders virtually never exercised their legal powers to remove directors on a simple majority vote.

The so-called Combined Code that developed from the Cadbury Report and its successors filled what was, in essence, a legal vacuum, by supplying guidelines on board structure and composition. The core features of the new system were a greater role for independent directors; encouragement to split the chairman and CEO positions; the introduction of board committees for dealing with audit, nomination, remuneration and other matters; and the formalization of internal audit processes. Although the Combined Code did not purport to be legally binding, and offered companies the choice of 'comply or explain', compliance rates have been high. Few companies take the option of explaining non-compliance in relation to more than a small number of Code provisions, despite the growth in its size and complexity, particularly since 2003.

A critical change that was implicit in these structures is the identification of 'governance' as something separate from 'management'. Management is concerned, as it always has been, with the organization and operation of the productive assets of the firm. 'Governance' is concerned with processes of delegation and accountability: shareholders elect the board which delegates powers to management; management, in turn, is accountable to the board and, at a further level, to the shareholders. Put this way, governance is about overall supervision, specific monitoring and control. But governance is also about strategy: the board must take a wide-ranging view of the strategic options open to the company. More loosely, the board is responsible for the culture of the organization; it is said to 'set the tone' for the way the company runs itself and projects itself to the outside world.

Another enduring influence of the Cadbury Report lies in its recognition of shareholders as the owners of the company. While the rights of shareholders as owners of shares are generally clear, their position as owners of the company is less secure. Since the early 20th century, U.K. court judgements have tended to establish the position of the directors as agents of the company, not of the shareholders, although the shareholders' ultimate ability to enforce their wishes is enshrined in their ability to change the articles of association and to dismiss directors (Davies, 2002, pp.115-116). At least until 1959, when Siegmund Warburg succeeded in bringing about the acquisition of British Aluminium against the strong opposition not only of its management but also of much of the City establishment, the idea that the fate of an important company could be determined purely by the ownership of its shares was probably not immediately apparent to many people (Chernow, 1993, pp.647-652). The Cadbury Report gave this concept a seal of approval which has thereafter been widely accepted in the UK as the normal order of things:

Thus the shareholders as owners of the company elect the directors to run the business on their behalf and hold them accountable for its progress. The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders (Cadbury, 1992, 6.1).

As noted above, much of the activity surrounding corporate governance matters in the UK, as in other countries, has been a direct response to corporate scandals and wrongdoings. In this sense, the Combined Code has its origins in the reaction to some of the more egregious cases of self-dealing and outright fraud of the early 1990s and has been consciously maintained thereafter as a defence against such scandals making a reappearance. However, if governance works well, it should be about more than just preventing self-dealing by senior managers. It should result in better managed and more sustainable organizations.

One aspect of this is a clarification of the role of executive directors and in particular of the CEO.

In the model generally followed in Britain, the delegation of the management function takes the form of devolution of power from the board to a single corporate officer – the CEO. The view is taken that delegation to an individual works more effectively than delegation to a committee. This leaves the other executive directors in a somewhat ambiguous position – although they will normally be the persons best informed regarding their own areas of concern, they are not on the board to represent or speak for any particular part of the corporate organization. Nor do the executive directors, collectively, speak for management as a whole: that is theoretically the job of the CEO. In practice, executive directors other than the CEO can be called on to advise the board on matters for which they have a particular responsibility, but there is an element of contingency about this arrangement. It is perhaps not surprising that most US companies have moved away from the practice of having several executive directors on the board, although it is arguable that these boards have thereby become less well informed, placing CEOs in a position of greater power. Despite moves to increase and strengthen the presence of independent external directors on UK boards – notably through the Higgs Report of 2003 - empirical evidence suggests that UK companies with a majority of executives on their boards perform better, in financial terms, than those whose directors are mainly non-executive (Dulewicz and Herbert, 2004, Dulewicz, 2005).

These developments in board structure are generally accepted as good progress in the U.K. but there is a danger of complacency. It could be said that British companies are managed more transparently than they were a decade and a half ago; it does not necessarily follow that they are managed better. Empirical research is equivocal. There is evidence, in the form of McKinsey's investor opinion survey in June 2000 (McKinsey, 2000), that investors are prepared to pay a premium for what they regard as good governance. Direct conversations with leading institutional investors often contradict this and, moreover, it is not the same thing as saying that good governance delivers higher returns for shareholders. There is some evidence, from the US, to the effect that companies adopting many of the features associated with 'best practice' in matters of governance – most notably, a majority of independent directors and separate chairs and CEOs – had better financial performance, but the direction of causation is disputed and other surveys contradict these findings (Gompers et al., 2003, Bhagat and Black, 2002, Dulewicz and Herbert, 2004). It is possible that companies which are better run are, as a result, better able to comply with the formal recommendations of corporate governance codes. If so, compliance is the result of good management, rather than being its cause. Even this effect may be temporary. As compliance rates increase and companies adjust to the model contained in the codes of best practice, the degree of adherence may tell us very little about how well any particular company is being managed. Companies themselves do not seem to benchmark their organisational performance or effectiveness against their level of corporate governance compliance.

The stress on governance may even have negative effects in some cases and compliance may give rise to considerable deadweight costs. The Cadbury Report observed that 'Statutory measures would impose a minimum standard and there would be a greater risk of boards complying with the letter, rather than with the spirit, of their requirements' (Cadbury, 1992, 1-10). This comment was made in the context of comparing the Report's proposed 'comply or explain' mechanism to a more formally regulatory approach, but in fact the current standing of the Combined Code and the practical difficulty of not complying may have created a situation very similar to a legislated solution, with all theincentives to create appearances that this implies. In theory, this could lead to a situation where a façade of compliance was used to conceal outright fraud, as in the case of Enron, in the USA. The emphasis that the Combined Code places on external accountability to shareholders, implicitly leaving out other constituencies, has led most companies to revise their objectives, downplaying their responsibilities to other stakeholders. Employment benefit schemes, for example, are often seen in instrumental terms, as ensuring the conditions for the maximisation of shareholder value. In the case of a clear conflict between shareholder and employee interests, of the kinds which often occur in the context of takeover bids and restructurings, the former now routinely prevail. The long-term implications of this change for employee morale and hence for organisational effectiveness are poorly understood.

The background to the emergence of the Combined Code in the UK is relevant here. Although it can be presented as a step towards the modernization of corporate structures, much of the impetus for its adoption has come from the lobbying activities of institutional shareholders and other interested parties. The liquidity that characterizes UK capital markets is not simply the consequence of spontaneous order. The practice of one-share/one-vote, the rules on pre-emption, and the ease with which takeover bids and restructurings can be mounted in the case of UK-listed companies, are all the result to some degree of pressure exercised through the professional bodies and trade associations representing financial institutions. Corporate governance codes are part of this wider regulatory framework, promoted by this interest group. Attention to shareholder interests has certainly proved a workable framework for UK corporate governance in recent years but it is not necessarily the only important issue to be considered. The Final Report on 'Key drivers of good "corporate governance" and the appropriateness of UK policy responses' (the 'Key Drivers Report') in January 2007 observed: 'It is important to go beyond the question of maximizing shareholder returns and consider to what extent different corporate governance configurations promote long-term, value-creating economic production in a fashion that benefits not only shareholders but also other groups that make specific investments in corporations' (Filatotchev et al., 2007, p.174, after Blair and Stout).

Although there is a belief, exemplified by the FRC's comments, quoted earlier, that the UK now enjoys a better corporate governance regime than many other countries, there is danger in adopting too complacent an attitude. Official concern to examine different aspects of corporate governance activity progressively since 1992 is demonstrated by the various reports that have been commissioned over the intervening years: Greenbury on directors' remuneration in 1995, Hampel on governance systems in general in 1998, Turnbull on internal controls in 1999, Smith on audit committees in 2003 and Higgs on non-executive directors in 2003. However, the impact of these activities on governance and whether they have led to real improvements may not have been adequately addressed: 'The first question to be tackled is whether fifteen years of soft regulation has brought significant changes in corporate governance practice and structure in the UK' (Cosh et al., 2007)

This question was asked specifically in the narrow context of whether corporate governance in the UK was adequate to ensure that takeover performance was increasingly favourable, in the sense that changes of corporate control would generate value, rather than destroy it, as earlier studies had suggested. This particular study suggests that there has been little or no improvement in this situation. The 'key drivers of "good" corporate governance and the appropriateness of UK policy responses' study approached the question more broadly. It identified 18 drivers of good corporate governance and considered where gaps in regulation[89] existed which permitted neglect. It concluded that although only small 'gaps' existed in areas such as information disclosure, boards, shareholder activism, auditors, internal control, and the market for corporate control, relatively larger 'gaps' existed in relation to executive pay, employees, and stakeholders in general. Although major institutional investors periodically query specific examples of high executive pay, employees and stakeholders in general are not overriding concerns for most of the shareholders whom the

89 Regulation, for this purpose, was considered to comprise 'mandatory regulation (uniform requirements), enabling or facilitative regulation (removing restrictions, allowing choice of structures), and flexible forms of soft-law such as codes based on comply-or-explain principles and self-regulatory norms of professional groups'.

currently accepted wisdom accepts as the owners of UK companies and for whose protection the present system appears to have been devised.

A demonstration of the kind of weakness that may lie beneath the surface of the present UK corporate governance regime is provided by the recent reaction against private equity firms' activities. Much of the opprobrium from unions and members of parliament has been focused on the favourable tax regime that the operators of these firms have hitherto enjoyed but the TUC has also called on the Treasury Select Committee to consider the following two measures to regulate private equity fund activity: (1) introduce new requirements to inform and consult the workforce in companies subject to private takeovers; and (2) introduce new protection for the terms and conditions of employees in takeover targets (TUC, 2007). The first measure specifically targets private equity acquisitions but the second is much wider and would imply added safeguards, presumably beyond the scope of existing legislation[90] , to protect the rights of employees at acquired firms. Hitherto, it has tended to be assumed that if managers are honest and shareholders are not deceived or robbed, then corporate governance must be sound. If corporate governance is also required to demonstrate benefits for the stakeholders in the companies it controls, and for the economy as a whole, then the approach adopted hitherto may prove too limited, at least in its present form and in the way that it is presently interpreted.

The structure of the British corporate governance debate since 1992 has been shaped by the Cadbury Report and the reviews that followed it. The Combined Code has brought these ideas together in an accessible format that has united corporate management, institutional investors and regulators in a common understanding of what is permissible and what is not. 'Soft regulation' has been adopted as the main driver of this regime and it has been generally successful; purely formal compliance with requirements has been resisted and the concept has taken root that good corporate governance is more of an attitude than a series of responses to a questionnaire. Moreover, regulators do not appear to have become complacent with this success and have periodically called for ancillary reviews to tighten potential loopholes in this approach or, in the case of the Higgs Report of 2003, to ensure that weaknesses in other countries are not about to surface also in the UK. All of this suggests that the structure is working and that more of the same sort of attention should suffice to keep it adjusted to changing conditions.

However, a key issue that has not been addressed so thoroughly is the question of whether the present structure is appropriate for everything that might be demanded of a corporate governance system. It was devised originally to prevent management from acting dishonestly and stealing or wasting shareholders' assets. The committee which produced the Cadbury Report was set up 'by the Financial Reporting Council, the London Stock Exchange and the accountancy profession to address the financial aspects of corporate governance' and its remit did not officially go beyond this; it was not asked specifically to consider issues such as how best to promote fruitful employment or how to strengthen the British economy – although it stated that it saw its work as contributing to the country's general economic welfare. The result has been a governance regime that has served shareholders well and has inculcated concepts of good practice among management, but attention to the interests of shareholders and management alone may not be enough to ensure the health of the economy. The following issues could usefully be addressed as part of the developing corporate governance agenda in the UK:

Should corporate governance be viewed more broadly than it has been since at least 1992 or is the present emphasis on managers' and shareholders' concerns indeed the best workable method?

Do the weaknesses identified in the present system of regulation with regard to executive pay, employees, and stakeholders in general represent areas where the whole concept of

90 Such as the Transfer of Undertakings (Protection of Employment) Regulations ('TUPE')

corporate governance should be reviewed? How could these issues by addressed in practice without destabilising the existing system, which, despite its faults, has achieved its intended objectives well to date?

There is a real danger that a review along these lines could end up as a purely intellectual exercise because the stimulus of scandal is lacking. It was abundantly clear, in the early 1990s, that recent events at certain companies were unacceptable and that countermeasures were needed; there was therefore immediate consensus among regulators and prominent members of the financial community in this regard. Unfortunately, labour force disaffection and economic decline are much longer term phenomena which seldom produce easily attributable results in the short term. Identifying the key issues and defining their nature may prove relatively simple, but difficulties are likely to arise in generating sufficient enthusiasm from the managers and shareholders who would probably have to support any action, most of whom are already adequately served by the current regime.

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4. UK Mutuals and Membership Organisations – Case Studies

For this section, we have surveyed established UK mutuals that are friendly societies and building societies, as well as a small number of large member based organisations and one employee owned business. They have been selected for their approach to governance in the context of being owned by their members, and the complexity of their operations.

Building Societies and Friendly Societies - Key findings are:

- Co-operatives legislation is less prescriptive than both Building Society and Friendly Society legislation, with fewer constraints on governance models
- It is the norm among building societies and quite common among friendly societies for the executives to serve on the board
- The codes of best practice applicable to building societies and friendly societies are closer to the Combined Code than the norm in the co-operative sector
- The direct election of board members (on a recommendation from the board) makes their non-executives effectively IPNEDs

Membership organisations – Key findings are:

Amnesty International:
- Bars recent employees and registered volunteer office workers from standing for election to their board
- Directors can be removed from office by an AGM or EGM
- National Board appoints and removes the Secretary and Chief Executive

National Trust:
- A small board of Trustees runs the charity
- There is a representative Council which appoints the Trustees
- The Majority of Trustees are Council members
- Half of the Council are elected and half appointed by partner organisations
- Members are able to participate in advisory Country and Regional Committees
- Additionally there are six Expert panels who provide independent advice to Trustees and management

The John Lewis Partnership – key findings are:

- It is governed by a Partnership Council, Partnership Board and the Chairman
- The Partnership Council is elected by partners and elects five of its number to the Board
- The Board runs the business and in addition to the Council appointees, the Chair, Deputy Chair and five appointees of the Chair sit on the Board with 2 IPNEDs
- The Chairman is fully executive and is nominated by the previous Chair
- The annual bonus is thought to be the primary motivating factor for employees

4.1 The Governance of Building Societies and Friendly Societies

These societies might be described as “cousins” of The Co-operative Group, having developed as self help mutual organisations during the eighteenth and nineteenth centuries. Traditionally, their legal structure has had similarities to the structure of co-operatives and their legislation was similar in content and style to the Industrial and Provident Societies Acts. However, from the 1980’s on, the deregulation of the market in financial services and the changing structures for the regulation of the banking and insurance industries at both EU and UK level led to legislative reform for building societies with the 1986 Act and for friendly societies with the 1992 Act. This, combined with the evolution and consolidation of societies of both kinds by merger and the demutualization of a number of the larger building societies, has led to significant differences in governance structure between consumer co-operatives and the building societies in particular. Friendly societies remain closer on structure to The Co-operative Group as many still retain the traditional Branch structure.

This short paper outlines the regulatory and legislative background, the self regulatory Codes applicable to these organisations, and the main features of the governance of two particular societies taken as examples before drawing out the relevance of this picture to the issues to be faced in dealing with governance of The Co-operative Group.

Regulatory and Legislative Background

Limited Business Purposes

Building societies register under the Building Societies Act 1986, as later amended. Large friendly societies wishing to have corporate status so as to be able to carry on a wide range of business register under the Friendly Societies Act 1992. In each case registration is permitted only if the society is to be limited by its constitution to carrying on business within a certain range of activities. In the case of a building society that is, principally, making loans secured on residential property and funded by their members[91] . In the case of a friendly society it is offering insurance and other benefits to its members and those connected to them by carrying out forms of insurance and other activities listed in the legislation[92] . In this respect these societies differ from industrial and provident societies which can carry out any business whatsoever.

Governance and Members' Rights

Both building societies and friendly societies are required to follow certain governance practices as a matter of law. For industrial and provident societies, this is left largely to the society's rules.

Both the BSA 1986 and the FSA 1992 require that there be a committee or board with at least two members, one of whom is to be the Chairman[93] . Both Acts lay down that a Chief Executive and a secretary must be appointed but that they can be the same person. They both also outline the role of the Chief Executive and, in each case the board is required to take all reasonable steps to appoint a person of sufficient knowledge and experience to be able to do the job[94] .

BSA 1986 requires that the board be elected either by a poll at a general meeting, at which proxies are allowed and proxy forms mailed out to all members, or by a postal ballot of all members. Even if the number of nominations is the same as the number of vacancies, there must be a vote for each vacancy, and if more votes are cast against a person than for him or her he or she cannot take office. The Act also stipulates who can vote in the election – all share account and borrower members[95] . Detailed rules set out in the BSA 1986 provide for the mailing to members by the society and at its expense of election addresses of limited length provided by candidates for the board as well as making detailed provision about notice periods and notices of meetings and key procedures at meetings of members. The FSA, acting as "registrar", is to arbitrate on any disputes about these matters.

The FSA 1992 permits friendly societies to use either a branch based delegate system or direct election by all members to elect the board (or committee of management). However, in the case of the use of a branch delegate system members' rights to vote at branch level are dealt with by the Act[96] . The Act does not lay down the same detailed rules about election information and direct mailing to members in that context as it does where there are direct elections by the whole membership. Generally, the FSA 1992 is less detailed in its prescriptions about governance than the BSA 1986.

Both BSA 1986 and FSA 1992 require a resolution of the board or management committee to approve the nomination of a person over the age of 70 (if the rules do not impose a lower age limit) which is then circulated to members before the election takes place.

91 Building Societies Axct 1986 (BSA 1986) section 5(1)
92 Friendly Societies Act 1992 section 1(2).
93 BSA 1986 section 58 and FSA 1992 section 27(1) & (2)
94 BSA 1986 section 59 and FSA 1992 section 28
95 BSA 1986 section 60
96 FSA 1992 Schedule12

Both Acts allow co-option in accordance with a rule which permits it but, in the case of BSA 1986, this can only be to fill a casual vacancy and the person's term ends when the next election is due and can never last more than 16 months[97] . This means that co-option of IPNED's is possible only for an initial short period should a vacancy arise. In the case of friendly societies co-option is permitted if the rules allow it - either to fill a vacancy or as an additional committee member. The person co-opted need not be a member of the friendly society[98] . This does permit the co-option of IPNED's to serve indefinitely if a society's rules allow it. Both Acts prevent the co-option of a person who was unsuccessful in an election within the previous 12 months.

These provisions are not directly linked to the prudential regulation of these societies by the FSA under the Financial Services and Markets Act 2000 (FSMA 2000). They are rather part of the earlier powers given by the specific legislation governing them to the Commissions which fulfilled the role of a registrar. However, they limit the choice of building societies, in particular, about their board structure and election processes.

Under FSMA 2000 all directors of friendly societies and building societies must be regarded by the FSA a fit and suitable and all must be accepted as Approved Persons for the controlled function of being a non-executive director (or of being a senior executive if that is their role). These requirements go to integrity as well as competence. These rules do not apply to organisations, such as The Co-operative Group not regulated under FSMA 2000. In the case of building societies and friendly societies, the requirements will be particularly demanding for executive directors and the board as a whole will be expected to have an appropriate balance of skills and experience for directing a financial services organisation.

Corporate Governance Guidance

In addition to the legal provisions laid down in their legislation, these societies are all subject to Codes of Best Practice on Corporate Governance akin to the Combined Code applicable to listed PLC's and the Code applicable to consumer co-operatives.
It is the general practice of most building societies and many but not all friendly societies that the Chief Executive plus one or more key members of the executive team serve as directors. This is not specifically required by the BSA 1986 or FSA 1992 which both contemplate these officers being either part of the board or operating under its direction.

Building Societies

In the case of building societies the applicable Code is given increased emphasis due to a requirement of the FSA in its Handbook, dealing with the prudential supervision of building societies, that societies should have regard to the Combined Code when establishing and reviewing their own corporate governance arrangements [99]. Up to the end of 2006 the FSA provided a model Corporate Governance Code which they urged building societies to adopt. Since then, the Building Societies Association (BSA) has produced guidance for building societies on how the Combined Code should apply to them[100] . The FSA accepts that building societies following this BSA guidance will be able to show that they have had regard to the Combined Code. BSA Guidance assumes the applicability of the Combined Code but makes exceptions and raises issues about its application to building societies in general or particular types of building society.

The BSA guidance suggests that building societies should consider how many of their non-executive directors can be classed as independent within the definition applicable to PLC's. It implies that the top twenty largest societies by size should have at least half of the board – excluding the chairman composed of such directors. Other societies should have a minimum of two of them. The guidance acknowledges that not all building societies

97 BSA 1986 sections 60 and 61(12)
98 FSA 1992 section 27

99 Section 1.3.2G of the BSOG section of the FSA Handbook
100 The Combined Code on Corporate Governance: BSA Guidance for Building Societies http://www.bsa.org.uk/docs/corporategov/bsacomcoderevguide.pdf

have appointed a senior independent director but urge those who take this view to devise another means whereby members can contact someone other than the chairman or an executive director and note that some other method of appraising the performance of the chairman should be found since the senior IPNED plays a lead role in that process[101] .

The guidance accepts the role of the Nomination Committee in leading the process for board appointments on merit and against objective criteria and the duty of the board to ensure orderly succession to board roles. This is to be done, as in a PLC, on the basis of evaluating the balance of skills on the board. The BSA Guidance also accepts the use of open advertising and search agencies as means of finding non-executive directors with the qualification that this will not apply on appointment of the Chair as s/he will come from amongst existing non-executive directors. Advertising among the society's own members is suggested as a method of recruitment. The guidance suggests dialogue with members through road shows, focus groups, members' magazines, and online forums. The BSA notes that the remuneration of all directors – executive and non-executive is decided by the members. It also recommends that societies follow the same practice as is required of listed PLC's in respect of providing members with detailed information about executive remuneration.

It is striking how much of the Combined Code is accepted as relevant to building societies without qualification. However, the statutory provision that all directors must be elected unless they fill a casual vacancy and that then they must face election within 16 months at most means that the board's role in respect of ensuring that IPNED's with relevant skills and experience serve on the board is carried out by recommendation to members during the election process rather than by co-option. This is also the case for most PLC's. Such a system is possible where an outsider with relevant skills can easily and quickly become a member by opening a savings account with £1000 or less in it (the qualification in building society rules which cannot require more than £1000 under BSA 1986) and can then be nominated as a director and recommended by the board to the members. Any existing member with such skills need only be nominated directly to the board and subjected to the election process..

101 ibid page 11

It would be more difficult to operate that system through a branch or delegate structure as the pool of possible members with the necessary skills would be limited, for example, to regional committee members and a new member would have to serve some years on area or regional committees to qualify for nomination as a director.

Friendly Societies

The Association of Friendly Societies has provided guidance on corporate governance for its members jointly with the Association of Mutual Insurers[102] . This was done in the form of Guidance elaborating the application of the combined code to friendly societies which is similar in form and content to the BSA Guidance. In response to concerns raised in the Myners report and earlier in the Penrose Report on the failings of governance in Equitable Life over a period of years, more detailed guidance was issued which emphasises formal and rigorous evaluation of board performance, and detailed matters to be assessed. Issues of member relations are also addressed very fully.

The key point that emerges here is that the board should take responsibility, possibly through a Nomination Committee, for the recruitment of non-executive directors with appropriate skills and experience. For those friendly societies with a branch structure this can only involve appropriate recommendations to the members unless the rules permit co-option by the board.

IPNED's with appropriate experience and skill

102 The Combined Code on Corporate Governance: an annotated version for mutual insurers July 2005 http://www.mutualinsurers.org/documents/AMI-Combined-Code.pdf and Corporate Governance for Mutual Insurers: Guidance published by AMI and AFS in response to the requests contained in the Myners Report October 2005 http://www.mutualinsurers.org/documents/MynersReview.pdf

can be co-opted to a friendly society's board as additional members if their rules allow this and this is the most obvious solution in the case of a society whose board is chosen through a delegate system. Some societies, however, share the building society model of direct election of the board by the whole membership either at a general meeting or by postal vote and this allows people with appropriate skills and experienced to be recommended to the general membership for election.

Examples from Societies

This section briefly examines the governance practices of the Nationwide Building Society Ltd – the largest building society – and the Benenden Healthcare Society Limited, a large friendly society using a branch structure.

Nationwide Building Society Ltd

Nationwide's board consists of a Chairman and seven executive directors and seven non-executives. All are elected by the members. Its Nominations Committee develops a strategy for succession and specifications for the skills required of directors. It then makes recommendations to the board which in turn makes recommendations to the membership when the elections to the board take place.

The society has Audit, Nomination and Remuneration committees consisting wholly of non-executive directors. They also have a senior independent non-executive director who can be contacted by members with issues they do not wish to raise with the executive or the Chairman. In addition, the non-executives meet once a year without executives present. The society regards all its non-executive directors as independent within the Combined Code definition. In the recruitment of executives and non-executives, outside candidates are considered with the help of executive research consultants employed for the purpose and that process is overseen by the Nomination Committee, being regarded as a continuing process of succession planning. That Annual Report deals point by point with the key recommendations of the Combined Code and explains how the society deals with them [103].

Benenden Healthcare Society Limited

This society has a branch structure. The branches meet twice in advance of the annual meeting of the society and there individual members can nominate people to the national committee of management which is elected by the conference on weighted voting by branches every other year. The secretary of the society is elected in the same way. Each branch also has its own committee and officers. The second meeting of the branch specifically mandates the branch delegates as to how they should vote at the society's AGM on resolutions and in elections to the Committee of Management.

It is interesting that in this society any member between the ages of 18 and 70 can be nominated by his or her branch to serve on the society's committee of management or as society secretary. The election is then conducted at the AGM on the basis of weighted votes by delegates from branches, depending on membership. This means that the only qualification for membership of the committee is membership of the society but that the delegate and branch structure is used for election. Thus the pool of possible directors is not limited to branch committee members. All candidates have to provide any information required by the committee as to their creditworthiness, financial or managerial experience and qualifications for the purpose of gaining approval by the FSA[104] . The society has an Audit and Remuneration Committee consisting wholly of elected non-executive directors but no Nomination Committee. Its annual reports do not deal with the question of the independence of directors but describe the system in place to deal with conflicts of interest by members of the committee of management.

As with The Co-operative Group, neither the Chief Executive nor the (elected) Secretary of the society is a member of the committee of

103 Nationwide Annual Report and Accounts 2006-2007 http://www.nationwide.co.uk/pdf/about_nationwide/FinalAnnualReport2007.pdf pages 38-41
104 Beneden Memorandum and Rules 2007 http://www.benenden.org.uk/downloads/rules_2007.pdf rules 26 to 29

management, which consists wholly of elected members.

Overall Contrasts with Consumer Co-ops: Conclusions?

Legislation More Prescriptive of Democratic Rights of Members

The Co-operative Group has more freedom to structure its governance system than either friendly societies or building societies as those organisations are constrained by more detailed legislative provision on governance and by the demands of the FSMA 2000 regulatory system applicable to them as financial services businesses.

Executives often on Board

It is the norm among building societies and quite common among friendly societies for the executives to serve on the board.

Prevalence of CG Codes and hence IPNED's and Committee Systems

The Codes of Best practice applicable to friendly societies and building societies are quite close to the Combined Code. Perhaps the biggest contrast with The Co-operative Group is the proactive role of the board and its Nomination Committee in analysing the skills available on the board and the skills needed. In the building society sector, in particular, the direct election of the board by members allows the use of recommendation by the board to assist in ensuring the election of enough non-executive directors with relevant experience and skills – effectively IPNED's but they are always subjected to the election process.

The Benenden model from the friendly society sector is interesting as it combines nomination and election to the board by branches with eligibility for any adult member aged between 18 and 70 for nomination. This increases the pool of potential non-executive directors dramatically while leaving the branches and delegate structure the power to decide who should be nominated and elected.

Could this be an acceptable alternative, or supplement, to a power under the rules for the board of The Co-operative Group to co-opt IPNED's?

4.2 Amnesty International

Amnesty International is a global organisation that campaigns for internationally recognised human rights. It is constituted as a limited company under UK law. Amnesty is a democratic, self governing movement, with over 2.2 million members worldwide, of which approximately 250,000 are members of its UK section. It undertakes research and action focused on preventing and ending grave abuses of the rights to physical and mental integrity, freedom of conscience and expression, and freedom from discrimination, within the context of its work to promote all human rights.

International Council
The International Council is the ultimate decision making body of Amnesty International. It consists of all the members of the International Executive Committee and representatives of all the sections and structures of Amnesty International. Each section and structure has the right to send one representative, and a possible additional five representatives depending on the size of its membership. It tends to have a good mix of staff and volunteers. The International Council has to meet at least once every two years and has the right to amend the Statute of Amnesty International, if it reaches a decision with a two thirds majority.

The Secretary General is responsible for appointing senior executive staff in close co-operation with the International Executive Committee.

The National Board
The Board is made up of members nominated by various constituent groups of the UK Section. There is a maximum number of 12 elected posts, and a minimum of six. Two members are nominated by local groups, two by networks, and one by country coordinators; and

the remaining places are open to any member to put themselves forward for election. Board members serve a three-year term of office and can be re-elected for one further three-year term before standing down. Elections are held for at least one third of the Board each year. The Board may also co-opt up to three additional members to serve one-year terms.
Members of Amnesty International are not allowed to become directors if they have been an employee, or registered volunteer office worker in the last two years. Directors can be removed from office by the AGM or an Extraordinary General Meeting.

The Chair and Vice Chair of the UK section is elected by the National Board, which is also responsible for the appointment and removal of the Company Secretary.

The National Board have ‘all the powers of the limited company’ but delegate day to day management to the Senior Management Team, who are accountable to the Board through the AIUK Director, who is appointed and can be dismissed by the Board.

Membership issues
Members of Amnesty International are a tremendous source of time, effort and money. The organisation is almost entirely funded through donations and membership fees, with approximately $190 million coming from its members every year.

However, it was felt that they get much more than money from their members. Members decide on Amnesty’s identity and where it wants to go. In terms of the work that is done, it is the members who carry it out, taking action to fight human rights violations. Whilst it is difficult to work out the exact impact of this, it was certainly felt that members can be visible and contribute to a discussion around an issue. As one respondent suggested their membership ‘is a well of people that we can tap into.’

Amnesty is an organisation that ‘wants to do a huge amount of work on a huge number of issues.’ What having a membership means to them is that quite simply they are able to cover a huge amount of work that otherwise their staff resource base simply could not cover.

It was also felt that being membership based also informs their discussions and policies in a way that would just not happen if they were a trustee based organisation, just doing think tank type of work. There was a feeling that it keeps them a lot more in touch with what people on the ground are thinking and doing. Particularly on the tough issues, it was felt that being membership based could allow Amnesty to take positions with a lot more strength behind it. Whilst it does mean that sometimes Amnesty cannot be as bold as its leadership would like it to be, it was felt that when they do take a position, it has a lot more credibility.

Attitudes of the Executive Team
It was felt that there was a huge mix of opinions on the executive team over the value of membership to the organisation. However, this said, it was felt that there is broad agreement that membership is something that everyone should be committed to. It was felt that the difficulties associated with the membership model are something that they manage because of the high level of commitment to the concept from the senior management team.

4.3 National Trust

The National Trust is a registered charity incorporated through an Act of Parliament, founded in 1895 to promote and look after places of historical interest permanently for the benefit of the nation across England, Wales and Northern Ireland. It is one of Europe’s leading conservation bodies, protecting through ownership, management and covenants 253,349 hectares of land of outstanding natural beauty, and 707 miles of coastline. It is also responsible for historic buildings dating from the Middle Ages to modern times, as well as ancient monuments, nature reserves, gardens, landscape parks, woodland and farmland. Its turnover in 2006/7 was £357 million.

It has approximately 3½ million members, with millions more coming to visit its sites every year.

Core Values
The mission statement of the National Trust has remained the same throughout its history. It reads: ‘the National Trust exists to look after special places, for ever, for everyone. We do so for the benefit of the nation.’

Change in Governance Structure
New governance arrangement for the National Trust came into effect on the 1st September 2005, through an Act of Parliament. This was the first change in the governance of the organisation since its inception, more than one hundred years ago.
The organisation had been previously governed by its Council, a body with 52 members, all of whom were directly elected by its members. The rationale behind the change was that whilst in the last hundred years the world had changed rapidly, the National Trust had not moved with the times. The last twenty years had seen a focus on corporate governance, and it was felt that the National Trust had to go the same route. The Council had previously been too large and unwieldy to make quick and effective decisions, and it had been felt that it lacked the expertise to fulfil both its ‘agency’ and ‘stewardship’ roles.

Overview of the new governance structure
The aims of the new governance arrangements are to:

1. Deliver clear, timely, well informed decision making
2. Adopt a consistent, open, fair and robust approach to appointments to governance posts
3. Be responsive to the views of those that take an interest in the work of the National Trust

Board of Trustees and the Council
There is:
• a small Board of Trustees which is responsible for the running of the charity and for making sure that the organisation works as well as possible to deliver its core purposes. The majority of the Board of Trustees are Council members
• a strong, representative Council which appoints the trustees and makes sure they discharge their responsibilities properly. The Council is made up of 52 members: 26 elected by the members of the National Trust and 26 appointed by organisations whose interests coincide in some way with those of the National Trust.

The combination of a representative body and a trustee body working together is supposed to provide both the strength and necessary challenge to ensure that the Trust delivers its core purpose and works efficiently and effectively as a charity and a large and complex business.

There are also a number of Country and Regional Committees, whose members provide advice and support to staff in the English regions, Wales and Northern Ireland, as well as to the Board of Trustees.

In addition the Trust has six Expert Panels, which provide top-quality, independent advice to the staff of the Trust and to the Board of Trustees.

The Board of Trustees
The Board of Trustees currently has 12 members. Due to its charitable status, all trustee positions are voluntary, and carry no salary. All members of the Board of Trustees serve 3 year terms, with elections to take place every year from 2008.

The Board meets 6-8 times per year. The focus of the Board’s work is on giving the Director General and the his team clear strategic direction, and on monitoring its delivery of agreed targets. The Board of Trustees is appointed by Council, with the help of its Nominations Committee. Two thirds of its members are drawn from Council, and one third are external. The external members are felt to be independent due to not being members of Council, although all trustees do have to be members of the National Trust.

Whilst there are no designated appointments to ensure that the correct range of skills are present on the Board, a skills matrix is taken into account by the Nominations Committee (of Council) when it recommends candidates for the

Board of Trustees.

It is expected that all trustees appointed will have knowledge of the aims and purposes of the Trust over the next five to ten years, as well as a thorough understanding of the themes and priorities identified in the Trust's strategic plan. They should also demonstrate and understanding of the governance of charities, and the duties and responsibilities of being a trustee.

Chair and Deputy Chair
Both the Chair and Deputy Chair are appointed by Council, again on the recommendations of the Nominations Committee. The role of the Deputy Chair is to support the Chair in all of these tasks and responsibilities, as well as chair the Appointments Committee of the Board of Trustees. The Governance handbook of the Trust again clearly set out skills that are required for both roles, although no formal qualifications are required.

The Council
The Council has 52 members, of which 26 are elected and 26 are appointed. All members are elected or appointed for an initial term of three years and are eligible to re-stand. Members generally serve two three year terms, although there is no limit on the number of times that they can re-stand. One third of members are put up for re-election or re-appointment each year. Elections for Council are held at the AGM, although all members of the National Trust can vote by postal ballot as well.

Senior Management Team
This is the executive arm of the organisation, made up of full time members of staff. It is headed up by the Director-General, who is appointed by the Board of Trustees. S/he is responsible for appointing his/her own team.

Commercial/democratic issues
Whilst constitutional change previously had to take place in Parliament, these powers now lie with the Board of Trustees, who is only required to consult with Council over amendments to the Constitution. This said, it would require a unanimous vote by the trustees, as well as agreement by the Charity Commission. In addition, Parliamentary approval would still be required to change the either the charitable purpose, or to end its charitable status.

Engaging more closely
The National Trust is now seeking to engage more deeply with its members. In its Annual Report, the Trust stated that 'we need to move from a narrowly based customer relationship to one based on wider support that is less transactional and more emotionally connecting. Our supporters of the future will want this even more.'

Attitudes of Executive Management
While the National Trust are very keen to 'engage' with their members, it was felt that they do not overly rely on the membership's ability to influence the work that they did. Of their 3.5 million members, only a very small proportion (less than 1%) were interested in the governance of the organisation. It was felt that the democratic structures only introduced very weak lines of accountability to members, given that such a small number was responsible only for electing half the Council members.

4.4 John Lewis

John Lewis is an employee owned partnership gifted by John Spedan Lewis by two settlements in Trust in 1929 and 1950. It has 68,000 permanent staff, who own 26 John Lewis department stores, 187 Waitrose supermarkets, an online and catalogue business, John Lewis Direct (www.johnlewis.com), a direct services company, Greenbee (www.greenbee.com), a production unit and a farm. It is an organisation with a turnover of £6.4 billion, in which its partners share in the benefits and profits of a business that puts them first. The last few years have seen the Partnership reap the investment that it has made in its long term success, with profits up 38% to £264 million in 2006/7.

Core Values and Principles
The values and principles are set out in their Constitution. They include:

1.The Partnership's ultimate purpose is the happiness of all its members... they share the responsibilities of ownership as well as its rewards – profit, knowledge and power.
2. Power in the Partnership is shared between three governing authorities, the Partnership Council, the Partnership Board and the Chairman.
3. The Partnership aims to make sufficient profit from its trading operations to sustain its commercial vitality, to finance its continued development, to distribute a share of those profits each year to its members, and to enable it to undertake other activities consistent with its ultimate purpose.
4. The Partnership aims to employ and retain as its members people…who are committed to working together… Relationships are based on…as much equality between its members as differences of responsibility permit. (It) aims to recognise their individual contributions and reward them fairly.
5. The Partnership aims to deal honestly with its customers and secure their loyalty and trust by providing outstanding choice, value and service.
6. The Partnership aims to conduct all its business relationships with integrity and courtesy, and scrupulously to honour every business agreement.
7. The Partnership aims to obey the spirit as well as the letter of the law and to contribute to the wellbeing of the communities where it operates.

Governance Structure
The structure is designed to give management the freedom to be entrepreneurial and competitive in the way they run the business for long-term success, while giving the company's owners, the Partners, the rights and responsibilities of ownership through active involvement in the business. It aims to devolve as much power to its Partners as is commercially prudent.

How Power is Shared
The power of the three governing authorities of the Partnership to direct its affairs depends on the consent of Partners.
The Partnership is governed principally by three bodies: the Partnership Council, the Partnership Board, and the Chairman

Powers
At or before the second meeting of each council, the Partnership Council elects one member to be its President. It also elects five partners to be appointed as members of the Board

The role of the Council is to represent partners as a whole. It has the right to discuss, ask questions and make recommendations on any topics that it wishes, and thereby hold principal management to account. It also functions more generally as a channel of communication between management and the partners. The Council can ask the Partnership Board to do anything it wishes, but they can refuse if they think it would damage the Partnership's interest.

The Council also decides policy on any kind of expenditure that the Chair refers to it, including matters relating to the use of profit such as discount, pensions and sick pay. Every six months, the Chair has to meet with council to discuss the Partnership's progress and answer questions on any topic that Council wishes to bring up .If Council decides that the Chair has failed, it may pass a 'Resolution upon the Constitution,' which will dismiss the Chair.

The Partnership Council can also sometimes play the opposite role, communicating the messages of the management back to the partners.

Motivations
Whatever does motivate people to stand, monetary considerations are certainly not a factor. There is no additional pay for being a Counsellor, and the role takes up a lot of time, probably more than a lot of line managers realise. The role means that Counsellors are often out for between 15 and 16 days per year, and can be out for even longer lengths of time.

Divisional Councils
Each division has its own Council, which meets at least twice a year, or as often as the trustees decide. At Waitrose, the Divisional Council is directly elected, although through smaller

constituencies than for the Partnership Board. At John Lewis, it is elected through a delegate structure via the local committees.
The role of the Divisional Council is to act locally in much the same way that the Partnership Council acts nationally. Its principle role is that of holding the management to account. The whole of the Divisional Management Committee attends their meetings, and reports back to the Council on their progress.

Local Forums
These are forums established in different branches or other units. The Partnership council sets, and can review, the guidelines for where they will be established and how they operate, including their membership, frequency of elections, admission of visitors, method of election and the basis for deciding constituencies. Every local forum has the right to meet at least twice a year without management present.

Partnership Board
The Board of Directors has the ultimate responsibility for issues of major policy and for allocating the financial and other resources of the business.
Five of the directors elected by Council; with the Chair, Deputy Chair and five appointees of the Chair also sitting on the board. In addition, John Lewis has also recently appointed 2 independent non-executive directors. Any partner can stand for director; but they do need to win votes in the Partnership Council, so it is a significant advantage to be visible to its members.

There is a good cross section of partners on the Partnership Board. Out of those elected two are from the shop floor of John Lewis (one department manager, one shop manager), one is the clerk to the Partnership Council, one is the Head of Buying at Waitrose, and the other is the Waitrose Registrar.

Whilst there is no official skills matrix for the Board it was felt that when the Council votes, they do tend to try to find a balance of skills for the Board. It was also felt that Council did tend to choose the best candidates independent of politics, and it was pointed out that there was generally at least one person elected to the Board who did not sit on Council.

The decision to have independent non-executive directors was relatively recent, and started with the appointment of the new Chair. The Board and the Council previously felt that this role could be adequately done by the current elected directors, many of whom have substantial retail knowledge and know the business inside out. However, it was felt necessary to increase their ‘peripheral vision.’ Even in such a short time, the feedback is that it has been very positive for board dynamics, and the two IPNEDs have also brought particular expertise in finance and information technology.

The Chairman
The Chair is nominated by the previous Chair, subject to the approval of the Partnership Board. It is a fully executive role.

The Chair also responsible for appointing the members of the two Divisional Boards. The Divisional board carries out divisional business plan, as set out by the Partnership Board. Increasingly they also have a voice in strategy. Whilst these executive boards are appointed by the Chair rather than the Managing Director of the Division, it is expected that he will be consulted, given that the Managing Director is responsible to the Chair for the performance of the organisation. There are currently two new Managing Directors at both divisions, and these have, however, come into their respective jobs with an existing team.
The role of Chair was also declared to be unusual given that the Chair is expected to serve for 10 years. There has, however, been talk of moving to a Nominations Committee for the role of Chair

Membership issues
It was felt that being employee owned added value to the business, making a crucial difference in levels of engagement and motivation. One respondent referred to sensing that ‘you are not just serving the community, but you are serving your fellow partners.’

This translates into low staff turnover rates, which being regularly in the low 20s per year are very good in comparison to their competitors. It was also felt that there retention rates are even better, as they have a lot of young partners in temporary jobs, who tend to move on once they have finished studying or go off to university. Financial consideration plays an important part in this, Whilst the wages offered are competitive, this is very much a market rate pay policy, with people receiving individually based pay rises, as merited by performance. These are individually based, and provide an important incentive. However it is the Bonus which is thought to be the primary motivator, with a feeling that people are also working together to enhance the bonus that they all receive. The degree to which this is a motivating force cannot be underestimated. One respondent stated that: 'for a lot of partners, the bonus coming in March just about covers what you have had to shell out on the credit card over Christmas. Many partners heavily dependent on it, and this figures in their financial planning.'

It also creates a sense of common mission throughout the year. It was felt that retail is a very week in week out business, in which people could see what they had achieved. It was felt that as the organisation got through Christmas and clearance, a real sense of excitement builds, with people making additional efforts as they feel that there is a mountain they need to climb.

Attitudes of executive management
They certainly spend a good amount of time involved in Council work, have to provide expert input into debates. It was felt that if they think that if they feel it is all a waste of time, they should wonder what they are doing in the Partnership. One respondent added: 'it's not as if it will come as a surprise to them once they have joined.'

Whatever the attitudes of executive management, it was felt that they are part of the Council and have to be involved. It was also felt that the Chairman wants his top team kept on their mettle by a strong Council.

5. International Mutuals – Case Studies

For this section, we have selected a number of mutuals from overseas, each of which operates within a single nation, in a particular market. The examples were chosen for their size, relative business success and complexity of business offer.

Case studies:

Rabobank – co-operative financial group, Netherlands
Desjardins – co-operative financial group, Canada
Migros – co-operative retailer and service group, Switzerland
S Group – co-operative retailer and service group, Finland
Nationwide Mutual – mutual insurer and financial services provider – United States of America

- Each of the selected mutuals has a unique governance structure
- We cannot say whether their relative success is related to the governance structures that are operated; we can reasonably conclude that they do not impede their success
- These examples have informed our thinking, especially in relation to Board operations and membership representation

5.1 Rabobank

Rabobank is a co-operative bank, founded in 1972, as a result of a merger between the regional central banks of the Dutch credit union movement. It is a secondary co-operative owned by 183 local banks. These banks in turn are owned by their individual members. It is one of the largest banking groups in Holland, and among the top 50 banks in the world in terms of asset size. It holds total assets of €556 billion with a turnover of just over €10 billion in 2006. It has 4.5 million active customers (more than a quarter of the Dutch population), of which 1.6 million are members, and is the largest provider of customer service banking in the country; with a 24% domestic share of the mortgage market, 40% share of private savings deposits, and 83% of all Dutch agricultural bank loans. It is also the fifth largest insurer in Holland.

Governance Structure

The co-operative has the following bodies: The Members' Council; The General Meeting; The Supervisory Board; The Board of Management.

The co-operative is also divided into departments, which are act as constituencies through which the Members' Council is elected, as well as serving a number of important membership functions.

The Members' Council

This is a directly elected body, elected through the Departments. The Members' Council has the power to:

1. Adopt and amend the Articles of association (of the local bank)
2. Appoint the members of the Supervisory Board
3. Veto the adoption of the financial statements
4. Veto the endorsement of the conduct of affairs and its supervision
5. To decide on the appropriation of profits for purposes of local and general interest
6. To convene a General Meeting in the interest of the co-operative
7. To set the remuneration for the members

of the Supervisory Board

8. To decide on a legal merger or legal division, in consultation with the departments

The General Meeting

The General Meeting of the co-operative has the powers to decide on its dissolution, or on the termination of its membership of Rabobank Nederland.

The Supervisory Board

The Supervisory Board is responsible for supervising the general policy and procedures of the Board of Management, as well as the general day to day procedures and the co-operative and its business. The Supervisory Board is responsible for presenting its views on general policy and procedures, and assists the Board of Management with advice. It supports the co-operative in maintaining its social programme.

The Board of Management

Subject to the powers given to other bodies as have been set out above, the Board of Management is responsible for the management of the co-operative.

Regional and National Structure

Regional Delegates Assembly

All 181 local member banks send a delegation to one of the 12 Regional Boards. Regional Delegates Assemblies represent local banks' interests among the member banks and with respect to Rabobank Nederland.
Their representation is based on the partnership structure, with an executive representative from the Board of Management, and a non-executive from the Supervisory Board.
The Regional Assembly elect a team of six people, who are also the representatives of each region in the Central Delegates Assembly, which has 72 members, made up of the six representatives from each region.
The Executive Board requires advice from the Central Delegates Assembly before:

a) Entering into or severing any long term co-operation with another company or legal entity
b) Acquisition of participating interest in another company, if the value is at least one twentieth of Rabobank's funds
c) Additions or disposals involving at least one twentieth of funds
d) Legal mergers or divisions

The Executive Board requires the approval of the Central Delegates Assembly for:

a) The proposals on the policy for the business of member banks presented each year by the Executive Board to the Central Delegates Assembly Meeting.
b) The proposed resolution of the Executive Board to adopt the budget of Rabobank Nederland.

The Assembly needs to meet before every General Meeting; whenever the coordinating committee (of the CDA), Supervisory Board or Executive Board consider holding a meeting necessary or desirable in the interest of Rabobank Nederland; whenever a decision needs to be made; or when requested by at least one fifth of all regional delegates assemblies.

General Meeting

The General Meeting takes place annually, unless an extraordinary meeting is called. There are between 5 and 6 representatives from each local bank, generally fairly evenly divided between members of their respective boards of management and supervisory boards.

The Supervisory Board

The Supervisory Board is appointed by the members of the General Meeting, although candidates are decided by the Supervisory Board themselves, who generally only give the General Meeting one candidate to choose from. This means that the Supervisory Board is essentially a self selecting board, with the General Meeting only having a power of veto over appointments. The Supervisory Board appoints the Executive Board, as well as appointing its Chair and Deputy Chair. All appointments have to be vetted by the Dutch Central Bank.

Membership issues

Recent years have seen a significant relaunch of Rabobank's membership proposition. In 1998, there were only 400,000 members of Rabobank, (less than 10% of its customers), and there were very weak levels of engagement.

The current focus of membership is in their interaction with members, not only through meetings, but also through communications. Central advice for local banks is to organise lectures, events and other network activities for members on a regular basis.

Research done by Rabobank has shown that members make substantially more use of their services than ordinary customers and that they are more satisfied than customers. Members are seen as having high expectations of their membership. It was felt that they value the social role the bank has, the additional knowledge they can obtain, the possibilities they get for networking and the opportunity to help think along with the bank and to actually take part in the decision-making process.

Commercial/democratic issues

Rabobank Nederland believes that it is more important for it to be focused on its customers rather than its individual members.
Discussions in 1998 focused on its core purpose as an organisation, and decided that strategically they were no longer a credit union, focused on the interests of its members, but a co-operative bank with a customer focus. This meant that whilst the recruitment of members from their customer base was a priority, membership was not an end in itself. It was felt that 'via the authority and influence of members Rabobank can be what it wants to be: "a customers' bank."'

Executive Management

It was felt that majority of the executive team both realise and value the difference between being an executive in a co-operative and in a limited company. One of the respondents re-membered that the first question of the CEO, when he began eight years ago, was with regards to his influence, and where he fitted in with the organisation. However, over time he realised that the co-operative structure is dependant on continual dialogue, and being constantly in contact with Rabobank's customers and members through all sorts of structures.

5.2 Desjardins

Desjardins is the largest co-operative financial group in Canada, and among the largest credit unions in the world. In 2006, it had assets of $135.1 billion and a turnover of $9.4 billion. It is the largest provider of financial services in Quebec, and the sixth largest provider of financial services in Canada. The organisation had a total of 6,039,412 members at the end of 2006, of which 5,770,757 were members of the 549 'caisses' in Quebec and Ontario, 49,817 were members of the Desjardins Credit Union in Ontario, and 218,838 were members of the 40 'caisses' in the New Brunswick and Marotoba federations.

Core Mission

Desjardins exists 'to contribute to the well-being of people and the economic and social development of their communities within the compatible limits of its field of activity.

Recent changes to its governance

Desjardins 2001 Congress on Co-operative Renewal saw them change their structure from a three tier to a two tier structure. Before this restructuring, they used to have decision making bodies at caisse, regional and federation level, with a Board of Directors and an executive team in every region as well as at a Federation level. The roles of the two boards were unclearly defined, and would lead to conflict between the Federation and the regions. Each region was politically led, and would fight its political struggles on the Federation Board of Directors.

Under the new structure, Desjardins has a two tier structure, with decisions only made at a caisse or federal level. The caisse has responsibility for its local business plan, its membership strategy and how it invests in its community. The rest of strategy is now all joined up at a Federation level, with the regional offices solely serving an operational and communicative function.

The Board of Directors

The Board of Directors is made up of 5 to 15 members elected by members during the Annual General Meeting. In addition to attending board meetings, the board members also work in committees to address certain specific issues.

The Board of Supervision

The Board of Supervision is made up of 3 to 5 members elected by members during the Annual General Meeting and acts as a "watch-dog" to ensure that the caisse runs smoothly. Its responsibilities are:

- monitoring caisse operations to ensure that it is managed in keeping with applicable laws, by-laws, standards and code of ethics
- addressing complaints
- giving opinions and making observations and recommendations to improve caisse operations as needed

The Annual General Meeting

The AGM is an annual meeting which all of the members of the caisse can attend. It has the responsibility for:

- Electing the Board of Directors and the Board of Supervision
- Deciding the level of dividend (within a scale recommended by the Federation and the officers of the caisses)
- Deciding how the Social Fund is distributed
- Deciding on mergers and constitutional change

Regional Structures

All of the officers of each caisse in each region come together in a Regional General Meeting, which is responsible for electing their Council of Representatives. There are 17 regions within the Desjardins Federation.

Assembly of Delegates

The Assembly of Delegates is made up of all the members of each of the 17 Councils of Representatives (still waiting for powers/responsibilities). The Assembly of Delegates elects the Chair/CEO, as well as some of the members of the Board of Directors.

The Board of Directors

The Board of Directors consists of 22 members, the majority of which are 'unrelated parties,' as the elected Chairs of the regional Councils of Representatives. Five of the members are 'related:' these are chair and CEO (which is one person), and four caisse executives who serve on the board. These are all elected at the Assembly of Delegates.

Directors serve for three year terms, with one third of the directors put up for re-election every year and there are provisions for ensuring that there is a cross section of the right skill sets on the Board.

The Chair/Chief Executive

Desjardins has taken a position against separating the functions of Chair and CEO. The joint role is elected by the Assembly of Representatives, with his/her primary responsibility to the membership of the organisation. The position of President and Chief Operating Officer was created in order to free Chair/CEO from operational considerations. The President and Chief Operating Officer Chairs the Executive Team, but the Chair/CEO will sit on it as well.

The Executive Team

There is also have an Executive Team of 7 people, appointed by the Chair/CEO, who are specialists appointed to deal with the day to day management of the organisation and suggest strategy.

Respective roles of the Executive Board and Board of Directors

The Board of Director's role is largely to deal with broad strategic issues, as well as succession planning and co-operative affairs.

Membership

All of the customers of the Desjardins credit unions are members automatically, and all customers of their subsidiaries can join. However, dividend payments are not currently linked to doing business with the majority of the Desjardins subsidiaries, although there is discussion within the Group whether there should be movement on this issue.

Member participation

Formally, the way in which members are principally involved is through their AGM. Apart from electing the two boards of their local caisse, members also set the level of dividend, and decide how the 'Social Fund' should be distributed. For dividend, there is generally a scale set by the Federation, as well as information given by the caisse management as to the level of capital that the caisse needs to continue. The caisse management will also generally make recommendations to where they think that the money from the Social Fund should go.

Employee Engagement

All employees of the business are members of Desjardins, they have to be as wages will only be paid into Desjardins accounts. Every year, a staff survey is carried out measuring employee motivation and engagement in all components. A significant level of the performance related bonuses of senior management are dependent on the results of the survey.

Executive Management

Regardless of executive attitudes to the co-operative nature of the business, it was felt that 'they don't have a choice,' in this regard. It was felt that if they work for Desjardins they have to comply, and all staff received special training around co-operative values.

5.3 Migros

Migros is the largest consumer retail co-operative in Switzerland, and until the recent merger of United Co-operatives and the Co-operative Group in the UK, was the largest in the world. It is one of Switzerland's largest enterprises, with a turnover of approximately £9.1 billion in 2006. The same year, Migros sold approximately 24% of the Swiss nation's food, and accounted for 17.8% of its retail sales.

Aside from its retail business, Migros has a number of subsidiaries that include: the 15 Migros industry companies (approximately £2 billion of sales in 2006), Hotelplan AG (approximately £792 million in 2006), Migrol AG (network of petrol stations with sales of approximately £748 million in 2006), Migros Bank (which holds approximately £12.3 billion in assets, as well as network printing, logistics, IT and media companies.

In 2006, the ten regional co-operatives in Migros had 1,993,543 members, and expect to hit over 2 million for the first time by the end of this year. This means that over 1 in 4 people in Switzerland are members of Migros.

Core Purpose

The purpose of Migros is:

- To group together co-operatives that are accountable to the principles that govern the Migros community, and put at their members', as well as the general population's disposition: their merchandise, quality services and cultural benefits.
- To defend, by common action, the interests of the Federation of Co-operatives, and other enterprises and organisations of the Migros Community.
- To promote the ideas and interests of the Federation, their economic and social values; as well as representing the rights of the member-co-operatives of the Federation politically.
- To spread and deepen the spiritual patrimony of Migros and the

Co-operative ideal.

- To coordinate, in the common interest, the commercial activities, objectives and activities of all co-operatives, enterprises, organisations and foundations grouped within the Migros Community, under reserve of their own status and autonomy.
- To represent the Migros community towards all third parties.

Rights and Obligations of the Federated Co-operatives

The federated co-operatives have the right to ask for the services of FCM and its subsidiaries, and ask for the assistance of FCM in the defence of their interests.

The Federation is responsible for:

- Production and marketing
- The promotion of wider aims and objectives
- The production of Migros magazine in at least 2 national languages
- The use of laboratories and testing facilities
- The use of central offices and staff
- Coordination in human resources and training
- Marketing and publicity
- Campaigns
- Acquiring land or property
- The creation of own research and teaching institute
- The formation and management of subsidiaries

Assembly of Delegates

The Assembly of Delegates is 'the supreme body of the FCM.' It consists of 111 delegates of which 100 are elected from the membership of the 10 regional co-operative councils and 10 are appointed from each of the regional boards. The Assembly of Delegates also elects a President, who does not have to a member of the Assembly. Once elected s/he is also appointed to the Assembly. It convenes at least twice a year to carry out its statutory duties.

The role of the President is to chair the Assembly, and if he is not present, it is chaired by the Vice President or one of the other officers. The officers prepare the agenda of the Assembly. In fulfilling this role, they have the right to demand information on all important issues (apart from any that the Board feel should be kept secret), and the right to be informed about the remuneration of any Migros employees.

The Assembly can be summoned by any of the other bodies (bar the executive) or by a fifth of all delegates or any of the ten regional co-operatives. The Board of Control helps the Assembly with the debate over the Annual Accounts

Board of Directors

The Board of Directors has 23 members. This consists of: the Chair (who is appointed by (waiting for response)), the Chief Executive (who is appointed by the Assembly of Delegates), one representative from each of the ten regional co-operative (normally the managing director), two staff representatives, as well as nine independent non-executive directors (who are appointed by the Assembly of Delegates).

The aim of this structure is to 'achieve a balanced ratio in the composition between internal and external members and to ensure that there is no accumulation of administrative offices within the Migros Community. There are no qualifications required to sit on the Board, although it was felt that there this does not affect its competence, due to the fact that the Board is almost entirely made up of high level executives within the Migros group, or independent non-executive directors selected for specific skills that they could bring to the Board.

Responsibilities

The board is responsible for the management of the Migros community as a whole. It determines the economic objectives and the non-economic objectives of the FCM and the Migros Community, and oversees and coordinates the achievement of these objectives.

The Board meets as often as is required, which is a minimum of at least six times a year.

Positions on the Board are elected by secret ballot.

Executive team
The accountability of the Executive Board runs through the Chief Executive, who is nominated by the Board of Directors, and appointed by the Assembly of Delegates. The Chief Executive has responsibility for the operational conduct of the business, and is able to nominate his executive team, but only with board approval. Members of the executive team are directly accountable to the President.

Regional Co-operatives
The regional co-operatives have two decision making bodies, the Co-operative Committee and the Board of Directors. The members of the Co-operative Committee are directly elected by the members through a postal ballot, and is responsible for appointing the Board of Directors. Both bodies are responsible for strategic issues that do not fall under the auspices of the Federation, such as the conclusion of important contracts with the Federation and important cultural actions. The Board of Directors is responsible for all aspects of the 'day to day' management of the co-operative, that does not fall to the Federation.

Membership issues
It was felt that members of the organisation can 'add value' through communicating their needs to the organisation. It was felt that the role of members was not really that different to that of customers in relation to the business, but if they were interested, they could involve themselves in the governance of the business.

Membership services are undertaken solely by the regional co-operatives. The only communication with the members that is undertaken centrally is the provision of Migros's weekly newspaper.

5.4 S – Group

The S Group is a major Finnish cooperative retail and service group. It is made up of Suomen Osuuskauppojen Keskuskunta (SOK) with its subsidiaries, 22 independent regional cooperative enterprises and 16 local cooperative enterprises. The members own the regional cooperative enterprises, which in turn own the central organisation, SOK. The group has almost 1.7 million members, which represent approximately 64% of all households in Finland. It had a turnover of €9.8 billion in 2006.

Mission
The S-Group's mission is to provide services and benefits for its members, its customer-owners. It was felt that this business idea guides both strategic development and practical operations, and it underlies day to day services for customer-owners at all of their S-Group locations. It was felt that the performance of the entire group can be assessed by how well they have succeeded in accomplishing this mission.

Governance structure
The AGM is SOK's highest decision-making body. Each co-operative enterprise is entitled to send to an AGM between five and eight representatives depending on the size of its membership. All of the representatives have the right to speak but only one of them has the right to vote on behalf of their regional co-operative.

The task of the Annual General Meeting is to deal with matters that are defined in the Statutes, such as adopting the financial statements, considering the profit/loss accounts, the discharge of officers from liability, the election of the Supervisory Board and the auditors and their remuneration. It also decided the level of profits that will be distributed by dividend. Extraordinary General Meetings may be convened as necessary.

Supervisory Board
The Supervisory Board has 22 members (one for each regional co-operative), and is elected

by the General Meeting on the basis of proposals made by the cooperative enterprises. Members of the Supervisory Board tend to be the Chair of the Supervisory Board of their regional co-operative. The Supervisory Board's role is to oversee that the administration of S-Group is attended to in accordance with the law, the Statutes, decisions of the General Meeting and the Supervisory Board as well as S-Group's best interests. The Supervisory Board has the power to accept and expel members of S-Group and appoint and dismiss the Chief Executive and other members of the Executive Board. It also decides on the remuneration of Executive Board members other than those who are employed by the regional co-operatives.

Whilst the General Meeting is nominally the highest decision making body, it was felt that in real terms, this role is played by the Supervisory Board, which tends to make decisions regarding S-Group's overarching strategy, as well as having the power to agree to constitutional change.

The idea is that by taking decisions over strategy through the Supervisory Board, they can bind the whole group of co-operative behind them. This then makes implementation easier, because each co-operative has had a representative in the decision making process, who can defend its decisions at a regional level.

Executive Board

The Supervisory Board elects the members of the Executive Board for a term of one year based on a proposal by the Committee of Presiding Officers. Under the Statutes, the Executive Board is comprised of the Chief Executive, who serves as chairman, and a minimum of three and a maximum of eight other members. The Executive Board of SOK in 2007 has eight members, six of whom are managing directors of cooperative enterprises and two of whom are employed by SOK as independent non-executive directors.

The Executive Board has the responsibility for the strategy of the whole of the S-Group business. It deals with strategies that affect the whole group, with its approval required in areas such as marketing, communication, training and other support functions.

Its responsibilities include confirming matters such as the objectives of the subsidiaries, the operational plans and the allocation of resources, as well as overseeing the implementation of related decisions. The Executive Board also oversees the operations of the associated companies to ensure that they act in the best interests of SOK Corporation and the S Group. It also monitors the building society activities of the regional cooperatives.

The Executive Board is also responsible for the appointment of the members of the Senior Management Team, and the remuneration of all those who do not sit on the Executive Board. It is also responsible for other management appointments. It met 21 times during 2006.

Chief Executive and Senior Management Team
The duty of the Chief Executive is to direct the activities of the Executive Board and the cooperative enterprise in accordance with the relevant acts, SOK's Statutes and the decisions of the governing bodies. The role of Chief Executive and Chair are combined.

It was felt that combining the two jobs of Chief Executive and Chairman made the job challenging, as it means that any prospective candidate has to not only effectively lead a board, but also be an expert in a number of business areas. The role of the Company Secretary at S-Group was seen as far more concerned with professional than governance matters. It was felt that his/her main role was as a support function for the Executive Board and the Chief Executive, which would take up 80% of their time. This said, the Company Secretary does play a role in some governance issues

Outside of its statutory role, the Senior Management Team is responsible for the operational and 'day to day' management of the business. It met ten times in 2006.

Executive Boards of the subsidiaries

The Chairman of the Executive Board of a subsidiary is, as a rule, a member of the

Executive Board or Management Team who is responsible for the subsidiary's operations and is employed by SOK. The subsidiary's Executive Board decides on the company's strategy, operational plans and budget as well as the hiring, terms of employment and dismissal of the managing director. The decisions of the Executive Board take into account the Corporation- wide principles and the decisions of SOK's Executive Board concerning the company's objectives, operational plans and allocation of resources.

Membership issues

It was felt that being member owned is the major factor in the success of S-Group as a business. One respondent stated that 'a co-operative society must be really co-operative…This means that its basic mission is to provide products, services and benefits to its members…It must always remember this.'

It was also felt that the other key to being a successful business was through forming a psychological and emotional bond with its customers. This can be seen in the words of another respondent, who stated that 'the members must feel, from an emotional point of view that this enterprise is my own enterprise.' Sponsorship is another way in which S-Group seeks to build and maintain its image as a responsible actor, and engage further with its membership. The aim of its sponsorship program is to allocate its investments to targets that support co-operative values, that in one way or another touch the life of every member or produce distinct benefits for members. One of their recent priorities has been to support children's and young people's sports activities. It was felt that the work that has been done over the last ten years to put this strategy in place is finally bearing fruit.

5.5 Nationwide Mutual

Nationwide Mutual is a mutual insurer, founded initially in 1925 by the Ohio Farm Bureau, and then 'sponsored' by Farm Bureaus in seven other states. Today it is a truly national business, owned by all of its policyholders, but still keeping links with the eight 'sponsoring organisations' that brought it into the world.
It is one of the largest insurance and financial services companies in the world, focusing on domestic property and casualty insurance, life insurance and retirement savings, asset management and strategic investments. In 2006, it had a turnover of over $22 billion and provided insurance to over 16 million policyholders.

It is also the sixth largest total property and casualty insurer in the United States. It is the number one provider of insurance of both farm and agribusiness insurance, as well as defined contribution pension plans. It is also the fourth largest homeowner insurer, and the sixth largest car insurer. For the last few years, it has also been the fastest growing insurance company is the US, with 2006 seeing its direct written premiums growing by 4% and its policies in force growing by 2%, in what is a highly competitive market. In 2006, it was the 104th largest company in the US.

Core Values

These are not set out constitutionally but are:
'We value people.
We are customer focused.
We act with honesty and integrity.
We trust and respect each other.'

Governance Structure

Nationwide mutual is owned by each of its 16 million policyholders. Its board consists of 16 members, 15 of which are elected and one (the Chief Executive) of which is appointed. Whilst the policyholders have the right to elect who they wish to the board, in practice they tend to sign over their votes as a proxy to the company board. There is no memory of nominated candidates being defeated in recent times.

The Chief Executive also sits on the Board of Directors, and is appointed by it. The Secretary is also a board appointment, and the Chair is elected from among the members of the board. There are also a number of sub-boards, for each of the approximately 150 companies that make up Nationwide Mutual, all of which are wholly owned subsidiaries. The largest of these are Mutual Fire and Nationwide Financial, which are all 'elected' in the same manner as the main board. Other boards are appointed by the Board of Directors, and tend to be made up of members of the main boards, as well as a number of people from management.

Recent Change in Governance

Around twelve years ago, Nationwide saw its governance arrangement change quite dramatically. Before that, most of its board members came from the leadership of their 8 regionally based 'sponsoring' organisations. These are essentially farm based organisations from eight states in the US, which was a hangover from their origins as a farm based mutual insurance company, founded by the Ohio Farm Bureau. These were responsible for nominations, which were screened by the Governance Committee (a Committee of the Board of Directors), and their nominees would be selected as candidates and elected at their Annual General Meeting through proxy votes. For the last twelve years, the Governance Committee has taken a different approach. This has been largely as a response to wider societal concerns about corporate governance, based on the fiduciary duties of directors. Nominations are now made by the Governance Committee, who has taken a much more careful look at the qualifications of their board members, so that they have a more diverse set of skills. However, they still solicit requests from their 'sponsoring' organisations for candidates, which are included in the Governance Committee's considerations. The majority (11) seats are still held by board members of their 'sponsoring' organisations, but they now have four independent directors with backgrounds in finance, auditing, insurance law and marketing.

Board Responsibilities

These include:

- Exercising their business judgment in representing the best interests of the policyholders and shareholders of the Companies.
- Approving a corporate philosophy and mission.
- Fostering the Companies as leaders in their industry.
- Selecting, monitoring, evaluating, compensating, and - if necessary - replacing the Chief Executive Officer, and other senior executives
- Ensuring management succession.
- Reviewing and approving management's strategic and business plans,
- Reviewing and assisting in the development of the positions of the Companies with respect to significant internal and external policy issues.
- Reviewing and approving the financial objectives, plans, and actions of the Companies, including significant capital allocations and expenditures.
- Monitoring corporate performance against the strategic and business plans
- Ensuring ethical behavior and compliance with laws and regulations, auditing and accounting principles and governing documents of the Companies.
- Retaining advisors, who may be independent of other advisors retained by the Companies, to the extent that they determine that such action will assist it in carrying out the duties listed above.

The board is also responsible for deciding issues of constitutional change, including any possible decision to demutualise.

Membership issues

It was felt that being member owned was of value to the business because it meant that they existed to serve their customers, rather than maximise profit for shareholders. It was felt that it was this that has enabled the culture at Nationwide to be more customer focused, as this is its original purpose.

Whilst they do not pay dividends, they use their

profits as capital for further growth, as well as holding down the prices of their policies to the customers.
Nationwide have now embarked on a series of initiatives designed to improve the customer experience, making it the central point of their marketing, as well as the central point of their service provision, with the aim being to create a customer experience that one respondent referred to as ‘vastly different to what people receive from other companies. It was felt that customer relationships should be the highest priority when they make decisions

Attitudes of Executive Management

It was felt that whilst the Chief Executive and his team support the mutual structure overall, there are very mixed attitudes as to how this in practice affects the business. It was also felt that the main impact that the mutual structure has is culturally, as can be seen with the customer focus of the organisation.

Because of their competitors, in a lot of ways Nationwide competes in much the same way as a PLC, as they, like their competitors, compete largely on price and coverage. It was felt that they probably give a bit more support in terms of claims and customer service, but the competitive nature of the US market means that all insurance firms need to ‘up their game’ in this regard.

The one area in which there was seen as being a particular conflict between the commercial and non-commercial considerations of the business was in the branch network. Due to the competitive nature of the market, Nationwide have found that they have had to shut a lot of their branches, having fewer, larger branches. This does have an impact on a number of their customers, who often do not like the fact that some of their branches are over twenty miles away.

6. Public sector governance

Introduction

This paper considers how public sector bodies and quasi public bodies in the UK are governed, and the implications of this for their engagement with stakeholders.

In most towns and cities the largest employers will be local government, the National Health Service, and the university or universities. There has been considerable discussion of and action on the corporate governance in both the health and higher education sectors, but first the situation in central and local government is considered.

Central and local government

Clearly the nature of governance and stakeholder involvement in Government – both local and central – is quite different than in the case of public limited companies, and the parallels between the two sectors are concomitantly limited. However, there have been some relevant developments, such as the Development of the Nolan principles, the introduction of Management Boards for Government Departments, and the development of Cabinet Government in local authorities.

The Nolan Principles

Lord Nolan was the first Chairman of the Committee on Standards in Public Life – an advisory non-departmental body established in 1994 by Prime Minister John Major in response to concerns regarding unethical behaviour, such as the 'cash for questions' scandal. The Committee's original terms of reference were: 'To examine current concerns about standards of conduct of all holders of public office, including arrangements relating to financial and commercial activities, and make recommendations as to any changes to present arrangements which might be required to ensure the highest standards of propriety in public life'.
The Committee's First Report (Nolan, 1995) established 'Seven principles of Public Life', as follows:

i. **Selflessness**: Holders of public office should take decisions solely in terms of the public interest. They should not do so in order to gain financial or other material benefits for themselves, their family, or their friends.
ii. **Integrity**: Holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that might influence them in the performance of their official duties.
iii. **Objectivity**: In carrying out public business, including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.
iv. **Accountability**: Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.
v. **Openness**: Holders of public office should be as open as possible about all the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands.
vi. **Honesty**: Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.
vii. **Leadership**: Holders of public office should promote and support these principles by leadership and example.

The Nolan Report also declared that all public bodies should draw up Codes of Conduct incorporating these principles, and that internal systems for maintaining standards should be supported by independent scrutiny.

Government Departments

Management Boards with Non-Executive Directors oversee the work of Government Departments. However, the Non-Executive Directors are not necessarily in the majority. For example, the Management Board for DFID is chaired by the Permanent Secretary and includes three Director Generals from the Department and only two Non-Executive Directors.

Departments are also subject to 'Capability Reviews'. But again, the civil service involvement in these reviews might be thought to cast doubts as to the independence of the process.

Nevertheless, it can be seen that these are mechanisms that aim to ensure good corporate governance for Government Departments.

Local Authorities

Local Government has moved to a 'Cabinet' style of governance that seeks to conduct the business of the authority in a more professional and expert manner. In effect, the elected councillors can be considered to be the 'non-executive directors' overseeing the work of the 'executive' officers.

The National Health Service

The Boards of NHS Trusts include Non-Executive Directors, selected according to the Nolan principles referred to above. Indeed, the Nolan Report included additional guidelines for NHS governance specifically.

The major development in governance and stakeholder involvement in the NHS has, though, been the creation of 'Foundation Trusts'. In a Foundation Trust, the Board is overseen by a 'Council of Members', which seeks to include representation of the various stakeholders – patients, local residents, employees, and other bodies such as the local authority and in the case of teaching hospitals, the relevant Medical School.

In September 2006, Monitor issued the final version of the NHS Foundation Trust Code of Governance, designed to promote good governance. This operates on a comply-or-explain basis, so that Trusts are expected to follow the Code's recommendations, or else explain why they have chosen not to. The 'comply or explain' principle is fundamental to the way in which corporate governance has developed in the UK, under the leadership of Sir Adrian Cadbury. This is in contrast to the more legislative approach taken in the US, particularly since the Sarbanes-Oxley legislation, introduced in the US in 2002 in response to the Enron and WoldCom scandals[105].

Mutuo has played a leading role in trying to ensure that the governance arrangements for Foundation Trusts will be such as to properly engage the stakeholders that are represented on the 'Council of Members' (or whatever equivalent term the relevant Trust chooses for its governing body)[106].

The University sector

Corporate governance of universities was analysed and reported on by Richard Lambert (2003), a Report commissioned by then-Chancellor of the Exchequer Gordon Brown. In his Report, Richard Lambert called for a streamlining of the Governing Bodies of universities, and with a majority of the members of such Governing Bodies being external to the University, or 'lay' members. However, the Lambert Report conflated the very different types and nature of universities across the UK, where there are in particular quite different traditions between Scotland and England, and within England between the pre- and post-1992 universities, and in addition the self-governing nature of the Universities of Oxford and Cambridge. All this is analysed in detail in the authoritative analysis and depiction of governance arrangements within the university by Shattock (2006).

Briefly, Shattock (2006) sees governance not

105 See Peter Richards, 'Why greed isn't good', Cambridge Alumni Magazine, No. 52, 2007.
106 See http://www.mutuo.co.uk/nhs_foundation_trusts.php

just as a matter concerned with the make-up of the governing body, but rather as the way in which the entire organisation is led and managed, including at Departmental level. A crucial distinction in most of the university sector has been between a governing council on the one hand, which has tended to include non-academic members, and the ‘senate’ on the other, made up of academics, which thus has responsibility for all academic matters within the university. The role of students includes staff-student committees at programme or departmental level, up to student representatives on senate and council.

Importantly, Shattock writes in the Foreword to his definitive study that ‘As a participant myself in the resolution of some of the issues described in chapters 6 and 7 and as the main author of the first three issues of the Committee of University Chairmen’s Guides on Governance, I am very conscious of the difficulty of adopting the appropriate governance steps as challenging events unfold quickly around one.’ (Shattock, 2006, p. xiii). The key point is that ‘corporate governance’ is not a one-size-fits-all model that can be adopted by an organisation which will henceforth be well governed; on the contrary, different types of organisations will require concomitantly diverse arrangements, and the appropriateness of these will alter over time as the world changes and as ‘events’ unfold. Hence Shattock’s reference to ‘appropriate governance steps’ – rather than ‘structures’ or ‘arrangements’ – and to these having to be adopted, as events unfold.

Conclusion

Concern for ‘corporate governance’ as a topic for public debate, analysis and regulation emerged in the very early 1990s with a series of corporate scandals. In 1990, Sir Adrian Cadbury – who had been Managing Director of Cadbury’s from 1965, overseeing its merger with Schweppes in 1969 – had published his book on The Company Chairman. Sir Adrian was thus a natural choice to be invited by the London Stock Exchange and big City accounting firms to chair a committee on financial corporate governance, whose report was published in 1992. The Cadbury Report has since been supplemented by various additional studies and Reports. The issues of governance have also been used as a lens through which to analyse the public and quasi-public sectors, with many of the same sorts of reforms being introduced, most obviously with the introduction of Non-Executive Directors and the increased emphasis put on the importance of ‘lay’ members of governing bodies. In the case of the NHS in particular, there has also been greater consideration of how governance arrangements can better facilitate stakeholder involvement, with the creation of Foundation Trusts as member organisations.

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7. Democracy and Governance – a Political Perspective

Matthew Ball and Peter Hunt

Often, co-operative society directors are criticised as behaving 'too politically.' We were interested to explore if this was a by-product of the requirement to be 'answerable' (at least for re-election) to an electorate, or some other factor. Equally, it has been suggested that elected (lay) directors may require particular support in order to undertake their roles. Is this a function of the type of person that is elected as a director, or is it a feature of the democratic process and prevalent elsewhere?

The objective of this piece of work has been to see how elected democrats interact with professional managers, what behaviours and attitudes they exhibit, and if there are parallels elsewhere for the experience of co-operative directors. We have used the findings of this work to inform our report into the independent secretariat role.

Primary research has been conducted with MPs and Councillors who have worked with professional executives as Government Ministers or leading Councillors.
Summary of findings

- MPs and Councillors are not elected on the basis of their qualifications
- No real training is provided to help them do their job well
- They are required to interact with expert government officials
- Sometimes there is a conflict between what democrats and officials want
- Democrats require professional support to undertake their duties
- In particular, they require access to genuinely independent expert advice
- Specific mechanisms, either formal or less so are required to support elected democrats

At a national level, we interviewed serving and former government ministers at Cabinet, Minister of State, and Under-Secretary of State level.

At a local level, we interviewed serving Councillors with experience of both committee and cabinet style local government structures.

Given the high public profile of contributors to this piece of work, it has been necessary to establish certain safeguards. To ensure frankness, and to protect the identity of interviewees, all contributions have therefore been anonymised.

Election results - the accident of democracy?

'Many forms of Government have been tried in this world of sin and woe. No one pretends that democracy is perfect or all-wise. Indeed, it has been said that democracy is the worst form of government except all those other forms that have been tried from time to time.'

Sir Winston Churchill *Hansard, November 11, 1947*

The electoral system in the United Kingdom permits all Commonwealth and Irish citizens resident in Britain to vote. The only categories excluded are those under the age of 18, convicted prisoners, certain mentally ill people and Members of the House of Lords.

Equally, any such qualified person may stand for election as a candidate. Constituencies for Parliamentary elections will encompass some 60,000 voters, who will have limited opportunity to interact with and therefore judge the merits of individual candidates.

The fact that the candidate appeals successfully to the electorate cannot in itself be taken as evidence of their inherent qualities. Rather it indicates merely that they received more votes than other candidates.

Of course, most candidates are elected as representatives of specific political parties. This means that in theory at least, there has been a process of quality control to ensure that the candidate is qualified for the job. However, we can only be sure that such a process will guarantee that the candidate satisfies the criteria of the selecting party. It may be that these are entirely subjective and more related to the candidate's affinity to their party than to the desired qualifications for undertaking the job.

At its most base, we might see the democratic process as a method for selecting the least unpopular candidate. This process puts a considerable onus on the political parties' respective selection processes to find sufficiently qualified persons.
Without even the filter of the party system, we can begin to see the substance for describing elections as the accident of democracy.

Making Democracy Work - The Politician's Perspective

Motivations to become an MP

Our MPs had a mixture of motivations for standing for Parliament. From a desire to change the world for the better to wanting to be more influential on issues that were close to them, entering Parliament was a positive decision.

At the same time, those who had previously served at local government level saw the potential for taking the 'next step' in being able to personally influence issues, policies and decisions.

Accountability and Representation

Each of the sample felt that they were directly accountable to their constituents, who had elected them, but that they also had a responsibility to represent their Party, but in that order.

> *I am accountable to ... firstly the constituents, secondly constituency Party, thirdly the national Party.*

Background of candidates

In our research, we were by definition only talking to candidates who had succeeded through the political system. They had made it through party pre-selection, been elected successfully, and then chosen from among their peer group to be leaders.

The interviewees have a broad range of previous work experience, having entered politics from a diverse range of backgrounds.

Most of the interviewees had also had previous experience of elected office – most commonly as local councillors. This gave them a valuable insight into the comparative roles of local and national politicians.

The Transition from local to national politics
We explored with our sample how they felt the role of local Councillor compared to being a Member of Parliament.

> *When I came to Parliament as an MP I feel I swapped power for influence as a Backbench MP.*

A consensus emerged that as a backbench opposition MP in particular, one has few opportunities to influence anything. It was felt that one had more power and could make things happen as Chair of a Committee on a council than as a Backbench MP in Parliament.

Interviewees felt that there were enormous differences between the roles, but enough similarities to make it useful to be a Councillor before becoming an MP.

Examples given were in terms of managing casework loads, how to cope with different issues in debates and how to prepare for meetings.

All agreed that local government is a good training ground for becoming an MP.

> *If you don't understand how local government works it makes it difficult to understand how central government works.*

We asked our sample about their decision making process and how it differed, if at all, since they entered Parliament.

In principle, it was felt that this was more of a personality issue than one of public role. However, the process adopted for influencing is certainly different.

> *If you are a backbench MP, you are like a backbench Councillor. You have influence not power so you can use that influence in a small area and you can bang heads together.*

In this sense it was felt that the process is very different. Being an MP is a full time job covering a wider range of issues. MPs have the pressures of constituency needs and surgeries and events, which create a more varied portfolio.

It was agreed that some areas are the same, for example they represent a community and it was felt is very important to account back to Party representatives through the constituency and branch level.

> *The key thing is when you stop enjoying sorting out the small problems that constituents have in their lives, this is the time when you should stop being an MP.*

One respondent felt that the decision making process was honed as a Minister rather than as an MP. As a Minister, one is required to make day to day decisions with sometimes immediate consequences. As an MP, these are more deliberative, but in terms of constituency case-work, can have more of a human impact.

> *The biggest change has been coming into government because you have to find the resources to solve problems. You can't just say how you want to change things you have to show how that change can take place and justify it.*

Respondents did not think that becoming an MP had changed their decision making process or attitude when dealing with others. It was remarked that it has given them more knowledge about things and a whole range of expertise about a whole range of areas which is beneficial but does in itself affect how they deal with certain decisions.

Having said that, the decision making process is faster moving than at local Government level.

The experience as a newly elected MP

Interviewees were asked if they were initially intimidated by the job or other, longer serving MPs. It was remarked that there is no real induction or job description for a Member of

Parliament, and that making a Maiden speech was in itself a daunting experience.

> *At first I was terrified, particularly making my maiden speech. Then another MP commented that I hadn't asked as many questions in the chamber as him, I felt forced to find things to ask.*

But given that most of our sample had previous experience of being a public representative, or in jobs that required public speaking, they found that they had the requisite skills to face this challenge.

Some had worked in the House beforehand and therefore did not feel as intimidated as some people. Most did not feel intimidated by other MPs, rather it was the Chamber that was intimidating.

Interviewees were asked how they built up their confidence. Most had forced themselves to intervene in debates and by learning the tricks of the trade.

The transition to Government

Interviewees were asked what experience they had between being a backbencher and being appointed Minister. Most had served as a Parliamentary Private Secretary to a Minister.

It was felt that this was a useful experience in learning how to influence Ministers and discover first hand more about the role of the Minister.

> *Some people don't like to be told the truth but you have to tell the Minister things they don't want to hear sometimes.*

We asked the sample if they thought that becoming a Minister had changed their attitude or behaviour when dealing with others. Most felt that the promotion did not change their behaviour in terms of dealing with personal relationships with others, even though it was agreed that as a minister the process of Government can be enormously frustrating.

> *I hope not because there are temptations in Ministerial Office. I see myself as being there to challenge civil servants. The better ones respect this. There is a delicate balance when you do this because you need their cooperation.*

Working with the Civil Service

We explored the relationship between Ministers and civil servants. We wanted to gauge attitudes to professional managers and advisors.

> *I believe 'Yes Minister' is the training manual for all departmental civil servants. It took 4 months to get a bottle of red ink! The integrity is there but young civil servants can't think outside the box.*

It was remarked that Civil servants are not averse to 'trying to slip things past ministers.'

> *They put things in your box to sign and they think major decisions you can just tick.*

Some had challenged their civil servants by making them discuss issues certain decisions. Apparently, some officials found this a novel approach. Some also took officials on visits to see how previous decisions were working. It was considered that the more experienced civil servants were more open to this approach than others.

> *A lot of ministers have forgotten the political stuff and have just become administrators, like the civil servants.*

The general view was that the civil servants are there to provide the best specialist advice and make sure the minister is not embarrassed. We were given examples of officials that could not be trusted under any circumstances but generally the experience was a good one. Over time, Ministers got to know which ones gave good advice and others they had to look more carefully at.

It was felt that civil service support is very professional but difficult to get them to understand that if you change the words it means something different.

> *The Civil Servants advise and Ministers have to decide. There were certain circumstances where the advise I was given was bad and I therefore had to make my own decisions about things. I trust officials -they are honest but not always right.*

It is important to give very clear advice on what a Minister wants from a briefing before they are due to speak in the House. Typically, they would have a scoping meeting with civil servants beforehand outlining the points they wanted raised or where they required extra information.

> *I trust the advice of specialist officials and filter their advice politically. Generalists are the worst vecause they want to intellectualise everything. Civil servants don't always understand politics or Parliament and some will find Ministers bullying and a lot of them are defensive.*

Accessing political advice was seen as a real problem. It was agreed that junior Ministers were at a distinct disadvantage because they do not have someone to bounce the political decisions off. Secretaries of State have Special Advisors and juniors need to make their own arrangements.

In some cases, Ministers had access to their Secretary of State's Special Advisors, but this was only helpful for political advice. Others sourced their political advice from outside, based on political contacts built up over a period of time.

It was generally felt that more Ministers should get Special Advisers - at least Ministers of State and then possibly for all junior ministers. Specialist policy advice had to be resourced informally. This would be tie consuming, and virtually impossible for a busy Minister to do effectively.

> *In my view we should professionalsie the role of Special Advisers - some do step over the line and tell civil servants what to do but sensible ones act as facilitators and try to get across to civil servant what their minister actually wants to put across.*

It was a frustration that Private Secretaries went everywhere with Ministers. It was felt that 'they often have no idea of homelife, or of constituency or family life.'

> The quality is very variable -there is a problem in terms of governance in Whitehall. Boards have been put in charge of governance. Non-execs have been brought in but have no contact with Ministers.

Other support for Ministers

We asked Ministers what other support they could access in order tu fulfil their jobs.

MPs employ research staff who are responsible for undertaking casework, providing briefings and general administrative duties. Typically, they are young staff with little non-political experience.

Consequently, many researchers are capable of producing punchy political material, usually on a Party political basis.

Our sample agreed that the House of Commons library is an excellent resource for research material, 'because their Parliamentary savvy is better than civil servants'. But this is the only publicly available resource.

It will depend on the issue that is being considered – if it is a technical administrative issue then Ministers have to take a brief. If it is on a broader moral political issue then it is necessary to research it separately, rather than to rely on what other people say.

> *Civil servants arm you with lots of information but it is not always right so*

good Ministers collect their own information as well.

Another resource for MPs and Ministers is the Parliamentary Party support unit. This is an office that produces policy briefing documents and they works closely with ministers. It was agreed that the usefulness of this resource has diminished over in recent years 'and the quality has become pretty awful.' There is an identified need to ensure that Special Advisors provide proper briefings for the Parliamentary Party.

Reconciling differences with the civil service

We asked our sample about their experience of reconcile political views on policy with those of the Civil Servants.

The mobility of Ministers and civil servants was seen as an impediment to good governance. Many civil servants move jobs on a regular basis and the Ministers are clearly the even more transient feature in any department. Special Advisors tend to travel with Ministers and so there is a real issue about the 'institutional policy and political memory' of departments.

Either by accident, or by design, many policy priorities can get mixed up in this process – particularly if a particular minister was driving the issue with less than full enthusiasm from their officials.

The system doesn't always show things from previous policy decisions made to the new Minister and that way things can get lost.

Parties have a manifesto, which is the broad policy framework and civil servants should work to this.

It is less clear when there is no manifesto commitment and the civil servants say they would get legal advice on it. When they say this you need to either talk to the lawyers or see a copy of the brief that is going to the lawyers. Often civil servants might be asking the lawyers why you shouldn't do something.

There was enthusiasm for the idea of bringing in people from outside, with experience, which might genuinely influence civil servants on how to take things forward. This can be achieved by arranging secondments from expert organisations.

One respondent was clear about how to reconcile differences with civil servants,' I don't. I tell them what my views are. They can robustly give their view but it is not their job to make the decision. It is mine.'

There is a quote from David Blunkett when told by his officials that he couldn't do something because it was not departmental policy. He said "departmental policy is what I and my ministers say it is."

Making Democracy Work - The Politician's Perspective

Motivations to become a Councillor

Our Councillors all wanted to get into politics for ideological reasons and a belief that they could change things by becoming a Councillor.

Accountability and Representation

Each of the sample felt that they were directly accountable to the people, who had elected them.

> *I represent the people who voted for me but have to balance that against my own ideological inclinations.*

3.3 Background of candidates

The interviewees have a broad range of previous work experience, having entered politics from a diverse range of backgrounds and as being a Councillor was only a part-time occupation they were still doing those jobs.

Most of the interviewees had served as School Governors and so were used to holding a position before they became a Councillor but not necessarily an elected position.

3.4 The Transition from School Governor to Councillor

We explored with our sample how they felt the role of being a School Governor compared to being a local Councillor.

All interviewees who had experience of this agreed that being a school governor was very specific but as a Councillor you have to deal with a whole range of subject matter.

> *Being a Councillor is much more of an embracing role. It tends to cover much more complex areas of work and you experience much more problems than you would ever encounter as being an elected school governor.*

3.5 The experience as a newly elected Councillor

Most of the interviewees stated that they did not find it difficult to speak in the Chamber when they were first elected but it was mentioned by one respondent that the public speaking course they had been sent on was very useful.

All the Councillors interviewed enjoyed dealing with individual constituents problems and helping to solve those problems

> *I find it quite relaxing and to some extent quite rewarding taking up issues and getting problems solved.*

3.6 Committee structure versus Cabinet System

> *Under the old committee system many Councillors went "native" they became the institution rather than being the representatives of people within the institution.*

Interviewees were asked which system they preferred and opinions were divided on this. Most believed the cabinet system had speeded up procedures while one of them preferred the committee system because they felt it was more democratic.

3.7 Working with Council Officers

We explored the relationship between Councillors and Council Officers. We wanted to find out whether Councillors felt they could trust their advice and how the interaction worked.

All interviewees found the Officers helpful, particularly when it came to technical matters but they did find that they had a lack of imagination.

> *Usually they were helpful - you get one or two strong personalities who try and thwart you.*

3.8 Other support for Councillors

Councillors were asked what other support they received in order to help them with their duties.

All of the Councillors had access to at least one full time political officer but all still did their own research and prepared their own speeches. All complained that there was not enough political support.

> *It is ludicrous to think that there is anything in the Party that actually helps. There is nothing there.*

3.9 Reconciling differences with the Council Officers

We asked our sample about their experience of reconciling political views on policy with those of Council Officers.

All agreed that is the job of the officers to make sure policy is enacted and they are there not to determine policy but to help Councillors work through what their policies are.

One of the interviewees criticised the officers for not always considering the implications of their policy advice on constituents' lives.

> *Officers forget people are out there and if I feel that their advice on policy affects my constituents' lives in a bad way then I won't take it.*

The last word?:

'The best argument against democracy is a five-minute conversation with the average voter.'

Sir Winston Churchill

How Government Works

Ministers

Ministers in charge of government departments are usually in the Cabinet. They are known as 'Secretary of State' or may have a special title, as in the case of the Chancellor of the Exchequer.

Once the Government has decided its policy, each minister is expected to support it or resign.

The holders of various traditional offices, namely the President of the Council, the Chancellor of the Duchy of Lancaster, the Lord Privy Seal, the Paymaster General and, from time to time, Ministers without Portfolio, may have few or no departmental duties. They are therefore available to carry out any duties the Prime Minister may wish to give them.

The three Law Officers of the Crown advising the UK Government are the Attorney General, the Solicitor General (for England and Wales) and the Advocate General for Scotland.

Ministers of State are middle-ranking ministers. They normally have specific responsibilities and are sometimes given titles, which reflect these functions, for example, 'Minister for Housing and Planning'.

The most junior ministers are called Parliamentary Under-Secretaries of State or, where the senior minister is not a Secretary of State, simply Parliamentary Secretaries. They may be given responsibility, directly under the departmental minister, for specific aspects of the department's work.

Departmental ministers normally decide all matters within their responsibility. However, many issues cut across departmental boundaries and need the agreement of more than one minister. The full Cabinet or a Cabinet Committee considers proposals where the issue is one that raises major policy concerns, is likely to lead to significant public comment or criticism, or where the departmental ministers concerned have been unable to agree.

Although this implies that Ministers are 'executive' in that they take decisions day to day, the reality is that their operational duties are limited to strategic decisions and 'signing off' decisions that have been prepared for them by their civil servants. Ministers are responsible for often highly technical policy areas, but are rarely selected for their own knowledge or particular policy aptitude. They are thus heavily reliant on the advice of expert civil service officials in carrying out their duties.

The Civil Service

The role of the Civil Service is to carry out the practical and administrative work of government through its civil servants. Civil servants are politically impartial and work to carry out the policies of the government department they work for under the control of elected Ministers.

The Civil Service has no separate constitutional responsibility. Civil servants are servants of the Crown. In effect, this means the Government of the United Kingdom, the Scottish Executive and the National Assembly for Wales.

Executive powers are generally exercised by ministers of the Crown, who are in turn answerable to the appropriate Parliament or Assembly. The Civil Service as such has no separate constitutional personality or responsibility. The duty of the individual civil servant is first and foremost to the minister in charge of the department in which he or she is serving. A change of minister, for whatever reason, does not involve a change of staff.

Cabinet ministers may each appoint a maximum of two special advisers. The Prime Minister approves all appointments and they are paid for from public funds. There are about 80 such advisers in the present administration. Their appointments come to an end when the Government's term of office finishes or when the appointing minister leaves the Government or moves to another appointment. They tend to be political 'shotgun riders' and rarely have particular policy expertise relating to their Minister's portfolio.

The Civil Service Code, introduced in 1996, is a concise statement of the role and responsibilities of civil servants. It was revised in 1999 to take account of devolution. The Code includes an independent line of appeal to the Civil Service Commissioners on alleged breaches of the Code. As of June 2001, civil servants constituted about 2 per cent of the working population in employment and about 10 per cent of all public sector employees.

As Minister for the Civil Service, the Prime Minister is responsible for central co-ordination and management of the Civil Service. He is supported by the Head of the Home Civil Service, who chairs the Civil Service Management Board. The Cabinet Office oversees the central framework for management of the Civil Service. Day-to-day responsibility for a wide range of terms and conditions has been delegated to departments and agencies, and to the Scottish Executive and the National Assembly for Wales.

How Local Government Works

Local government powers

Local authorities work within the powers laid down under various Acts of Parliament. Their functions are far-reaching. Some are mandatory, which means that the authority must do what is required by law. Others are discretionary, allowing an authority to provide services if it wishes.

Local authorities exercise power within statutory restrictions. In certain cases, ministers have powers to secure uniformity in standards to safeguard public health or to protect the rights of individual citizens. Where local authorities exceed their statutory powers, they are regarded as acting outside the law and can be challenged in court.

The main link between local authorities and central government in England is the Communities and Local Government department. However, other departments, such as the Department for Education and Skills, the Department for Work and Pensions, the Department of Health and the Home Office, are also concerned with various local government functions.
In Scotland, Wales and Northern Ireland, local authorities now deal mainly with the devolved Parliament and Assemblies.

About two million people are employed by local authorities in the UK. These include school teachers, the police, firefighters and other non-manual and manual workers. Education is the largest locally-provided service, with 0.9 million full-time equivalent jobs. Councils are individually responsible, within certain legislative requirements, for deciding the structure of their workforces.

Every part of the UK is covered by a local authority fire service. Each of the 59 fire authorities must by law provide a firefighting service and must maintain a brigade to meet all normal requirements.

Local decision-making and public scrutiny

Council policies and decisions need to be reviewed and scrutinised, therefore rigorous arrangements to do so are implemented in all new decision-making structures.

Some decisions, such as the acceptance of policies and the budget, are reserved for the full council, but most of those relating to the implementation of policy are for the executive. The executive is also responsible for preparing the policies and budget to propose to the council. Decisions may be taken by:
the executive collectively, individual members of the executive, committees of the executive, officers of the authority.

Executives and councils are accountable to their communities. The executive is also able to delegate decision-making to area committees and to enter into partnership arrangements with other authorities.

The new arrangements are designed to ensure that people know who in the council is responsible for taking decisions, how they can have an input into decision-making, and how they can hold decision-makers to account.

The public, including the press, is admitted to meetings of the executive when key decisions are being discussed. They also have access to agendas, reports and minutes of meetings and certain background papers. In addition, local authorities must publish a forward plan setting out the decisions that will be taken over the coming months. Local authorities may exclude the public from meetings and withhold papers only in limited circumstances.

What does a Councillor do?

Every day, councillors have to balance the needs and interests of their residents, voters, political parties and the council. All these groups will make legitimate demands on the councillor’s time on top of their personal responsibilities to family, workplace and friends.

The councillor's role takes in:

- representing the ward
- decision-making
- policy and strategy review and development
- overview and scrutiny
- regulatory duties
- community leadership and engagement.

representing the ward

The primary role of a councillor is to represent their ward and the people who live in it. They also have a responsibility to communicate council policy and decisions to people in the ward. Members of political parties may find that their party offers advice and guidance on doing this.

decision-making

Councillors have a central part to play in making decisions that impact on their ward and across the whole area covered by their council. They will be involved in decision-making through:

- full council
- regulatory committees such as planning control or licensing
- local voluntary organisation management
- sitting on boards and as school governors
- membership of partnership boards
- being employers of staff on appointments
- panels and disciplinary or grievance appeals.

policy and strategy

Councillors influence and determine the development and review of the council's policy and strategy. They contribute to this through their:

- role in overview and scrutiny
- involvement in advisory groups and partnerships
- interaction with executive members
- role as a representative on local community groups
- role on area forums and committees
- case work
- membership of a political group.

overview and scrutiny

Councillors have always been required to scrutinise the council and the overview and scrutiny function is a natural extension of representation. The process has recently become more clearly defined and distinct and the role of councillors now includes:

- a check on activities of the executive through call-in powers
- monitoring and reviewing policy formulation and implementation
- policy development
- quality review
- scrutiny of external bodies and agencies.

regulatory duties

Local authorities are not just service providers, they also act as regulators. This involves councillors in quasi-judicial roles on special committees appointed directly by the council, such as planning and licensing committees. Most councils arrange special training for councillors undertaking these quasi-judicial responsibilities. In these roles, councillors are required to act independently and are not subject to the party group whip.

community leadership and engagement

Community leadership is at the heart of modern local government and councils are taking on new responsibilities for working in partnership with other organisations, including the voluntary and community sector, to improve services and the quality of life of citizens.

(Taken from IDeA Councillors Guide 2006-2007)

8. Employee engagement and participation

Introduction

When it comes to promoting employee engagement for the purpose of enhancing the country's productivity, the current UK Government has tended to stress financial participation. This is unfortunate, since financial participation is just one part of the story, and on its own may fail to deliver.

Employee ownership

Employee ownership and/or financial participation through Employee Stock Ownership Plans (ESOPs) tend to be associated with enhanced business performance[107] , although evidence on this point is mixed[108].

107 Miller, K.L. and Monge, P.R. (1986), 'Participation, Satisfaction and Productivity': A Meta-Analytic review', Academy of Management Review, 29: 727-753; Conte, M.A. and Svejnar, J. (1988), 'Productivity Effects of Worker Participation in Management, Profit-Sharing, Worker Ownership of Assets, and Unionisation in US Firms', International Journal of Industrial Organisation, 6(1): 139-151; Addison, J.T. and Belfield, C.R. (2000), 'The Impact of Financial Participation and Employee Involvement on Financial Performance: A Re-Estimation Using the 1998 WERS', Scottish Journal of Political Economy, 47(5): 571-583; Blinder, A.S. (ed.) (1990), Paying for Productivity: A Look at the Evidence, The Brookings Institute, New York; Wadhawani, S. And Wall, M. (1990), 'Effects of Profit-Sharing on Employment, Wages, Stock returns and Productivity: Evidence from Micro-Data', Economic Journal, 100: 1-17; D'Art, D. (1992), Economic Democracy and Financial Participation: A Comparative Study, Routledge, London; Bhargava, S. (1994), 'Profit-Sharing and the Financial Performance of Companies: Evidence from UK Panel Data', Economic Journal, 104: 1044-1056; Kruse, D. (1996), 'Why Do Firms Adopt Profit-Sharing and Employee Ownership Plans?', British Journal of Industrial Relations, 34: 515-538; Fitzroy, F.R. and Kraft, K. (1997), 'Co-operation, Productivity and Profit-Sharing', Quarterly Journal of Economics, 102: 23-35; Poutsma, E. And Huijenm, F. (1999), 'European Diversity in the Use of Participation Schemes', Economic and Industrial Democracy, 20(2): 197-223; Pendleton, A. (2001), Employee Ownership, Participation and Governance: A Study of ESOPs in the UK, Routledge, London; Kruse, D. (2002), 'Research Evidence on the Prevalence and Effects of Employee Ownership', Journal of Employee Ownership Law and Finance, 14(4): 65-90; Sesil, J.C. (2006), 'Sharing Decision-Making and Group Incentives: The Impact on Performance', Economic and Industrial Democracy, 27(4): 587-607.

108 Miller, K.L. and Monge, P.R. (1986), 'Participation, Satisfaction and Productivity': A Meta-Analytic review', Academy of Management Review, 29: 727-753; Conte, M.A. and Svejnar, J. (1988), 'Productivity Effects of Worker Participation in Management, Profit-Sharing, Worker Ownership of Assets, and Unionisation in US Firms', International Journal of Industrial Organisation, 6(1): 139-151; Addison, J.T. and Belfield, C.R. (2000), 'The Impact of Financial Participation and Employee Involvement on Financial Performance: A Re-Estimation Using the 1998 WERS', Scottish Journal of Political Economy, 47(5): 571-583; Blinder, A.S. (ed.) (1990), Paying for Productivity: A Look at the Evidence, The Brookings Institute, New York; Wadhawani, S. And Wall, M. (1990), 'Effects of Profit-Sharing on Employment, Wages, Stock returns and Productivity: Evidence from Micro-Data', Economic Journal, 100: 1-17; D'Art, D. (1992), Economic Democracy and Financial Participation: A Comparative Study, Routledge, London; Bhargava, S. (1994), 'Profit-Sharing and the Financial Performance of Companies: Evidence from UK Panel Data', Economic Journal, 104: 1044-1056; Kruse, D. (1996), 'Why Do Firms Adopt Profit-Sharing and Employee Ownership Plans?', British Journal of Industrial Relations, 34: 515-538; Fitzroy, F.R. and Kraft, K. (1997), 'Co-operation, Productivity and Profit-Sharing', Quarterly Journal of Economics, 102: 23-35; Poutsma, E. And Huijenm, F. (1999), 'European Diversity in the Use of Participation Schemes', Economic and Industrial Democracy, 20(2): 197-223; Pendleton, A. (2001), Employee Ownership, Participation and Governance: A Study of ESOPs in the UK, Routledge, London; Kruse, D. (2002), 'Research Evidence on the Prevalence and Effects of Employee Ownership', Journal of Employee Ownership Law and Finance, 14(4): 65-90.

High commitment work systems

High commitment work systems require a management strategy that aims to utilise the more progressive elements of human resource management (HRM) practices to create a motivated and committed workforce through providing employees with a sense of personal control and efficacy (Greenhaus and Beutell, 1985; Arthur, 1994; Osterman, 1995; Appelbaum et al, 2000; Berg et al, 2003).

Specific initiatives include the promotion of functional flexibility, multi-skilling, autonomous work teams, problem-solving groups (i.e. quality circles and suggestion schemes), induction and inter-personal skills training, team briefing, information disclosure and appraisal schemes, together with greater opportunities for self-management and/or employee participation in decision-making (Osterman, 1988, 1992 and 1995; Katzenbach and Smith, 1993; Dunphy and Bryant, 1996; Wood and de Menezes, 1998; Wood, 1999b; Ramsay et al, 2000; Wood et al, 2003:227).

Furthermore, firms may seek to pay 'efficiency wages', through setting remuneration levels above the market determined wage level, which will further encourage the avoidance of shirking and promote loyalty to the organisation. This will typically involve the creation of an internal labour market that uffers employees from the stress and uncertainty caused by external, competitive labour markets (Arthur, 1994; Huselid, 1995).

The theoretical basis for these initiatives is that organisations can benefit from encouraging increased employee involvement and productivity in the workplace. Guest (1998:42) argues that “the whole rationale for introducing HRM policies is to increase levels of commitment so that other positive outcomes can ensue”. The increased flexibility of human resource practices is additionally associated with the development of the ‘flexible firm’ (Hunter et al, 1993).

The literature has focused primarily upon the benefits to the firm arising from a high performance approach. Accordingly, several studies found that high involvement work systems predict superior organizational performance and lower labour turnover (Leonard, 1987; Arthur, 1994; Huselid, 1995; Becker and Gerhart, 1996; Ichniowski et al, 1996; Shaw et al, 1998; Batt, 2002; Handel and Levine, 2004). However, more recent research has highlighted its impact upon worker outcomes, such as job satisfaction (Batt, 2004), wages (Handel and Levine, 2004), voice (Bryson, 2004),redundancy (Osterman, 2000) and labour turnover (Batt et al, 2002).

The high performance paradigm has a critical literature. This includes, firstly, the suggestion that managers may take undue advantage of the absence of restraints upon their actions to make ‘unfair’ decisions (Colvin, 2006). Thus, certain theorists argue that managerial autonomy should be constrained, with particular respect to the flexibility to hire and fire, through enhanced protection for employees (Huselid, 1995; Colvin, 2004). Secondly, Godard (2004) notes that high performance systems do not change the underlying structure of the employment relationship. Managers remain dominant in terms of decision-making, and employee influence remains marginal. Thus, whilst high performance systems may reflect a change in the work situation, it is only a superficial change.

Barker (1993) makes a similar point when he reports his findings that self-directed work teams imposed a powerful self-disciplining effect upon team members, thereby indicating that the targets established for teams to meet facilitates the transfer of the enforcement of company objectives from managers to team colleagues. Hence, high performance initiatives do not necessarily eliminate, or even reduce, the degree of unfairness experienced within the workplace (Colvin, 2006). Finally, Godard (2004:355) argues that “little attention has been paid to whether the performance effects of high performance practices may also be contingent on more structural variables”. Thus, it is important to discern the actual effect that high performance initiatives are having upon firms and their employees, and ensure that this implied effect is not simply a failure to properly specify the econometric model.

Drawing together a number of the main points made in the literature, there are a number of points to consider. Firstly, different forms of flexible working programme design may fit more appropriately with the prevailing business strategy. Thus, innovative HRM practices which promote ‘high quality’ employee initiatives may benefit corporate strategies based upon quality and differentiated products rather than price, whilst flexibilisation schemes that reduce wage and non-wage costs, may correspond to a competitive strategy based primarily upon delivering a low cost-price (Dicken, 1992). Secondly, the effectiveness of flexible work schemes is enhanced through bundled implementation (Appelbaum and Batt, 1994; Ichniowski et al, 1996; Batt and Valcour, 2003; Eaton, 2003).

Different types of labour flexibility should not necessarily be viewed as mutually exclusive but as complements. Indeed, Michie and Sheehan-Quinn (2001:290) found that more than one quarter of employees enacted at least two different types of flexible initiatives. Thus, whilst clusters of complementary flexible work practices have been found to have a significant impact upon productivity, individual initiatives by themselves may only have a minimal impact (Milgrom and Roberts, 1990; Kandel and Lazear, 1992; Baker et al, 1994; Holmstrom and Milgrom, 1994; Ichniowski et al, 1997; Hoque, 1999; Perry-Smith and Blum, 2000). However, whilst research design should recognise the potential for a range of policies to have a greater combined impact than the sum of their individual parts, nevertheless, studies that fail to distinguish between individual components of flexible working risk omitted variable bias (Robinson and Wilson, 2006:32).

Conclusion

The research literature does suggest that employee engagement can enhance the performance of businesses and other organisations. Many firms have thus sought to create such engagement through the use of various Human Resource Management practices, including financial incentives through employee share ownership schemes and stock options.

The evidence suggests that two factors need to be present to ensure the success of such policies. Firstly, the policies need to be pursued in a coherent manner; one policy by itself may fail to have an impact if it is undermined by other management behaviours and practice that fail to support – or even undermine – that one initiative. And secondly, there must be a degree of belief amongst the employees that the policies being introduced or implemented are genuine, and not just a fad or even a trick, and that they will be pursued consistently and not just abandoned at some point in the future. How this belief amongst the workforce can be generated and sustained is then a further important question in its own right. It certainly requires the managers themselves to believe in the policies.

It also requires a degree of assurance that management will be permitted to pursue the policies over the long term and will not be subject to outside pressure for example from shareholders to abandon the policies to cut costs or for some other reason. Thus, mutuals should have an inherent advantage in being able to deliver such assurances and thus generate the necessary belief in and support for the policies that can create enhanced organisational commitment and thus corporate performance.

But even for mutuals, none of this will follow automatically from the mutual form itself. Firstly, the above conditions need to be met, for example ensuring that middle management understand and are committed to the policies. And secondly, the policies and their purpose need to be communicated clearly and consistently to all employees and other stakeholders. Corporate governance structures need to be adopted and adapted over time with these requirements in mnd.

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9. The Governance of investor-owned companies

For this review, it has been important to examine the key factors that have influenced the way in which other sectors have responded to the corporate governance agenda. For this paper, we have examined, in an international context, how investor owned companies have pproached this.

Making the Co-operative Group work for its shareholders and visa versa could involve the adoption of systems of governance used by other institutions and businesses. Those with relevance to this end are set out below.

Because modern finance theory views the capital market as an information-processing mechanism through which the performance of firms and their managers is continuously (and efficiently) being evaluated, it is sanguine about the role played by external shareholders in ensuring good governance. External shareholders offer discipline and accountability, and, in a wider sense, the capital market gives firms a benchmark against which to judge their own performance.

In a private company, the shareholders are more likely to play the role of 'insiders' for whom exit options are limited and a continuing commitment to the firm is likely, either in the form of long-term financial support or, in the case of family-owned firms and companies in which the only shareholders are also employees, a direct contribution to the process of production. In this respect, private companies are similar, in their incentive structure, to partnerships (indeed they are sometimes called 'quasi-partnerships'), the essential difference being that, unlike partners, the shareholders are not responsible for the company's debts.

In 'mutuals' the members of the company are also customers who tend to have a long-term relationship with the organisation. The traditional building Society, in the UK, or savings and loans institution in the US, is the best example of this. The term 'Co-operative' is generally used to refer to forms where the members of the company are also its employees; as we have just seen, the private company form and the partnership are also well suited to employee ownership.

All these forms share a model of 'insider corporate governance' which has the following features: restricted exit options, a long-term time horizon for investments (whether of labour or finance), and the vesting of voice and voting rights to a restricted class of shareholders, customers or employees. If there is external finance, it comes in the form of debt that does not confer the privileges of membership of the firm on the supplier. In this respect, two further corporate governance forms are of interest. These are the public interest company or, in the UK, 'company limited by guarantee', which has no external share capital, and the charitable trust, is governed by a combination of regulatory controls and strict legal confinement of its powers.

It is inaccurate here to speak of insider governance since these forms have no members as such, either internal or external, but they are closely aligned to 'internal' forms such as mutuals, partnerships and private companies from the point of view of the time horizons concerned and the degree of autonomy that managers enjoy from external capital market controls.

Even in the context of a public company that is also listed, shareholders have limited voting and governance rights, and, above all, cannot substitute themselves for the management of the company; they have the right to replace the members of the Board and can vote to change the management team, but even this right varies greatly from one jurisdiction to another.

There is nevertheless evidence that managers of listed companies enjoy much less autonomy with regard to external financial pressures, mediated through the corporate governance system, than they did a generation ago (see Jacoby, 2005). The British and American systems, in particular, underwent a significant shift towards the empowerment of shareholders, or, more precisely, of capital markets, beginning in the 1970s and gathering pace after that as a result of the rise of the hostile takeover bid and the associated ‘market for corporate control’. There is a case for saying that in Britain and America, both company law and corporate governance practice up to the middle decades of the twentieth century were based on a managerialist model, in which the role of the senior managers was to mediate between the interests of the different corporate constituencies or ‘stakeholders’ (Blair, 1995). The idea that managers should act predominantly, let alone exclusively, in the interest of shareholders, would have been regarded sceptically as recently as the 1960s when the mission statements of public corporations often made no reference at all to shareholder interests, claiming instead that these firms advanced the well being of their employees or of Society at large.

For this reason, it has been suggested that the pressures upon managers in listed companies are such that they are likely to be reflected in the way the company is managed. This will have implications for investment strategy, spending on research and development, and the employment practices of those organizations. Because of the short-term time horizons involved and the opportunities for low-cost exit, corporate governance forms in which a dominant external stakeholder can exercise influence over managerial practice are, in principle, less likely to invest for the long-term, and less likely to seek to generate cooperation between management and labour. Managers in listed companies will come under pressure to prioritise dividend payouts and share price increases over distributional compromises with employees designed to elicit their loyalty, such as implicit promises of job security. In addition, formalised voice rights for employees will make less sense in the context of listed companies, given the emphasis placed by management on accountability to shareholders. More generally, we would expect corporate governance form to have an influence on the propensity of managers to adopt human resource management practices of a particular kind.

In particular, in organisations with a dominant external stakeholder, this perspective would predict a lesser degree of engagement between managers and employees over organisational issues and greater use of individualised incentives, including financial ones.
In certain industries, such as the utilities, regulatory pressures may constrain managements to pursue long-term investment strategies and to seek compromises with core workers and their representatives. Beyond industry, shareholders may be persuaded to take a longer term view of their investments, in particular where they themselves are pension funds with an extended time horizon (Armour et al., 2003). In different national contexts, other regulatory influences, such as those of labour law or the influence of government, may mediate the effects of shareholder value (Conway et al., 2007; Deakin and Rebérioux, 2007). The question of how far these effects actually do counterbalance shareholder pressure is one for further research.

What has been said so far mainly relates to the legal form of the ‘investor-owned’ company. There is little support in purely legal terms for the idea that a company limited by share capital is ‘owned’ by its shareholders, but the idea that it is, is asserted by certain bodies (such as the representatives of institutional shareholders) and is sometimes taken as a given by policy makers and commentators.

It is surprisingly difficult to find support within core company law for the notion of shareholder primacy. It cannot be done by referring to the rhetorical claim, associated with today’s pension funds and other institutional investors, that shareholders ‘own the company’. No legal system acknowledges this claim. If we understand a company to be the fictive legal entity that is brought into being through the act of incorporation, it is not clear in what sense such a thing could be ‘owned’ by anyone. But more pertinently, nor does the ownership of a share entitle its holder to a particular segment or portion of the company’s assets, at least while it is a going concern.

The law on directors' duties is no more helpful. In the English-law based common law systems, with only a few exceptions, directors' fiduciary interests of loyalty and care are owed to the company, not directly to the shareholders. In practice, the company's 'interests' will often be synonymous with those of its members, that is, the shareholders. However, shareholders are not entitled to engage directly in the management of the enterprise; this is the responsibility of the Board. According to Delaware corporate law, 'the business and affairs of every corporation… shall be managed by or under the direction of a Board of directors' (see Millon, 2002: 92). Many of the formative cases of English company law, dating from the nineteenth and early twentieth centuries, make the same point (see Davies, 1997: 183-88).

Company law does not refer to the level of returns to which shareholders are entitled or when they might be received. This ambiguity enabled the Company Law Review Steering Committee, in the review of UK company law which was concluded in 2002, to express its support for the idea of 'enlightened shareholder value': this implies

'[a]n obligation on directors to achieve the success of the company for the benefit of the shareholders by taking proper account of all the relevant considerations for that purpose' including 'a proper balanced view of the short and long term, the need to sustain effective ongoing relationships with employees, customers, suppliers and others; and the need to maintain the company's reputation and to consider the impact of its operations on the community and the environment' (Company Law Review Steering Group, 2000: 12; see also Company Law Review Steering Group, 2001: 41).

The Company Law Steering Group regarded its proposal as a compromise between the 'enlightened shareholder value' position and a 'pluralist' point of view that would have seen management as having multiple commitments to a range of stakeholder groups. The Steering Group accepted the position that making management formally accountable to a diverse body of stakeholders might limit the effectiveness of managerial decision making and blur lines of accountability. Nevertheless, the Steering Group's proposal was based on the proposition that 'companies should be run in such a way which maximizes overall competitiveness and wealth and welfare for all' (emphasis added). The means chosen to achieve this end were the 'inclusive duty' and 'broader accountability'.

Section 172 of the Companies Act 2006, which is headed 'Duty to promote the interests of the company', now provides that:

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole…

(3) In fulfilling the duty imposed by this section a director must (as far as reasonably practicable) have regard to –

(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between the members of the company.

The idea that the company is an organisation or 'entity' with a distinct set of interests above and beyond those of all the stakeholder groups combined is even more clearly articulated in the US civil law systems. These recognize the 'enterprise' as a legal form that corresponds to the organisation. This is distinct from the concept of the 'company' which essentially describes a set of claims to income streams and property rights. The explicit recognition of the company's organizational dimension has implications for the way in which stakeholder interests are recognized, as this quotation from the Viénot report on French corporate governance recognized:

In Anglo-Saxon countries the emphasis is for the most part placed on the objective of maximising share values, whilst on the European continent and France in particular the emphasis is placed more on the human assets and resources of the company… Human resources can be defined as the overriding interest of the corporate body itself, in other words the company considered as an autonomous economic agent, pursuing its own aims as distinct from those of its shareholders, its employees, its creditors including the tax authorities, and of its suppliers and customers; rather, it corresponds to their general, common interest, which is that of ensuring the survival and prosperity of the company (Viénot, 1995, cited in Alcouffe and Alcouffe, 1997).

Various versions of this concept of the 'company interest' have been expressed in continental European law and practice since the period of industrialisation in the second half of the nineteenth century; it was articulated in the 'communitarian' concept of the enterprise advanced by the German jurist Otto von Gierke in the 1890s, and in the corporatist model popularised by the industrialist and politician Walther Rathenau in the 1920s.

A significant strand of German corporate law theory remains sceptical of the US-inspired model, and theories based on the varieties of capitalism approach, stressing the importance of firm-specific human capital in co-ordinated market systems, recently deployed to explain and defend the core civilian model (see Gelter, 2007 on Germany, and Rebérioux, 2007 on France).

The Panel on Mergers and Takeovers, a self-regulatory body set up by the financial and legal professions and financial sector trade associations based in the City of London, had no direct legal powers of enforcement. Its provisions were strictly observed, however, since UK-based financial and legal professionals who were found to have breached the Panel's rulings could be barred from practising as a consequence. As a result of the adoption by the European Union of the Thirteenth Company Law Directive, the Panel has recently acquired a statutory underpinning, but the substance of the Code remains essentially the same as it was before and it continues to be based on the Panel's deliberations and rulings. The expectation of both the UK government and of the Panel is that the implementation of the Directive will not have a major impact on the Panel's mode of operation.

The City Code reflects the strong influence of institutional shareholder interests within the UK financial sector, and their capacity for lobbying to maintain a regulatory regime that operates in their favour (Deakin and Slinger, 1997; Deakin, Hobbs, Nash and Slinger, 2003). Its most fundamental principle is the rule of equal treatment for shareholders: 'all holders of the securities of an offeree company of the same class must be offered equivalent treatment'.

This is most clearly manifested in the Code's 'mandatory bid' rule which requires the bidder, once it has acquired 30 per cent or more of the voting rights of the company, to make a 'mandatory offer' granting all shareholders the chance to sell for the highest price it has paid for shares of the relevant kind within the offer period and the preceding year.

The Code also imposes on target directors a series of specific obligations that can be thought of as clarifying their duty to act bona fide in the interests of the company, but in some respects extend this duty. The target directors must first of all obtain competent, independent financial advice on the merits of the offer, which they must then circulate to the shareholders with their own recommendation. Any document issued by the Board of either the bidder or the target must be accompanied by a statement that the directors accept responsibility for the information contained in it. While the point is not completely clear, the likely effect of this is to create a legal duty of care, owed by the directors to the individual shareholders to whom the information is issued (and not to the company as is the case with their general fiduciary duties).

All this places the directors of the target in the position of being required to give disinterested advice to the shareholders on the merits of the offer, and makes it more difficult for them to resist a bid simply on the grounds that it would lead to the break-up of the company.

What we plan to achieve for the Co-operative Group is a position whereby stakeholders and management can operate effectively despite their structural conflicts of interest. For example, where a CEO proposes the closure of several shops in an area for the long-term sustainability of the Group, Corporate and Individual Members particularly employees must have mechanisms in place to ensure the right outcomes.

As illustrated legal progress in the City arena has already dealt with this kind dilemma. The question is does the Co-operative Group need a mandatory code with regard to takeovers and good governance?

A major change appeared to be about to take place in the early 2000s as a result of the adoption of the 13th Directive in the EU and changes in the Japanese system which encouraged the revival of hostile takeover activity, but a closer inspection also shows that there has been resistance to attempts to institutionalize a market for corporate control. The first significant document in the current round of initiatives was the report of the High Level Group of Experts on takeover bids, published in October 2002. This argued that what the EU needed was 'an integrated capital market' in which 'the regulation of takeover bids [would be] a key element' (High Level Group, 2002a: 18). The report noted that 'the extent to which in a given securities market takeover bids can take place and succeed is determined by a number of factors', including general or structural factors affecting financial markets, and company-specific factors such as rules of company law and articles of association affecting voting rights, protection of minority shareholders, and the legitimacy of takeover defences. It then observed that 'there are many differences between the Member States in terms of such general and company specific factors', with the result that the EU lacked a 'level playing field'.

Most large Japanese enterprises are listed companies with (by international standards) a relatively high degree of dispersed ownership. In the immediate post-war decades, cross-shareholdings were common, and indeed were actively deployed as a means of limiting the influence of foreign investors. Between the mid-1960s and the mid-1970s the 'stable shareholding ratio' across the listed company sector as a whole, including cross-shareholdings, rose from 47% to 62% (Miyajima and Kuruoki, 2005: 5-6). However, the ratio had declined again to 45% by 1993 and was only 24% in 2003. Cross-shareholdings of the traditional type represented only 7.6% of the total in 2003 compared to 17.6% in 1993 (NLI Research, 2004). Foreign shareholdings have risen from 11.9% of the market in 1996 to 26.7% in 2005 (National Stock Exchanges, 2006). In 2006 around 8% of the first (main) section of the Tokyo stock market, 196 companies in total, were more than 30% owned by overseas investors (TSE, 2007, p.4).

At the same time, large Japanese companies continue to stress their role as social institutions or 'community firms' which provide stable employment to a core of long-term employees, in return for a high level of commitment and identification with the goals of the firm. This tension between the legal form of the enterprise and its changing ownership structure, on the one hand, and its aspect as a social institution, on the other, has recently been thrown into sharp relief by a series of hostile takeover bids.

The most controversial of these, involving the planned takeover of Nippon Broadcasting System (NBS) by the internet service provider Livedoor, which was launched in February 2005 (see Whittaker and Hayakawa, 2007). NBS had a cross-shareholding agreement with Fuji Television Ltd. which in turn dominated a corporate group, the Fuji-Sankei media conglomerate. Livedoor's intentions were widely interpreted as being based on 'greenmail'. When NBS attempted to issue new stock in order to dilute Livedoor's holdings and frustrate its bid, the courts declared the move unlawful. In granting Livedoor an injunction, the Tokyo District Court ruled as follows:

It is inappropriate for the Board of directors of a publicly listed company, during a contest for control of the company, to take such measures as the issue of new shares with the primary purpose of reducing the stake held by a particular party involved in the dispute, and hence maintain their own control. In principle the Board, which is merely the executive organ of the company, should not decide who controls the company, and the issuing of new shares, etc., should only be recognized in special circumstances in which they preserve the interests of the company, or the shareholders overall.

When this judgment was appealed, eventually, to the High Court, it was upheld:

The issue of new shares, etc., by the directors – who are appointed by the shareholders – for the primary purpose of changing the composition of those who appoint them clearly contravenes the intent of the Commercial Code and in principle should not be allowed. The issue of new shares for the entrenchment of management control cannot be countenanced because the authority of the directors derives from trust placed in them by the owners of the company, the shareholders. The only circumstances in which a new rights issue aimed primarily at protecting management control would not be unfair is when, under special circumstances, it aims to protect the interests of shareholders overall.

However, the High Court also ruled that defensive measures would be potentially legitimate in four situations: greenmail, asset stripping, a leveraged buy-out, and share manipulation. This was an approach based in part on the jurisprudence of the Delaware courts (Milhaupt, 2005). Unable to make a new rights issue, NBS instead lent shares, minus voting rights, to two friendly parties, and Live-door subsequently agreed to drop its bid. It sold its shares in NBS to Fuji Television, with Fuji Television, in its turn, taking buying around 12% of the shares in Livedoor.

Around the same time, the economics ministry METI and the Ministry of Justice issue takeover guidelines which drew in part on the report of METI's Corporate Value Committee (CVC). The report of the CVC refers to the concept of 'corporate value' in the following terms:

The price of a company is its corporate value, and corporate value is based on the company's ability to generate profits. The ability to generate profits is based not only on managers' abilities, but is influenced by the quality of human resources of the employees, their commitment to the company, good relations with suppliers and creditors, trust of customers, relationships with the local community, etc. Shareholders select managers for their ability to generate high corporate value, and managers respond to their expectations by raising corporate value through creating good relations with various stakeholders. What is at issue in the case of a hostile takeover is which of the parties - the bidder or the incumbent management - can, through relations with stakeholders, generate higher corporate value.

The Guidelines take a more shareholder-orientated view, referring to corporate value as 'attributes of a corporation, such as earnings power, financial soundness, effectiveness and growth potential, etc., that contribute to shareholder interests'. However, they also recommended giving scope for companies to put anti-takeover defences in place to deal with what could be regarded as opportunistic or predatory bids. In 2006 a new law, the Financial Instruments and Exchange Law, amending basic securities legislation, came into effect. This introduced a version of the mandatory bid rule: a party purchasing 10% of a company's stock over a three month period would be required to make a public tender offer or be limited to holding no more than one third of the company's issued share capital. In 2006 changes to company law came into effect which formally allowed companies to put in place anti-takeover defences. These include the powers to issue special class shares with limited voting rights or which can be compulsorily repurchased by the company (thereby depriving a potential bidder of its stake), to make rights issues which exclude a bidder, and to issue golden shares which confer certain rights such as the power to appoint directors or restrain voting rights. The latter type of provisions requires two thirds majority support from existing shareholders.

The response to these developments has been complex and multi-layered (see Whittaker and Hayakawa, 2007; Buchanan and Deakin, 2007). On the one hand, a large number of companies have put in place takeover defences. By February 2007 197 listed companies had announced anti-takeover strategies of various kinds (Nikkei, 2007). Some large companies, such as Toyota, have strengthened intra-group cross-shareholdings in an attempt to deflect Livedoor-type bids, and others, such as three main steel producers, have announced anti-takeover defence pacts.

At the same time, there has been some resistance to the growing use of anti-takeover defences. One of the main institutional investor bodies, the Pension Fund Association (PFA), has made clear its opposition to takeover defences which do not have the approval of a simple majority of shareholders. The Tokyo Stock Exchange (TSE) has also been hostile to poison pill type defences, seeing them as a barrier to stock market transparency and to accountability. In March 2006 the TSE amended its own guidelines to allow golden shares, after the main employers' federation, the Keidanren, criticized the Exchange's previous opposition to this type of arrangement, but the TSE guidelines continue to stress the need for majority shareholder approval, in line with the PFA position. Further evidence of growing shareholder pressure comes in the form of dividend increases which, in a number of cases, can be traced to activist shareholder pressure in the companies concerned.

Having said that, the current position of Japanese law is a long way from the model of the City Code. Notwithstanding the introduction of a version of the mandatory bid rule, the Japanese position is closer to Delaware law, which permits poison pills, but with a clearer authorization for takeover defence in the face of 'greenmail' or asset restructuring. The concept of 'corporate value' is being distinguished from the US-inspired 'shareholder value' in contemporary debates. Managerial practice, too, continues to prioritise the model of the community firm, with only few exceptions. This statement, made to one of the present authors by the president of a large company in the course of empirical research on Japanese corporate governance during the autumn of 2006 (see Buchanan and Deakin, 2007) is typical of current attitudes:

I'm not quite sure whether shutting out these sorts of opportunities [i.e. bid approaches] can really be called 'corporate defence'. However - this is a Japanese sort of environment - the fact is that 6,000 people are working in our group and hitherto they have always had a great feeling of confidence and attachment towards the management. Accordingly, with regard to philosophy, even if for the sake of argument someone were to appear with a philosophy that was even more elevated than ours, I would be very worried and doubtful as to whether these employees who are currently contributing their confidence and attachment to us would continue to do so in the same way for them.

As we have seen, one of the central features of the British (and now, to a degree, the EU) model is the mandatory bid rule. This is at the core of the City Code system which aims to protect the right of minority shareholders to access, in proportion to their holdings, the surplus generated by a takeover bid. It is an important stimulus to the fragmentation and dispersion of ownership while also discouraging the construction of cross-shareholdings. Influenced by a mixture of British and EU practice, many systems have adapted a version of the mandatory bid rule in the past ten years as part of a general realignment of takeover regulation in favour of the protection of minority shareholder interests: 1987 in Malaysia, 1994 in India, 2000 in Pakistan, 2000 in Chile, 2002 in Argentina, 2005 in Mexico (Siems, 2007).

A similar trend can be observed in transition systems as a result of the adoption of the

Thirteenth Company Law Directive. Two important aspects of the Directive are the 'Board neutrality rule' which limits the scope for takeover defences both ex ante and during a bid, and the 'breakthrough rule' under which poison pills and golden shares can be overridden during a bid. Most western European systems have taken up the opportunity provided by the Directive to derogate from both these rules, but the rate of take up of derogations is lowest in the Central and Eastern European (CEE) countries which constitute the 'accession' member states: the Board neutrality rule has been adopted in the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Slovakia and Slovenia, and the breakthrough rule has been adopted in Estonia, Latvia and Lithuania. Of the CEE accession states, only Poland has followed the lead of Germany and other western European countries in rejecting both the breakthrough rule and the Board neutrality rule.

In the economies of the common law world, there is growing evidence of shareholder rent extraction. A side effect of successive takeover waves from the 1970s onwards is that, in Britain and America, the net contribution of new equity to the financing of the corporate sector as a whole has become negative. This is the result of share buy-backs and the 'retirement' of capital following mergers. The phenomenon has led to questioning of the sustainability of the current model from within the business school community, as in Allen Kennedy's afterword to his 2000 book The End of Shareholder Value:

How many companies would spend their wealth on stock buyback programs if their objective was to create wealth? How many companies would see fit to cut R&D expenditures if their objective was to build wealth? How many companies would shed long-term, loyal employees, their heads crammed full of information valuable to the company, if their objective was to create wealth?

In a similar vein, Marjorie Kelly (2001), writing in the pages of the Harvard Business Review, argued that:

stock-market investors have become, collectively, an extraordinarily unproductive force in business. Indeed, for the last two decades, their contribution to corporations has been literally negative… it's wrong to shovel money out to shareholders in ever larger scoops and force other stakeholders to pay the price.

Most trades of shares in listed companies consist of movements from one shareholder to another with no new capital being supplied to the company. From an agency theory perspective, this can be described in terms of the role shareholders play in disciplining corporate management. Thanks to the takeover revolution and the changes associated with it, the managers of listed companies must maintain shareholder approval. If they do not, they face the prospect of a takeover bid. In practice, this means that companies have to satisfy, on a continuing basis, shareholders' expectations for high rates of return on equity. If they can do this, a rising share price becomes an asset in its own right which can be deployed to fund growth through acquisitions (Millon, 2002). This in turn has given rise to the problem of a short-term focus on share price maximisation at all costs, which may lead to an accentuation of capital market volatility and to a greater risk of corporate collapses along the lines of the Enron case (Bratton, 2002).

Since the late 1970s, the economic effects of takeovers have been the focus of intensive study. Econometric analyses have shown that it is not necessarily the worst performing companies which are targeted for takeover; in particular in the UK (and to a lesser extent in the United States) size is a more relevant factor (see Franks and Mayer, 2000). Nor do mergers following hostile bids consistently lead to improved performance. While hostile bids do better than agreed mergers, on average there is only a small positive effect on share prices from hostile takeovers (Cosh and Guest, 2001), and the range of outcomes is wide (Mueller and Sirower, 1997). Thus, while target shareholders undoubtedly do well from hostile takeover bids, shareholders in bidder companies, on average, make only slight gains, if that. Such evidence puts in doubt the theoretical claim that hostile

takeovers enhance the efficiency and competitiveness of organizations.
An alternative explanation for the high takeover premiums paid to target shareholders was provided by the 'breach of trust' hypothesis developed by Andrei Shleifer and Lawrence Summers in a much discussed paper published in 1988. The paper was developed against the backdrop of the activities of corporate 'raiders' such as T. Boone Pickens and Carl Icahn who were active in US takeover markets in the mid-1980s. Several hostile bids mounted at this time led to large-scale job losses in organisations where employment security had previously been a stated priority of management.

The key to the 'breach of trust' hypothesis was the analysis of implicit contracts. According to the theory, employees are willing to make firm-specific investments in human capital in return for an implicit promise of job security which amounts to a return on their 'investment'. Firm-specific human capital in this context means 'skills or knowledge or networks of personal relationships that are specialized to a given enterprise and that are more valuable in that enterprise than they would be in alternative uses' (Blair, 1996: 8). Because of such specialization, employees become 'locked in' to a particular enterprise. They thereby become vulnerable to ex post renegotiation of implicit contract terms by management. In the context of a hostile takeover, downsizing enables management to capture the future 'rents' or income streams which would otherwise have accrued to employees, and to convert them into takeover premiums for the shareholders' benefit. Because this practice directly benefits shareholders only at the employees' expense, it is a simple wealth transfer. Its impact on productive efficiency is at best neutral, but more likely negative. As Margaret Blair (1996: 12) puts it,

Firms that focus solely on share value will have an incentive to shut down operations that are not generating profits for shareholders even though these operations may still be generating substantial real economic rents. From the point of view of Society at large, this is, obviously, inefficient. Moreover, over time such policies are likely to discourage further investments by employees in firm-specific human capital.

The Shleifer and Summers paper identified the hostile takeover as the principal mechanism by which the redistribution of wealth from employees to shareholders takes places. As long as the incumbent management remains in place, implicit contracts with employees are enforced through reputational effects. Companies which renege on expectations of continuing employment will be unable to motivate existing employees or attract new ones. However, following a successful bid, a new management team comes in and finds itself in a different position. The new team aims to realize short-term gains to meet the costs of the takeover through asset disposals which, in themselves, reduce the need to attract and retain employees. In effect, the post-bid restructuring places the parties in an endgame situation, where implicit contracts ceased to be self-enforcing. The effect was summed up as follows (Shleifer and Summers, 1988: 44):

Hostile takeovers are external means of removing managers who uphold stakeholder claims. Takeovers then allow shareholders to appropriate stakeholders' ex post rents in the implicit contracts. The gains are split between the shareholders of the acquired and the acquiring firms. At least in part, therefore, the gains are wealth redistributing and not wealth creating.

Although there are literally hundreds of econometric analyses of aspects of hostile takeover bids, the breach of trust hypothesis has been relatively little studied using this methodology. The quantitative methods which are used to measure the effects of bids upon shareholder wealth are not able to specify whether those gains came from increased productive efficiency or wealth transfers. One study, which found evidence that hostile takeovers in the UK between 1987 and 1996 were associated with significant falls in both employment and output, concluded that, after controlling for the change in output, the overall effect of such mergers was to enhance the efficiency with which labour was utilized at firm level. On this basis the paper claimed that 'the results are generally supportive of the view that merger activity, particularly related and hostile merger activity, promotes efficiency'. However, the authors also accepted that 'if the observed employment reductions constitute a reneging on the implicit terms of the labour contract, in the sense of Shleifer and Summers (1988), there may be associated costs generated through the subsequent reductions in firm-specific human capital investment by employees. These will be manifested in lower output levels but any such changes would be very hard to identify' (Conyon et al., 2002: 40).

Deakin, Hobbs, Nash and Slinger (2002) report the findings of an empirical study whose objective was to construct a sample of bids which contained examples of both hostile and agreed bids, and cross-border bids by UK companies and for UK companies mounted during the period 1993-1996. In interviews we put this question to company directors, lawyers, merchant bankers, institutional shareholders and employee representatives:

> Did directors' duties to consider interests of creditors and employees as well as those of shareholders affect the preparations for, the conduct of and the aftermath of the bid?

On the central question of directors' duties, the response was almost invariably that while directors might consider employees' and creditors' interests, the outcome of a bid was determined by shareholder value. Shareholder value took precedence over all other considerations. The responses to the question are separated out below by group, with advisers first, followed by directors, employee representatives, and institutional investors. A typical comment from an adviser was as follows:

> Directors do consider employees' interests, but no-one really knows what that means. At the margin the touchy-feely things matter, but the Board of directors, faced with 2 people offering £1 and £1.10 must go for the higher. The decision, of course, is not usually put like that, but I don't know of any cases where employees' interests have come first.

Employees were only mentioned out of lip service to the obligation of the offeror company to state its intentions with regard to employment:

> Directors' duties to consider other interests are rarely an issue unless the company is near to insolvency. These clauses together are a bit of a sop. Rule 24 of the Code requires a statement of intentions towards employees, which always gets reduced to the standard phrase: 'the bidder will ensure that all rights of the target employees will be met in full.' Sometimes people do say more - sometimes a target will screw a stronger statement out of the bidder. And where companies intend not to make redundancies, they will tend to say it.

More pithily, we were told: 'much is spoken about directors' duties to employees, but it is rarely relevant'; and, 'the Takeover Code and Companies Acts just muddle these issues up: directors have to recommend 'the deal' when they are really just recommending the price.'

Directors told us that their focus was on the financial aspects of a bid:

The one thing that [our merchant bankers] kept *saying was that 'you have to be sure that when you say that a price is inadequate, you mean it and can back it up.' Were we advised that we could take into account the interests of the company as a whole? No - the primary advice was that 'there is a price at which you have to say yes.'*

In particular, non-executive directors were identified as advocates for the shareholder interest, even where this meant dismembering the corporate enterprise:
Were we advised of our legal obligations to our shareholders? Yes - there was lots of advice. One of the non-executive directors did push us

hard to consider closure and selling up as an option to get maximum shareholder value (about 5 years before the bid).

Institutional investors likewise thought that directors should focus on shareholder concerns. One was 'happy with the idea that directors owe duties to "the company" but was of the view that 'during a bid, especially, the directors understand this as being a duty to shareholders.' Another considered that for directors to perform according to their fiduciary duties, 'they had to show that it was in the interests of shareholders to sell'. The pursuit of stakeholder interests was not seen as a viable alternative to shareholder value:

> *It is hard to make a case that [the duty to further the interests of the company as a whole] affected the bid greatly. In principle a defending company might put employees' interests before those of shareholders but they are basically serving shareholders' interests first. If directors have a duty, it is to ensure that employees have marketable skills. I see directors' duties to employees as being more like pension rights protection than long-term employment safeguards.*

Employee representatives were less clearly opposed to bids than might have been thought. Hostile bids were sometimes seen as shaking up incumbent managerial teams with which the employees had little by way of common interest. Hence employee representatives commented unfavourably on the tendency of target directors to be excessively well-rewarded even before bids, in pay and share options, and on the negative effect this had on the workforce. Particular criticism was reserved for the practice of linking managerial remuneration to the number of workers dismissed:

> *The other thing that caused trouble was the directors' incentives schemes. They had a bonus system which had work completed according to certain targets divided by the number of staff that they employed to do it. So what they did was to sack a lot of staff, and employed outside contractors, to fulfil their conditions and increase their bonuses.*

None of the employee representatives were convinced that a higher commitment from management to consultation would have materially affected the bids in which they were involved. In part this was out of a frank recognition that the decision was in the hands of shareholders and hence was 'purely a commercial thing'. The priority was to keep lines of communication open after the bid in an attempt to avoid compulsory redundancies and smooth the way of the new owners. This was a typical comment:

> *We take the view now that we're not going to be able to prevent [the takeover] - so we try to get the best deal we can. Given the current industrial relations climate, I don't think that even a 'requirement to consult' would make much difference.*

For target directors, the nature of the advice received was of paramount importance. During bids, they saw their duty in terms of maximizing the potential value of the company as a financial asset of the shareholders. This obligation stood before any requirement to consult employees, to consider their interests, or to further the interests of the company as a whole. Even outside the bid period, the perceived 'duty' to focus on shareholder value could lead a non-executive director to see it as his role to force management to consider closing down the enterprise. Correspondingly, institutional investors applauded directors who saw their responsibilities in these terms.

The attitudes of employee representatives are best described as pragmatic. They expected little from target managers whose interests were seen to be tied up with share options and remuneration packages which would leave them better off whatever the outcome of the bid. There was no expectation of consultation with the target management, and no prospect of it making a difference to the outcome of the bid if it did take place. By contrast, the intervention of bidders could be seen in a positive light, particularly where there had already been a breakdown of trust with incumbent management. Informal links could be established with the bidder at an early stage, and a relationship constructed with a view to the future, even it was recognised on both sides that the most immediate issue was likely to be the management of redundancies.

At a micro level, three empirical studies can be highlighted for the way that they link together the study of corporate governance transformations and changes in the management of labour: Rubinstein and Kochan (2001), Deakin, Hobbs, Konzelmann and Wilkinson (2007) and Jackson, Höpner and Kurdelbusch (2005)[109].

Rubinstein and Kochan (2001) provide for a detailed account of Saturn, a US vehicle manufacturer set up as an experiment in partnership between General Motors and the United Auto Workers union. This seminal study revealed the difficulty management faced in articulating the priority granted to shareholders interests and the building up of a framework involving long term commitment between employers and employees.

Deakin et al. (2006) report case-study evidence based in particular on a series of interviews in British companies since the mid-1990s. Their objective was to assess the degree of compatibility between stock market liquidity and cooperation in labour relations. At a first level, their study shows that partnership arrangements with employees are vulnerable to shareholder pressure. Yet, they also found that different mediating strategies may be available to help to deal with financial-return requirements without adopting a low road-low equilibrium approach to labour management. In particular, they find that labour law rules favouring worker voice, as well as product market regulation fostering competition based on quality rather than on price, might favour Co-operative strategies between employers and employees. In sum, those devices allow firms to base profit strategy on a 'high road', 'progressive' HRM.

This result echoes the conclusion reached by Jackson et al. (2005). Their analysis synthesises a series of studies looking at the changes in human resource management in German listed companies subject to increasing stock market pressure. They observe a tendency to reduce the number of salaried staff, to fall back on a stable core of employees, although most often without mass redundancies, instead using voluntary departures, early retirement, and so on. Within companies, average wage level tended to rise, while the use of individual and collective bonuses was becoming more widespread. They suggest that the strong institutionalisation of worker involvement in German companies, through collective bargaining and codetermination rights (for work councils and at the Board-level) has not been damaged to any great extent by the transformation of corporate governance toward a more market-based system. To some extent, codetermination has even facilitated corporate restructuring, in a way that has proved to be quite beneficial for the remaining workforce: the evolution of codetermination toward an insider-oriented, efficiency-driven model (rather than a political instrument aiming to alter the capitalist system) is somewhat consistent with financial return required by active stock market. Vitols (2004), looking at the influence of the rise to power of investment funds on German corporations, similarly observes the emergence of a hybrid model, termed 'negotiated shareholder value'. In this model, minority shareholders requirements for financial return have to be negotiated with corporate insiders, and these negotiations generally alter the nature of those requirements.

The case studies carried out by Deakin et al. (2006) and Jackson et al. (2005) at least reveal a more subtle picture than the 'low road hypothesis' which is conventionally stated in the literature: partnership arrangements with workers as well as an increase of the average wage level are possible, despite pressures for financial return coming from shareholders. This might even suggest a 'high road' scenario, in which financial return requirements are delivered on the basis of a long term horizon, through heightened investments in human capital. Yet two observations qualify this possibility. First, additional investments in human resources appear to be restricted to a

109 Vitols (2002) is more concerned with global business strategy, than with labour management per se.

limited number of permanent or 'core' employees: in the German case, listed companies adopting shareholder value practices reduced total employment. Second, the choice of a high road strategy for the management of labour appears to be closely connected to the existence of devices (legal or organizational) supporting worker voice. The use of micro (firm or workplace-level) data to assess the impact of stock market on labour management might deepen our understanding, for it combines the possibility to obtain statistical representative results with the ability to differentiate among organizations at the infra-national level (Pendleton and Deakin, 2007). For example, it should be possible to test whether workplaces belonging to listed companies whose equity capital is mostly held by financial investors have distinctive human resource management practices and whether those practices are more of a 'low road' or 'high road' nature.

One of the advantages of a French / British comparison is that relatively similar datasets are available, which provide a uniquely detailed map of workplace relations in the two countries: the Workplace Employee Relations Survey (WERS 2004) for Britain and the 2004 Relations Professionnelles et Négociations d'Entreprise survey (REPONSE 2004) for France. The questionnaires on which the datasets are based are not identical but there are many similarities; and REPONSE has been, to a large degree, modelled on WERS. Those surveys consisted in three sets of questionnaires (one addressed to a management representative, one to an employee representative and one to a small number of employees) for a representative sample of establishments.

In the British case, a number of studies have been devoted to the analysis of the links between corporate governance (legal form and ownership) and HRM practices on the basis of the WERS survey. Konzelmann et al. (2006), examining WERS 98, found that a corporate governance regime that privileges remote stakeholders (as is the case in public listed companies) tends to operate as a constraint on the delivering of commitment-based HRM. 'while performance advantages can be derived from commitment-based HRM systems, a corporate governance regime that privileges remote stakeholders may operate as a constraint on such systems'. This analysis used public company status as a proxy for being listed, since WERS 98 did not distinguish between listed and non-listed companies. Pendleton and Deakin (2007), carrying out a preliminary analysis of WERS 2004 which did contain this distinction, found no statistical difference between listed establishments and non-listed ones in terms of long term commitment with employees or in terms of consultative practices. Controlling for size and sector, they also did not observe any significant impact of being listed on training effort by firms.

A different approach was taken by Conway, Konzelmann and Wilkinson (2007) which involved grouping the corporate governance variables in WERS 2004 into a series of composite categories which included public sector organisations, listed companies, non-listed public companies, private companies, owner-member/public interest firms (a group including mutuals and Co-operatives), partnerships and self-proprietorships. They found that public sector organisations (where taxpayer/government pressure is strong) and listed companies were more likely to use formal HRM than most of the other categories. Managers in the public sector and in listed companies were more likely to report that they had joint consultation procedures with employees; however, in the employee survey, only partnerships and self-proprietorships were positively associated with consultation. Employees in the public sector and in listed companies were less likely than in other categories to report that they had a degree of control over their work, and employment in listed companies was negatively associated with a perception of job security. Stress was positively associated with employment in the public sector and in listed companies. Job satisfaction levels were lowest in listed companies, followed by the public sector, and highest in owner-member firms, partnerships and self-proprietorships. Employees in listed companies were also significantly more likely to report a lack of trust than those in other groups.

A direct comparison between Britain and France, using WERS 2004 and REPONSE 2004, has been carried out by Conway, Deakin, Konzelmann, Petit, Rebérioux and Wilkinson (2007). By excluding the public sector component of the WERS survey, a high degree of homogeneity between the WERS and REPONSE samples was achieved. The choice of variables in this study was influenced by the need to have a common frame of reference across the two questionnaires. More precisely, six (dependent) variables were selected in the management questionnaire: the level of training provided for by the employer, the autonomy granted to workers (degree of control over their work), the importance of team working (% of employees involved in formally designated teams), the use of individual performance related pay (PRP) and degree of worker involvement in the negotiation of targets. The same set of control variables were introduced into the (logistic) regressions: establishment and organization sizes, establishment age, sector, market share and the evolution of activity (growth, decline, stability). In the French case, it was found that being listed was positively and significantly associated with training levels , autonomy at work, team working and the use of PRP . In comparison, being listed in Britain was positively associated to team working, but not to the other practices. Further, stock market quotation was negatively correlated with the degree of autonomy at work, a result that Conway, Konzelmann and Wilkinson (2007) also exhibit on the basis of the employee survey. Therefore, having a stock market listing had few effects on HRM practices in the British case, a result that was similar to previous studies.

Summing up, there is some evidence in the empirical research which we have surveyed to suggest that French listed companies are adopting high-road HRM practices as a way of responding to the particular mix of stock market pressures and additional institutional constraints to which they are subject. Evidence that external shareholder pressure is influencing HRM is to be found in the studies which demonstrate the statistical link between being listed (whether or not the equity capital is highly penetrated by investment funds) and the adoption of a particular bundle of HRM techniques which include a reluctance to workforce increases, greater use of production to agency labour and subcontractors, higher levels of training, the use of PRP and other incentive devices, and increased remuneration for those workers keeping their jobs. This may indicate a move to a model of 'negotiated shareholder value' (see supra, Vitols, 2004) in which rents are shared by shareholders and a core of well protected, and highly incentivised and remunerated, workers. This route is the most feasible one available as a means of maintaining overall competitiveness, given the high intensity of worker involvement in French companies.

In Britain, case study evidence suggests that listed companies adopt a range of approaches to the management of labour, depending on their sectoral context and particular history of labour-management relations. The WERS 2006 survey does not indicate that HRM in listed companies is fundamentally different from management practices elsewhere; however, employees in listed companies, together with those in another category characterised by external stakeholder control (the public sector, with an important pressure from the taxpayer/ government pressure is strong), reported lower job satisfaction, less control over their work (a point corroborated by managers), and more stress. Employees in listed companies reported a lower degree of trust and a lower expectation of job security than those in other categories. These results are not straightforward to interpret because of the multiplicity of corporate governance categories used in the studies concerned. However, they suggest that a high road strategy has not, on the whole, taken root in the listed company sector in Britain, and that the kind of compromises struck in the 'negotiated shareholder value' model are not present there to the same degree as they are in France (and Germany).

10. Sample Stakeholder Charters

Introduction

All key Co-operative Group stakeholders have expressed a desire for governance reform and this has significant ramifications for the Group's Board and the constituent elements of the business.

The need for a clear delineation of "rights and responsibilities" within the Group has also arisen as a result of the review process, both as a supporting element of governance reform and as a "lesson learnt" from the review of similar overseas Co-operative businesses.

We believe that the creation of stakeholder charters provides the best route for establishing the exact roles of key stakeholders within the Group. A selection of sample charters is set out below to illustrate how this process would work throughout the Co-operative Group. The charters will establish what each stakeholder can reasonably expect from their participation in the Co-operative and what they are expected to do in return.

(i) Individual Members

Rights:

- ***Financial*** – to receive a twice-yearly dividend payment
- ***Participatory***- to be consulted and exercise choice via a transparent voting process, with regard to a) delegated representation within the Group and b) local constitutional issues
- ***Ethical*** – to receive a "Co-operative Guarantee" i.e. that their society will adhere to the founding principles of the movement

Responsibilities:

- ***Financial*** – to contribute to the development of the Co-operative movement and, in the case of office holders, to maintain the highest standards of fiscal probity
- ***Participatory*** – to be "activist members" and take a full part in the movement's democratic processes
- ***Ethical*** – to be cognisant of the principles of the Co-operative movement and act in accordance with its key tenets

(ii) Customers

Rights:

Financial – to purchase goods and services of the highest quality at a fair cost and not be subject to overt "profiteering" by the Co-operative Group

Participatory – to have recourse to local Co-operative Group representatives and be consulted on the range of products available within retail outlets

Ethical – to trade with a retail group that consistently maintains the highest standards, with regard to the fair trade sourcing of its products, employment conditions of staff and contribution to local communities

Responsibilities:

Financial – to trade fairly and maintain loyalty to the Co-operative Group

Participatory – to provide feedback on the range of goods and services available within local retail outlets and help maintain the presence of "their Co-op" as a community resource

Ethical – to be cognisant of the efforts made by the Co-operative Group to trade in an ethical manner and accordingly source its retail products i.e. the "Co-operative Retail Guarantee"

(iii) Board members

Rights:

Financial – to receive fair and market benchmarked remuneration for their contribution to the Board and Co-operative Group

Participatory – to take a full role and be heard in strategic Board discussions or as members of individual Board Committees e.g. Corporate Governance/Audit etc.

Ethical – to be treated by the Co-operative Group in accordance with the founding principles of movement and with respect to contemporary corporate governance practices

Responsibilities:

Financial – to dispose their duties with regard to the highest standards of personal and corporate probity

Participatory – to demonstrate a detailed understanding of the strategic challenges faced by the Co-operative Group and deliver a professional contribution to Board proceedings

Ethical – to act in all respects as "ambassadors" for the Co-operative Group and in doing so take full account of the movement's historical commitment to fair trade and the communities within which it operates