PROMOTING CORPORATE DIVERSITY IN THE FINANCIAL SERVICES SECTOR

By Jonathan Michie

Foreword by Danny Alexander MP

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Acknowledgements

The contents of this Report were discussed at a seminar held at Kellogg College, University of Oxford, on August 16th 2010, and I'm grateful to the participants for their contributions and for their subsequent comments on drafts of the text, namely: Adrian Coles, Director-General, The Building Societies Association; Andrew Haigh, Chief Executive, Engage Mutual Assurance; Peter Hunt, Chief Executive, Mutuo; David Llewellyn, Professor of Money & Banking, University of Loughborough and an Associate of the Oxford Centre for Mutual and Employee-owned Business; Jeremy Palmer, Head of Financial Policy, The Building Societies Association; Martin Shaw, Chief Executive, Association of Financial Mutuals; and Mark Willetts, Policy & Communications Officer, Mutuo.

I would like to thank those colleagues who were unable to attend the seminar but kindly commented on the draft, namely Andrew Gall, Economist, The Building Societies Association; Geoffrey M. Hodgson, Research Professor in Business Studies, University of Hertfordshire; Christine Oughton, Professor of Management Economics, SOAS, University of London; and Andrea Westall, Strategy and Policy Consultant.

I'm grateful for research assistance from Nadia Vanteeva, for organisational assistance from Sandra Gee, and for media assistance from Maria Coyle, all of the University of Oxford; and also for media assistance from Fiona Cornes of The Building Societies Association and Matt Ball of Mutuo.

Jonathan Michie

September 9th 2010

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Preface

Following the unprecedented economic turmoil of the last two years, and as we emerge from the worst recession since the 1930s, the election of a new Government in the UK provides a tremendous opportunity for the creation of a safer, fairer and more diverse financial services sector.

The Government has publicly stated its commitment towards greater financial diversity and the promotion of mutuals. The BSA and AFM are delighted therefore that Mutuo has commissioned this new research from the Oxford Centre for Mutual and Employee-owned Business that explores and sets out how strengthening the presence of mutuals will contribute to a more stable financial services industry.

This report provides an in-depth appraisal of the underlying causes of the credit crunch and of the global financial recession that followed in 2008/2009. It analyses the lack of financial diversity within the UK financial services system as a contributory factor to these developments, and argues the case for stronger representation from financial mutual organisations to contribute to systemic stability. The Oxford Centre has provided a commendable piece of research that sets out, with great clarity, why we need diversity.

It sets out the pathway to achieving a healthier financial services sector and a regulatory system that will recognise the unique benefits that mutuals bring to financial diversity – a lower appetite for financial risk, focus on service, stability and member engagement.

We passionately believe a strong and vibrant mutual sector is good for society and for everybody's financial well-being. We call upon the Government, and all those committed to a financial services sector that is both more stable and fairer to consumers, to act upon the recommendations that are contained within this report.

"...as we emerge from the worst recession since the 1930s, the election of a new Government in the UK provides a tremendous opportunity for the creation of a safer, fairer and more diverse financial services sector."

Adrian Coles, Director-General, Building Societies Association

Martin Shaw, Chief Executive, Association of Financial Mutuals

Foreword

By The Rt Hon Danny Alexander MP

Chief Secretary to the Treasury

The Coalition is determined to ensure that our financial services industry serves the country, rather than the other way round. That is why we wasted no time in announcing our intention to build a framework that seeks to balance the benefits brought by the UK's financial sector with the associated risks to the economy.

Our action to reform the financial regulatory framework is designed to ensure that the new Financial Policy Committee, Prudential Regulation Authority and Consumer Protection and Markets Authority will together radically improve financial regulation in the UK, providing a dedicated focus on macro-prudential analysis and action; strengthening the prudential regime by placing it in the Bank of England; and ensuring that the interests of consumers and participants in financial markets are given the appropriate degree of priority.

The Government has also established an Independent Commission on Banking to examine the structure of UK banking with regard to both financial stability and competition. The Commission will assess the links between size, risk and competition for the financial sector.

We want to ensure that there is room for diverse providers of financial services to flourish in a fair and competitive market. Building societies, friendly societies, mutual insurers, co-operatives and credit unions all have long traditions of providing an alternative to shareholder owned businesses and provide choice and competition that is valued both by consumers and by the Government.

The Government recognises the importance of open discussion and I welcome this report as a contribution to this crucial debate as to how we can best deliver a stable and diverse financial services sector.

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Executive Summary

The Government's Coalition Agreement is committed to diversity in financial services:

> We want the banking system to serve business, not the other way round. We will bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry. (The Coalition: our plan for Government, 2010, p.9)

This Report sets out a detailed and realistic strategy for achieving these goals.

Diversity of ownership types and business models creates a corresponding diversity in forms of corporate governance; risk appetite and management; incentive structures; policies and practices; and behaviours and outcomes. It also offers wider choice for consumers through enhanced competition that derives in part from the juxtaposition of different business models. However, the UK financial services sector is dominated disproportionately by a single business model, namely the large, shareholder-owned plc. This domination of the shareholder ownership model – whose purpose is to maximise financial returns to the shareholders – proved a lethal combination with the financial deregulation, the creation of new financial instruments and the subsequent rising levels of debt over the past twenty years. Ever greater risks were taken to drive up financial returns and 'shareholder value', culminating in the global credit crunch of 2007-2008 which in turn created the first global recession since the 1930s, during 2008-2009, from which the UK and global economies are only slowly recovering. As the Bank of England's latest Financial Stability Report notes:

> Policy action is needed to reduce the structural problems caused by banks that are too important to fail (TITF). Larger UK banks expanded much more rapidly than smaller institutions in the run-up to the crisis and have received disproportionate taxpayer support during this crisis. That reflected a misalignment of risks on TITF banks' balance sheets, due to implicit guarantees on their liabilities.

This has left a legacy problem which is likely to constrain bank lending for some time. Alongside the macroeconomic costs, the interests of individual consumers were sacrificed by managers of shareholder-owned companies focussing on shareholder value – now dubbed by one of its champions, Jack Welch, as 'the dumbest idea in the world'.

The credit crunch, which was caused by the activities of private sector banks, resulted in the UK Government giving them a bailout of perhaps £80bn. In addition, the Government borrowed in order to provide the fiscal boost that was co-ordinated internationally to prevent a slide into global depression. These costs, along with the additional hit to Government finances that a recession causes, as tax receipts fall and unemployment benefits and other such payments rise, have combined to create the fiscal deficit and accumulated debt that we are all having to pay for through increased taxes and cuts in services. Given the financial, economic and social costs of that credit crunch and concomitant recession, a key priority for policy needs to be to put in place measures to prevent a reoccurrence in the future. Otherwise such problems may well recur, whether that be in 10, 20 or 30 years time.

In a situation of uncertainty and unpredictability, we cannot know which model will prove to be superior in all possible future circumstances, so we ought to be rather cautious before destroying any successful model. The global economy is a complex system. An important point about complexity is that many complex systems are intrinsically unpredictable, even if we know everything else about them. Thus, the problem is not just that the economic future is uncertain, but that it is fundamentally unpredictable. As **The Economist** notes:

> Just as an ecosystem benefits from diversity, so the world is better off with a multitude of corporate forms. (The Economist, 2010, p. 58)

The loyalty that mutuals show to their locality will often be reflected in local sourcing, which means that mutuals may contribute more to the local and regional economies than do private companies. In addition, many mutuals deliver goods and services that would simply not be provided at all by plcs. And because of the social purpose inherent in many mutuals, they tend to give, proportionally, greater support to local charities and other such bodies than do plcs, with the mutual sector giving well over one per cent of its surplus to the local community, beating the generally accepted benchmark for good corporate governance; this is not just in terms of cash, but also various support 'in kind', such as the use of premises, and encouraging staff to spend time supporting local charities and other initiatives.

The UK context: a lack of diversity

For the market as a whole to benefit requires that the various corporate models each enjoy the necessary critical mass, defined as the degree of market share necessary to enable that model to operate successfully and thus to provide real competitive pressure on the other players within the market. Other European countries tend to have several co-operative banks, which tend to be important lenders to the SME sector, whereas in the UK there is only one. The UK's 500 credit unions have total assets of around half a billion pounds – far short of what would be necessary to provide serious competitive pressure on the high street banks. The mutual insurance sector in the UK, at 5 per cent of the total insurance market, compares badly to the 30-40 per cent typical of the other large insurance markets globally. And the demutualisations of the 1980s and 1990s reduced the mutual building society sector below the critical mass to really deliver what a more diverse financial system would offer.

There is a fundamental attitude problem within the UK amongst the media and regulators, with the shareholder owned company being regarded as the 'normal' or 'natural' way of doing business. Other ownership models may be accepted, yet all models tend to still be judged against criteria appropriate for the shareholder ownership model. And the large plc, at that. Thus, for example, on the issue of raising capital, the Financial Services Authority (FSA) appear, at times, to view all companies as if they were, or should be, large plcs.

There is a bias against the mutual corporate form. At least in part, this is because of its inability to easily raise capital, despite the fact that this reduces their risk appetite and thus means that a financial services sector with a strong mutual sector will have a greater diversity of risk appetite, which is a positive outcome in terms of creating a stable and robust financial services sector – as reported in IMF and other research.

Measuring diversity

For Government to achieve its aim of enhancing diversity it needs to measure the degree of diversity over time so that progress can be measured, and assurance can be given that the risks of a future credit crunch are indeed being reduced over time. This might include geographical diversity, to promote a greater local and regional spread of such institutions.

Regulatory barriers to diversity

The Government has announced that it will create a Prudential Regulation Authority (PRA) as a subsidiary of the Bank of England, and a new Consumer Protection and Markets Authority (CPMA) which will take on the FSA's responsibility for consumer protection. This recasting of the UK's financial regulatory structure presents a rare opportunity to ensure that the issue of diversity is properly accounted for. In terms of responsibilities, what should these new regulatory bodies look like if they are to prove useful partners for the mutual sector, enabling the mutual sector to achieve critical mass, and thus creating greater corporate diversity?

One of the problems in the past with UK policy making is that mutuals have often been an afterthought. This can result in opportunities being missed and in wrong-headed policies being pursued. There is now an opportunity to formalise a relationship between policy makers and the mutual sector that could avoid these costly mistakes. A formal, longer-term relationship is needed.

A strategy for financial diversity

Within the new regulatory framework, there needs to be a clear responsibility in the regulator's charter to promote diversity of ownership. In the past, the objection to taking this step is that it would require legislation. But now there is going to be legislation in any case, and there is going to be a new regulator, so this is the moment to ensure that the regulator is given proper responsibility towards fostering diversity and promoting mutuals. So, firstly, the regulator must have a responsibility and a requirement to demonstrate that they are taking diversity into account.

Secondly, the regulator needs to have somebody within the organisation who is at a senior level defined as a head of mutuals policy and who is therefore charged with demonstrating that regulation does not prevent mutual organisations from competing on an equal basis with non-mutual forms. (There is no-one with that remit currently, and thus there is no particular incentive for anyone in the organisation to think beyond the standard plc model.)

Thirdly, regulation needs to be proportionate. Regulation and the demands it makes represents a powerful competitive advantage for large incumbent players because they can absorb that cost. The resource costs and the monetary costs impact more heavily on smaller players, constituting a barrier to entry – you have to comply with regulation before you have done

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your first deal – and it stops the smaller people thriving in a way that would provide meaningful competition to the big incumbents. On the whole that disadvantages mutuals, and it is certainly a barrier to greater diversity. Ironically, it actually favours the 'Too Important to Fail' banks that are part of the problem.

Fourthly, on the PRA and CPMA:

i. 'promoting mutuals and fostering diversity' needs to be in their objectives;
ii. they should both be committed to take account of diverse business structures;
iii. there needs to be a mutuals' policy function in both the CPMA and the PRA: these bodies need somebody on the inside who understands the difference at the grass roots of producing policy in diverse sectors.

Fifthly, the Bank of England:

i. needs to have its accountability improved along with its increased powers;
ii. should be required to explain what the impact of major policy decisions would be on mutuals and on the degree of diversity of the financial services sector; and
iii. should also be required to report on diversity in the sector, producing an annual review of diversity and how its actions have promoted it.

Thus, good, strong and transparent regulation is required that takes account of the particular structures within the mutual sector. To achieve this would require a mutuals policies function within the PRA and CMPA, with them reporting on the success of their efforts to promote diversity, and also commenting on the impact on diversity and on mutuals of each individual significant regulatory proposal.

The Coalition Government has already shown a strong degree of interest in mutuals, and this is likely to prove important to a range of government functions. A Minister for Mutuals – similar in status to the Minister for the City – would be able to deal across the various government departments that have to deal with the mutual sector. A Minister for Mutuals would be responsible for all types of mutuals in all sectors – in manufacturing, retail, health, education, non-financial services, football clubs and so on, as well as for the financial services sector. Given the weight of business, this would need to be a Treasury minister – suitably supported by sufficiently qualified and senior officials – that also had a responsibility in BIS and cross-cutting responsibility across Government as necessary. Fundamentally, the Minister for Mutuals would ensure parity of esteem for the mutual and proprietary models, which is a principle of public policy and which should set the agenda for regulators.

Government must not allow the UK's financial services sector to return to the 'business as usual' model that has proved so costly to the economy and to public finances. Already we have seen a return to the bonus culture, which is fuelled by profits boosted by the increased market power of banks which have been rescued by the taxpayer. It is vital that the banks face competition from mutuals, which would also reduce the risk of the credit crunch being repeated.

Keeping a reformed Northern Rock independent of the big banks will be good for competition. Northern Rock could be converted to an asset-locked public interest mutual. As a mutual committed to its core business, a remutualised Northern Rock would help the Government by supporting competition and diversity through the maintenance of a strong mutually-owned financial sector.

There are plenty of examples of the positive role that mutuals can and do play, but these positive impacts could be greatly enhanced given the right environment and political goodwill. The benefits of creating a more diversified financial services sector include greater stability, more accountability to consumers, reduced systemic risk, and better access to financial services. The research suggests that mutuality appeals to consumers. But consumers do need to be given the choice – and that choice needs to be preserved rather than allowing mutuals to demutualise or to be crushed by the ever-increasing costs of staying in business. Positive words count for little if the downward trend in the number of mutual organisations in financial services is allowed to continue. There is an urgent need to translate positive words into substantive actions.

1. Introduction

In the run up to the 2010 General Election, the Mutuals Manifesto set out plans from the co-operative, mutual and employee-owned sectors to put people at the heart of business and society (Mutuo, 2010). (The current Report refers to 'mutuals' as including all member-owned, or 'stakeholder-owned' organisations, including mutual building societies and insurers, friendly societies, co-operatives, credit unions and employee-owned organisations.) Following the election, the incoming Government's Coalition Agreement included a commitment to fostering diversity in financial services

> We want the banking system to serve business, not the other way round. We will bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry. (HM Government, 2010, p. 9)[1]

The consultation document on Financing a private sector recovery issued jointly by the Department for Business, Innovation & Skills and HM Treasury stated that:

> Mutuals play a strong role in local communities, building long-term relationships with members and often operating in areas of economic and social deprivation. The range of services offered by building societies and other mutuals has expanded as the legal framework has been updated, and in response to changes in technology and customer demand. The Government is interested in views on the role that mutuals could play in facilitating access to finance for businesses and providing greater choice in financial services. (Department for Business, Innovation & Skills, 2010, p. 32)

And the Treasury White Paper on A new approach to financial regulation: judgement, focus and stability, stressed:

> The need to maintain diversity in the financial services sector (for example, by removing barriers to entry where possible, and ensuring that its rules do not disadvantage mutually owned financial institutions). (HM Treasury, 2010, p. 32)

Furthermore, the coalition Government has talked a lot already about the 'Big Society' and this suggests a growing role for organisations owned by their customers or employees, to improve efficiency and accountability, in public services and private enterprises. Thus the Chancellor of the Exchequer said in the Commons on 16th June that:

> 'Building societies and mutuals have an important role to play in the future. We want to strengthen them and support those who want to create mutuals.'

The question therefore is how Government can actually deliver on this commitment to promote and support corporate diversity in the financial services sector.[2] The purpose of this Report is to set out a detailed and realistic strategy for achieving this goal of fostering diversity in financial services by promoting mutuality.

Notes

1 The Coalition Government uses the term 'mutual' in the same inclusive way as in the current Report.

2 The Office of Fair Trading is also currently reviewing barriers to entry and expansion in banking, and the Government has established an Independent Commission on Banking, chaired by Sir John Vickers, to review the structure and performance of the banking sector with a review to reforms that would enhance competition. Increased corporate diversity would play a positive role in achieving the aims of both these investigations, and conversely, any breaking up of the 'too important to fail' banks would provide an opportunity to enhance both the corporate and geographic diversity of the sector.

2. The purpose of diversity

The financial services sectors of all countries are characterised by a degree of diversity in terms of ownership types and business models. This variety of business models creates a corresponding diversity in forms of corporate governance; risk appetite and management; incentive structures; policies and practices; and behaviours and outcomes. It also offers wider choice for consumers through enhanced competition that derives in part from the juxtaposition of different business models. The diversity of ownership forms and business models, generally includes a balance between public and private ownership, with the private sector being distributed between shareholder-owned plcs, other private ownership such as private equity, and a range of 'stakeholder ownership' models including co-operative banks, mutuals and credit unions, which in this Report are included within the generic term 'mutuals'. Mutuals are competitive players in the financial services sector and act to drive competition in the market, benefiting customers through keen pricing and generally speaking a greater choice of providers.

However, the UK financial services sector is dominated disproportionately by a single business model, namely the large, shareholder-owned plc. The demutualisations of the late 1980s onwards withdrew around 70 per cent of assets from the mutual building society and insurance sectors, thus substantially reducing their critical mass.

This domination of the shareholder ownership model, whose purpose is to maximise financial returns to the shareholders, proved a lethal combination with the deregulation over the past twenty years which led to the creation of new financial instruments, rising debt levels and a bloated financial sector – generally referred to as a process of financialisation. Ever greater risks were taken to drive up financial returns and 'shareholder value', culminating in the global credit crunch of 2007-2008 which in turn created the first global recession since the 1930s, during 2008-2009, from which the UK and global economies are only slowly recovering. As the Bank of England's latest Financial Stability Report notes:

> Policy action is needed to reduce the structural problems caused by banks that are too important to fail (TITF). Larger UK banks expanded much more rapidly than smaller institutions in the run-up to the crisis and have received disproportionate taxpayer support during this crisis. That reflected a misalignment of risks on TITF banks' balance sheets, due to implicit guarantees on their liabilities. (Bank of England, 2010, Page 11)

This has left a substantial legacy problem which is likely to constrain bank lending for some time (Llewellyn, 2010). Alongside the macroeconomic costs, the interests of individual consumers were sacrificed by managers who were primarily focussed on shareholder value. One of the champions of shareholder value, Jack Welch, in 2009 called it 'the dumbest idea in the world'. Alan Greenspan, the former chairman of the Federal Reserve – and described by the Financial Times as 'a high priest of laissez-faire capitalism'[3] – announced in 2008 that the credit crunch had exposed a 'mistake' in the free market ideology which had guided his 18-year stewardship of US monetary policy: 'I have found a flaw', Greenspan announced, referring to his economic philosophy, 'I don't know how significant or permanent it is. But I have been very distressed by that fact.'[4]

The credit crunch, which was largely caused by the activities of private sector banks, resulted in the UK Government giving them a bailout of perhaps £80bn. In addition, the Government borrowed in order to provide the fiscal boost that was co-ordinated internationally to prevent a slide into global depression. These costs, along with the additional hit to Government finances that a recession causes, as tax receipts fall and unemployment benefits and other such payments rise, have combined to create the fiscal deficit and accumulated debt that we are all having to pay for through increased taxes and cuts in services. Given the financial, economic and social costs of that credit crunch and concomitant recession, a key priority for policy needs to be to put in place measures to prevent a reoccurrence in the future. Otherwise such problems may well recur, whether that be in 10, 20 or 30 years time. (And there is evidence that the incidence and frequency of bank crises around the world has increased over time – see for example Eichengreen and Bordo, 2002.)

2.1 Diversity of ownership and business models

A major contribution to ensuring the necessary systemic stability is to create a more diverse financial services sector. Diversity of ownership and business models promotes systemic stability and is also good for customers because of the resulting increased competition and choice, quality of service and fairness.

Andy Haldane, Executive Director of Financial Stability at the Bank of England, has described well the way in which one of the factors that lay behind the 2007-2008 global financial crisis was that individual institutions had been diversifying and that while this might be thought to reduce risk, it does not if all are diversifying in the same way, so instead the system becomes more concentrated (Haldane, 2009, pp. 18-19). It is a classic fallacy of composition, that what is good for an individual institution acting alone does not apply when you consider all of them together. In addition to increasing risk through reduced diversity, this process also had the effect of shifting risk from the shareholder-owned banks that moved into investment banking, to the public sector, on account of the Bank of England's obligation to act as Lender of Last Resort and the Government's obligation to support systemically important banks.

The Centre for European Policy Studies (CEPS) has recently produced two major and comprehensive research studies of diversity in European banking (CEPS, 2009 and 2010). Both reports emphasise the advantages of having diversity in banking structures and models, and illustrate this with case studies of several countries. The purpose of these reports is not to argue that one model is superior to others, but precisely that advantages accrue through diversity. Their first report, Investigating Diversity in the Banking Sector in Europe found that 'The most important conclusion is that the current crisis has made it even more evident than before how valuable it is to promote a

"Policy action is needed to reduce the structural problems caused by banks that are too important to fail" pluralistic market concept in Europe and, to this end, to protect and support all types of ownership structures' (Ayadi et al., 2009, p. 3). Interestingly, the book's front cover is a picture of a coral reef, showing great variety, but the message the authors were trying to get across by this was not the wonder of "Oh, look, there are lots of different fishes, lots of different plants"; that was not their point. The point they were seeking to illustrate is the idea of biodiversity, namely that "you just do not know how important any one of these small things are and if you disturb some trivial looking fish, you might think that it would not make much difference to anybody, but in reality it might precipitate a chain of events that could, for example, eventually collapse the coral reef off the coast of Australia".[5]

Thus, the argument here is that in a situation of uncertainty and unpredictability, we cannot know which model will prove to be superior in all possible future circumstances, so we ought to be rather cautious before destroying any successful corporate forms. The global economy is a complex system. An important point about complexity is that many complex systems are intrinsically unpredictable, even if we know everything else about them. Thus, the problem is not just that the economic future is uncertain, but that it is fundamentally unpredictable.[6] As The Economist notes:

> Just as an ecosystem benefits from diversity, so the world is better off with a multitude of corporate forms. (The Economist, 2010, p. 58)

Variety is the evolutionary fuel in economic development as well as in biology (as detailed, for example, by Hodgson, 1993). Diversity is desirable across the economy, and diversity within the financial sector itself – both a variety of corporate forms and geographical dispersion, with stronger local presence – tends to support a broader variety of corporate forms in the rest of the economy which in turn enhances competition and consumer choice (Gagliardi, 2009). And promoting corporate diversity in the financial services sector itself contributes greater local presence, as the plcs tend to be more London based. Thus, promoting mutuality within financial services would not only create a more competitive and robust financial services sector, it would also bring the added benefit of fostering a more diverse economy more generally, in both corporate and geographic terms.

The loyalty that mutuals show to their locality will often be reflected in local sourcing, which means that mutuals may contribute more to the local and regional economies than do private companies. In addition, many mutuals deliver goods and services that would simply not be provided at all by plcs. And because of the social purpose inherent in many mutuals, they tend to give greater support to local charities and other such bodies than do plcs, with the mutual sector giving well over one per cent of its surplus to the local community, beating the generally accepted benchmark for good corporate governance; this is not just in terms of cash, but also various support 'in kind', such as the use of premises, and encouraging staff to spend time supporting local charities and other initiatives.[7]

The globalisation of financial services has resulted in the ownership of banks and insurance companies being increasingly overseas, with management of shareholder owned organisations having concomitantly less allegiance to the UK. The UK insurance market in particular is now largely in the hands of overseas owners, and some see the UK as a saturated and less attractive market – hence Zurich Financial Services' recent announcement that it is moving its operations to Ireland, AXA selling its life arm, Aegon closing much of its UK capacity, and Prudential's failed attempt to purchase AIG. Mutuals by contrast are generally owned by UK consumers and most remain entirely focused on the UK market.

Government would no doubt like to see the financial sector improving financial services provision across the various markets, including adequate finance for small businesses, adequate finance for house purchase and low-cost homeownership, and better financial inclusion for those currently marginalised. There is strong evidence from the UK and globally that a more diverse financial services sector will help to deliver in all these areas.[8] Mutual suppliers often occupy markets that plc companies won't – for example, with less profitable consumers; so mutuality provides access to financial services, not just access to a bank account but also access to borrowing, to insurance, and so on, and the reason for this is in part because mutuals can take a much longer view regarding return on capital. The challenges of an ever-ageing population, lack of pension provision, long-term care, care at home and health are all areas where diverse business models can also create solutions to emerging problems. Diversity of ownership structure is good for systemic stability, and diversity of ownership is also good for consumers and others for a range of additional reasons, including the quality of service, and the effects which a diverse sector will enjoy in terms of competition, choice, pricing and fairness.

2.2 Ownership and purpose

The purpose of a shareholder-owned bank is to make a return to the shareholders, period. That is what it is there for. The purpose of a customer-owned business is to provide whatever it is the customers want the business to provide for them, subject, of course, to maintaining financial viability. It is for this reason that the CEPS reports characterise non-shareholder value banks – referred to as Stake-holder Value (STV) institutions – as 'dual bottom line' models in contrast to Shareholder Value (SHV) institutions as being almost exclusively focussed on profitability and shareholder value.

Thus, it is not only a difference in ownership structures – it is also a difference in business models. That is why Ayadi et al. (2009 and 1010) refer to 'shareholder value' versus 'stakeholder value' banks, because there are fundamental differences in the business models between these two broad categories. Having a diverse set of institutions and therefore a diverse set of business models increases competition because it is generally the case you get more competition not by just adding more firms with the same business model but by also adding firms with different business models to those which are already there. Thus the competition effect is greater with different business models rather than just having yet another institution of the already dominant form.

This point about business models also feeds into the issue of systemic stability. Across Europe, stakeholder value banks in general performed less badly in the crisis than did shareholder value banks and that is partly – there are also other reasons – due to their different business models and the fact that they manage risks differently.[9]

In addition, another major reason for promoting corporate diversity relates to risk aversion. What one wants is a diversity of appetite for risk within the system. Mutuals will tend to have less appetite for risk than will shareholder owned banks. The case of the Dunfermline Building Society is the exception that proves the rule: it failed not because of the weakness of the building society business model but on the contrary, because it was tempted away from that business model and was adopting policies and practices more appropriate to a shareholder-owned bank. Ayadi et al. (2009) found there to be a natural business model associated with different types of ownership structure, and that institutions which got into trouble were those that deviated from that natural business model associated with the particular ownership structure they had. That was certainly the case for Dunfermline.

On appetite for risk, one of the features of a mutual and of many stakeholder value banks is that they cannot easily inject external capital, and this tends to limit their risk appetite, and that was precisely what Ayadi et al. (2009 and 2010) found to be the case, consistently, across Europe. The Dunfermline Building Society deviated away from the tolerance of risk associated with the inability to inject easily more external capital.

This feature of mutuals limits their risk appetite and thus means that a financial services sector containing a critical mass of mutual organisations will have a spread not only of business models but also therefore of appetites for risk. This is a positive feature and one that should be applauded and encouraged, to create a more stable and robust financial services sector. Ironically, the Regulator in practice takes the opposite view: this inability to inject easily more external capital is viewed as a weakness in mutuals. Similarly, the FSA is currently threatening to pursue a policy in relation to mutual capital for mutual insurers and friendly societies that could prove disastrous for the sector.

This pro-plc bias is a fundamental weakness of the UK economy, going far beyond the Tripartite Authorities, and stretching back decades. We therefore discuss this further, in Section 5.3 below, when considering the lack of diversity in the UK financial services sector.

Notes

3 Francesco Guerrera, 'Welch rues short-term profit 'obsession'', Financial Times, 12th March 2009.

4 Andrew Clark and Jill Treanor, 'Greenspan – I was wrong about the economy. Sort of.', The Guardian, 24th October 2008.

5 Professor David Llewellyn, a contributor to the Ayadi et al. (2009) study, speaking at a seminar at Kellogg College, University of Oxford, August 16th 2010.

6 Andrew Clark and Jill Treanor, 'Greenspan – I was wrong about the economy. Sort of.', The Guardian, 24th October 2008.

7 See Michie and Blay (2004) for further detail.

8 The Co-operative Bank, for example, doubled its lending to small businesses over the last three years (see The Daily Telegraph, 27 August 2010).

9 For more detail, see Llewellyn (2009).

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3. The existing research, evidence & literature

In 2003, Mutuo undertook a major piece of work to survey the existing literature, conduct its own surveys, and undertake case studies of mutual organisations to discover what the evidence was both about the potential benefits to be had from a non-plc business model and also the degree to which existing mutuals were actually taking full advantage of those opportunities (see Cook et al., 2003). The survey of members of Yorkshire Building Society (YBS) and Oxford, Swindon and Gloucester Co-operative Society (OSG) found that customers of both organisations considered that the business model contributed to the organisation's reliability, with:

- 75% saying that they liked the fact the building societies, unlike banks, have no shareholders
- 58% of YBS members said that they felt a sense of ownership that they did not experience when dealing with a bank
- 66% thought that building societies provide better feedback than banks
- 72% of OSG members felt that the Co-operative acts more in members' interests because it is not answerable to 'Big City' investors, with 95% agreeing with the statement 'The Co-op is trustworthy'
- Building society members were four times more likely to trust their mutual than a plc

The survey of the general public found that they were also more likely to trust a building society than a bank and twice as likely to invest in one in the future. While these surveys were undertaken some years ago, it is unlikely that the level of trust in shareholder-owned banks will have risen between 2003 and 2010.

The case studies found that the organisations were aware of the opportunities that their business model presented, with their own interests aligned with the interests of their customers. However, these were major, successful organisations that had agreed to participate, and the good practice discovered could well have been ahead of the average for the sector.

"... more likely to trust a building society than a bank and twice as likely to invest in one in the future."

3.1 The academic research

'Agency' problems are created by the separation of ownership and control in plcs, where the interests of shareholders and managers are not aligned. Managers may take on risky projects which offer high rewards but are characterised by high levels of risk. Fama and Jensen (1983a, b) argue that one should expect plcs to be involved in activities which generate uncertain cash flows, as the residual claim structure of these organisations makes them more suitable to handle risk. It is questionable whether agency theory can be applied straightforwardly to banks that are insured by a lender of last resort and that therefore face virtually no risk of bankruptcy. But in any case, a high-risk-high-return strategy may not necessarily be the most profitable and sustainable. Mutual organisations were formed to serve a clientele which favours less risky investments (Mayers and Smith, 1981, 1986; Smith and Stutzer, 1995).

Mayers and Smith (1988), using mutual insurance firms as an example, also point out that these organisations combine owner and policyholder functions, thereby ameliorating agency conflicts that exist between owners and customers. Consequently, the managers of mutual organisations have lower incentives to engage in the undertaking of risky projects, when compared to plc managers. Similarly, Rasmusen (1998) argues that plc banks will generally be characterised by riskier investment profile than mutual banks. Using data on property-liability insurance companies during 1980-1987, Lamm-Tennant and Starks (1993) also find that stock companies have higher total risk when compared to mutuals. Born et al. (1995) compared the performance of U.S. plc and mutual companies in the insurance industry from 1984 until 1991, finding both that plcs were more likely to decrease their business in non-lucrative situations, and also that plcs had bigger losses when compared to mutuals for given premium amounts.

The evidence suggests that mutuals can exhibit similar or even superior performance to plcs. Valnek (1999) analysed the performance of mutual building societies and plc banks in the UK over 1983-1993, finding that plc banks incur higher costs in the form of loan-loss reserve provisions, which attributes to the fact that mutuality minimises agency conflicts between owners and depositors. Heffernan (2003) examined the pricing behaviour of demutualised building societies along with mutuals to address the question of whether the change of ownership structure would cause managers to put shareholder concerns ahead of customer interests: this econometric study using monthly interest rate data for 1995-2001 on deposit products and mortgages confirmed that managers began to set prices to improve profits at the expense of depositors and mortgagees.

On credit unions, Goddard et al. (2002) note that in the US, a combination of credit unions' traditions of pursuing social, educational and development objectives, along with the liberalisation of the 'common bond' and membership regulations, led to a significant rise of market share, with 30 per cent of US citizens belonging to a credit union. Due to their co-operative philosophy and ability to provide for their members, credit unions have often ranked as the number one financial institution in terms of member satisfaction in the American Banker's Association surveys (Kaushik and Lopez, 1994). Karels and McClatchey (1999) found that – due to their mutual co-ownership structure, which leads to risk-reduced behaviour – the introduction of deposit insurance in the US did not result in enhanced risk-taking activity. More than 50 per cent of the Irish population are members: credit unions 'have become so much an intrinsic part of daily Irish living that it is difficult to imagine what Ireland would be like without them' (McCarthy et al., 2000, p. 2). In New Zealand, credit unions' assets in 1999 were 430 million NZ dollars, with 134,097 registered members (Sibbald et al., 2002); by 2009 this had risen to 620 million NZ dollars with 171,000 members.[10] Globally there are over 49,000 credit unions in 97 countries, representing 184 million members with over $1.3 trillion in assets.[11] McKillop et al. (2002) argue that although credit unions in the UK are comparatively small, they do combat financial exclusion. Jones (2008) also finds that credit unions in Britain have played a role in achieving financial inclusion, and argues that these institutions are best placed within the financial services to impact poorer communities.

In a major and well-respected piece of research by the International Monetary Fund, Hesse and Ĉihák (2007) investigated the impact of co-operative banks on financial stability using data from 29 major advanced economies and emerging markets that are members of the OECD, and found that co-operative banks tend to be more stable than commercial banks, and that these results can be attributed to less volatile rates of return. Angelini et al. (1998), using a sample of small firms in Italy, argue that the success of co-operative banks can typically be attributed to their institutional set-up which overcomes problems of asymmetric information between lenders and borrowers. In another IMF study, Fonteyne (2007) argues that co-operative banks might be less fragile than other banks as they have a stable deposit and customer basis, they focus on capital preservation, and they do not maximise profits but rather customer surplus, which could serve as a potential cushion in weaker periods; further, the dispersed membership and the dominance by managers in risk-taking decisions might reduce incentives for risk taking and thus fragility. Fonteyne also reports that 'as consumer-owned institutions, co-operative banks have a comparative advantage in gaining the trust of their customers' (2007, p. 4).

In a similar study to Hesse and Ĉihák (2007)'s IMF paper, Beck et al. (2009) analyse the German banking sector. As they note, it is a nice laboratory for such research, since roughly a third of the sector is private, about a third public, and around a third mutual. They find that the incentive structures, behaviours, risk appetite, and likelihood of failure do indeed vary across the different ownership types and business models. In terms of creating a system that will not respond lemming-like to a given set of incentives, it might be said that it is not just a nice laboratory setting but also a wise and robust ownership structure for a country's financial services sector. In addition to being structured to make speculative bubbles less likely, the different behavioural patterns also make the sector more likely to be robust in face of various shocks and crises. Beyond these general points, they report:

> Our findings suggest that co-operative banks are the most stable financial institutions in Germany, as measured by the z-score, i.e. the distance to insolvency, followed by savings banks and private banks. Decomposing the z-score, we find that privately-owned banks are more profitable and better capitalised than both savings and co-operative banks, which, however, is more than compensated by the higher volatility in profits. This is consistent with Hesse and Cihak (2007) for their OECD sample. Using the NPL-score as a measure of lending risk yields similar results, although there is no significant and consistent difference between co-operative and savings banks in lending risk. The findings confirm the stability-enhancing impact of co-operative banks due to their focus on capital endowment protection and consumer surplus maximisation as well as their disperse shareholdings.

Brunner et al. (2004) find that the performance of co-operative banks in Germany, Spain, France and Italy has not been inferior to that of traditional commercial banks. Outside the UK, co-operative banks tend to play an important role in local communities, acting as a source of finance for small businesses. The lending conditions are affected by local 'group interactions', where the banks have an advantage in screening and monitoring borrowers (Russo and Rossi, 2001). The borrowers also benefit from relationship-based loans, as they receive access to credit (Becattini, 1990).

Following a major investigation into the banking sector across the key economies of Europe (Austria, Finland, France, Germany, Italy, Netherlands and Spain), Ayadi et al. (2010) report that the empirical evidence suggests no radical difference in terms of performance and efficiency between plc (and more generally SHV) banks on the one hand and non-plc (STV) banks on the other, but that there are systemic and welfare benefits to be derived from a successful non-plc sector, and that a financial system populated by a diversity of ownership and governance structures, and alternative business models, is likely thereby to be more competitive, systemically less risky, and conducive to more regional growth.

3.2 Industry studies

Research commissioned by the Building Societies Association from GfK NOP found customer service to be better in mutuals than in other organisations, with satisfaction levels at mutuals higher than at plc banks on both savings and mortgages, and significant differences in mutuals' favour on questions regarding value for money, fairness, trust, support for customers getting into financial difficulties, and comments and feedback being taken seriously (BSA, 2010). Indeed, this BSA research which began in 2007 has found this consistently, each year.

Martin Lewis's money saving expert website recently published a survey of over 17,000 UK consumers' views on service standards. While the sample is self-selecting, of those responding, customers of the largest high street banks were more likely to rate the service 'poor' and less likely to rate it 'great' than were customers of BSA members, with the Co-operative Bank 2nd in the listing, and 3rd place going to Nationwide Building Society (www.moneysavingexpert.com).

The blog page of the Financial Services Club looked recently at Britain's best and worst banks for customers, and pointed out that the Co-operative Bank subsidiary Smile generated the highest customer score for current accounts in a Which? magazine survey of 15,000 customers in January 2009; that Yorkshire Building Society was second in customer assessment of service in the mortgage market; and that the employee-owned John Lewis scored the highest mark for customer satisfaction with credit cards, followed by Nationwide and Smile (www.thefinanser.co.uk, August 2010). The blog also pointed out, looking further back, that a BBC Watchdog survey of over 13,000 viewers in February 2008 put First Direct top, with Co-operative Financial Services and Nationwide Building Society in second and third positions.

The annual round-up of Which? member satisfaction surveys, including the one referred to above, reports the best and worst ratings across current accounts, savings, credit cards and mortgages. For current accounts, the top five and bottom four are reported, with three of the top five being mutuals, and all the bottom four being plcs. For savings, the three 'best for consistency' are reported, with two of the three being mutuals. For mortgages, again, sixty percent of the top five were mutuals, and all the bottom ten were non-mutuals. For credit cards, similarly only two of the top five were plcs (with one of the other three being employee-owned John Lewis), and again, the percentage of mutuals in the bottom ten was zero (Which? Money, 2010).[12]

A survey of more than 10,000 consumers undertaken by Moneywise, the personal finance magazine and website, earlier this year showed a wide ranging mutual presence among firms rated highly by customers for trust-worthiness and service (Moneywise, July 5th 2010). On customer service, non-plc non-shareholder-driven organisations came first and/or second in the categories for best current account overall, best current account for online service and for call centre service, best current account for branches, best savings account for online services, best customer service for mortgages, best credit card overall, best credit card for fraud protection, best credit card for call centre service, best home insurance provider, best motor insurance provider, best savings provider, best cash ISA provider, best critical illness provider and best provider of private medical insurance. Given that the mutuals' market share of many of these markets is low, it is clear that they took a disproportionately large share of the awards. Indeed, looking at all 32 categories (with a winner and highly commended in each, giving 64 opportunities for firms to get a mention) just one mention is taken by a big plc high street brand.

The Financial Ombudsman Service also produces statistics on the percentage of complaints upheld, on which Tony Hazell (the highly respected Personal Finance Editor of the Daily Mail) commented: 'Why does Lloyds TSB have 51% of complaints upheld [by the Financial Ombudsman Service], HSBC 57% and Barclays 65%? Against this, Nationwide Building Society has 31% upheld and Yorkshire 19%. This implies that building societies really do treat their customers better." *(Financial Adviser, March 2010).*

In Australia, regular customer surveys of the whole financial services sector by Roy Morgan Research find consistently that the mutual sector receives the highest levels of customer satisfaction. For example, the most recent survey (March 2010) found an average of 72.8 per cent of customers of plc banks were satisfied, while 86.4 per cent of customers of credit unions were satisfied and 88.0 per cent of customers at building societies were satisfied (www.roymorgan.com, also reported on www.abacus.org.au).

In Canada, a quarterly survey of a regionally and demographically representative sample of families gathers data from across the financial services sector on a number of metrics, such as 'overall customer service excellence', which are then used to generate annual Best Banking Awards. In 2010, for the sixth year in a row, first in 'overall quality of customer service' were credit unions, which also came first in several of the other categories.[13]

".Research commissioned by the Building Societies Association from GfK NOP found customer service to be better in mutuals than in other organisations,"

Kellogg College

One of the reasons for the better performance by mutuals on customer satisfaction is that the organisations are owned by and answerable to their customers, so the incentives, policies, practices and organisational culture are all geared to that business model, in much the same way as in a plc all those aspects of the business model are focussed on the external shareholders. One corollary of the different business model is that while plcs pay dividends to their external shareholders, mutuals can return those funds to the members via two routes: firstly, by reducing the margin between what they charge customers and what they pay to savers, and secondly by investing more in customer service, whether having more branches available or being more sympathetic than would be a plc when members fall behind with mortgage payments. In principle, the whole of this dividend could be returned to the members via just one route or the other, but in practice most mutuals will want to deliver both types of benefit – in cash and in kind – so will strike a balance between them. On average, management expenses plus dividend payments were found to be around 30-35 per cent higher in building societies that demutualised compared to those that had remained mutuals (BSA, 2005).

That different ownership forms and business models engender concomitantly different organisational cultures was illustrated at Woolwich Building Society. The document circulated to members in January 1997 prior to the vote to demutualise stated:

> We believe very strongly that retaining the Woolwich's culture and values is important for ensuring that the Woolwich's high standards of customer service are maintained and for safeguarding the future of its management and employees.

A year later, the following was reported:

> Commenting on the departure of 25% of the group's senior managers during and since the conversion process, John Stewart, Group Chief Executive, said – 'Culture has been the biggest change at the Woolwich over the last year to 18 months. A building society culture is wonderful in terms of customer care, but it isn't particularly good at identifying where the value is in the business. We need a different type of person in the future.' (Financial Times, 19th February 1998)

In the income protection sector, actual claims acceptance in the mutual sector for health insurance claims are indicatively significantly higher than in the private sector (although most plc insurers refuse to publish these data). Aggregate data from friendly societies indicate that for income protection policies, 95 per cent of claims in 2007 were paid in the year, and the following year – despite the recession and hence increased .pressures – that percentage remained at 95 per cent. One consequence of this is that IFAs are increasingly aware of friendly societies, and against an income protection market that has fallen significantly in recent years, friendly societies are showing high levels of growth.

Similarly, an April 2010 survey by Money Management of 'with profits' products showed the average return by mutuals outperformed returns from plcs over 25 years by 24 per cent (see www.financialmutuals.org). This is a direct result of the mutual insurers being able to retain profits for the benefit of policyholders.[14] It also contradicts the myth that only large well-capitalised companies can achieve high rates of return.

The Association of British Insurers 2009-2010 Customer Impact Survey – which explores in depth the relationship a customer has with their company – found the score for the industry as a whole fell from 52 per cent in 2008 to 51 per cent in 2009 (ABI, 2010), but for mutual insurers the score in 2008 had been 57 per cent,[15] and this rose to 58 per cent in 2009.[16] Customers of mutual insurers and friendly societies were more likely than customers of plcs to believe that their company really cares about them and treats them fairly. 52 per cent of mutual customers agreed or strongly agreed that the insurance industry has an excellent reputation, compared with 48 per cent of customers of plcs.

Research undertaken by one of the bodies that merged to form the Association of Financial Mutuals (namely the Association of Mutual Insurers) in May 2006 explored public attitudes to mutuals. In omnibus quantitative research it was apparent that spontaneous awareness remains low, with 55 per cent of the 1,013 adults interviewed aware of the role of mutuals, and only 28 per cent confident that they could explain the difference between a mutual and a public limited company. However when qualitative research was added through discussion groups in April 2007, it was apparent that consumers who were given an understanding of mutuality quickly became strong advocates of the model – factors such as heritage, customer focus, superior returns, and value for money were all found to be recognisable strengths of the mutual model. The focus groups (even prior to the financial crisis) also highlighted a mistrust of remote, self-interested plcs.

In summary, research appears to indicate that customers relationships with plc banks and insurers are typified by intransigence, convenience and price, whilst in mutuals, customers habitually benefit from value, service and a sense of belonging.

3.3 Benefits of mutuality and diversity

The reason for reporting the above evidence is not to suggest that non-plcs should be supported by Government because they do a better job than do plcs in terms of quality of service, customer satisfaction or any of the other various measures. The point is that the Government has rightly identified that the UK's financial services market requires greater diversity, and this requires the promotion of mutuals. A natural question is whether such a move, in addition to delivering a more stable and robust financial services sector, would have any impact, either positively or negatively, on the above performance measures for the industry – quality of service, customer satisfaction, etc. All the evidence is that achieving greater diversity would indeed have an impact on these other factors, and that the impact would be positive.

The key point is that building societies, mutual insurers, friendly societies, credit unions, and co-operative banks have an alternative business model from plcs, as they are required to serve the interests of their members rather than maximising financial returns to external shareholders. These organisations therefore have different incentives and will respond differently to new developments in the economy, thus reducing the risk of herd behaviour and hence producing a more stable and robust financial system. The different business models also provide competition to each other, of a qualitatively different type than is provided by just adding an additional firm with the same business model. Thus, firstly, the different business models have different behaviours and outcomes, and some may be more appropriate for some markets and functions and less so for others. That in itself is a reason for ensuring diversity of providers is not obstructed.

Secondly, the different behaviours and reactions to events mean that a diversified financial system is more stable and robust, and less likely to create bubbles and crashes. Given the costs of the 2007-2008 credit crunch, this stability is worth a lot – including in financial terms. Thus, if there are opportunities to boost diversity that would be expensive in the short run, they may well pay dividends in the long term. Avoiding the costs of investing in diversity may prove to be a false economy – and an extremely expensive one at that.

Thirdly, the greater degree of competitive pressure that will be produced by different business models competing against each other will tend to improve the service to customers over and above the improvement referred to in point one, of just greater choice. Corporate diversity promotes competition and drives further innovation and performance improvements.

Notes

10 See New Zealand Association of Credit Unions, Annual Report 2009. (The population of New Zealand is just over 4 million.)

11 See the World Council of Credit Unions, www.woccu.org

12 Also reported at www.which.co.uk as 'Big banks fail customer service test', August 22nd 2010.

13 http://www.cucentral.ca/Default.aspx?DN=0d8bcd3aa563-43b1-a36d-ebd691779ab7&l=English and as reported in Credit Union Central (2010). Sample size was 38,978 households. The 410 credit unions affiliated with Credit Union Central of Canada have assets of $121 billion and more than five million members.

14 AFM research indicates that around three pence from every pound received by plc insurers is paid out to shareholders.

15 The researchers indicate that a 1% difference is material given the size of the sample – this information and the 57% figure are from the author's interview with Martin Shaw (Director-General, Association of Financial Mutuals), September 9th 2010.

16 See: http://www.financialmutuals.org/index.php?option=com_content&view=article&id=32%3Abetter-service&catid=3&Itemid=25

4. The UK context: a lack of diversity

The discussion in Section 2.1 above was in effect defining what a diverse market looks like, namely, one where there are a range of players big enough to deliver bulk transactions at low cost, one where there is opportunity for more specialist players to be able to deliver more specialist services in a different way, and one where there is a mix of ownership and hence a mix of prioritisation across organisations. Using that as a basis for asking how well does the UK measure up against it, the answer would have to be 'poorly', not as well as other countries, and having got worse over the past twenty years, both in absolute terms and in comparison with, certainly, other European countries.

4.1 The UK financial market's need to diversify

Like other European economies, the UK economy as a whole is made up of a range of corporate forms. The public sector is, despite its growth over the past decade, far smaller than it was during the 1950s, 1960s and 1970s. There are then a range of private ownership forms, from sole traders and family businesses, to partnerships, shareholder owned companies, and other forms such as private equity. The 'stakeholder owned' forms we are including within the umbrella term of 'mutuals', which includes co-operatives, building societies, mutual insurers, friendly societies, credit unions and employee-owned firms. What is striking about the UK financial sector is not only that the mutual sector is smaller than in other European countries, and that this lack of diversity has become worse over the past twenty years, but also, private ownership itself is peculiarly lacking in diversity within the UK's financial sector, where there are very few banks owned by private individuals or partnerships. The shareholder owned company has a disproportionate and unhealthy dominance.

This is mirrored by a very poor degree of geographical dispersion. And the fact that the mutual sector was allowed to decline over the past twenty years – indeed was incentivised to, by the legislation enabling building societies to demutualise along with the lack of any regulatory attempt to prevent carpet-bagging – has exacerbated this relative lack of local and regional presences of financial service sector firms in the UK.

Different business models will drive innovation and competition. The fact that you may have a very different view on what success looks like for your business will drive innovation, will drive competition, will drive change, whereas if firms are all essentially trying to do the same thing, then you will have less competition and innovation. And again, the lack of local engagement will weaken both the degree and nature of innovation – with innovation being more likely, in the UK's financial services sector, to be in new financial products to be traded globally rather than in meeting the needs of local businesses and consumers.

For the market as a whole to benefit from the presence of diverse corporate forms requires that the various corporate models each enjoy the necessary critical mass, defined as the degree of market share necessary to enable the

"The public sector is, despite its growth over the past decade, far smaller than it was during the 1950s, 1960s and 1970s."

co-operative sector, or the credit union sector, or the mutual sector to operate successfully and thus to provide real competitive pressure on the other players within the market. Other European countries tend to have several co-operative banks, which tend to be important lenders to the SME sector, whereas in the UK there is only one. The importance of co-operative Banks in the SME sector in many European countries is powerfully illustrated in CEPS (2010). The UK's 500 credit unions have total assets of around half a billion pounds – far short of what would be necessary to provide serious competitive pressure on the high street banks. The demutualisations of the 1980s and 1990s reduced the mutual building society sector below the critical mass to really deliver what any sensible definition of diversity in the financial system might offer. A remutualised Northern Rock would represent an important step towards restoring diversity, and is therefore discussed in Section 7.5 below. The mutual insurance sector in the UK, at 5 per cent of the total insurance market, compares badly to the 30-40 per cent typical of the other large insurance markets globally. This is the result of mutual insurance having suffered from an even greater exodus of assets due to demutualisations over the last 25 years than did building societies.

4.2 The impact of the credit crunch and recession

In 2007 the share of the insurance sector served by mutuals was 3.9 per cent. Because the mutual sector was more robust in the face of the financial crisis, their share for 2008 was up to 5.3 per cent; this was a reflection both of a dramatic reduction in the market overall, and the mutual sector seeing an increase in premium income of over six per cent, with 55 out of 60 mutuals outperforming the market. However, this is a recent phenomenon – over the years, the mutual insurance market has shrunk significantly because of the ease of demutualisation, unlike in other parts of Europe, the US and Japan, where mutual insurers have market shares of 30 per cent plus.

Over the last 18 months or so building society mortgage and savings balances have declined compared to the big banks, whose balances have increased slightly. Nevertheless, looking at institutional failure, in the UK deposit-taking banking sector, one building society actually failed and two big banks and three or four smaller banks actually failed. Added to that are the shareholder-owned banks that only did not fail because of state support. It is interesting to note that two banks that failed altogether (Northern Rock and Bradford and Bingley) were former building societies that converted to plc status. A vast amount of money was pumped in – without which, who knows what would have happened. In addition to the £80 billion that went to the banks, there was the Asset Protection Scheme, which was only for the shareholder owned banks and was not offered at all to building societies. And in both 2008 and 2009 the mutual sector as a whole remained profitable while the plc sector in banking did not – hence the taxpayer bailouts.

So the non-plc sector certainly suffered as a result of the credit crunch and recession –

indeed, it would have been quite inconceivable to imagine that they could have somehow escaped the effects of the recession and the collateral damage caused by the crisis that had its origins in the plc sector. And public policy has not, unfortunately, been helpful in this regard. But all that notwithstanding, the non-plc sector has generally proved more robust and resilient than has the plc sector in the face of the credit crunch and recession, including within the financial services sector. And the far more important and fundamental point is that while the mutual sector has suffered as a result of the credit crunch and recession, it did not cause the credit crunch. This was caused, at least in part, by the activities of the plc banks – including those, such as Northern Rock, who had abandoned mutuality in order to become plc banks.

The importance of this point is to learn lessons for the future, both to minimise the danger of another credit crunch in 10, 20 or 30 years time, and also to create as resilient a financial services sector as possible, so that the damage to the economy from any financial crises in the future is as limited as possible. On both scores, a serious rebalancing of the UK's financial services sector towards mutualism is required. A more diversified financial services sector would be less likely to create financial crises in the future. And those financial crises that do occur will be less costly to the economy, the greater the degree of corporate diversity within the financial services sector.

Furthermore, Llewellyn (2010) argues that, as a result of the crisis, banks will become more constrained in their lending and that lending margins are likely to widen. Indeed, this has already occurred. A similar point has been made by Reinhart and Reinhart (2010) who argue that the legacy effect of the crisis could last for a decade or more. This gives yet more weight to the arguments in favour of more diversity in the banking and financial services sectors, most especially as the UK has been more badly affected by the crisis than many other countries, and because the degree of diversity in the UK is significantly lower than in most other European countries. One of the powerful lessons of the crisis is that it is systemically hazardous to rely on a single business model.

The austerity measures planned by the new Coalition Government will certainly have an impact on both the provision of financial services in the UK and on the demand for them. The emergency budget and measures announced so far may well have a particularly detrimental impact on mutuals and on the least affluent consumers. In particular, the abolition of Child Trust Fund vouchers undermines a highly effective campaign, by friendly societies in particular, to encourage parents from across the social spectrum to save for their childrens' futures, whilst the abolition of the Saving Gateway, which had been supported in principle by credit unions and building societies, will remove a valuable source of wealth creation from the poorest families. This appears to contradict the Chancellor's own message of support for diversity, and reinforces the risk of a chasm opening between positive sentiment and detrimental action.

4.3 An attitude problem

There is, though, a fundamental attitude problem within the UK amongst the media and regulators, with the shareholder owned company being regarded as the 'normal' or 'natural' way of doing business. Other ownership models may be acceptable (public ownership, customer ownership, or employee ownership), yet all models tend to still be judged against criteria that are appropriate for the shareholder ownership model. And the large plc, at that. Thus, for example, on the issue of raising capital, the Financial Services Authority appeared, at times, to view all companies as if they were, or should be, large plcs.

The FSA has in particular questioned the relevance of 'mutual capital' within mutual insurance companies' with profits funds, indicating that the value of membership is very limited, and therefore that all the assets belong to current policyholders, potentially thereby removing the main source of capital and investment available to mutual insurers and friendly societies. This has a materially adverse effect on mutuals, who see themselves as the custodian of funds created over many generations of policyholders, for the benefit both of today's and future policyholders. It has been suggested that this could have a "cataclysmic effect" on the mutual insurance sector.[17]

Reference was made in Section 2.1 above to the bias against the mutual corporate form, and to this being at least in part because of its inability to easily raise capital, despite the fact that this reduces their risk appetite and thus means that a financial services sector with a strong mutual sector will have a greater diversity of risk appetite than would otherwise be the case, which is a positive outcome in terms of creating a stable and robust financial services sector – as reported in the IMF and other research referred to above.[18] When a crisis hits, the ability to raise capital is in any case not enough, and confidence and liquidity become essential, hence the Royal Bank of Scotland having to go to the taxpayer. According to the then-Chancellor Alistair Darling, RBS was within two hours of failing: 'I remember a frenzied call from a very senior member of RBS and… it was quite clear that the bank was going to fail within a couple of hours, and he said: "what are you going to do?" … They had got to the stage where they just couldn't raise any money any more.'[19]

There is, then, huge pressure from the regulatory environment, and from certain elements of the media, for mutuals to behave and measure themselves like non-mutuals, because that is how they get compared. There is little appreciation that a diversity of business models is precisely what is needed. Non-plcs should be encouraged to articulate why they are different, why they measure themselves differently, why their risk appetite is different, why their stakeholders are different, and why what success looks like is actually different. Firms with diverse ownership and business models are trying to do different things for different people with a different overall purpose.

4.4 Looking to the future

Looking forward, the danger is that policy makers will base their solutions on the plc providers. Certainly in insurance, when Alistair Darling commissioned his Vision for the insurance industry in 2020, there was no mutual input into that at all.[20] When Government develops new initiatives, too often this is done without any mutual involvement – as with the National Employment Savings Trust now. Government recognises the need for diversity within the financial services sector. But Government has to both support and exploit that diversity to the full, by involving all players in diagnosing the problem and finding solutions, rather than just assuming that the solution will lie in the shareholder owned plcs.

Notes

17 Jeff Prestridge, Mail on Sunday, October 2009.

18 Ironically, building societies have also been subject to a disproportionately high share of the compensation costs associated with failed banks. Building societies generally – although, admittedly, not universally – behaved prudently in the housing market upswing, yet are now forced to pay for those who acted less prudently. The allocation of FSCS levies relates to the size of each contributor's retail deposit balances, so building societies, which raise the great majority of their funds from their traditional retail savings customer base pay – relative to their total balance sheet – significantly more than those banks that have chosen to neglect their retail deposit base and have instead relied excessively on wholesale funds from the markets – despite this behaviour being one of the main causes of the financial crisis.

19 Today Programme, Radio 4, 14th August 2010.

20 See Insurance Industry Working Group (2009); Alastair Darling was Government co-chair of the Working Group.

"There is, then, huge pressure from the regulatory environment, and from certain elements of the media, for mutuals to behave and measure themselves like non-mutuals, because that is how they get compared. "

5. Measuring diversity

For Government to achieve its aim of enhancing diversity it needs to measure the degree of diversity over time. But currently the data are not adequately used to measure diversity. Given the cost to the UK economy of the credit crunch and recession, it is vital that the firm-level data already collated by the FSA and Bank of England are used to assess the extent of diversity and to enable progress to be measured, thus giving assurance that the risks of a future credit crunch are indeed being reduced over time.

This work on measuring diversity would need to include the necessary definitional work, setting out what was to be measured. This would include the market shares taken by shareholder owned companies, by the various mutual corporate structures, and by others. It might also include other aspects, such as geographical diversity, to promote a greater local and regional spread of such institutions.

In this context, it is important to appreciate that diversity can help serve varied circumstances and needs from corporate through to consumer through to demographics – with the solutions being as diverse as the actual problems.

Measuring diversity would need to look at individual financial markets, such as current accounts, mortgages, savings, unsecured loans, lending to SMEs, and insurance markets – general and life insurance – and in each case consider what is the share in those markets of the stock of outstanding business and flow of new business taken by UK institutions and overseas institutions, by plcs and mutuals (and different forms of mutuals), by old established institutions and more recently established institutions, and look at how the various market shares change over time. There are various key performance indicators (KPIs) – market share is referred to above as an example, but there may be other KPIs that should be reported on, when measuring and tracking diversity. Care would need to be taken, however, that commercially sensitive data were not revealed by publishing any of these data.

6. Regulatory barriers to diversity

The Government has announced that it will create a Prudential Regulation Authority (PRA) as a subsidiary of the Bank of England, and a new Consumer Protection and Markets Authority (CPMA) which will take on the FSA's responsibility for consumer protection. This recasting of the UK's financial regulatory structure presents a rare opportunity to ensure that the issue of diversity is properly accounted for. In terms of responsibilities, what should these new regulatory bodies look like if they are to prove useful partners for the mutual sector, enabling the mutual sector to achieve critical mass, and thus creating greater corporate diversity?

One of the problems in the past with UK policy making is that mutuals have often been an afterthought. This can result in opportunities being missed and in wrong-headed policies being pursued. Given the Coalition commitment, there is now an opportunity to formalise a relationship between policy makers and the mutual sector that could avoid these costly mistakes. A formal, longer-term relationship is needed. The following Section 7, on future strategy, includes a number of detailed policy measures that could profitably be adopted, but to embark on such a reform agenda without at the same time establishing mechanisms for regular and continuing dialogue and consultation would be an opportunity missed.

6.1 Barriers to entry

An important point is the number of new entrants. The ability for anything other than a shareholder business to actually be launched is very limited in the UK. Substantive capital requirements drawn up primarily with shareholder-owned banks in mind mean it is virtually impossible to get a group of stakeholders together in whatever guise to launch a new mutual in financial services.

It is not just the capital solvency requirements – the fundamental weakness of mutuals, in the face of current regulatory requirements, is they do not have access to external capital in the same way as investor-based institutions. They cannot, because that is the central basis of being a mutual. In the regulated financial services you cannot any longer, perhaps with the exception of credit unions, start small and learn as you go – which you could in the 1850s when most building societies were formed, and for the insurance sector, you can in many parts of Europe still. The hurdles are higher in the UK than they are elsewhere.

6.2 Retaining diversity

The Treasury White Paper talks about removing barriers to entry as part of maintaining diversity (HM Treasury, 2010). But it is equally important to conserve the – limited –diversity we already have. Setting up new organisations in regulated financial services is always difficult because of the regulatory barriers, and our current regulatory architecture tends to favour large incumbents over smaller and new players, and for the most part the larger incumbents in banking are plcs and the smaller players are mostly mutuals. If we were to lose our existing bit of diversity, one might then reduce barriers to entry as low as you like, but a small number of new mutual entrants are unlikely to have a significant impact on the level of diversity overall – so conserving existing diversity is crucial.

7. A strategy for financial diversity

As referred to in Section 1 above, the Government's Coalition Agreement includes the following commitment to fostering diversity in financial services: 'We want the banking system to serve business, not the other way round. We will bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry.' (HM Government, 2010, p. 9) The following Section seeks to present practical proposals for action that the Government could take to achieve these objectives of diversity, mutuality and competition. These proposals require action to be taken both on the regulatory framework and on the policy making infrastructure of Government itself.

7.1 Measuring diversity

The first and most urgent step for Government to take is that discussed in Section 5 above, namely to develop an effective set of measures for the degree of diversity – and to then actually undertake this measurement exercise at regular intervals, making the information publicly available. The Government has given a clear undertaking to 'foster diversity in financial services, promote mutuals and create a more competitive banking industry', so the degree of diversity will need to be monitored over time, and reported on, with a target set for the degree of diversity to be achieved and with regular reporting against this target. What would constitute desirable and realistic targets should be informed by analysis and consultation, but a key factor should be to ensure that the various corporate forms achieve the sort of critical mass necessary for them to pose a significant competitive challenge to others in the sector, thus driving innovation and ensuring a focus on customer service. We suggest below that responsibility for measuring diversity and tracking progress might lie with the Bank of England.

7.2 Regulating for diversity

Within the new regulatory framework, there needs to be a clear responsibility in the regulator's charter to promote diversity of ownership. In the past, the objection to taking this step is that it would require legislation. But now there is going to be legislation in any case, and there is going to be a new regulator, so this is the moment to ensure that the regulator is given proper responsibility towards fostering diversity and promoting mutuals. So, firstly, the regulator must have a responsibility and a requirement to demonstrate that they are taking diversity into account.

Secondly, the regulator needs to have somebody within the organisation who is at a senior level defined as a head of mutuals policy and who is therefore charged with demonstrating that regulation does not prevent mutual organisations from competing on an equal basis with non-mutual forms. (There is not anyone who has that particular remit currently and, therefore, there is no particular incentive for anyone in the organisation to think beyond the standard plc model.)

Thirdly, regulation needs to be proportionate. Regulation and the demands it makes represents a powerful competitive advantage for large incumbent players because they can absorb that cost. The resource costs and the monetary costs impact more heavily on smaller players, constituting a barrier to entry – you have to comply with regulation before you have done your first deal – and it stops the smaller people thriving in a way that would provide meaningful competition to the big incumbents. On the whole that disadvantages mutuals, and it is certainly a barrier to greater diversity. Ironically, it actually favours the 'Too Important to Fail' banks that are part of the problem. There is a precedent with the rules relating to credit unions which much more effectively enable new organisations to be developed, and this approach could and should translated to other forms of mutual, to remove the barriers to entry and early survival.

Fourthly, on the Prudential Regulatory Authority (PRA) and Consumer Protection and Markets Authority (CPMA):

i. the White Paper makes it clear that the CPMA is responsible for the 'promoting mutuals and fostering diversity' agenda: this needs to be written into new PRA objectives as well;
ii. there should be a commitment in the PRA and the CPMA to take due account of diverse business structures; and
iii. there needs to be a mutuals' policy function in both the CPMA and the PRA: these bodies need somebody on the inside who understands the difference at the grass roots of producing policy in diverse sectors – people who don't automatically assume that the plc model is the only model; a counterweight is needed to that general assumption that this is how banking and insurance is organised.

Fifthly, on the Bank of England:

i. given the immense extra powers that the Bank of England now has, it is urgent that its accountability improve concomitantly;
ii. it is also vital that the Bank be required to explain decisions in relation to mutuals on each regulatory rule: what the impact on mutuals is, in the context of the commitment to promote mutuals; and
iii. the Bank should also be required to report on diversity in the sector, producing an annual review of diversity and how its actions have maintained it; this would utilise the measurement of diversity referred to in Section 7.1 above, which should be the responsibility of the PRA rather than the Treasury.

Thus, good, strong and transparent regulation is required that takes account of the particular structures within the mutual sector. To achieve this would require a mutuals policies function within the PRA and CMPA, with them reporting on the success of their efforts to promote diversity, and also commenting on the impact on diversity and on mutuals of each individual significant regulatory proposal.

7.3 A Minister for Mutuals

The Coalition Government has already shown a strong degree of interest in mutuals, and this is likely to prove important to a range of government functions. A Minister for Mutuals – similar in status to the Minister for the City – would be able to deal across the various government departments that have to deal with the mutual sector. A Minister for Mutuals would be

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responsible for all types of mutuals in all sectors – in manufacturing, retail, health, education, non-financial services, football clubs and so on, as well as for the financial services sector. Given the weight of business, this would need to be a Treasury minister – suitably supported by sufficiently qualified and senior officials – that also had a responsibility in BIS and cross-cutting responsibility across Government as necessary.

The following section cites some of the current policy issues specifically within the financial services sector that need addressing by Government, and all these and more would become the responsibility of the Minister for Mutuals, but of course other issues will arise continually. Fundamentally, the Minister for Mutuals would ensure parity of esteem for the mutual and proprietary models, which is a principle of public policy and which should set the agenda for regulators.[21]

7.4 The financial services policy agenda

Working with the several hundred firms across mutual building societies, mutual insurers, friendly societies and credit unions, the Minister for Mutuals could set out a strategic vision for delivering on the Coalition Agreement's commitment to fostering diversity and promoting mutuals within the financial services sector. Most of these firms are members of the three member bodies, the Building Societies Association,[22] the Association of Financial Mutuals,[23] and the Association of British Credit Unions Limited.[24] This section highlights some of the key policy proposals that these bodies endorse and which could provide some quick wins along this new path to greater diversity.

The Bank of England's June 2010 Financial Stability Report stated that 'the larger UK banks expanded much more rapidly than smaller institutions in the run up to the crisis and have received disproportionate taxpayer support during this crisis that reflected a misalignment of risks on too important to fail (TITF) banks' balance sheets, due to implicit guarantees on their liabilities' (Bank of England, 2010). The effect of both taxpayer support and the perception that large banks are too important to fail is affecting activity in the retail deposit and mortgage lending markets now. The TITF banks now dominate the retail savings and mortgage markets – this is partly a result of public policy over the last two or three years. Mutuals are keen to discuss with Government how best to **restrict such activities** of taxpayer funded institutions so they do not affect adversely the activities of those institutions that did not receive taxpayer support.

The legislation related to mutuals has fallen significantly behind the Companies Act and leaves the sector at a significant disadvantage. For example, legislation was introduced in the Companies Act 2000 on electronic communications, which including other provisions means companies can allow proxy voting electronically, and shareholders of plcs are deemed to consent to **electronic communications** from their companies unless they say otherwise. No such legislative order has to date been introduced for friendly societies and credit unions, whilst that introduced for building societies was limited, meaning that the default position in the building societies sector is that members have to be sent documents. There would be efficiency and environmental benefits if mutual legislation was brought in line with company legislation.[25]

Whilst it is encouraging that the Government has identified a growing role for mutuals, the experience in financial services is that top-line messages need to be supported by **effective legislation and regulation**. The mutual sector suffers from legislation that has failed to keep pace with company legislation, such that mutuals often operate at a significant disadvantage. To be able to compete on equal terms with proprietary organisations will require mutual legislation – such as the Friendly Societies Act, the Building Societies Act and Co-operative and Credit Union laws – to be updated. The Financial Services Authority demonstrated no effective capability to take diversity of ownership into account when developing the regulatory rulebook. Mutual insurers and building societies both suffer from rules designed to improve the accountability and solvency of large banks, which simply do not translate into mutuals. This is partly explained by the failure of the FSA to appoint a senior person with responsibility for overseeing mutual policy. This situation is mirrored in the Treasury.

Mutual insurers hold significant volumes of capital: unlike building societies this money is not lent to borrowers, but is instead invested – in equities, property, or gilts. It may be possible to develop a wider range of **options for investment** that are more efficient in the real economy and to support government initiatives – such as creating investment vehicles to invest in infrastructure projects, or in providing the seed capital that would enable the creation of new mutuals.

Equally there is little focus on enabling young people to save for targeted purposes such as funding secondary education or house deposit. Ironically the Child Trust Fund was the one product best designed to achieve that. As consumers have a range of savings needs that interweave throughout their lifetime we would argue that the concept of **lifetime savings accounts** should be introduced into the UK. Further work on **financial inclusion** is also needed: AFM and its members have been active in this area, with members involved in the pathfinder money guidance project and with websites focused on consumers in general (www.ownedbyyou.org) and on young children (www.funtosave.org).

Given mutuals' heritage of **providing benefits** before the welfare state, there is scope to contract out certain state benefits to the mutual insurance sector. For example the sector has significant experience of running products that sit alongside statutory sick pay and long term invalidity benefits – and all the evidence suggests mutual companies can operate such schemes more cost effectively and with better claims handling and monitoring. Contracting out this work would enable employers to offload sick pay costs to insurers, individuals to have sick pay schemes tuned to their own circumstances, and the exchequer to reduce costs.

Similarly, there is scope for a broader role for mutuals in UK **healthcare**, where AFM members already provide complementary

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services and would make ideal prospective partners to the NHS.

7.5 Remutualising failed financial institutions

Government must not allow the UK's financial services sector to return to the 'business as usual' model that has proved so costly to the economy and to public finances. Already we have seen a return to the bonus culture, which is fuelled by profits boosted by the increased market power of banks which have been rescued by the taxpayer. It is vital that the banks face competition from mutuals, which would also reduce the risk of the credit crunch being repeated.

Keeping a reformed Northern Rock independent of the big banks will be good for competition. Northern Rock could be converted to an asset-locked public interest mutual. As a mutual committed to its core business, a remutualised Northern Rock would help the Government by supporting competition and diversity through the maintenance of a strong mutually-owned financial sector.

In any exit process the Government needs to realise the optimum value for the taxpayer. A re-launched and re-mutualised Northern Rock can pay for the taxpayer stake over time. A deferred payment profile can give the optimum outcome, both returning the full value to the taxpayer but also achieving other public policy goals.

Given that remutualisation would strengthen competition and create a more diversified financial sector, it could be expected to generate an advantage to the taxpayer over the long run in excess of the immediate benefit of any capital proceeds in the short run.[26]

The case for remutualisation has been made in detail, as argued for example by Michie and Llewellyn (2010). Any alternative proposal, such as returning it to being a shareholder owned bank, should report to the taxpayer what the increased risk thereby is of a repeat of the credit crunch, whether that be in 10, 20 or 30 years, as there is no doubt that a financial services sector more dominated by shareholder-owned bank would run a greater risk of repeating that outcome than would a financial services sector with a stronger mutual sector. To return Northern Rock to the private banking sector would also not only undermine but would run quite contrary to the Coalition Government's stated policy 'to foster diversity in financial services, promote mutuals and create a more competitive banking industry.'

Thus, if the taxpayer is going to be exposed to increased risk – which includes financial risk, and thus does carry a financial cost to the taxpayer which would need to be acknowledged; and if the clear policy of Government is to be abandoned in such a dramatic fashion, then at the very least there should be a full explanation of the process gone through and the arguments against mutualisation.

7.6 A progressive agenda

Looking beyond the next two or three years, it is important to view the whole – diverse – financial services sector as both innovative and fluid, and this applies within the various business models as well as to the balance of market shares between such models. Thus, the mutual sector could transform its own models; we are not necessarily talking about a photograph of today's mutual model. For example, one of the findings of Ayadi et al. (2010), which analysed the role of co-operative banks in Europe, is that the UK is the only one of the countries studied that did not have what they termed 'central network institutions' – the collective. For example, Rabobank is not only a bank in its own right but it is also a confederation of 52 'little Rabobanks'. So, while one difficulty for non-plcs may be their small size, there are models that can cope with that; the central network institutions enable their members to buy in economies of scale from outside because they are too small to generate them inside but the crucial difference between that and outsourcing is that the central network institution is actually owned by the members, and is an integral part of the business model. However, culture and tradition have tended to prevent such a model developing in the UK, and there would also be substantial difficulties combining legacy systems and co-ordinating the pooling of resources and procurement in order to benefit from cost reductions. Furthermore, such a model could be difficult to establish under current UK competition law. Nevertheless, it is important to stress that the mutual model is an evolving one, and there are a range of interesting success stories across Europe, and indeed in North America and elsewhere. The UK has a lot to learn from the experience of other European countries which clearly value the advantages of diversity in the financial sector.

Likewise, the third element of the Butterfill Act enables – subject to the passage of appropriate secondary legislation – all types of mutual institution to merge with each other (apart from credit unions which are exempt from the legislation), yet secondary legislation has so far been enacted only to enable a building society to merge with an industrial and provident society. Other types of mutual-to-mutual mergers are still not possible. This is an anomaly that should be corrected.

In both these immediate and longer term examples, the Minister for Mutuals could play an important role in foreseeing and removing unnecessary impediments to institutional changes. This would allow the non-plc sectors to evolve, fostering diversity within the financial services sector. This would of course require continuing dialogue and discussion with the sector as it itself evolves.

While examples have been given above of the positive role that mutuals can and do play, these positive impacts could be greatly enhanced given the right environment and political goodwill. The benefits of creating a more diversified financial services sector include greater stability, more accountability to consumers, reduced systemic risk, and better access to financial services. The research suggests that mutuality appeals to consumers – but they do need to be given the choice, and that choice needs to be preserved rather than allowing the existing mutuals to demutualise. Positive words count for little if the downward trend in the number of mutual organisations in financial services is allowed to persist. There is an urgent need to translate positive words into substantive actions.

Notes

21 This is discussed in The Mutuals Manifesto 2010 (Mutuo, 2010).

22 The BSA represents mutual lenders and deposit takers in the UK, including all 49 building societies. These mutual lenders and deposit takers have total assets of over £365 billion and approximately 22 million members.

23 AFM has 57 members and represents mutual insurers and friendly societies in the UK. Between them, these organisations manage the savings, protection and healthcare needs of 20 million people, have over 14,000 employees, with total funds under management of over £80 billion.

24 ABCUL has 326 members with almost 1000 employees, although the sector as a whole has 487 organisations with over 650,000 members, turnover of £63m and assets of £592m.

25 A draft legislative order currently in development fails to provide equivalence to Companies Act rules.

26 The above four paragraphs are from the Mutuals Manifesto 2010 (Mutuo, 2010, p. 9).

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- Provide research into the performance of the mutual and co-owned sectors
- Deliver a curriculum that is closely matched to the needs of relevant businesses and the development of their current and future leaders
- Encourage debate and advance new thinking about mutuality and co-ownership
- Create a national and international network of academics, practitioners and policy makers

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The Centre is supported by the member organisations for co-owned and mutual businesses in the UK – Mutuo and the Employee Ownership Association. The Centre's first corporate sponsor is Simplyhealth.

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The Employee Ownership Association is the voice of co-owned business in the UK. It is the business association for companies who are substantially or wholly owned by the people who work for them. Its members include the John Lewis Partnership, Arup, Unipart, Mott MacDonald, Blackwell, Martin Currie, eaga and Baxi Partnership; long established co-owned companies like Scott Bader and Tullis Russell; and a diverse range of other successful enterprises. The Employee Ownership Association represents a thriving sector worth around £25 billion annually and growing.

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