

A tale of two reviews

The last few weeks for the Co-Op could perhaps be called “a tale of two reviews”. Firstly, there was Sir Christopher Kelly’s report into the disastrous takeover of Britannia Building Society by the Co-Op Bank. Secondly, there was Lord Myners’ review of governance in the Co-Op Group.

I shall start with a brief response to the Kelly report.

Sir Christopher’s report tells a shocking story of deceit, corruption and utter incompetence in both the Co-Op and Britannia, both before and after the merger. The true state of Britannia’s balance sheet appears to have been deliberately concealed from those tasked with doing due diligence, and there were financial shenanigans designed to create the illusion of value when in reality value was being destroyed. Britannia was by no means a sound business prior to the merger: it had extensive subprime mortgage exposure and a highly leveraged (and it now transpires, overvalued) commercial property book. But what I find more worrying is the evidence that AFTER the merger the enlarged Bank was [not in control of its loan book](#). In the 2011 accounts, nearly a third of its loan portfolio was described as “unrated” for risk. Put bluntly, the Co-Op Bank under Neville Richardson had no idea what risks it was carrying on its balance sheet, let alone how to manage them.

In my view the Britannia disaster and its aftermath will eventually prove fatal for the Bank as a co-operative enterprise. The recent news that an additional £400m would be needed to meet regulatory capital requirements was another nail in the coffin, since it forced the Group to dilute its shareholding still further. The Co-Op Group Board is now giving serious consideration is now being given to the possibility of floating the Bank as an independent commercial entity. If this goes ahead, there will no longer be a Co-Operative Bank. Even the name may have to be changed.

But the failure of financial and risk management at the Co-Op Bank exposes a deeper malaise. In essence, what happened at the Bank was a failure of Co-Operative values. A bank that deceives its owners and mistreats its customers is not an ethical bank, however many ethical investments it makes. The Co-Operative Group lost control of its bank long before the hedge funds moved in.

Sir Christopher makes it clear in his report that attempts by Group Board members to evade responsibility for the Britannia merger and its consequences are unacceptable. “We didn’t know, we were kept in the dark” is no defence. Admittedly, professional boards in other financial institutions have been equally incompetent: but that is no reason to excuse what happened here. It is a sad reflection on the state of the Co-Op Group Board that those responsible for the disastrous Britannia merger and the subsequent mismanagement of the Bank could so comprehensively deceive them, to the detriment of the Co-Operative businesses and members.

And this brings me to the Myners Review.

Myners’ review goes far beyond the troubles of the Bank. It examines the state of the Co-Op Group as a whole. And for me, it made incredibly sad reading. The Co-Op Group is a shadow of what it was when I was a child, when it was the market leader in retail and at the heart of the communities it served. Despite successive attempts at reform, it has failed to respond to the challenges of an increasingly competitive retail environment. It is in long, slow, possibly terminal, decline.

I think we all know that the Co-Op Group must undergo radical reform if it is to survive. I have no doubt that Myners’ recommendations were done with the best of intentions. But he presented his argument so badly that instead of bringing together co-operators and executives in a shared commitment to reform, he set people’s backs up and generated opposition and even outright hostility.

And yet I think he was on the right track. So I want to revise Myners – to explain his recommendations differently, hopefully in a form that Co-Operators will feel more comfortable with and that will better reflect what the Co-Operative Group is really about.

The heart of the Co-Op Group is its values and principles. These should all be familiar to everyone, but here’s a reminder (from Myners’ report):

Exhibit 2 – TCG Values and Principles		
Co-operative values	Ethical values	Principles
<ul style="list-style-type: none"> - Self-help – we help people to help themselves - Self-responsibility – we take responsibility and answer for our actions - Democracy – we give our members a say in the way we run our businesses - Equality – no matter how much money a member invests in their share account, they have one vote - Equity – we carry out our business in a way that is fair and unbiased - Solidarity – we share interests and common purposes with our members and other co-operatives 	<ul style="list-style-type: none"> - Openness – nobody’s perfect, and we won’t hide it when we’re not - Honesty – we are honest about what we do and the way we do it - Social responsibility – we encourage people to take responsibility for their own community and work together to improve it - Caring for others – we regularly fund charities and local community groups from the profits of our businesses 	<ul style="list-style-type: none"> - Voluntary and open membership – membership is open to everyone - Democratic member control – all members have an equal voice in making policies and electing representatives - Member economic participation – all profits are controlled democratically by members and for their benefit - Autonomy and independence – co-operatives are always independent, even when they enter into agreements with the Government and other organisations - Education, training and information – co-operatives educate and develop their members as well as their staff - Co-operation amongst co-operatives – co-operatives work together with other co-operatives to strengthen the Co-operative Movement as a whole - Concern for community – co-operatives also work to improve and develop the community, locally and internationally

Source: The Co-operative Group website

There are two that I particularly want to highlight:

ETHICAL VALUES: Caring for others – we regularly fund charities and local community groups from the profits of our businesses

PRINCIPLES: Member economic participation – all profits are controlled democratically by members and for their benefit.

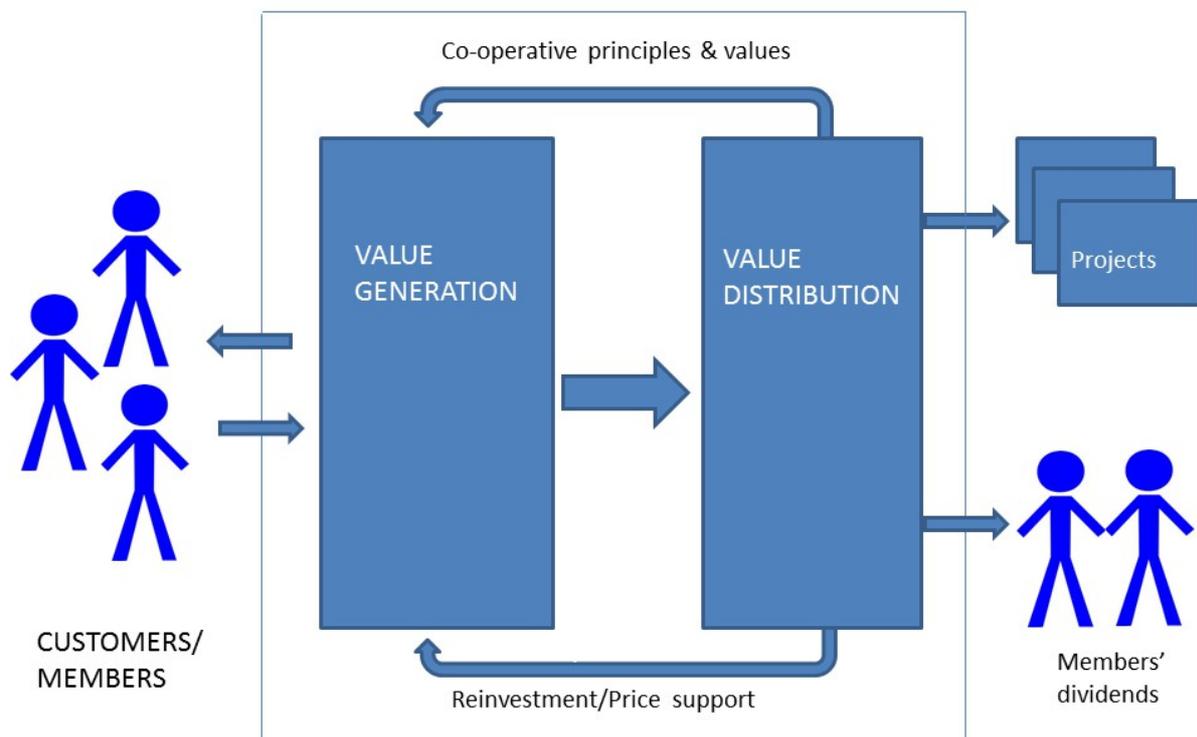
Both of these discuss how the profits created by the Co-Op Group should be used. But the existence of profits is simply assumed. Yet profit-making for a co-operative business is a contentious matter.

I don’t know how many times I have heard people say to me, “It’s not about profits”. Oh yes it is. I know many Co-Operators feel more at home with the values of the public sector and the third sector, where service, not profit-making, is the primary objective. And I know that many co-operators prefer to use the term “surplus”, rather than the capitalist word “profit”. But it’s the same thing really. And the word that the Co-Op Group itself uses is “profits”. That is therefore the word I shall use.

The Co-Op Group is a commercial business and its job is to make profits. Indeed it MUST make profits. Without them, the social purposes of the Co-Operative Movement cannot be achieved. In order to redistribute profits, you must first make them.

It was clear to me from Myners' report that lay directors are often more comfortable discussing how profits should be used than how they should be earned. Myners is critical of directors who discuss matters he considers trivial. His criticism is unfair: many of these matters are very far from trivial – it DOES matter how we use the profits we earn. But they are not the principal concern of the Board. The Board's job is to run the business, in accordance with the Co-Op values and principles, in order to generate profits for members. How those profits are used – whether to fund social projects, reduce prices, support loss-making business lines that are socially important, or pay dividends to members - is the legitimate concern of members and their representatives.

So there is a separation at the heart of the Co-Op. On one side there are what we might call the Value Generators – the Board, Executive and staff of the Co-Op Group – who interact with customers (many, but not all, of whom are also members). On the other side are what we might call the Value Distributors – the Co-Operators – who interact with community groups and individuals.



Obviously this is a much simplified model, but it gives you the general idea. Both sides are essential. Both are bound by the same set of co-operative principles. And actually both have shared objectives. They just have different jobs.

What Myners has attempted to do is reflect this separation in his new Board structure. On the Value Generation side, he has suggested a professional Board which has the knowledge and expertise to

run the business on commercial lines while respecting co-operative principles & values. On the Value Distribution side, he has proposed a new Membership Committee, made up of elected Co-Operative members.

However, he has failed to explain adequately what the relationship between these two bodies should be. And this has unfortunately led to lay directors feeling that they are being “excluded” or “downgraded”. Nothing could be further from the truth. The Board is accountable to the membership for its adherence to Co-Operative principles and for the financial performance of the Co-Op Group as a whole. So the Membership Committee is not a “subordinate Board”, and lay directors have not been “downgraded”. On the contrary – since the Board would be accountable in important respects to the Membership Committee, it is if anything an “upgrading”.

But perhaps more importantly, the new structure would free up lay directors to concentrate on their real interests, enable the Board to concentrate on running the business, and clarify where accountability really lies.

I have only scratched the surface of the governance question here. There are important matters such as the recruitment of NEDs where I feel Myners gets it wrong. And there are matters he does not discuss at all, such as the development of future leadership. There is still much to discuss. But I hope my contribution has helped move the debate along.