

# MUTUALS – CAN WE LEARN FROM THEM?

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A mutual structure – where an enterprise is owned either by its employees or its customers – is a relatively rare choice for regional enterprises. Family businesses will have little reason to convert, and the advantages for a growing business in need of capital are not obvious. Mutuals are relatively rare, too, in the US and Europe, but that does not mean we cannot learn from them. Indeed the concept became fashionable for a while in the wake of the banking crisis because mutuals appeared positioned to serve society better than the greedy and ultimately toxic banks.

The theoretical advantages are obvious. An enterprise that is owned by its customers is likely to give them better service. It will be more trustworthy and less likely to cheat them. The cooperative movement in the UK, which was started by the Rochdale Pioneers Society was a reaction to the habit of privately

owned food retailers of adulterating food to make it cheaper, for example by adding things like sawdust into bread. One of its long-standing principles is that its customer members receive a share of the profits.

Similarly, a company owned by its employees is more likely to have a well-motivated workforce with high productivity and good service that will secure the franchise.

For many mutuals, the structure of their operations looks like the key to success. VanCity Services is an innovative financial services company in Vancouver, Canada, with assets of C\$17.5bn. Founded in 1946, it has had a major impact on its local community. Among its achievements are that it was the first financial institution in Canada to offer a daily interest savings account, calculating interest on a daily basis and created the country's first socially

responsible mutual fund. Its board is elected by its membership which numbers over 400,000, and the company seeks to abide by a clear set of values and commitments on which it consulted with members, staff and community leaders.

Yet there are also drawbacks. The board has come under criticism for its practice of recommending new members for election. On the one hand this is designed to ensure it has a well qualified board. On the other, critics say the process has become undemocratic and can lead to entrenchments of the existing board and management. According to one of its critics, member Mark Latham, the risk with cooperatives is that their power structure can tend towards being an oligopoly.

Another problem is that mutuals cannot easily raise additional capital when they want to expand. Since there is no room for outside shareholders in their structure, they cannot issue new equity. They may be able to raise money in the long-term debt markets, but this is not going to provide a capital cushion against loss, which can be particularly problematic in the financial sector.

Of course, the answer may be that mutuals need to keep a close eye on long-term cash generation so that they build up a cushion of home-grown capital. But this may not always be easy if the customers who own it are more interested in squeezing profit margins so that they get a more favourable deal on their purchases.

Mutuals therefore need strong boards able to develop a clear commercial strategy and manage risk. But, as the Vancity experience shows, it is not always easy to select the right people and ensure that they are accountable. How can a body with several hundred thousand customer owners pick an effective board, and how can the board account to them for their actions?

The UK Cooperative Society hit trouble a couple of years ago because its bank ran up large losses after buying a failing mortgage lender. The organisation was shaken to its very core and Lord (Paul) Myners, a former investor and government minister and a noted expert on governance, was brought in to sort out its governance. He found the board was dysfunctional. It lacked expertise. Many directors had no idea about their organisation's return on capital. They were appointed through a complex process which was very political and did not reflect merit.

In short the board was not fit for its core purpose of overseeing strategy and risk and making sure the organisation was accountable. Moreover the organisation was highly resistant to reform, and its bank meanwhile has had to accept outside capital in order to stay solvent, although the new investors have showed themselves determined to maintain its ethical ethos.

So what are the lessons from the mutual experience. First, a strong customer focus and a motivated workforce are important ingredients for a successful business. Of course, these can exist outside a mutual structure but management and owners may have to work a bit harder to deliver. Second, what matters for success are access to capital and governance arrangements which favour robust oversight and decision-making and accountability.

These are where mutuals are vulnerable, but the requirements are universal ones, applying also to listed companies with a dispersed ownership base and to family businesses. Regional companies may not want to become mutuals, but they can learn from them just the same.