

The Co-operative Group Roller Coaster Ride:

Boards, management, and members all taken on a big spin—but it's not over yet

BY DAVID J. THOMPSON

What was the largest consumer cooperative in the world, the U.K. Co-operative Group, has lately been in trouble, and things look bleak for its offshoot bank. As we prepare for publication, a new headline reads:

The Co-operative Bank looks set to fall into the hands of US hedge funds and other big institutions after they tore up the embattled lenders £1.2bn rescue plan

The compressed chronology below has many more such dramatic leads—Ed.

You will find hard to believe what you are about to read describing the abject failure of governance and management of a legendary co-op. But, yes, it did happen recently to one of the largest co-op organizations in the world. If you don't think this could ever happen to your co-op, you may need to think again about how you could prevent it. Aspects of this sad saga have been regrettably repeated by some co-ops in the U.S. At the end of this article I will pose some critical questions about this co-op catastrophe.

At its 21st-century peak in 2012, the Co-operative Group in the United Kingdom was then the largest consumer cooperative in the world, with 8 million members, an annual sales volume of over \$20 billion, and employing over 100,000 people.

However, in less than a decade, the Co-operative Group went from being the crown prince of co-ops, crowing proudly at the United Nations, 2012 International Year of Co-ops, to being a beleaguered board led by possibly out-of-control management selling off massive assets to avoid corporate collapse. On another front, their exposed offshoot, the Co-operative Bank, was groveling to meet the greedy demands of a shadowy disparate group of American culture and hedge funds. Few multinational companies have undergone such a mercurial meltdown.

The Rochdale Pioneers must have rolled over in their graves. The goodwill built since 1844 about being the most ethical, the best of economic democracy, and the leadership of the alternative economy was undermined, seemingly by cooperative self-destruction.

Chronology of a catastrophe

The headlines about the crash of the Co-operative Group became news in the national press in 2012 and seem never to end. Let's look at a short chronology of the roller coaster ride.

2011

- May: "In the past three years we have carried out the biggest merger and the biggest acquisition in the group's history, through joining forces with Britannia and acquiring the Somerfield food chain. None of this means we can now rest on our laurels. Now is the time to keep our foot firmly on the accelerator." —Peter Marks, CEO of Co-operative Group, in remarks ahead of the annual meeting.
- October–November: 150 cooperative leaders from around the world gather at the United Nations (UN) in New York City to initiate the launch

of the International Year of Cooperatives. Peter Marks, CEO of the Co-operative Group gives keynote speech at the ICA international forum. Co-operative Bank hosts reception for UN attendees. Co-operative Bank Chair Paul Flowers gives an uplifting speech about the bank's glowing future. On that same night, Peter Marks gives a similar gung-ho speech about the promise of the Co-operative Group. Marks and Flowers are at front and center of the ICA's UN New York celebrations. I was there and regretfully do admit to being taken in by the enthusiasm of Mr. Marks and Mr. Flowers, as was almost everyone else present.

- December: Co-operative Bank chosen by the Conservative government to be the one entity to acquire 600 plus branches of Lloyds Bank.

2012

- The United Nations celebrates the International Year of Cooperatives.
- Worldwide promotion of the International Year of Cooperatives.
- End-of-year rumblings about large losses at the Co-operative Bank for year 2012.

2013

- \$1.6 billion loss reported by Co-operative Group for 2012.
- April: Co-operative Bank abruptly withdraws from effort to buy over 600 branches of Lloyds Bank.
- Co-operative Group's CEO Peter Marks asked to step down and bring forward retirement.
- Treasury orders an independent inquiry into the affairs of the Co-operative Bank going back to 2008.
- May 1: New CEO of the Co-operative Group, Euan Sutherland, starts work.
- May: Paul Flowers asked to step down by Euan Sutherland, CEO of the Co-operative Group (parent company of the Co-operative Bank).
- June: Government regulators demand that the Co-operative Bank raise \$2.4 billion of equity to fill a black hole in its balance sheet.
- July: Co-operative Group launches its own independent review, chaired by former Treasury mandarin Sir Christopher Kelly, to look at "strategic decision making, management structures, culture, governance, and accounting practices."
- November 3: Paul Flowers, chair of the Co-operative Bank, filmed allegedly buying cocaine and crystal meth.
- November 6: Paul Flowers appears in front of Treasury Committee of the House of Commons to answer queries about the governance of the Co-operative Bank.
- November 17: *Mail on Sunday* publishes photos and video of Flowers allegedly buying drugs.
- November 19: Len Wardle, chair of the Co-operative Group, resigns amid the scandals.
- November 21: Former Co-operative Bank Chair Paul Flowers arrested on drug charges.
- U.S. hedge funds get 70 percent ownership and complete control of the once "ethical" Co-operative Bank.

April 2015: the Co-operative Group returns to profit after the sale of its 700 pharmacies and 17,000 acres of farmland helped the co-op avoid collapse.

2014

- February: Co-operative Group likely to announce at the May annual meeting a 2013 year-end loss of \$3.2 billion.
- March 8: *The Observer* newspaper runs story with headline, “New Co-op storm as board awards bosses huge pay and bonus deals.” *The Observer* was sent secret internal board documents and published the salary/benefits of the CEO and others.
- March 10: Sutherland does not come to work and resigns in a letter accusing the Co-operative Group as being “ungovernable.” CFO Richard Pennycook appointed as Interim CEO.
- Behind many closed doors, the disillusioned lenders to the Co-operative Group decide they have had enough of the Co-operative Group’s unwieldy and unanswerable multilayered democratic corporate structure.
- Lenders refuse Co-operative Group access to over \$1.6 billion from the proceeds of the sale of half of its assets.
- Just days away from financial collapse, Pennycook concludes negotiations with 23 banks and 25 equity holders. Management of Co-operative Group forced to craft a “City/Wall Street” corporate board charter to run the organization. New proposed charter is a board of only 11 members, reduced from 20. The new charter limits one member/one vote to apply to election of only three directors on the 11-member board. Bankers say take the deal or we’ll take over the Co-operative Group and sell it off. In the new charter, proposed Rule 118.6 forbids any changes to the charter (bylaws) of the Co-operative Group by the members except with the approval of the eight remaining nonelected board members.
- May 17: At a special membership meeting of the Co-operative Group the participants agree (per the lenders’ requirements) to change the governance and adopt a transitional board.
- August 30: At a second special membership meeting of the Co-operative Group, the participants voted to adopt the new charter, which has eight of its 11 board members not elected by the co-op’s members.
- September: Bankers accept new charter and begin releasing part of \$1.6 billion in funds. Pennycook appointed CEO by new board. Pennycook begins rapid restructuring of the remaining organization.
- October 13: Co-operative Group Chief Executive Pennycook, told a conference the mutual was now “stable” but that half its assets, built up over 150 years in business, had been wiped out by the crisis.

2015

- February 19: Under the new charter, the transitional board of Co-operative Group appoints Allan Leighton as the first independent board chair. The new governance structure can be seen at: <http://www.co-operative.coop/corporate/press/press-releases/headline-news/chair/>.
- April: The new Co-operative Group board puts forward a slate of only three names for the three seats. The 100-strong National Members Council demands reinstatement of three other candidates and demands there be a contested election. Board ignores request.
- April 9: The Co-operative Group returns to profit after the sale of its 700 pharmacies and 17,000 acres of farmland helped the co-op avoid collapse. The beleaguered group, posted profits before tax of \$186 million in 2014. This compares to a \$465 million loss in 2013.
- May 16: contentious annual general meeting held. To avoid legal action, the Co-operative Group board agrees for 2016 to increase member-elected seats from three to four, to put forward more than one name per open seat, and to have a contested election by the members.
- November: Sales up at the Co-operative by 1.5 percent. The Co-operative’s market share gain of 0.1 percentage points to 6.3 percent is its first year-on-year share gain since 2011.

Key questions:

Was the Co-operative Group too big? I oppose the argument that cooperatives don’t work if they get too big. If we want cooperatives to play a larger role in the world, then

we need to tackle the questions of size and governance.

Why did the Co-operative Group allow itself to become the servant of highly leveraged debt and venture capital? With membership set at one pound (\$1.43 in 2015), I don’t believe that the 7 million members felt any ownership of the co-op. With such pitiful member equity, the Co-op had to borrow extensively beyond its means to keep running. It was the value of the assets that kept the lenders interested. In the end, it was one bank, one vote. Why did the Co-operative Group not pursue a robust plan for member capitalization?

Why was the Co-operative Group board out of control? Had the board given up its role in holding management accountable? Did the unwieldy tiered structure deliver an ineffective board? Was the board capable of keeping up with the incredible growth-through-acquisition phase? Was there an agreed-upon strategic plan, or was the Co-operative Group following uncharted political opportunities?

Did management take on too many new projects? Why did management resort to unsustainable debt to achieve growth? Why did the new CEO, Sutherland, start using the term customer instead of member? Did management give the board a choice of grow or die? Was management hiding core problems from the board? Whose job was it to say “enough”?

Were the members forgotten and dismissed? How could all of this have been adequately communicated to the members, and did the Co-operative Group think it needed to be? Was being a member a cheap and meaningless marketing ploy? Why did the Co-operative Group repel every suggestion relating to developing member equity? Why was the Co-operative Group not interested in “making membership meaningful”?

Relevance to the future

What will the Co-operative Group look like in the future? Here’s what has been promised:

- In April of 2014, just prior to the annual meeting, CEO Richard Pennycook said to the *Co-operative News*, “At the heart of our purpose will be our determination to be distinct, remain true to the essence of our co-operative roots, and deliver for our members, customers, and the communities in which they live.”
- In May of 2015, the headline in *This is Money* magazine, stated, “New era at Co-op as members back chairman Allan Leighton’s reforms to make board more professional and democratic.”
- At the same time, in a letter to the Co-op members Allan Leighton said, “Our job today is to hold on to everything that has served us well in the past and at the same time demonstrate our relevance to the future. It will be a challenge to get this right. But I have joined the Co-operative because I believe we have the vision and the talent to see this recovery through to long-term and sustainable success.”

The new chair and board started off badly but have agreed to be more responsive. Only actions will tell if the new Co-operative Group will move towards being a cooperative organization that we can once again be proud of.

For useful commentary about this era of the Co-operative Group, go to <http://www.thenews.coop/>. See in particular, *Co-operative News*, “When big co-ops fail,” by Peter Couchman and Murray Fulton, 15 January 2016

Disclosure: David J. Thompson owns a one-pound share in the Co-operative Group. □