June 2014

Welcome and response to the ‘Straw Man’ proposals for governance at The Co-operative Group

1.1 This briefing identifies key issues that arise from the ‘straw man’ proposals pack for governance reform at The Co-operative Group released in June 2014.

1.2 The contents here been drafted by Helen Barber and Ed Mayo, with input from Research Adviser Professor Johnston Birchall.

2 An inclusive model of governance design

2.1 We continue to endorse the underlying case for governance change, in the context of a clear set of weaknesses and urgent set of commercial challenges for The Co-operative Group.

2.2 Our interests in this paper are to support the process underway in our largest member, The Co-operative Group, by encouraging informed debate.

2.3 We welcome the extensive efforts that are being made to consult member representatives and corporate members in the development a new model of governance for The Co-operative Group. This increases the chance of its success - good governance is about the effective alignment of interests and, in any organisation, this rests on behaviours of consent and co-operation and not just on the formal articulation of authority and accountability.

2.4 There are minor inconsistencies in the pack, and additional work in other task groups that are not covered, but it is to the credit of the Board and Executive that this is being shared in an open way and our comments are intended to be in line with this spirit. If useful to expand on any point, we would be happy to do so.

3 Strengths and Weaknesses of the Myners Review proposals

3.1 We believe that the substantive proposals prepared by the Myners Review have been a good basis on which to build. We assessed these in our May 2015 report Myners Plus, drawing on three elements of co-operative good governance worldwide: expertise, representation, member voice.
3.2 We welcomed the strong focus on expertise and the increased emphasis on member voice. We endorsed the ‘twin peaks’ model of a national Board and Council, each with distinct but complementary roles.

3.3 At the same time, we warned that the detail of the specific model proposed, in relation to the placement of the Nominations Committee, could also lead to a “a scenario in which the governance practice under the proposed design is considered to anaesthetize member control, with perceptions of a self-selecting Board, subject to a rubber stamp vote by members.”

3.4 This conclusion was hotly contested by Lord Myners, who argued that, when it comes to selecting new Board members, “the individuals who are best equipped by experience and skills to make that evaluation are the Group Board members.” The risk of allowing member representatives on the Council to carry out this function (with, we proposed, a minority on the committee of Board members) could be to “diminish the importance of the requisite professional skills and experience.” Better, he argued, to trust that Board members will apply their experience in a meritocratic way.

3.5 It is important to recognise that both views may be correct and may prove to be so at different times.¹

4 A focus for governance reform on expertise

4.1 Governance design is for the long-term and needs to be robust under different circumstances. For now, the assumption appears to be that there is a need for such a step change in expertise on the Board, given the commercial challenges and high level of competition the Group faces, that governance reform proposals may need to trade off member voice and representation where these may be in tension with this focus on expertise.

4.2 The difference between the Myners Review proposals and the Straw Man pack is a shift from the election by members of a selected slate of expert non-executive directors to the approval by members of a selected slate of expert non-executive directors, coupled with the open election of a small number of additional, qualified directors.

4.3 The Myners Review in effect cautioned against contested elections, arguing that: “individuals of the highest calibre are unlikely to be attracted to a Board that is subject to an electoral process that is based on a different interpretation of democratic member control.” The Straw Man proposals reintroduce a limited degree of potential contest for Board places.

4.4 In simple terms, in both, the underlying change is to move from a majority of lay directors, elected by lay representatives, to expert directors, selected by expert directors.
5 Are there other ways to ensure expertise?

5.1 We stated in our response to a series of questions set by the Myners Review in February 2014 that: “there can be considerable diversity in how democratic member governance operates - there is not ‘one way’ to govern a co-operative or mutual business. It is, however, misleading to assume that there is necessarily a tension between member control and the expertise needed to direct a business. Having a Board with the relevant skills to oversee executive managers in the interests of members is exactly what representative structures are intended to lead to. The key is appropriate governance design.”

5.2 There are, in principle, three ways to design in expertise through a selection / election process:

- The first – lay directors elected by lay members (or their representatives) – is what the Myners Review terms “the democratic lottery”. This model in fact works well where there is a close relationship and engagement of a co-operative with its members, where the members can have a real insight into the strategic and operational issues that the business faces.
- The second – expert directors elected or selected by lay representatives – is widely used in mass membership co-operatives and balances expertise with a responsiveness and accountability to the member owners.
- The third – expert directors selected by expert directors – is used in a range of mutual and trustee-owned enterprises, and may be associated with lower levels of member accountability and control over time.

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<th>Three ways to design in Board expertise</th>
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<td>1. Lay directors elected by lay members or representatives</td>
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5.3 Our view is that it is possible for the Co-operative Group, if it chose to do so, to operate with the second approach.

5.4 The way to achieve this would be to make the Nominations Committee a sub-committee of the Council rather than the Board.
5.5 The Nominations Committee would include:
  • a minority of Board directors, in order to ensure effective liaison around the perceived needs of the Board, and
  • a limited number of Council members selected from the key constituencies of individual and corporate members.

5.6 As a variant on this, the Board could retain rights of co-option for a limited number of places, within the overall Board numbers required, ensuring that the Board has a degree of flexibility in terms of its own conception of the mix of skills required.

5.7 It is worth adding that there is no legal view that we are aware of that would disbar this option on its own because of an impact on fiduciary duties or the absence in UK law of a set model of two-tier governance:
  • The Board has to be sovereign in terms of governance and act in the interests of the society, but the selection process for Board candidates is not something, all things being equal, that needs to compromise this.
  • Indeed, the current Group governance model operates with the approval of the regulator and without this as a concern – at present Board members are selected from and elected by regional boards and independent societies, rather than their eligibility or approval having to be, as a result of legal advice, a matter for a Board sub-committee.

5.8 The upside of this option would to ensure that the Board was not conflicted by self-selection. The downside would be if there proved to be an insufficient focus, even with professional advice, on the selection of directors with sufficient expertise.

6 Do the Straw Man proposals live up to the May 2014 Resolution and how do they compare to the Myners Review?

6.1 Compared to the Myners Review proposals, the mass membership have somewhat less rights - with approval over a majority of pre-selected independent non-executive directors, voting for three board places from eligible candidates drawn from the membership and no right of say over significant transactions.

6.2 However, there is the likelihood of contested elections for those three places, as well as for the Council. This reduces the potential risk in the original Myners Review proposals that ‘one member, one vote’ could be seen as democratic in name only.

6.3 A hybrid model of the two might be the option to have elections for the Board in three categories:
• The first would be member-nominated directors, of which three (or whatever number is chosen) would be elected.
• The second would be representative-nominated directors\textsuperscript{ii}, of which the balancing number would be elected.
• The third would be the Chair, selected for a set term through the appropriate process.\textsuperscript{iii}

6.4 However, we would repeat our comment that, even with this, a Board that is essentially self-selecting for a majority of its members suffers from relatively weak democratic legitimacy.

6.5 Indeed, the role of the Nominations Committee in the Straw Man proposals, including only Board members and the option of the Chief Executive sitting as a member, is still more problematic than the model outlined in the Myners Review, which argued that “because the creation of the Nominations Committee is an innovative step for the Group to adopt, it is of fundamental importance that it should command credibility as an impartial body working to objective standards and recommending candidates for Board approval on the basis of strictly meritocratic criteria. In order to build confidence in this process, the Review recommends the inclusion of two NMC-designated \textsuperscript{[Council]} representatives on the Committee.”\textsuperscript{iv}

6.6 There are therefore relative strengths and weaknesses in both the Myners Review recommendations and the Straw Man proposals. There may be options and variants, which can improve the governance design. Even so, with one qualification, both can be taken to be substantively in line with the resolution passed with unanimity in the Special General Meeting of the Co-operative Group in May 2014.

7 Demutualisation

7.1 That one qualification is the absence so far of substantive proposals around protection against demutualisation. The resolution agreed unanimously by The Co-operative Group’s members included four principles, including the commitment to the inclusion of necessary provisions in the rules of the Co-operative Group to protect against de-mutualisation.

7.2 The legislation currently industrial and provident societies acts – soon to be Co-operative and Community Benefit Societies Act 2014 does not provide for co-operative societies to have a statutory asset lock, nor does it allow for the full entrenchment of rules. In order to protect against de-mutualisation many societies’ rules including those of the Co-operative Group provide that a transfer of assets on dissolution should only go to another society which is in membership of Co-operatives UK or to Co-operatives UK itself to be applied in accordance with co-operative values and principles.
7.3 The inclusion of the independent apex body is important in this context and it ensures that this provision is followed through and monitored in the event of dissolution. To further secure and embed this de-mutualisation provision there should be a commitment for the Co-operative Group to be a member and remain in membership of Co-operatives UK, or any future body recognised by the International Co-operative Alliance as the representative body for the UK.

7.4 Not only does this add surety in this regard, it provides further confirmation of the commitment of The Co-operative Group to the co-operative values and principles.

8 Both the Straw Man and the Myners Review propose the separation of Board Chair and Council President

8.1 In our report, Myners Plus, we recommended that the separation of the roles of President and Chair of the Group Board is potentially problematic as it could easily lead to disunity or conflict between the Council and the Board.

8.2 In his response, Lord Myners described, in his characteristic style, the model of a single Chair as “fundamentally flawed” and suffering from “an impossible conflict of interest”.

8.3 There may indeed be reasons for having separate people with separate roles, and it is fair to say that acting as Chair of the Board is in itself a significant and demanding role. However, on this matter the evidence in practice is clear and Lord Myners is misled. Having a single Chair for the Council and the Board is commonplace among large and successful co-operatives worldwide.

8.4 It is the opposite – working with two separate people – that we do not find and for good reason – the flaw is that it introduces conflict. While the two bodies have distinct roles, the art of co-operative governance is to find ways to blend and bind different elements of governance into a single endeavour. The inclusion of Council members on Board sub-committees is one example of helping to do this.

8.5 Under the Straw Man proposals, the way the President’s role is described looks to be more ceremonial than powerful. Again, this would be fine if there were only one board that they both work to, as in the International Co-operative Alliance over time for instance, or as in the old-style mayoral system in English cities where a mayor was appointed for ceremonial duties separate from the role of the leader of the council. This may be something that evolves over time, but if the preference is to have two separate people fulfill these roles, then there needs to be very close attention paid to the dynamics of this in practice.
9 The powers of the Council

9.1 The Straw Man proposals, in line with the Myners Review, stress that the Council is a powerful body, able to hold the Board to account.

9.2 Under the leading global assurance framework that has emerged for understanding corporate accountability (titled AA1000), we have no doubt that the Co-operative Group can be an exemplar for good practice. However, that same framework makes clear that the powers that are set out in the Straw Man proposals are ones largely that require the Board to give an account, rather than be held to account in formal terms (with clear potential sanctions for non-compliance).

9.3 The Board, for example, sets the budget for the Council. The Council’s main power is to advise on the distribution of surplus monies. The argument that Council members should not have any indirect fiduciary duties can, if overstated, lead to their having no powers at all. Their only power then is their ability to embarrass the Board. If so, this means there are fewer genuine checks and balances, and ultimately makes the role of the Council dependent on the attitude of the Board towards it.

9.4 Having the Nominations Committee under the Council would clearly help to resolve this, as the Council would be operating as representatives of the member owners in selecting the Board that was charged with a clear mandate for leadership and delivery.

9.5 In terms of options to explore around wider powers, we note the comments of Cliff Mills of Mutuo that a “way of retaining some effective control for members is for their representatives to have the power to remove directors (or some of them) if they are not adequately discharging their duties, or are acting outside the agreed forward plans and strategy. The shareholders of a company have such a power of removal, and it is an essential ingredient of achieving a proper balance of power in the overall architecture. Even if such a power was given to the members in the rules, in an organisation with a very large number of individual members, it would be very difficult to exercise such a power making it ineffective. Such a power should therefore be held by members’ elected representatives.”

9.6 Equally, there are some elements of the proposals which may appear convoluted or bureaucratic and are therefore worth testing further:

- Campaigns – does this risk being elevated into a complex governance process rather than a model of how successful campaigning organisations work?
- Purpose – is this a fundamental change to the rules of the society, therefore subject to a constitutional vote, or simply an expression of fundamental strategy that should emerge through governance and effective management?
10 How clear is all this to members?

10.1 Member control requires that members, on balance, feel that they are in control.

10.2 One potential weakness is that it is not clear to members quite how all of this adds up. The idea of electing a Board to run the organisation is a clear and simple one, now adopted by all independent societies. The idea of electing a minority of Board members, and approving others, and electing people to a different body, the Council (with rare names involved such as ‘the Senate’), is going to be somewhat confusing.

10.3 This may be a matter for further work – and indeed perhaps qualitative market research (and if this were a new food product, it would indeed be market tested before launch”).

10.4 One option is to see that it would be helpful if the Council was elected through geographic constituencies from the primary membership, because then it is clear at least to members that, when it comes to the ballot box, you have a national set of candidates and then a regional set of candidates.

11 The need to learn from co-operative best practice

11.1 There are some weaknesses in the way that the Myners Review, while excellent in many respects, was conducted, as we consider that it:

- overlooked the evidence of governance models in large co-operatives worldwide that was available to it
- was unfortunate in drawing on a theoretical model in which participative governance is assumed to incur costs but not generate any benefits."vii

11.2 What results is an exclusive benchmarking with the PLC sector. In some cases, this can lead simply to the wrong analysis. For example, it is misleading to characterise member elected directors as not being non-executive directors. If these members are employee members, for example, then there will need to be guidelines to ensure appropriate process and conduct - but this is nothing new in the co-operative sector.

11.3 At the same time, we warmly welcome the reference in the Straw Man pack to the Co-operatives UK Code of Governance and would be happy to liaise on this to ensure that connections are made where possible.”viii

11.4 There is one wider point, in particular, around the Myners Review that is important to flag up. This is that the recommendations, echoed in the Straw Man proposals, do end up complicating rather than simplifying the ownership model of The Co-operative Group and without fully considering the implications of becoming akin to a multi-stakeholder co-operative of members drawn from a) customers b) retail societies and c) employees.
11.5 As we wrote in our March 2014 response to the Myners Review interim proposals in relation to the interplay between governance, ownership and strategy: “who it is in business for – is it primarily for its members, customers, employees or the wider community? Of course, there are some overlaps, but its business strategy cannot be given direction and its performance cannot be assessed until the ordering of these different types of ownership is decided. The design of governance components, such as the Council for example, will need to be aligned so that the main ‘owner’ is fully represented.”

11.6 So, the Group would become in effect something like a multi-stakeholder co-operative, under the new proposals. But there has been very little evidence of thinking what the changes, with the reference to an employee constituency, means for the governance and strategy of the Group. A critical view would be that the employee dimension has been a nod to the idea of worker empowerment with no worked-through conception of how genuinely to empower colleagues, or what it would mean for overall strategy if they were.

11.7 Eroski is a European consumer and worker-owned retailer. Last year, with the endorsement of members, it decided to reduce wages by an average of 5% in order to protect jobs - lower salaries by 2.5% and higher salaries by up to 7.5%. This is a strategy for remaining competitive, alongside its focus on innovation. The process of engagement, coming from a tradition of worker co-operatives, that led to this is of an entirely different level to what has been considered to date at The Co-operative Group.

11.8 This can evolve of course over time, but it is helpful to recognise the need to learn from co-operative best practice and that it has implications for governance and strategy.

12 Regular review

12.1 In our March 2014 response to the interim Myners Review recommendations, we argued that “from our research on good co-operative governance worldwide, we see that best practice is to have a continual process of adjustment and review in relation to governance, rather than the stop-start, top-to-bottom overhauls which have characterized The Co-operative Group in recent years. There should be a commitment to a review on a regular basis, so the governance remains effective and reflective of the membership and development of the co-operative business.”

12.2 It is not clear whether the current proposals can be completed in full for a September 2014 Special General Meeting, or whether only the essential rule changes required to ensure ‘full speed ahead’ for reform. It makes sense to be as ambitious as possible, in order to ensure that governance reform serves business recovery rather than distracting from it. At the same
time, governance needs to evolve and there should be an understanding and process in hand to enable reflection on governance practice and to build, correct or improve where needed.

Summary of key points

1. We welcome the significant progress that has been made in terms of content and inclusive process.
2. The option of achieving appropriate expertise on the Board through a Nominations Committee that reflects co-operative practice elsewhere, as a sub-committee of the Council, could be considered.
3. A hybrid model of the Straw Man proposals, coming closer to the Myners Review intention of enfranchising the membership more widely, would be to have election of all Directors, but under different categories - rather than election of some and approval of others.
4. Both the Straw Man and the Myners Review proposals are consistent with the resolution passed at the Special General Meeting, with the qualification that there is work to complete on tackling the risk of demutualisation.
5. One option to contribute to the safeguards against demutualisation would be to embed in the rules a commitment to membership of Co-operatives UK, or any successor body acknowledged by the International Co-operative Alliance as the representative apex body for co-operatives in the UK.
6. We continue to advise, from practical experience, in favour of one person acting as Chair of the Board and Council.
7. We note that there may be benefit in exploring further the issue of powers for the removal of directors.
8. It would be of benefit for The Co-operative Group to conduct rapid qualitative market research on member views on the key elements of the proposals, including names and the basis of elections for the Council, in order to ensure that the governance design that emerges is as intelligible as possible for members.
9. There will be a need over time for the Co-operative Group to learn from co-operative best practice in other contexts.
10. It will be helpful to identify and commit to a process for an ongoing periodic review of governance design.

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Welcome and Response to 'Straw Man' proposals

Notes

i There is evidence in organizational life of decision-makers that select on meritocratic grounds …and also, particularly where the wider accountability framework is weak, for decision-makers that, consciously or unconsciously, select people that match their profile and outlook.

If there is a mandate from members and member representatives for a shift in the profile of expertise in the Board, for illustration to increase expertise around innovation and new technology or to bring on board expertise from a large co-operative overseas, then this could be easier if the Board were not self-selecting …and, conversely, more restricted if it were.

ii i.e. names put forward by the Nominations Committee

iii The focus in the Straw Man proposals on independent professional non-executive directors does reintroduce a potential separation between different classes of directors that the Myners Review quite reasonably warns against.

iv Why not, we therefore concluded in Myners Plus and would reiterate now as an option, let all the directors be voted in, with a panel of applicants selected by the nominations committee, as in co-operatives overseas such as Co-op Swiss?

v But, of course, this can work both ways – the Board could in turn campaign to have some member representatives voted out.

vi ‘Loved by us Governance’ perhaps…

vii See the notes in our report Myners Plus, for more on the evident weaknesses of this theoretical framework.

viii And indeed we would hope to learn from this exercise for our wider work with co-operatives around the practice of governance.