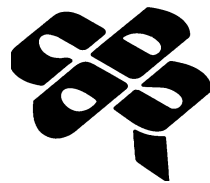


Co-operative Federation of Victoria Ltd



**Privatisation
of
Co-operatives**

**Registered Office:
P.O.Box 356 Beechworth VIC 3747
Telephone: 03 57 282005
Fax: 03 57 282284
Email: cfedv@netc.net.au**

PRIVATISATION OF CO-OPERATIVES

This paper is about the privatisation of co-operatives – co-operatives that consider and may convert into companies.

A co-operative is a voluntary and democratic association of individuals and, therefore, it is not surprising that from time to time co-operatives consider privatisation and, sometimes, decide to convert.

Fundamental to this consideration is for a co-operative to examine why it was established in the first place and whether the “benefits” of privatisation are short-term windfalls. In recent years mutual insurance companies in Australia have demutualised. In 1995 National Mutual members agreed to demutualise and the French company AXA Assurance bought a \$1 billion 51% shareholding. In 1997 Australian Mutual members voted to demutualise – 98.3% voting yes. The mutual became a shareholder owned company on 1 January 1998 and is expected to be listed in the middle of 1998.

Received economic wisdom tends to assume the inherent competitiveness and efficiency of private companies. The Australian Stock Exchange (ASX), for example, has been attempting for several years to persuade co-operatives to list on the stock exchange.

Back Into The Past

In its most recent attempt the Stock Exchange is offering a gradual demutualisation - allowing co-operatives to implement restrictions on shareholding initially on listing. An example of this is Farm Pride Foods, formerly the Egg Industry Co-operative, which prohibits anyone from holding more than 20% of Farm Pride for the first three years. This is not a concession towards member control. The assumption is that once listed co-operatives will be gradually converted to the virtues of company status – and the whims of investors. Whether gradual or not, the inevitable outcome is the conversion of a co-operative into a company.

As the ASX has admitted it is interested in a case-by-case examination and it reserves its discretion and is interested in such issues as whether additional rights could be extended to inactive members and whether the structure is likely to allow market forces to push the entity towards a more orthodox structure over time.

The Boston Consulting Group has pointed out that listing a co-operative on the ASX changes the relationship of a co-operative with its farmer members. In commenting on Wesfarmers Limited, the Group notes: “Wesfarmers still provides services and products to the rural sector, and the company is still controlled by farmers. However, and especially with the expansion of the company into areas such as retailing, the focal point of the relationship between the company and farmers is the value which Wesfarmers can deliver, not the services or goods which it provides.”

Co-operatives, then, are being asked to go back into the past – to inevitably expose their members to the very conditions that necessitated the establishment of co-operatives.

Market Realities

If members no longer wish to continue the obligations and benefits of member ownership and control and if they have lost their attachment to co-operative values and principles, then, conversion into a company is appropriate. But, then, there may be differences between members of a co-operative and a conversion decision depends on the efforts by members and the board, management and advisors who have important roles in advising the membership of the options and the consequences.

This paper, then, sets out to identify those market realities that are central to a co-operative's consideration of the privatisation option, what factors could influence this consideration and what issues need to be considered.

Initially, however, it is necessary to remind ourselves why individuals and their communities establish and develop co-operatives. In a market economy, many factors influence the price for goods and services; an important one being the relative bargaining strength of buyers and sellers. Small consumers and producers have the common disadvantage because of their smallness compared to those who supply their production resources and those that ultimately buy their produce. Small producers and consumers are squeezed by and between big players in the market place who, acting principally in the interests of their shareholders, take the lion's share of profit.

Often, it is only when small consumers and producers come together in a co-operative that they can be assured of fair prices. This is a market reality. This has not changed since the 19thC. In recent years, for example, venison producers and strawberry growers have formed co-operatives to secure fair market prices. A co-operative is a member-owned and controlled enterprise in which the small consumer or producer is the cardinal stakeholder. For small consumers and producers co-operatives represent economic power. It is the co-operative that gives the small consumer and producer bargaining power.

Market realities have not changed since the 19thC – small consumers and producers remain at a disadvantage unless they form co-operatives for their mutual benefit.

Issues

What influence the process of how and whether a co-operative considers the privatisation option include:

- Capitalisation
- Membership
- Management
- Board
- Advisers
- Legislation
- Financing

➤ Public policy

Each of these elements will now be discussed in the context of a co-operative considering privatisation.

Capitalisation A co-operative may require extra capital to grow and, therefore, continue to be or achieve competitiveness and cost-effectiveness – internal funding, borrowing or external equity. Members may be reluctant and/or unable to provide additional capital that is necessary. If the members are unable and/or unwilling to provide the extra capital that is necessary, then, the management and board need to examine and recommend on capitalisation options. External equity introduces new demands on a co-operative by investors e.g. external appointment to board, reduction in prices paid to members and greater accountability. Initially or subsequently, external investors may also be willing to provide a premium on shares if members agree to convert to private ownership. Surviving dry members who are no longer active in the co-operative may be susceptible to investors over converting into an investor owned company. This is particularly important over the next two years when co-operatives have to introduce active membership provisions. Langdon has suggested an acceptable hybrid model which sustains member control in perpetuity provided the co-operative sustains profitable trading and sound commercial decision making. Joint ventures and strategic alliances are another way to raise the necessary capital.

Membership An informed and active membership is essential for the board to make informed decisions about capital investment and reserves build-up or increasing returns to members. Members responsibilities include using the co-operative, investing in the co-operative through their shareholding, taking an interest in the co-operative, attending member meetings and informing themselves about issues and providing input to the board and management so that the co-operative can serve its members. Members lose control of their co-operative when they choose not to be informed and participate. This isolates the board and management and encourages decision-making without members – a shift from a member focus to a corporate focus.

Management. There are critical differences in the management of a co-operative and a company. Whether managers capture the agenda for change in the co-operative depends on the board. Management education and theory is based on investor ownership structures. There is not a culture of co-operative management. Management may be externally recruited for necessary experience and expertise but lack co-operative culture relevance which, then, has to be provided by the Board. The Management is appointed by the Board and is accountable to the Board and has a particular responsibility to develop and maintain communications with members. Member education is a key responsibility of management. Management must present restructuring and growth proposals in the context of how they maintain member control. Management has a responsibility to maintain and develop profitability, return on capital, increase asset values and maintain or change directions – based on a clear understanding and agreement of the board's expectations. Management may make unpopular decisions and recommendations but these are not necessarily inconsistent with the co-operative's structure and character. Managers may be attracted by the capacity to increase their income through privatisation with an increased salary package.

Board The actual and perceived skills of the directors and the willingness and capacity of co-operatives to train directors are critical to whether the board maintains control of the agenda for change. Critical to this is whether the board treats all members equitably and requires this of managers or is and expects managers to be accountable to mem-

bers in proportion to their business dealings with the co-operative. The publicly defined investor-based perception of the skills of directors may influence the board into ignoring the unique nature of a co-operative and the consequences this has for the roles of directors. The Board has a responsibility to ensure that members are informed, that they have an opportunity to participate and that this participation is meaningful. It is a responsibility of the Board to understand and agree on the interests of members and ensure that management responds to these interests. The board has to recognise how membership ownership and control should influence board policies and management practices. Continuous information is necessary to maintain the loyalty of old members and educate new members. In a company directors are accountable to shareholders in proportion to their shareholding. The co-operative board has the choice of strategically structuring the co-operative for member-benefit or as a corporate entity. Independent directors can assist co-operatives if their skills complement those of the existing directors by providing additional depth and experience but they also need to accept the uniqueness of the co-operative structure and values or they could undermine the co-operative.

Advisers. Co-operatives need to establish whether their business advisers understand and are sympathetic to co-operative ownership and control or their advice could be prejudicial. Business advisers do not necessarily understand and/or sympathize with co-operative ownership and, therefore, their advice might exclude co-operative ownership and tend to recommend familiar corporate structures and processes that ignore the unique characteristics of co-operatives. Accountants, lawyers and other business consultants who may be engaged to advise a co-operative considering privatisation are accountable to either management or the board – not to members. The quality and relevance of their advice depends on what they are asked to advise on, their experience and expertise with what co-operatives and their objectivity towards co-operatives and the terms of reference and guidance provided by the board and/or management. A group of small businesses that wanted to form a co-operative were recently persuaded by their lawyer to register as an association. “There is too much paperwork,” the lawyer claimed. The lawyer knew a bit more about associations than co-operatives. Unfortunately, a bit was not enough and registration as an association was not allowed by the Registrar because their proposed activity was to be profit-making.

Legislation Legislation must be understood by members, board and managers in providing a framework for what is achievable and how. Legislation may be inappropriate and restrict the development of co-operatives. The Co-operation Act 1981, for instance, made it difficult for co-operatives because of its paternalistic and restrictive requirements. Cooperative legislation can be critical in protecting the co-operative character and competitiveness of co-operatives. Two examples of this have been the issues of inactive members and interstate trading. First, legislation has not consistently allowed for the removal of inactive members who become the prey of investors seeking to convert co-operatives to companies. NSW did introduce active membership provisions several years ago and this has now been adopted in other States. Second, co-operative legislation made it difficult for co-operatives to operate in other States and imposed onerous conditions. Both these issues have been significantly resolved in Victoria with the Co-operatives Act 1996.

Financing The sources of finance for co-operatives can be limited and sometimes banks have sought to privatise a co-operative as a condition of receiving a loan. Co-operatives need to establish whether financial institutions are sympathetic to co-operative ownership. There is no inherent inefficiency in co-operative ownership. The absence of co-operative banks has limited the financing possibilities for co-operatives. The establishment of the Rabobank in Australia has provided co-operative capital for ag-

gricultural co-operatives. There is a responsibility here for the board and management to explore and identify financing sources that do not compromise the integrity of the co-operative.

Public policy. The dominant and emerging public policy values and principles tend to exclude the co-operative option. Instead, there is an emphasis on public or private models of service provision. There is an explicit or implicit assumption that co-operatives are an inferior form of ownership – less efficient, productive and competitive. To ageism, sexism and racism must be added co-operativism – individual and group actions which discriminate against co-operatives. This can be direct or indirect discrimination. Direct discrimination is where certain behaviour, actions or activities are based on assumptions about the organizational characteristics of co-operatives. Indirect discrimination is when a co-operative is required to comply with requirements or conditions with which they cannot or which has an unreasonable impact on the co-operative i.e. a loan conditional on a co-operative privatising.

Conclusion

A decision by members of a co-operative to privatise should depend on reliable and accurate information, which sets out the benefits and costs of the various options. Recommendations from boards, managers and advisers that seek to subvert full information disclosure should be rejected by members as misleading. It is only under the condition of full information disclosure that members can voluntarily and democratically decide the future of their co-operative.

Whether there has been full information disclosure depends on the member education activities of the co-operative over a long period of time and the seriousness in which members understand and accept their obligations.

Ultimately, the members of a co-operative decide by a voluntary and democratic process. This is fundamental to co-operation. If the required membership majority of a co-operative vote for privatisation, it is their democratic decision.

It is ironic that once a co-operative is privatised the majority of shareholders will not be able to vote to return to a co-operative structure. First, because companies are controlled by a majority of shares – not shareholders. Second, because Corporations Law does not presently allow companies to transfer to the jurisdiction of co-operative law.

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