A set of keys is positioned in the upper right corner of the cover. The background is a solid red color. Faint, diagonal text is visible in the background, including the words "demutualization", "mutualization", and "remutualization".

A CO-OPERATIVE DILEMMA

CONVERTING ORGANIZATIONAL FORM

Edited by Jorge Sousa and Roger Herman

A Co-operative Dilemma

A Co-operative Dilemma Converting Organizational Form

EDITED BY
JORGE SOUSA AND ROGER HERMAN



UNIVERSITY OF
SASKATCHEWAN

Centre for the Study
of Co-operatives

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Editor's note: The word "co-operative" appears with and without the hyphen in this book, reflecting different usage in the jurisdictions under study.

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Converting Organizational Form

An Introductory Discussion

JORGE SOUSA AND ROGER HERMAN

WHEN PEOPLE DEVELOP ENTERPRISES, THEY CHOOSE AN organizational form that best suits the purpose of the initiative and the context in which it will exist. How that choice is made and what influences the final decision is usually fairly clear. It will be affected by worldwide conditions such as globalization as well as regional and local factors, including the following:

- familiarity with or confidence in a particular model
- the ability of a model to achieve the objectives of the stakeholders
- the existence or absence of professional infrastructure in the development process
- the suitability of legal frameworks within which to work
- enabling or prohibitive public policy

Most often, rather than any single factor, it is a combination of these and other issues that influence the final choice of organizational form.¹

It is not difficult to imagine how a co-operative model might be the best choice where the objectives of the enterprise include local, democratic decision making and providing benefits to the users of the services offered by the organization. A desire for personal financial gain and individual or proportional decision-making power might be better served by investor-owned, partnership, or sole-proprietorship models.

And the provision of highly regulated social services may work best as part of a state-owned organizational form.

Sometimes, as organizations evolve, stakeholders change, or environments and contexts shift, the original organizational form becomes, or appears to become, less suitable for achieving the objectives of the enterprise. If that happens, the stakeholders may choose to re-evaluate the appropriateness of the existing form and make an adjustment to, or undertake a complete conversion of, the organization's structure. This book examines these processes from a variety of perspectives. But first, it provides a brief overview of the organizations at the core of the dilemma — co-operatives and mutuals — and a discussion of co-operative identity, which we have used as a foundation for our examination of organizational conversion.

Co-operatives and Mutuals

Co-operatives and mutuals belong to a family of entities that share similar organizational characteristics and form. Both operate on the principle of mutuality, in which people come together for a common purpose.² Members have the dual role of being business owners as well as beneficiaries, and the primary source of capital is a combination of member equity investment and proceeds from the sale of goods and services. In both cases, decision making is democratic and surpluses are generally distributed back to the members as patronage refunds or reinvested in the business to sustain the growth of the organization. Surpluses may also be earmarked for specific purposes that enable the organization to fulfil its social mandate to the community.

The terms co-operative and mutual are in some instances used interchangeably, while in others, one is considered a subset of the other. Stephen Yeo explains the difference between them and the history behind the distinctions as follows:

Co-operation and mutuality may usefully be seen as describing a spectrum, on which actual co-ops and mutuals are variously

placed. A *division of labour* between organizations described as one rather than the other grew up in Britain under Victorian legislation which distinguished between Friendly Societies (in Acts of Parliament from 1793 onwards) and Industrial Provident Societies (in Acts of Parliament from 1852 onwards). As in all divisions of labour between and within productive organizations, a contrived and cultural set of social or sometimes anti-social relations soon appears to be spontaneous, or natural. In this way, Co-ops came to be regulated as such, and Friendly Societies to be regulated as part of a related but different “industry,” that of mutual insurance.³

Such distinctions are commonly applied in jurisdictions around the world and typically reflect the governing legislation. Although some readers may find using the terms interchangeably to be too great a generalization, we believe that the usage is appropriate for this examination of the conversion phenomena.

The co-operative model has gained considerable prominence in numerous economic sectors in most nations of the world.⁴ Put simply, co-operatives and mutuals provide a means for members of a group to achieve some end that might otherwise be impossible, or at least more difficult, if undertaken individually. In some instances, application of this organizational form is a response to a need for particular goods or services otherwise unavailable. Other times, co-operatives provide a counterbalance in an economy dominated by monopolistic or oligopolistic players, while in yet other cases they offer a model of enterprise “with a difference.” This difference may reflect the co-operative’s democratic nature or its associational function, which might more naturally accommodate goals beyond the purely economic, such as education and training for members and concern for the community. These other goals, be they primary or secondary — often referred to as social goals — reveal some of the clearest distinctions between co-operatives and other types of organizations. In reality, the motive for developing co-operatives is usually some mix of the reasons outlined above, with the aim generally being to balance social and economic needs.

Co-operatives appear across different sectors of the economy — in

agriculture, community development, finance, health care, recreation, retail, utilities, to name a few — and by necessity are competitive with their investor-owned counterparts. In many nations, co-operatives capture a significant segment of particular markets. In Canada, for example, in 2007, the credit union movement (including the caisses populaires in Quebec) had \$211.8 billion in assets.⁵ A co-operative business usually serves a defined membership⁶ and operates on the principle of mutuality. A distinguishing feature of the model is that the member simultaneously assumes various roles, including user, owner, director, and beneficiary.⁷ This is in sharp contrast to investor-owned firms, in which shareholders' (or an individual owner's) behaviour is guided by profit-making objectives, decision-making authority is typically proportional to the level of ownership in the organization, and owners are seldom users of the enterprise's services. In order to fully understand what sets co-operatives apart from other types of organizations, we need to take a closer look at the essence of this organizational form.

Co-operative Identity

A key strength of the co-operative model is its clearly stated identity, which most organizations work hard to preserve. The International Co-operative Alliance, in its "Statement on the Co-operative Identity," defines a co-operative as "an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise." The Statement provides, further, that "Co-operatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity. In the tradition of their founders, co-operative members believe in the ethical values of honesty, openness, social responsibility and caring for others." Finally, the Statement sets out seven "principles [or] guidelines by which co-operatives put their values into practice."⁸ Taken together, the definition, the statement of values, and the accompanying principles (shown opposite) provide a clear understanding of co-operatives and mutuals

1st Principle: Voluntary and Open Membership

Co-operatives are voluntary organisations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

2nd Principle: Democratic Member Control

Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner.

3rd Principle: Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.

4th Principle: Autonomy and Independence

Co-operatives are autonomous, self-help organisations controlled by their members. If they enter into agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

5th Principle: Education, Training and Information

Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public — particularly young people and opinion leaders — about the nature and benefits of co-operation.

6th Principle: Co-operation among Co-operatives

Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures.

7th Principle: Concern for Community

Co-operatives work for the sustainable development of their communities through policies approved by their members.⁹

and how they operate. Co-operative identity is comprised of all three components and it is important that individual parts (the principles, for example) not be used as a simple checklist to determine if an organization is or is not a co-operative.

While the “Statement on the Co-operative Identity” provides a useful explanation of the term, an examination of the literature reveals a variety of understandings regarding what is meant by co-operative identity. And although the development of the Statement (completed in 1995) was itself a deliberate attempt to bring resolve to the question of what was understood, meant, or intended by the term,¹⁰ a considerable range of interpretation remains. Indeed, some authors¹¹ suggest that co-operative identity as manifested by definitions, values, and principles is subject to change over time and in response to evolving local circumstances. They also note that, while abiding by a core understanding of what a co-operative is, flexibility is important.

Other researchers describe a co-operative culture based on characteristics that reinforce a collective responsibility to focus on the needs of the many rather than the few.¹² Fairbairn takes this idea much further. Outlining a cognitive, or *thinking*, model for co-operatives, which explains how organizations can effectively undertake change, he suggests that “the co-op must have a sense of what it is, where it came from, what it does, and where it is going — a sense of identity, or to put it another way, an organizational culture.”¹³ He goes on to suggest that “different members may identify with different characteristics of the co-operative, and this needs to be well understood by all involved, including, as much as possible, the members. Different members have different identities, and the co-operative needs to connect with as many of these as it can.”¹⁴ How a co-operative understands and addresses a changing context will reflect how effectively it handles this meshing of identities. If this relationship is not well understood, a co-operative’s response to changing circumstance may not reflect the members’ preferences, which could result in a loss of member loyalty. Likewise, if the co-operative does not change with the times, and its members do, it may find itself no longer relevant to those members.

Daniel Côté suggests that many co-operatives today, especially in mature sectors such as the banking and agri-food industries, are experiencing what he describes as a “crisis” of co-operative identity.¹⁵ Côté attributes several factors to this:

- a shift from a concept of “member” towards one of “customer”
- a loss of ties between members and their organization because membership is often broadly open and available at minimal cost
- a movement by many co-ops towards more capitalistic behaviours, following the rules of the market

Côté sees the threat facing these organizations as a combination of these structural changes and the complexities currently challenging managers and elected officials. He suggests that the resulting loss of cohesion leaves co-operative members “no longer clear about what they have in common, and how their specific relationship with their co-operative is different from their relationships with capitalist enterprises.”¹⁶ Fortunately, Côté finds hope for preserving the co-operative identity through what he calls a “New Co-operative Paradigm,” in which organizations make deliberate efforts to evaluate, develop, protect, promote, and preserve their co-operative identity, and in doing so, create member loyalty and a competitive advantage over capitalist enterprises. Côté provides the following list of items to consider in conducting an analysis of a credit union’s co-operative identity:

- democracy within the credit union and existing cohesion among members
- ideological core, i.e., the core values and mission
- strategic directions and criteria for making decisions
- business practices, i.e., management of the market, sales force, human resources, commercial portfolio, etc.
- the credit union’s impact on stakeholders (members, employees, and the community)¹⁷

This list, in fact, could be used as a basis for assessing the identity of any co-operative.

In addition to Côté and Fairbairn, a variety of other scholars have suggested that co-operatives, by virtue of their “difference,” have a strategic advantage over their competitors.¹⁸ If a strong co-operative identity results in a clear co-operative difference, and if that difference offers an advantage over non-co-operative competitors, then examining how an organization has managed its identity may help to inform a consideration to convert organizational form.

It is our suggestion, then, that co-operative identity provides a useful starting point for understanding conversions of organizational form, as will be shown in the case studies that follow. Organizations with a weak co-operative identity fail to differentiate themselves from alternative business forms and thus compete on the terms dictated by the capitalist model. On the other hand, organizations that have deliberately paid attention to preserving and promoting their co-operative identity are in a better position to differentiate themselves and to use that difference as a competitive advantage. Reaping the associated benefits of the co-operative advantage should motivate even greater attention to strengthening the co-op’s identity, thus developing a positive feedback loop. Further, groups considering conversions into co-operatives may be motivated by the perceived advantages of developing a co-operative identity.

It is useful to consider this logic when examining the conversions presented in the following chapters of this book. While the authors preparing the case studies were not specifically instructed to address co-operative identity in the organizations they studied, each case reveals evidence of how the organization both perceived and handled its identity.

The ICA “Statement on the Co-operative Identity,” with its accompanying definition and set of principles, provides a lens through which to view co-operative organizations, their activities, and their decisions. This is not to suggest, however, that the Statement is a template or prescription. It can be more usefully viewed as a basis upon which organizations can build their own co-operative identity, which will also be affected by contextual considerations.

The context in which organizations exist influences their behaviour, strategies, and decision making. Readers should particularly keep in mind the overarching influences such as globalization that are at play in shaping the world as we know it.¹⁹ All organizations attempt to respond to such external influences; indeed, books, journals, conferences, and even careers have focussed on understanding how this might be manifested. Innovation is often held up as the necessary ingredient of success in a rapidly changing environment. The next section touches on some of the external pressures facing co-operatives and examines a couple of innovative responses.

The Pressure to Innovate

Many co-operatives have faced the challenge of how to respond to a membership base evolving under the growing influence of global market forces. In some cases, economic growth within the organization has placed the co-operative identity at risk.²⁰ Coleman suggests that a loss of autonomy and greater reliance on the global market is reshaping the co-operative identity.²¹ Agricultural co-operatives, for instance, facing reduced visibility or even termination of their businesses, are being forced to explore the feasibility of expansion in response to an increasingly borderless global market. Limited opportunities to accumulate capital constrain a co-operative's ability to compete with private businesses and corporations that provide similar services.²² Furthermore, the spending of surplus can be limited by legislation and intermarket demands. Under these pressures, co-operatives are examining whether existing business practices can maintain the viability of their organizations, let alone the co-operative identity,²³ and have responded by introducing innovations aimed at alleviating these limitations. Some have adjusted their business practices to resemble private-sector business and corporations, including nonmembers, for example, in decision making. New co-operative legislation in some areas allows for nonmember investors. "Many farmer-owned co-ops are building relationships with companies throughout the food chain.... Most are involved in joint ventures. Most have subsidiary LLCs. None are the

same.”²⁴ Co-operatives that have implemented significant innovations in response to mounting challenges have changed key features of the co-operative identity.²⁵ A couple of examples are discussed below.

The New Generation Co-operative

A variety of strategies have been aimed at securing greater access to capital. One of these was the creation of the New Generation Co-operative (NGC), which provided a way for farmers to increase their incomes and to offset some of the negative impacts of changes in agriculture.²⁶ An NGC is a closed-membership, value-added, processing co-operative. The form became popular in the US in the 1990s in North Dakota and Minnesota and interest has subsequently spread to neighbouring states and provinces. The new co-operatives represented the efforts of a younger generation of farmers to tackle the challenges of deregulated agricultural markets and specialized market niches. Their impact extended beyond the farm gate, with rural communities looking to the model as a development strategy to boost rural disposable income, employment, and population.²⁷

While NGCs operate generally according to the co-operative principles, two elements distinguish them from traditional co-operatives: restricted membership and delivery shares. Membership is restricted to producers who purchase delivery rights to the processing facility; purchasing delivery shares raises capital and allocates the right of delivery among members.²⁸ Each share entitles a member to deliver one unit of farm product (e.g., one bushel of durum, one bison) to the co-operative, thus creating a contract between members and the organization. NGCs raise a large portion of their capital requirements through member equity, supplementing this by issuing preferred shares, which allows investment from community members or other interested parties. While preferred shareholders do not have voting rights, it is easy to imagine how outside investors could influence decision making in the co-operative.

The Limited Liability Company

The Limited Liability Company (LLC), a membership-based US model, offers an additional means for co-operatives to obtain new sources of capital²⁹ and, in addition to the option of outright conversion, has proved a “popular vehicle for established cooperatives to organize joint ventures with other cooperative and non-cooperative firms.”³⁰ An LLC, for example, “could be used by a cooperative and a commercial firm to develop a new branded product. The cooperative might provide raw produce to the LLC, which manufactures it into a finished product under license from the commercial food company and sells it to third parties.”³¹ In this case, the LLC functions as an independent company and the relationship with the co-operative is treated as a partnership. The responsibilities and obligations of the partnership are outlined in an operating agreement,³² but a key feature is that each holds limited liability in terms of its activities.³³ One of the challenges of this arrangement is how to address the issue of a co-op member’s interests overlapping with the interests of the LLC, since he or she could be a member of both. This scenario leads to a concern that the co-op could potentially implement decisions that benefit the LLC at the expense of the co-operative, thereby reducing the co-op’s effectiveness and autonomy.

While there are a number of similarities between co-ops and LLCs, there are also some distinct differences. Voting in an LLC, for instance, is based on the amount of equity invested in the business, whereas in a co-operative, it is based on the democratic principle of one member, one vote. And earnings in an LLC are allocated according to a member’s level of equity investment rather than being based on patronage, as they are in a co-operative. In addition, an LLC allows for the possibility of outside investment, which is not the case in a traditional co-op. An incentive for co-ops in the US choosing this route is the potential for introducing additional capital to tackle issues of growth and debt, although some researchers have urged caution in embracing this innovation. Jorgenson suggests that the model can weaken co-operative structures and is, in fact, a slippery slope towards shifting decision-making power away from the original members of the co-op towards

new equity partners, who are not attached to the organization's social mission.³⁴

While both options discussed above have gained some popularity, assessments of the impact of modifying the co-operative structure have raised the important question of whether “the co-operative model can survive in an increasingly concentrated, deregulated, privatized and global business environment.”³⁵ And indeed, some co-operatives have decided that they cannot, which brings us to the most extreme form of innovation — a complete conversion of organizational form — demutualization. The concept of demutualization and two additional and closely related and contrasting forms of conversion — mutualization and re-mutualization — are examined in the following section. They are the subjects of the case studies included in this book.

Demutualization

A recent trend, usually referred to as demutualization, has seen the conversion of co-operatives into investor-owned firms. Chaddad and Cook describe this type of conversion as follows:

... demutualization refers to changes in the ownership structure of user owned and controlled organizations from a mutual to a for-profit, proprietary organization. As a result of demutualization, residual claim and control rights are reassigned among stakeholders with implications to firm behavior and performance. In particular, co-operative membership rights are converted to unrestricted common stock ownership rights in a corporate organization. Most of the time, demutualization is followed by public listing, which allows the firm to acquire additional risk capital from outside investors.³⁶

Nadeau and Nilsestuen offer a slightly refined definition, describing demutualization as

... a transition from member-ownership and control of an organ-

ization to ownership and control by third-party investors. This transition may involve a change in the corporate structure of the organization or it may result from the purchase of the organization by an investor-owned or private company.³⁷

The essence of both of these definitions is the transition of ownership, control, and benefit from co-operative member to investor. This change affects the very identity of a co-operative and presumably any difference or advantage that the former structure may have offered. As both Chaddad and Cook and Nadeau and Nilsestuen report, demutualization has become more common in the past two decades. So common, in fact, that the conversion option is increasingly included in strategic planning processes.³⁸

Research has offered a variety of explanations for, or themes emerging from, this growing trend. Chaddad, using the perspective of an economist, provides the following observations:

- waves of demutualization often follow disruptive institutional and market changes
- mutual-to-stock conversions are efficiency enhancing
- demutualization ameliorates perceived financial constraints
- demutualization provides members access to unallocated equity and reserves
- demutualization is related to weak governance systems
- demutualization is creating co-operative hybrids³⁹

Nadeau and Nilsestuen (2004) point out that the potential for large profits to flow to various stakeholders outside the general membership may also be driving the demutualization agenda.⁴⁰ Those positioned to gain include managers, board members, business consultants, and other investors. The growing trend of tying executive compensation to economic performance may encourage managers to pursue strategies that result in the strongest economic performance of the organization at the expense of other performance measures. These other measures often relate to social objectives that become less attractive, or at least more problematic, for managers. In the worst-case scenario, executive compensation can include a consideration to provide stock options —

an arrangement that both drives and necessitates the conversion of the organization.

Nadeau and Nilsestuen propose that a lack of member education is central to most demutualization decisions.⁴¹ Members who do not fully understand the benefits they derive from the existence of their co-operative, or who choose not to be actively involved in their organizations, are more likely to support, or at least not resist, efforts to convert their co-operatives. Likewise, members elected to govern the organizations require skills and knowledge that will enable them to lead their businesses in directions that will be of most benefit to members. If they are not properly prepared for this role, the organization is especially vulnerable and subject to the influence of professional managers and consultants pursuing conversion agendas.

Examples of co-operative businesses undertaking demutualization because of economic struggles and an inability to sustain rapid growth have increased across sectors where they have thrived for many years. Investigations exploring reasons for this have typically pointed to the need for increased access to capital,⁴² but also often note a simultaneous lack of attention to the co-operatives' social mission.⁴³

Clearly, opinions on and understandings of demutualization vary. For many co-operators, the trend is troubling and should be adamantly opposed, while others argue that conversions are part of the life-cycle of a co-operative that has not deliberately worked to maintain its co-operative identity.⁴⁴ Still others go so far as to suggest that demutualization should be encouraged in order to achieve full enterprise value for the stakeholders.⁴⁵ We offer the following list of factors commonly associated with reasons why co-operatives and mutuals consider the demutualization option:

- the need to acquire new capital
- a method to achieve greater liquidity
- a process to realize greater enterprise value
- a way for members to access equity
- ineffective governance
- a disengaged membership

- the promotion of conversion by consultants
- monetary incentives for executives and/or elected officials

Mutualization

Another type of organizational conversion that appears to be gaining traction is referred to as mutualization. While there is no standard definition of the term, it is commonly understood to be the opposite of demutualization. More specifically, mutualization involves the conversion of an investor-owned firm (IOF) or a public service into a co-operative structure. This type of conversion usually involves transferring assets to a newly developed membership composed of former customers or users of the services and sometimes former employees, stakeholders, or shareholders. The pursuit of mutualizing an IOF or public service can be a response to cuts in services previously provided by private businesses, corporations, or public agencies. Decisions to make such cuts usually reflect inadequate profit margins or, in the case of public agencies, the downloading of government services. In other instances, the choice to mutualize reflects a desire by stakeholders to have greater ownership and control over the organizations providing the services they use. Ironically, as will be seen in the case studies in this book, the formation of new co-operatives through mutualization is occurring in some of the same sectors where other co-operatives are choosing to demutualize. We offer the following list of factors commonly associated with reasons why individuals and groups consider the mutualization option:

- access to service provision otherwise unavailable
- a continuation of service provision that is threatened to discontinue
- a desire for greater influence or control of organizations providing services
- the benefit of aligning users-owners-controllers
- a recognition of the “co-operative advantage”
- strong leadership driving proposed change
- strong attachment to local community
- a means to mitigate the impact of loss to local economy

Remutualization

As the name suggests, the final form of conversion examined here is that in which an organization that has gone through a demutualization process decides at some later time to return to a co-operative form. These cases provide a rich opportunity to explore the perceived advantages that motivated the return to a previous structure. We offer the following list of factors associated with the decision to remutualize:

- reconsideration of the advantages offered by the co-operative form
- changes to the environment in which the organization operates
- changes among the organization's stakeholders or what they want the organization to do for them

Research Objectives

Although both demutualization and mutualization have become more common in recent years, there is a notable absence of research exploring the issues that contribute to the decision to alter an organization's structure. This book explores and analyzes the factors that play a role in both types of transformation in sectors as disparate as housing, agriculture, finance, insurance, healthcare, recreation, and utilities in case studies from Canada, Australia, and the United States. It also examines the phenomenon of remutualization in several organizations in Ireland.

The case studies in the next section of this book were guided by a number of research questions:

- What factors led to the change in organizational form?
- Who led the conversion effort?
- Are there sectors where conversion is more likely to occur?
- What is the impact of current laws and regulations?
- Has the level of member awareness of the nature of the co-operative influenced the conversion sought by the organization?

- What are the potential impacts of the conversion?

Given that the notion of co-operative identity is at the core of our investigations, readers are encouraged to look for indications of how the organizations discussed in the following chapters regarded and treated their co-operative identity, why they may have chosen to abandon it, and in other instances, why they sought what it might provide. Our ultimate intention is to provide both insight into and a framework for understanding organizational conversion, with the hope that this will contribute to further discussion and some practical lessons for groups attempting to resolve this particular co-operative dilemma.

Endnotes

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Section One

Demutualizations

Credit Co-operative to Credit Corporate Australian Credit Unions

JUDY JOHNSTON

Background

IN AUSTRALIA, IT WAS NOT UNTIL THE MID-1940S, AND post-World War Two, that a formal co-operative credit union movement began to develop at a subnational level, state by state, with different histories and details. However, by 1956, in the dominant economic state of New South Wales (NSW), for example, there were about twenty thousand credit union members involving about £1 million (pre-decimal currency¹) in loans. In those days, credit unions were seen to be “thrift associations.”²

Credit union numbers continued to grow and by the late 1960s were the fastest developing organizations in the financial sector, often workplace-based, and with more than 325,000 members. They had found a niche, offering credit through membership and tight bonds of association, to many who had not previously been able to access credit on reasonable terms. However, credit unions were not evenly distributed across the financial sector. There were considerable variations in growth and size, with a few large credit unions increasingly dominant

in the movement. Overall, too, credit unions only represented about “0.5 percent of total credit.”³

From around the beginning of the 1970s, credit unions began to be recognized formally as credit co-operatives, through specific state-based legislation, and with certain prescribed responsibilities. However, further development of the credit union movement, with supposed support from evolving industry organizations, was marked by disputes about how to advance the movement as a whole. There were also periods of decline and growth across the sector, when credit union credibility and perceived legitimacy were often questioned. Adverse publicity directed towards the mutual subsector as a whole, some of which was simply incorrect, led to a crisis of confidence in the sector overall, to limited collapses, and to rushed withdrawals of funds. Despite some opposition, this situation resulted in the establishment, in NSW, of a credit union savings guarantee fund in the late 1970s.⁴

Notably, too, there were continuing official concerns about the lack of professional management and the financial status of credit unions and other mutual-style organizations. Eventually, a series of governmental reforms would change the shape of the credit union movement, probably irretrievably, away from the importance of membership towards a greater interest in markets and financial accountability.⁵

Reasons for the Conversion

A number of factors have been particularly relevant to organizational conversion from the credit co-operative to the credit corporate. First, the deregulation of the financial sector in 1984 was an early catalyst for change. On the positive side, the added competitiveness and development led to greater technological co-operation within the credit union movement. Co-operative federalism resulted in the eventual establishment of an Australia-wide services organization in 1992, representing around 80 percent of credit unions and designed to address problems in the movement. On the negative side, the structure of state-based credit unions, under different legislation with many dissonances, made

co-operation challenging. Furthermore, the deregulated financial sector became increasingly aggressive, with credit unions subjected to a declining market share. This occurred at the time that the fundamental purpose of credit unions was becoming less and less relevant.⁶

Second, during the 1980s and 1990s, a number of high-profile failures occurred among mutual financial services organizations, although credit unions were not involved.⁷ Nevertheless, there was general concern expressed at the governmental, public sector, and community level about the accountability and management of these types of institutions, credit unions included.⁸

Third, as the challenges and complexities of the financial sector increased, professionalism began to develop in credit union governance and management. Professional managers with experience in the banking sector were increasingly being employed to replace managerial amateurism and willing volunteerism. There were obvious resultant challenges to co-operative principles, in practice, especially the role of members and democratic processes.

Fourth, in 1997, credit unions lost their tax-exempt status. This meant they were no longer able to compensate for their smaller scale with privileged benefits. Inevitably, costs rose, often resulting in the imposition of increased handling fees on accounts, which reduced the competitive advantage of credit unions over banks.⁹ Thus, a series of events challenged the continuing status of credit unions as credit co-operatives. It was only a matter of time before the conversion into credit corporate occurred.

The Conversion Process

From mid-1999, all credit unions were officially designated as (Australian) Authorized Deposit-taking Institutions (ADIs) and came under the same legislative regime of the federal government as other ADIs, such as banks. As such, credit unions were moved from their state-based legal status as credit co-operatives and were simply bundled into the broad category of ADIs under the federal government's *Banking* (1959) and *Corporations Acts* (amended 2001).

Under the *Corporations Act*, credit unions were registered as companies, limited by shares, or guarantee. Legally, they lost their credit co-operative status and, in effect, officially became credit corporates. In the conversion into company form, the only special acknowledgement of the membership and mutual nature of credit unions that remains is found in the respective constitutions, registered with the federal government.¹⁰ Nevertheless, credit unions remain as membership organizations, but with increasing tensions and incompatibilities between their commitments to members and their statutory obligations to the regulators.

Credit unions, like all ADIs, are subjected to the regular, usually biennial, scrutiny of the Australian Regulatory Prudential Authority (APRA).¹¹ Through the Australian Financial Institutions Scheme (AFIS), APRA attempts to maintain high prudential standards and contingency fund requirements across the financial services sector. Credit unions under AFIS, for example, are “required to hold 15 percent of assets in liquid form,” compared to 6 percent for banks.¹²

Australian credit unions have not technically demutualized across the board, but the impact of major legislative change has created a de facto form of demutualization in terms of the effect the legislation has had on all credit unions. This challenges the continuing adherence to co-operative principles and notions of mutuality.

While there was a declining trend in credit union numbers prior to the 1999 legislative change of organizational form, the reduction in numbers has continued. During the eleven years leading up to late 2005, the number of credit unions dropped by around 50 percent, from 310 in 1994 to 151 in June 2006. It was predominantly smaller credit unions with net assets of less than AUD\$2 million that left the sector, at least in the early 1990s. However, as organizational numbers have decreased (at the time of writing, around 3.5 million, or less than one out of five of the total population), total assets have increased, amounting to AUD\$33.1 billion in June 2005.¹³

The reasons for the diminishing numbers of credit unions in Australia are numerous. For example, small and medium-sized credit

unions have encountered major problems in meeting the increased prudential requirements. This has led to rearrangements, such as mergers and co-operative partnership arrangements, in an attempt to achieve greater economies of scale. Between January 2001 and July 2005, there were forty-nine credit union mergers across the sector. The majority of this activity was among credit unions with “less than [AUD\$]20 million in total assets” merging with larger entities.¹⁴

The strategy of mergers is also common and increasing among larger credit unions, great numbers of which have merged, or are merging, as a way of creating greater competitive advantage against the banks. Not all mergers have resulted in positive synergies, however, and have simply increased rather than decreased the management challenges.¹⁵

Mergers are changing the nature of membership from a tight bond of membership to a loose one, to the point where the “community of interest” of mutuality and organizational democracy has been put at risk.¹⁶ As one chief executive officer of a medium-sized credit union who has been in the business for more than thirty years explains, the principles of co-operation are espoused but not necessarily adhered to in practice any more. One reason is because the regulatory requirements impose such a high level of qualifications and response from senior ADI managers that democratic processes are difficult if not impossible to acknowledge.¹⁷

The relationships established between credit union staff and members, as customers, are now difficult to distinguish from any other kind of effective relational management that any ADI, or other competitive entity, would employ. Customer service is an issue across the sector and is seen as a possible area where competitive advantage for credit unions can be enhanced.¹⁸

The fundamental and primary product of credit unions, offering credit to those who cannot find credit elsewhere, no longer exists. Credit is largely available to most of the population, well beyond the range of Australian ADIs and into retail and other sectors. Customers as members, although significantly loyal to their credit union, might

spread their access to financial services across the competitive ADI market or even into the non-ADI sector, seeking cheaper rates or more attractive services and products.¹⁹

Technological advancement in the financial services sector has helped to reduce obvious differences within subsectors and is affecting organizations such as credit unions. It is now a competitive necessity to emulate or lead the banks with technological capability.²⁰

Mutuality is as intangible a concept as it is tangible in terms of prescribed benefits.²¹ It is therefore difficult to support or defend the notion of mutuality being a primary driving value of core business and, as such, credit unions struggle with defining “member value” in real terms.²²

The ADI sector is strongly subject to the influence of consultants, accountants, and other financial advisers seeking to support greater competitive advantage. This makes the sector and credit unions in particular more dynamic overall, and probably seeds ideas about growth, merger, and acquisition far more than in the former state-based regulatory regime. Although the Credit Union Industry Association is involved in examining these kinds of issues in depth, including regulatory gaps, the strategic focus has certainly changed beyond issues relating to mutuality and membership, *per se*.²³

Demutualization

Not surprisingly, during the periods surrounding the major shifts in organizational form and operations, credit unions, like other financial institutions, have looked towards formal demutualization. In 1997, just prior to the change to corporate status, Sunstate Credit Union was the first credit union to demutualize and embrace total corporatization, choosing to merge with a publicly listed building society. At the time of demutualization, Sunstate had 19,358 shareholders, 2,725 depositing members without shares, reserves of AUD\$80.36 million, and was able to meet prudential requirements. Operating profit was forecast to increase in 1998. The credit union was in a reasonable market position

and could have continued to operate on its own. If it had been genuinely concerned about its market status, it could also have followed the option of merging with another credit union. A last option was to wind up the business and distribute its assets equally.²⁴

In proceeding to demutualization, however, Sunstate directors and management did not obviously support the supposed organizational value of mutualism. Of the four million shares in the building society available to Sunstate members, two hundred thousand were offered to each of the directors and employees. It has since been estimated that directors were eligible for distinct benefits with around a three-hundred-fold advantage over ordinary members. Sunstate directors had served lengthy terms, with seven having a combined total of about 130 years. Sunstate's general manager was reported to have been particularly privileged in the demutualization process, and employees received a greater benefit than ordinary members.²⁵

Furthermore, those members of Sunstate who chose not to take up the shares, possibly because they could not afford to do so, received nothing, as the assets of Sunstate went to the merged and demutualized entity. It was estimated that around 86 percent of Sunstate's members received nothing through the demutualization process. In this case, as with other poorly conceived demutualizations in the broader financial sector, there were major windfalls for some. Equally, there were obvious corporate excesses quickly put in place — the carpetbagging effect — which challenged the ethical aspects of conversion. The regulators did not respond to the Sunstate situation at all.²⁶

There have been moves towards formal demutualizations since Sunstate, and there is continuing activity in the credit union sector to this end. However, following the organizational conversion of credit unions to ADIs, there were no actual demutualizations for a number of years. This might have been because of highly negative media coverage surrounding demutualizations outside the credit union movement, which were largely seen to have failed.²⁷

Nevertheless, in 2003, a credit union in the state of Tasmania almost proceeded with demutualization. Legally, 75 percent of any

credit union membership is required to support the demutualization motion. In this case, not quite 74 percent of members voted in favour of it, apparently on the basis that capital expansion was needed.²⁸ This was a near demutualization and is fairly typical of the activity and continuing speculation about whether the process is advisable or not.

Demutualizations can occur in two fundamental ways — by choice or by hostile takeover and acquisition. Motivations for formal demutualization may include competitive drivers such as access to capital, growth, or diversification of products and services. One factor that may well support continuing attempts at demutualization is a reported high degree of member ignorance about the impact of a change from a member-based to a shareholder-based organization.²⁹

Hostile takeovers need to be supported by the board of the targeted credit union once the price offered is in the interests of members. Currently (2006), a situation that began as a friendly approach has become the first attempt at predatory acquisition of a credit union by a publicly listed building society. This is in a sector of large, merged credit unions, which are likely to be attractive to a range of potential predators. Another worrying turn in this first hostile case is that the regulator, the Australian Securities and Investments Commission (ASIC), has allowed the predatory company access to the credit union's member register, which has the potential to allow the hostile company to put undue pressure on credit union members. While ASIC's decision is being challenged in court, the situation indicates that there are a number of loopholes that need to be addressed.³⁰

The Australian government imposes no financial penalty that might be a disincentive to demutualize, and there is no legislative protection for members, although some amendments to specific credit union constitutions are now proposed.³¹ How to value and distribute funds is still not well developed, although where demutualization has occurred, there may have been ASIC-approved restrictive covenants (with sunset clauses) in terms of the total of share acquisition. Increased regulatory requirements and difficulty raising capital will likely contribute to a continuing interest in demutualization.³²

Impact of the Conversion

There are predictions that the turbulence within the credit union sector will continue, with remaining entities likely decreasing to between 75 and 120 by 2010. This will probably be achieved through continuing demutualizations, friendly mergers, and hostile takeovers in a financial sector that is already mature and “crowded.” An overriding philosophical driver in the sector is that large organizational form is best.³³

Regulatory requirements are increasing, too, through continuing legislative reform, especially related to globalization. This encompasses the cost of compliance with international accounting standards and money-laundering protection. Since 2001, compliance costs alone for the credit union sector are estimated to have been more than AUD\$23 million. The Basel II³⁴ capital adequacy framework, while postponed until January 2008, will likely further increase compliance costs for risk management processes. Technology investment required to support compliance adds to overall costs. Escalating fixed compliance costs are easier for larger entities to accommodate, but the situation has led to outsourcing and shared-services provision by third parties to reduce compliance and other costs.³⁵

While ADI status has imposed tougher prudential and other regulatory requirements, along with additional compliance costs, the situation has actually given credit unions greater authority to act. In reality, credit unions have become more efficient. For example, “cost-to-income ratios ... decreased from 80 percent in 2000 to 76.1 percent in 2004 across the sector, with the larger end (above AUD\$50 million in total net assets) achieving the greater economies of scale. Nevertheless, the limits on external capital raising continue to pose challenges, although possible alternatives to demutualization are being explored.”³⁶

Observations and Recommendations

There is no doubt that the credit union sector in Australia has changed irretrievably and that the credit co-operative of origin no longer exists. As the CEO interviewed³⁷ indicates, the imposed dramatic regulatory

changes for credit unions were a “huge awakening” and “frightened the daylight out of folk.” From a “fumbling away” and “lazy” approach to governance and management, credit unions have been forced to make dramatic changes and “ramp up.” There has been enormous turbulence in the sector and both the “game” and the rules of the game have changed. Some have been “chewed up” by the market and they have usually merged or exited. “It is not a bad thing,” although it has meant that “the industry is starting to implode and it is collapsing upon itself.” Undoubtedly, the “not a bad thing” view is shared by many in the sector, perhaps with the exception of those credit unions at the smaller end still struggling to survive.³⁸

Nevertheless, as a collective movement or a sector, credit unions now sit just behind the top four banks in terms of combined assets, although their share of total financial services is less than 2 percent. However, the overall importance of mutuality and membership as primary driving forces is being or has been lost in terms of democratic values and social relations. An informed and removed managerial structure is now more important than the individual members. While the new regime means that members as depositors are better protected than they have ever been, any particular concern for member borrowers, apart from their capacity to honour agreements, is effectively no longer relevant. The issue is whether the diminution of the value of mutuality and membership matters in the environment of a highly competitive and challenging financial sector.

From a philosophical and ideological perspective, it is regrettable that the co-operative ideals are being eroded officially through regulatory and legislative change and high levels of professional governance. The inherently social nature of the credit co-operative in action and in purpose has largely disappeared from credit corporates, in both form and function, even though a membership base continues to exist. Managers and directors still have a choice and can apply co-operative ideals as an important basis of organizational culture as well as management and governance. After all, the co-operative ideals are now largely encompassed in other trendy but well-motivated management philosophies of sustainability and corporate social responsibility.³⁹

In pragmatic terms, the shift to expand a range of competitive

financial products across the sector means that credit unions as corporate organizations, whether espousing or adhering to co-operative principles or not, have certain higher-level prudential and fiduciary obligations that sit above the notion of mutuality. Mutuality, therefore, becomes a subservient construct in official terms as adherence to prudential requirements becomes the driving organizational force. As the legislation stands, credit unions are simply Australian ADIs and are not differentiated organizationally. Unless something changes at a high strategic level, it is likely that this situation will remain into the foreseeable future.

The Credit Union Services Corporation Australia Limited, as the main industry body, is attempting to lobby on behalf of the movement to achieve official recognition for the different organizational and membership status of credit unions.⁴⁰ There is a move towards a collective formation of a body representing both credit unions and mutual building societies.⁴¹ The Credit Union Foundation of Australia has also developed a corporate social responsibility kit that will allow credit unions to report directly on these indicators, it is hoped, as a counter to the banks and with some specific initiatives such as micro-credit programs proposed or underway.⁴²

However, it is increasingly difficult to find points of differentiation between credit unions and other ADIs. In reality, there are probably only one or two credit unions left that espouse and emulate the co-operative principles as “tree huggers” and “real mutuals.”⁴³ The belief is, too, that if mutuality really mattered to the public, the credit union sector would be “thriving,” which it is not. Furthermore, the credit union movement has achieved its aim to provide low-cost credit and has largely eliminated the loan sharks of old. In this sense, it is proposed that the credit union movement should celebrate its achievements and move on, accepting that the sectoral transformation means that there is probably no turning back. Nevertheless, there are opportunities for supporting mutualism even within the current hybrid corporate organizational form.

Endnotes

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33. Benson Partners, *Overview Paper* and *Strategic Paper*, 18; CEO interview.
34. The Basel Committee on Banking Supervision, made up of senior banking officials from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States, was established in 1974 to provide a forum for banking supervisory matters. Although not a formal regulatory authority, the committee has great influence over the supervising authorities in many countries. Recognizing the emergence of larger more global financial services companies, the committee introduced the Basel Capital Accord

(Basel I) in 1988 to strengthen the soundness and stability of the international banking system by requiring higher capital ratios. The objective of Basel II is to modernize the existing capital requirements framework to make it more comprehensive and risk sensitive.

35. Benson Partners, *Strategic Paper*, 19.
36. Benson Partners, *Overview Paper* and *Strategic Paper*, 13.
37. CEO interview.
38. ACCORD Research.
39. Rogers, "Shrink or Swim"; and Benson Partners, *Overview Paper*, 12.
40. Mathews, "Co-operatives."
41. Australian Credit Union, "Credit Unions and Building Societies Join Forces," 2006, retrieved 27 June 2007 from http://www.abacus.org.au/media_centre/releases/2006/24032006.html
42. Australian Credit Union, "Credit Unions Fight Back on Corporate Social Responsibility," 2006, retrieved 27 June 2007 from http://www.abacus.org.au/media_centre/releases/2006/08042006.html
43. CEO interview.

When You Need to Expand Dakota Growers Pasta Company

MICHAEL BOLAND

Background

IN 2002, DAKOTA GROWERS PASTA COMPANY (DGPC) had 1,155 members — durum wheat producers who operated in the states of Minnesota, Montana, and North Dakota. The company owned an integrated durum wheat milling and pasta manufacturing facility in Carrington, North Dakota, that could grind over 12 million bushels of durum wheat into semolina and produce 275 million pounds of pasta annually, and a pasta manufacturing facility in New Hope, Minnesota, that could produce 165 million pounds of pasta per year. The company marketed organic pasta and had an exclusive distribution arrangement with an Italian pasta manufacturer, Gruppo Euricom. DGPC also supported a research and breeding program that focussed on developing scab-resistant, high-gluten wheat varieties. DGPC's mission was to help its members become more profitable:

Dakota Growers Pasta was founded on the dream to provide farmers with the means to secure a future for themselves and their families. To succeed in this endeavour, our owners and employees pledge to always apply the “Quality Assured” idea in everything we do. We believe that the customer is our single most important asset

and that we must constantly strive to improve and to do it better than the day before. We take great pride and care in everything we do, because it is our past as well as our future.¹

The company was organized as a co-operative in 1991. Durum wheat producers were the voting members who controlled the co-operative, the owners who provided the equity capital, and the patrons who received the benefits of use, including a market or buyer for their durum wheat and a share of the profits based on use or patronage. Profits, or net income, were usually distributed as patronage refunds per bushel.

Farmers had been talking about developing the co-operative for years because they wanted to see more profit from the durum they grew. In 1991, a group of them decided to see if their ideas could be put into action. They undertook a feasibility study and elected an interim board of directors, and then launched the real sales pitch as they began selling stock to their peers.

Producers paid \$125 to join the co-operative and \$3.85 (the historical per-bushel average for North Dakota durum wheat) per share. Members were required to purchase one share of stock for each bushel of durum wheat they wanted to sell annually to DGPC. The total number of shares sold matched the capacity of the mill.

The DGPC growers' agreement obligated each member to deliver a set amount of durum wheat to the company from their own production based on the number of shares the member had purchased. If a member could not supply wheat of the desired quality, DGPC would purchase the wheat on behalf of the member and charge them the current market price. These agreements gave DGPC a competitive advantage because they allowed the company to source high-quality durum wheat.

The DGPC stock was an asset that could be traded or exchanged among members at a privately negotiated price. This meant the stock price could appreciate or depreciate in value from the initial issue price or subsequent exchange price. However, DGPC always carried the stock on its books at its nominal issue, or book, price.

The co-operative has gone through many changes since its inception and has become successful in a short period of time (see tables 1, 2, and 3 at the end of this chapter). Members received patronage refunds (sometimes called patronage dividends) from 1996 to 2000, and in July 1997, the company declared a three-for-two equity stock split. The company has been relatively profitable and has increased the value that members received for their durum wheat relative to non-DGPC members in North Dakota. Because the plant had lower costs relative to others in the industry, it increased market share and, hence, net income.

Reason for the Conversion

In 1999, the DGPC board of directors began discussing the future direction of the co-operative. A number of factors in the late 1990s affected durum wheat production in eastern and central North Dakota. Wet weather enabled disease caused by scab to spread, and the 1996 Farm Bill allowed farmers to plant crops other than durum in North Dakota. Consequently, many of the DGPC owner-producers were unable to deliver high-quality durum wheat as required by their growers' agreements. This jeopardized the company's status as a co-operative because its members were no longer patronizing it with their wheat. Furthermore, some producers wanted a more liquid market for their stock shares in DGPC. The co-operative realized that access to public debt and equity markets would be needed if DGPC was to expand because the members did not have equity capital.

In late 1999 and early 2000, DGPC's directors considered a report from a large regional investment banking firm on various options for corporate structure and capital sources that might be available to the co-operative. The board began to explore the advantages and disadvantages of remaining a co-operative, converting to a limited liability company (LLC), or becoming a publicly traded corporation.

The advantages of remaining a co-operative included being member controlled and not incurring the transaction costs of conversion.

Significant disadvantages included an inability to access capital markets beyond the member-owners, a lack of liquidity for stock shares, and the inability of many members to deliver durum wheat.

One of the primary advantages of an LLC was retaining governance in the hands of producers. However, this structure would incur a significant tax liability because the transaction would involve liquidating the co-operative and redistributing the assets into the LLC. These assets had appreciated in value, which would result in a tax liability to members. In addition, an LLC structure would not provide the desired level of liquidity or the same access to capital as a publicly traded corporation.

The board of directors recommended that members vote to convert into a corporation. One of the advantages of this structure was that it allowed other individuals, including non-producers, to become equity-holders, thus creating liquidity for the stock shares. Increased access to capital was another advantage, since outside equity-holders could include non-producers, who were more likely to consider investing in DGPC. A third advantage was that members would no longer be required to deliver durum wheat, which was a requirement of their membership in DGPC. The conversion would allow them the privilege but not the obligation to deliver the durum wheat. One disadvantage was the potential increase in the equity-holder's tax obligation. Conversion meant that DGPC would pay corporate tax on any distributions and the equity-holder would pay personal income tax on those same distributions.

The Conversion Process

In December 2001, the DGPC board voted unanimously to initiate conversion to a corporation. North Dakota statutes in 2002 did not allow for such a conversion, so the process of converting from a co-operative into a corporation involved first converting into a Colorado co-operative, which would be merged into a Colorado corporation, which would then merge with the North Dakota corporation. The resulting entity would be a North Dakota corporation.

The producer-members of the co-operative would become members of the North Dakota corporation, and the co-operative's equity (membership stock, common equity stock, preferred stock, and non-qualified allocated equity) would be converted to equity in the corporation. The membership stock (one share) would be converted to twenty-five shares of common stock in the corporation. Each share of common stock would have one vote for any issues presented to the stockholders. Each share of common equity stock would be converted into one share of common stock and one share of Series D delivery preferred stock.

DGPC had three classes of preferred stock. Owners of Series A and Series B would receive an equal number of Series A or Series B preferred stock, respectively. Series C preferred stock would be converted into twenty-four shares of common stock and twenty-four shares of Series D delivery preferred stock. Series A preferred stock was held by the City of Carrington, North Dakota, while Series B preferred stock was held by New Rockford Community Credit Union and Montana-Dakota Utilities Corporation. Series C preferred stock was owned by members of DGPC's executive management team. The preferred stock had no voting rights.

The non-qualified allocated equity was non-cash patronage income earned by the members but not yet allocated by the board of directors. Non-qualified meant that the members were not taxed upon receiving notice that this patronage income had been earned but not yet allocated as cash. Each \$7.36 of non-qualified allocated equity would convert into one share of common stock. A mechanism was provided to allow members to deliver durum wheat if they so desired after the conversion if DGPC announced it was purchasing durum. Provisions were also made to protect the shareholders in the event of a hostile takeover.

By late January 2002, the complex series of mergers described above was complete. Finalizing the conversion required a vote of the DGPC membership on the merger of the Colorado and North Dakota corporations. In February 2002, DGPC filed documents with the United

States Securities and Exchange Commission describing the conversion. Nine regional meetings were held in early May 2002 to provide information to the members, who subsequently voted in favour of the conversion on 22 May 2002.

Impact of the Conversion

Additional liquidity for the shares has occurred since the conversion, but trading volumes for the stock have been minimal according to DGPC's most current annual report. Two companies, Variable-Investment Advisors and Alerus Securities, facilitate trading of the DGPC common stock.

In January 2004, DGPC introduced Dreamfields™ pasta, created using a patented technology that reduces the number of digestible carbohydrates. The technology can also be used in rice and dehydrated potatoes. DNA Dreamfields Company LLC is owned by DGPC, Tech-Com International (a science company that developed the technology), B-New (a new-brand development and marketing company), and Buhler Inc. (a global equipment manufacturer that conducts research and development on new product lines). DGPC owned 24 percent of DNA Dreamfields Company LLC when it was first formed and has since increased its ownership to 46.7 percent.

MVC Capital of New York, an outside investor, provided \$5 million in equity to DGPC in August 2004 and received common stock shares totalling 6.8 percent of common equity (909,091 shares of stock with a \$5.50 value per share). They also have a representative on the board of directors.

In 2005, DGPC paid its first dividend since the conversion with a \$0.04 per share payment to holders of Series D delivery preferred stock and \$0.04 per share payment to holders of common stock. It also constructed a new short-goods pasta line at the New Hope facility in 2005, which increased its pasta manufacturing capacity to 230 million pounds.

Observations and Recommendations

The conversion from a co-operative into a corporation generated considerable discussion. In general, DGPC was regarded around the world as a successful example of a New Generation Co-operative,² and the story resonated with many individuals and organizations. The main questions asked by DGPC's stakeholders centred around three main issues: control, ownership, and benefit. Control issues were linked to the importance of being solely owned and controlled by producers in a certain geographic region, the performance of a producer-controlled board vis-à-vis an investor-controlled board, and changes in capital structure resulting from an investor-controlled board. For example, prior to the conversion, the board of directors controlled 2.2 percent of the members and votes. After the conversion, DGPC's board would control 11.2 percent of the common stock, which resulted in greater influence on items submitted to the membership for a vote.

Ownership issues were primarily linked to the role of outside equity and its impact on common stock price volatility, costs of debt capital vis-à-vis member capital, and whether it would be possible to find outside equity holders who would invest in DGPC through preferred stock without voting rights. Benefit issues included changes in tax liabilities due to the conversion and whether the pattern of income distribution would change after the conversion, such as DGPC retaining more earnings rather than paying cash dividends.

Prior to the conversion, only durum wheat producers who patronized DGPC could own common stock with voting rights. After the conversion, anyone who owned common stock had voting rights. The conversion has allowed an outside equity holder to acquire stock and a seat on the board of directors. After the conversion, dividends were to be paid on the preferred stock before the common stock. The company had a loss in 2003, but in 2005 the board declared a dividend on both common and preferred stock. Furthermore, shares of common stock could now be transferred to any person, whereas before the conversion, shares could only be transferred to active producers.

The dialogue regarding conversion identified several key factors.

Among them was the openness regarding the reasons for recommending conversion. The owners understood the reasons surrounding durum wheat production in eastern and central North Dakota because they were producers. This resulted in a frank and open discussion about the conversion. The producers also understood that, although they had provided equity capital for various expansions (as seen in table 1), they did not have the equity to provide future growth. Converting to a corporation still allowed members to deliver their durum wheat if they chose, which was also important.

There have been no outward signs that the conversion has changed the overall long-term strategy of DGPC. It still uses durum wheat from the region in its semolina-grinding and pasta-manufacturing plants. The external capital has helped it expand, and DGPC is well positioned to take advantage of the changes occurring in the US pasta industry.

Table 1: Major Events and Activities, 1991–2005

Date	Activity
1990	North Dakota durum wheat farmers contributed cash for a feasibility study of an integrated durum-milling/pasta-manufacturing plant
1991	Results came back positive (15 percent return on investment over and above the ten-year durum wheat average price per bushel of \$3.85) Tom Dodd was hired as general manager
Jan.–Feb. 1992	1,200 durum wheat farmers from western Minnesota, North Dakota, and northeastern Montana pledged \$12.5 million in equity towards a \$40-million durum mill and pasta plant in Carrington, ND
July 1995	First year of operation completed with 3.2 million bushels of durum milling capacity and 120 million pounds of pasta produced

Feb. 1996	1,085 producers contributed more than \$9.7 million in equity towards an expansion
Summer 1996	Durum mill expansion (mill production increased to 6 million bushels of durum per year)
Summer 1997	Pasta plant expansion was completed (production increased to 240 million pounds)
Winter 1999	Acquired Primo Piatto (an additional production capacity of 200 million pounds of pasta) and Carrington facility expanded to 12 million bushels of durum milling per year and 270 million pounds of pasta capacity
Feb. 2002	DGPC filed conversion documents with the United States Securities and Exchange Commission
May 2002	DGPC became a North Dakota corporation
Jan. 2004	Dreamfields™ Pasta introduced
Aug. 2004	MVC Capital of New York invested \$5 million in DGPC
Fall 2005	Expanded New Hope facility
Dec. 2005	Dividend paid on preferred and common stock

Table 2: Selected Income Statement Data for Year Ended July 31
(in thousand dollars)

	2005	2004	2003	2002	2001
Net revenues	155,619	144,679	136,806	152,465	135,921
Cost of goods sold	-136,179	-132,245	-125,160	-130,502	-124,811
Gross profit	19,440	12,434	11,646	21,963	11,110
Marketing, general and administrative expenses	-16,507	-8,345	-9,816	-9,382	-9,631
Loss on asset impairment	0	-704	0	0	0
Operating income	2,933	3,385	1,830	12,581	1,479
Other expense-net	-1,817	-2,835	-2,364	-3,365	-3,574
Non-controlling interests	3,003	0	0	0	0
Income before income taxes	4,119	550	-534	9,216	-2,095
Charge to record deferred taxes upon conversion from a co-operative to a corporation	0	0	0	-6,105	0
Income tax	-1,606	-214	105	-1,277	311
Net income	2,513	336	-429	1,834	-1,784
Cumulative effect on prior years of changing to a different inventory valuation method	0	0	0	0	0
Dividends on preferred stock	0	0	-3	-10	-15
Net earnings on common/equity stock	2,513	336	-432	1,824	-1,799
Weighted average common/ equity shares outstanding	13,169	12,265	12,355	11,382	11,253
Net earnings (loss) per common equity share outstanding	0.19	0.03	-0.03	0.16	-0.16

**Table 2 (cont): Selected Income Statement Data for Year Ended July 31
(in thousand dollars)**

	2000	1999	1998	1997	1996	1995
Net revenues	136,862	124,869	119,621	70,702	50,494	41,239
Cost of goods sold	-116,890	-106,062	-100,229	-58,357	-43,318	-35,789
Gross profit	19,972	18,807	19,392	12,345	7,176	5,450
Marketing, general and administrative expenses	-9,713	-7,886	-6,754	-3,542	-2,532	-2,021
Loss on asset impairment	0	0	0	0	0	0
Operating income	10,259	10,921	12,638	8,803	4,644	3,429
Other expense-net	-3,929	-2,434	-3,264	-1,877	-2,022	-2,021
Non-controlling interests	0	0	0	0	0	0
Income before income taxes	6,330	8,487	9,374	6,926	-2,622	1,408
Charge to record deferred taxes upon conversion from a co-op to a corporation	0	0	0	0	0	0
Income tax	1,298	-499	0	0	-4	28
Net income	7,628	7,988	9,374	6,926	2,618	1,436
Cumulative effect on prior years of changing to a different inventory valuation method	0	-3,429	0	0	0	0
Dividends on preferred stock	-4	-143	-15	-36	-39	-42
Net earnings on common/equity stock	7,624	4,416	9,359	6,890	2,579	1,394
Weighted average common/equity shares outstanding	11,166	8,603	7,356	7,356	5,568	4,674
Net earnings (loss) per common equity share outstanding	0.68	0.53	1.27	0.86	0.47	0.31

Table 3: Selected Balance Sheet Data for Year Ended July 31
(in thousand dollars)

	2005	2004	2003	2002	2001
Cash	229	589	5	2,866	3
Working capital	20,156	16,586	13,429	23,013	14,420
Total assets	135,130	119,415	122,390	125,541	128,658
Long-term debt (excluding current maturities)	25,385	21,087	28,263	38,274	47,594
Redeemable preferred stock	7	20	33	54	113
Stockholders' equity	61,132	58,619	53,818	56,090	54,267

Table 3 (cont): Selected Balance Sheet Data for Year Ended July 31
(in thousand dollars)

	2000	1999	1998	1997	1996	1995
Cash	1,725	3,425	182	5	1,448	155
Working capital	25,089	31,065	22,813	6,329	8,184	2,400
Total assets	131,857	135,873	124,537	68,739	49,894	47,842
Long-term debt (excluding current maturities)	51,626	59,116	66,056	27,131	18,860	24,822
Redeemable preferred stock	126	53	253	453	820	970
Stockholders' equity	60,533	58,982	36,875	29,956	24,866	13,497

Endnotes

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2. L. Egerstrom, *Make No Small Plans: A Co-operative Revival for Rural America* (Rochester, MN: Lone Oak Press, 1994).

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Striking a Balance: Lilydale Poultry Co-operative

ELLEN GODDARD, GETU HAILU, AND FREDA GLOVER

Background

LILYDALE POULTRY CO-OPERATIVE WAS CREATED IN 1940, partially to provide eggs to Great Britain. Since then, it has had a long history of processing chicken, turkey, and eggs in western Canada. Lilydale operates in a supply-managed industry in which primary production patterns are fixed through regional production quotas and the market is protected by restrictive import quotas.

Over the past twenty years, Lilydale has pursued an ambitious program of upgrading and automating plants and acquiring other western facilities (a summary of these is presented in Appendix 1, pp. 61–70). As of 1999, Lilydale had Hazard Analysis Critical Control Point approved processing plants in Abbotsford and Port Coquitlam, British Columbia; Wynyard, Saskatchewan; Calgary, Alberta; and two plants in Edmonton, Alberta, including the head office. It also had four hatcheries and one equipment-manufacturing division. The company provided products for all of western Canada, including British Columbia, Alberta, Saskatchewan, and Manitoba, as well as parts of the Yukon, Northwest Territories, and Quebec. It also exported to

Japan, Mexico, Russia, and the United States. By the 1990s, Lilydale had become a diverse food processing company focussed on a growing international marketplace.¹ Lilydale took pride in its extensive product line — hundreds of items including chicken, turkey, beef, and pork.

Despite all of this development, Lilydale has also faced financial issues over the past twenty-five years, primarily concerning its capital investments. Much of the co-operative's growth was financed with debt, and large losses were incurred. The company was finding it difficult to make patronage payments and pay out retained equity to its members who were retiring from the industry. The co-operative was also losing market share to competitors. In order to survive, Lilydale ceased to be a co-operative in June 2005.²

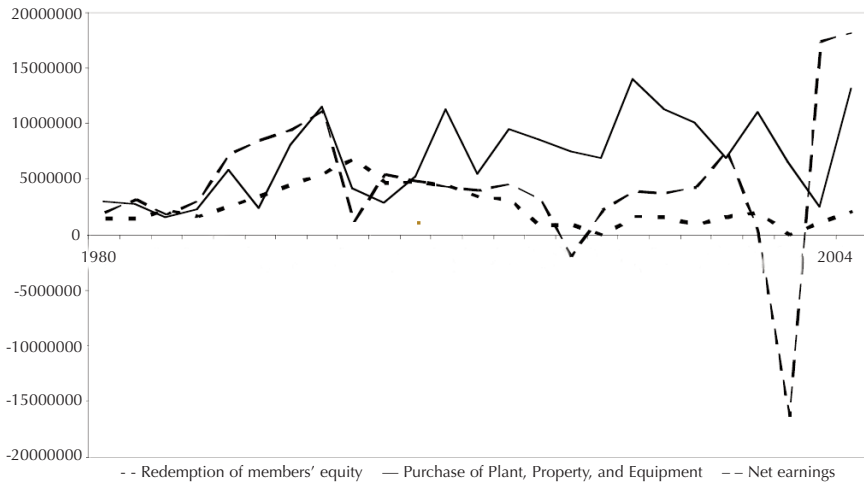
Reasons for the Conversion

Faced with a number of financial challenges, Lilydale had to rethink its strategy if the company was going to continue in business. The conversion from a co-operative became necessary due to large losses (the largest was \$16.3 million in 2003) and about \$65 million in long-term debt. A mounting debt and the inability to redeem members' equity was generating a certain amount of dissatisfaction.³ The co-op was also losing market share to competitors like Maple Leaf.⁴ When it was proposed in 1997 that the company adopt a more corporate structure, members maintained their desire for Lilydale to remain a co-operative.

In an effort to address Lilydale's debt issues, then Chief Executive Officer Frank Burdzy closed a processing plant and an egg facility in Edmonton and moved some of the turkey processing co-operatives from British Columbia to Edmonton in 2002.

The asset sales helped Lilydale make a \$17.5 million profit in 2004.⁶ According to Ed Rodenburg, who took over from Burdzy in 2004, during the two years leading up to 2005, Lilydale's debt was cut by more than half and its balance sheet seemed solid. At the same time, the bank requested a more aggressive infusion of equity from members, resulting in the creation of the Member Investment Program in 2003.

Figure 1: Net Earnings; Purchases of Plant, Property, and Equipment; and Redemption of Member Equity, 1980–2004⁵



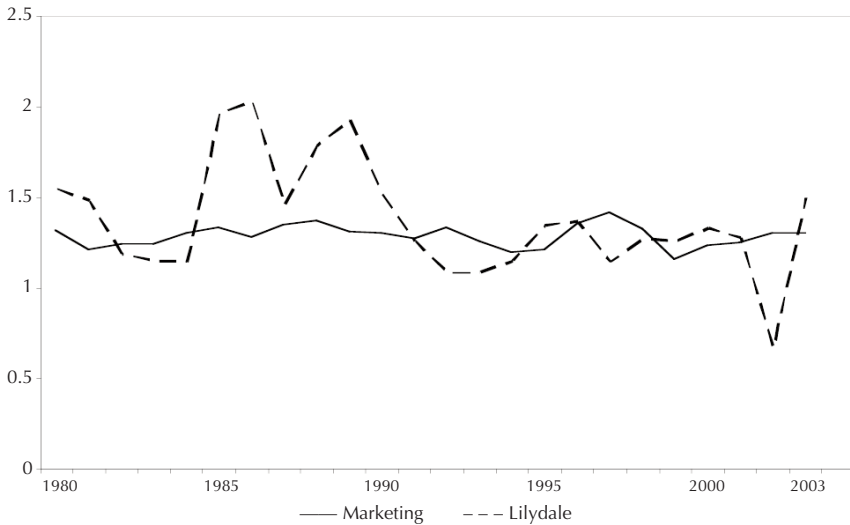
Its lack of success (other than the check-off portion) led the organization to consider alternate structures.

In June 2005, Lilydale member delegates voted “overwhelmingly” in favour of the switch from a co-operative to a conventional corporate structure.⁷ This change, according to the CEO, gave members more flexibility in managing their equity and also allowed employees to invest in the company.

Lilydale’s finances were in good shape until the early 1990s, when its debts became significant (see financial ratios in figures 2 to 4.)

Figure 2 highlights the differences between Lilydale’s current ratio⁸ as compared to the current ratio of the total agricultural marketing co-operatives sector. Current ratios are a measure of a firm’s liquidity, highlighting the relationship between current assets and current liabilities, and indicate a company’s ability to meet short-term obligations. If the current assets of a company are more than twice the current liabilities, that company is generally considered to have good short-term

Figure 2: Current Ratios for Lilydale and the Total Agricultural Marketing Co-operatives Sector, 1980–2003⁹



financial strength. The current ratio for Lilydale only approached 2 in the mid-1980s, although the ratio over most of the sample is not dissimilar to that of the sector as a whole. The sharp decline in the current ratio in 2002 predicated the significant sell-off of assets to reduce debt levels.

A company's debt-to-equity ratio provides some indication of the firm's financial leverage. This ratio is normally used for investor-owned firms but provides some information relevant for co-operatives as well. The ratio indicates the number of dollars of debt per dollar of member equity. Ratios higher than 2 are considered particularly serious. In Figure 3, Lilydale exhibits high debt-to-equity ratios at the end of the sample period, resulting again in the decision to sell off assets to reduce debt.

The total asset turnover ratio is one indicator of asset management. Generally, the higher the ratio is, the better the firm is using its assets. In Figure 4, Lilydale appears to have strong asset turnover ratios, much stronger than for the agricultural marketing co-operative sector as a whole.

Figure 3: Debt-to-Equity Ratios of Lilydale and the Total Agricultural Marketing Co-operatives, 1980–2003¹⁰

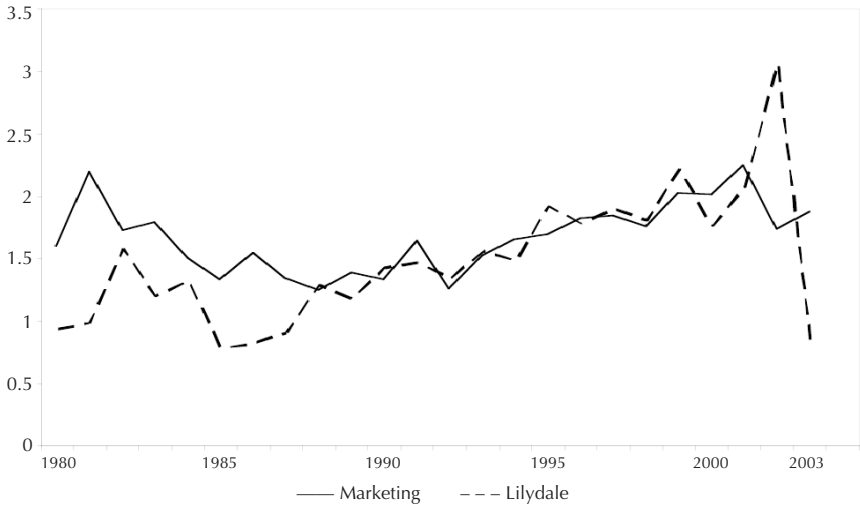
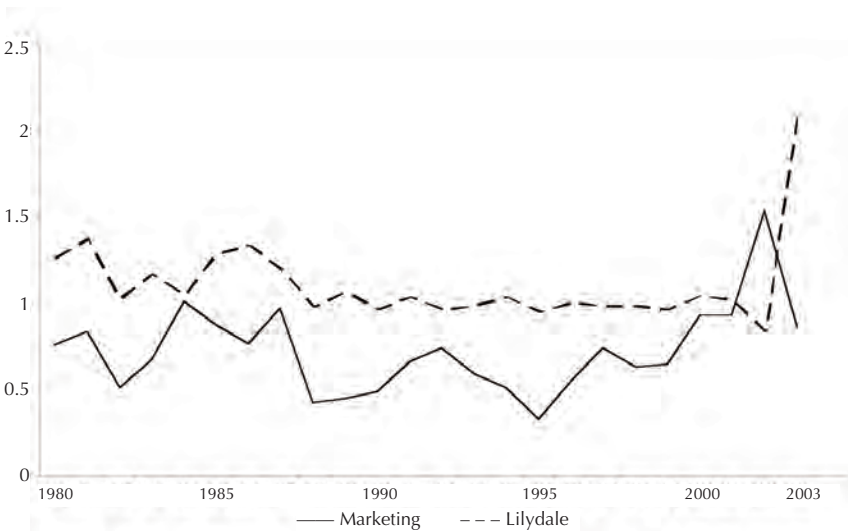


Figure 4: Total Asset Turnover Ratios for Lilydale and the Total Agricultural Marketing Co-operatives, 1980–2003¹¹



By 2002, Lilydale's current ratio had dropped significantly compared to that of the total agricultural marketing co-operatives sector. At the same time, the company's debt-to-equity ratio shot up, exceeding that of the comparable sector. Lilydale's total asset turnover was higher than for the sector until 2002, when it plummeted. The company's financial ratios are comparable to total agricultural marketing co-ops until 2002, a year when profits became negative and dramatic changes in its financial position predicated the necessity of economic restructuring for the company.

The Conversion Process

Based on the valuation provided by PricewaterhouseCoopers, the board of directors concluded that a conversion was in the best interests of Lilydale and its members. The conversion process started with months of consultations between the board and the farmers who owned the co-operative. The farmers were educated on the benefits and implications of the change and were given the option to convert their membership equity in Lilydale into common shares or subordinated debentures of the new corporation. Lilydale remained a private corporation, with the board of directors retaining control over share transfers. In May 2005, Lilydale sent out detailed information circulars on the restructuring proposal to its members, after which senior executives followed up with a week-long road show.

On 21 June 2005, delegates representing the members from all regions voted in favour of the resolution to convert Lilydale to a corporation. The company was converted under the *Canada Business Corporations Act* pursuant to a court-approved plan of arrangement. The Alberta Court of Queen's Bench granted the final order on 22 June 2005.

Impact of the Conversion

The change from a co-operative to a corporation is expected to give members some flexibility with their equity management. Under the

new structure, members will be entitled to cast votes equal to the number of shares they hold, not based on how much they use the corporation. According to the restructuring plan, the change will encourage investment from existing shareholders as well as welcome outside investments and help expand Lilydale's growth and business opportunities. The new corporation is also adopting a loyalty program designed to recognize and reward suppliers who deliver all or a substantial portion of their production to Lilydale. This would serve as an incentive for both shareholders and non-shareholders to send their products to Lilydale.

The existing structure of the poultry-processing sector may provide incentives for other major processors to purchase shares in Lilydale. Since the decision to change Lilydale's business structure, other processing plants have been created in Lethbridge (Sunrise Poultry) and Saskatoon (Prairie Pride Natural Foods Ltd.), reducing Lilydale's access to chickens and, in the case of Saskatoon, resulting in significant layoffs.¹²

Observations and Recommendations

The transformation of Lilydale from a co-operative to a corporation did not happen overnight. The board of directors proposed the idea to their members after the banks suggested strongly that Lilydale needed to access more equity, and then the failure of their Member Investment Program forced a different solution to their debt problems. The board put together a comprehensive restructuring plan, which they sent to their members to inform them about what to expect and how the new organization would be run. After getting member approval, plans were put in place for the transition of Lilydale from a co-operative to a corporation.

Organizations in a situation similar to Lilydale's before they converted must do a lot of research to determine the best options for their company. And members of a co-operative who decide to change the structure of their organization must carefully evaluate their options. A

traditional co-op may consider transforming into a New Generation Co-operative, restructuring as a corporation, or selling assets to other existing businesses. In some cases, a co-operative within a certain geographic region may decide to restructure as a corporation to allow investment from out-of-region growers,¹³ resulting in an organization with similar ownership and little change in company objectives.

The conversion is somewhat different if existing members are not interested in further investment in the organization and there is no pool of potential grower-members to recruit. With supply management in the Canadian poultry processing sector, new members cannot easily be recruited to the industry without a significant investment in production quota. As a result of this investment, grower-members may not have the desire or ability to invest further in the processing co-operative. With the majority of financial returns being generated on the farm with negotiated cost-of-production pricing from national and provincial marketing organizations, the immediate necessity to also own the processing capacity may not seem as urgent to current growers as it did when the co-operative was created. Co-operatives that do not wish to change their structure must generate enough capital to meet their equity-redemption needs and their debt associated with asset acquisition. Over-reliance on debt necessitated a change in business structure for Lilydale.

Appendix 1: Lilydale's Major Events and Activities, 1980–2005.

Date	Activity
1980	<p>The new hatchery in Edmonton was completed and the formal opening was held on 30 October 1980. The hatchery was projected to meet the chicken requirements of the hatchery division until 1985.</p> <p>An egg-quality-improvement program was set up for all the hatching egg flocks supplying the three chick hatcheries.</p>
1981	<p>The main concern of the co-operative was inflation. High interest rates and the cost of processing their products and putting them on the market reached an all-time high. No increases in per-capita consumption of poultry in Canada in the past two years continued to pose challenges for the firm.</p> <p>There were extensive equipment changes at the Lethbridge plant. Upgrades included installation of an additional boiler and a new electronic sizing and packaging system, and upgrading of the refrigeration system.</p> <p>The co-operative spent approximately \$2.6 million on capital acquisitions.</p>
1982	<p>The co-operative spent approximately \$1.34 million on capital acquisitions:</p> <ul style="list-style-type: none"> • \$682,000 addition to the Edmonton plant • \$224,000 to purchase other processing equipment • \$13,000 to purchase delivery trucks and new chicken and turkey liners • \$216,000 to pave staff and customer parking lot in Edmonton • \$76,000 to purchase additional processing equipment in Lethbridge • \$51,000 to purchase hatchery division equipment • \$82,000 for capital expenditures at the co-operative's farms
1983	<p>The co-operative signed a six-month agreement with the</p>

National Chicken Marketing Agency to reduce quotas. To keep their chicken tonnage within the negotiated limits, production of roasting chicken and Cornish game hens was curtailed. The market was also lost for their hatching egg shippers, which caused an immediate surplus of hatching eggs and necessitated the early slaughter of breeder flocks.

- 1984 The co-operative acquired a processing plant and hatchery at Clearbrook, British Columbia.

The co-operative had misgivings about the national agencies, in particular the Canadian Chicken Marketing Agency's reaction to demands from processors and others who were able to persuade the boards that Ontario needed a special allocation of production for its burgeoning further-processing trade. This, they claimed, had resulted in the collapse of values and severe losses at the producer and wholesale levels.

- 1985 In comparison to other areas of agriculture, the co-operative had an outstanding year as the demand for poultry meat continued an upward trend in Canada.

Investments in capital assets amounted to approximately \$2.3 million. This included an addition to the Lethbridge hatchery. The co-operative's computer system was also upgraded.

In March, the board of directors of the Scott Poultry Association and Lilydale's board met to discuss a possible merger of the two organizations. After many meetings, discussions, and negotiations, the two organizations agreed to merge effective 1 January 1986.

- 1986 The co-operative spent approximately \$7.8 million on capital assets. The Lethbridge plant was converted into a fully automated facility. Expenditures on upgrading the operating equipment in the newly acquired Port Coquitlam and Victoria processing plants totalled \$704,000 more than the original purchase price of the facilities.

The co-operative reported problems with supply manage-

ment at the national level and complained that government representatives on the supply management committee ignored the advice of the processing industry.

Another source of concern to the processing segment of the industry was the apparent authority of the Special Trade Relations Board to source poultry products in the United States if it did not like the Canadian price.

1987 This was a growth year for the co-operative.

The co-op purchased Van's Sausage Company in Edmonton for \$5 million.

On 30 July, a tornado struck the city of Edmonton. One of the hardest-hit businesses was the Canada Packers poultry plant. An arrangement between Lilydale and Canada Packers enabled the latter to operate from the co-operative's Edmonton plant.

1988 It was a difficult year for the co-operative. The rate of growth in per capita consumption of chicken had been decreasing nationally, dropping from 6 percent in 1983 to about 3 percent in 1988.

1989 The buying patterns of large retailers in western Canada continued to change. Lilydale faced a market with few buyers, which affected their bargaining power.

There was a continuing swing in customer preference to boneless breasts and the co-operative responded by adding five more deboning lines.

Expenditures for the year amounted to \$2.8 million, including the five new deboning lines and a new nine-piece cut machine for the Edmonton plant. These expenditures occurred after a cautious start to the year in which, based on spring financial returns, no new capital expenditures were planned.

There was a great deal of unease and uncertainty in the

poultry industry, with the General Agreement on Tariffs and Trade (GATT) attempting to reduce agriculture subsidies.

- 1990 Overproduction and fierce competition characterized the 1990 chicken market.

A \$2.1 million addition was built on the Edmonton plant.

- 1991 Oversupply caused poor results in the processing division for most of the year, which led to lower selling prices and reduced processor margins.

Capital spending in the processing division was significant in 1991. A \$5 million addition was made to the Abbotsford plant to provide space for freezer, cooler, shipping, and office areas. Capital expenditures at the other five processing plants for new equipment amounted to \$3.4 million.

- 1992 The turkey segment of the operations performed poorly. Wholesale prices of turkey dropped by over 15 percent during the year. This was caused by surpluses across Canada, which put pressure on processor margins.

The co-operative was concerned about its debt and equity financing arrangements. Since 1985, the co-op had earned \$49.1 million, but during that period, equity redeemed to members totalled \$37.9 million (77.2 percent of earnings) and \$50.5 million was spent on capital expenditures. If the co-op was to remain strong and grow to meet future demands, less reliance on debt was crucial. The members were therefore asked to support the actions necessary to achieve a sound financial balance with sound membership equity.

Capital expenditure in the processing division totalled \$3.5 million, with a large expenditure at Abbotsford to equip the new further-processing facility, and new automated chicken multi-cut processing lines at the other plants.

GATT talks remained unresolved.

- 1993 Processing division results improved as the turkey market

strengthened considerably over 1992 levels and the chicken market remained steady.

The board of directors and management were keeping a close eye on the financial health of the co-operative. There was need for capital spending on plants and equipment, but insufficient funds were being generated to finance it. Capital expenditures totalled approximately \$2.2 million, including \$780,000 for a sewage treatment plant at the Victoria facility. In March, the co-op purchased the Hygrade hatchery at Linden, Alberta.

The demographics of the co-operative's membership were putting a strain on its equity position. The redemption of equity to members reaching sixty-five increased from about \$200,000 per year in previous years to \$1.2 million in 1993.

GATT negotiations were completed. Canada lost, so the tariffication proposal prevailed.

- 1994 The co-operative signed an agreement to purchase Sunrise Poultry Ltd., subject to the approval of the Bureau of Competition Policy in Ottawa.

There were turkey recalls at two large retail food chains in British Columbia, resulting in losses of approximately \$950,000.

There was no general redemption of equity, but \$700,000 was redeemed to members who had reached sixty-five years of age.

Plant expansion at Van's Quality Foods, started in 1993, was completed. The co-op purchased a plant previously owned by a dairy in Edmonton for use as a front-half deboning plant.

The competitive pressures on processors increased tremendously.

- 1995 There was overproduction in the chicken industry. Capital expenditures included three European-style automated

eviscerating systems for the Edmonton, Lethbridge, and Port Coquitlam plants. As well, incubators were starting to be replaced in the Abbotsford hatchery.

The financial position of the co-operative forced the board of directors to indefinitely suspend equity redemption of any kind.

The acquisition of Sunrise Poultry Ltd. was deferred indefinitely as the Bureau of Competition Policy had not approved the merger.

The co-operative incurred losses instead of net profit.

- 1996 The major problem of the co-operative continued to be poor selling margins in both the turkey and chicken segments.

Installation of a new air-chilled processing system, automated transfer machines, and improved cut-up and packaging lines at the Calgary plant cost approximately \$3 million. Abbotsford hatchery incubator replacements cost \$1 million.

A fire at the Linden hatchery on Christmas Eve destroyed approximately 60 percent of the building.

Members indicated that they wanted Lilydale to remain a co-operative and requested better communication from the board. The result was the introduction of a member newsletter and an employee newsletter.

- 1997 This was a successful year for the co-operative. There were significant advancements in new product development, solid growth in sales volumes, and improved earnings. Much of the increase in earnings was due to new and innovative products and brand launches.

Improved performance allowed the equity redemption policy to be reinstated, with \$1.6 million being redeemed to members in the spring (\$1.2 million represented full redemption of equity to members who had reached age sixty-five).

Capital expenditures in the processing division totalled \$9.3 million, including \$5 million at the Port Coquitlam plant and \$1.1 million on the automation of turkey processing plants in Edmonton and Abbotsford. As well, \$1.4 million was spent renovating the Abbotsford hatchery. Total expenditures were approximately \$14 million.

The turkey segment continued to perform poorly. The quotas set by the national board continued to oversupply a market that had not shown a per capita increase in consumption in over fifteen years.

- 1998 The turkey market across Canada was stronger as national quotas were reduced for the 1998 production year due to extremely poor results in the preceding three years.

Four specialized breast deboners were purchased for the West Edmonton plant, costing \$850,000. Total capital expenditures were approximately \$11 million.

As a result of the Linden hatchery fire, a 10,000-square-foot addition was made to the Edmonton hatchery.

- 1999 Production ceased at the Victoria location in January.

The focus was on expansion in western Canada, which resulted in the acquisition of Sunnyland Poultry Products Ltd. in Wynyard, Saskatchewan, in February.

Total capital expenditures were approximately \$10 million.

There was a weak chicken market both in the primary-processing and further-processing segments of the co-operative.

The turkey segment had an excellent year.

The board of directors continued to be concerned with the co-operative's underlying financial structure. The amount of profit as a return on sales volume, asset investment, and member equity needed to be larger if the co-op was to meet its goals of financing growth, reducing debt, and redeeming member equity.

- 2000 Equity redemption totalled \$1.6 million to estates and to members who had reached age sixty-five.
Total capital expenditures were approximately \$6.9 million.
The co-operative was able to pay down its long-term debt by \$7 million.
- 2001 Manufacturing costs increased due to rising utility costs. A strategic plan was put in place to steer Lilydale's decision-making processes over the next three years and beyond.
The tragedy of September 11 had an impact on the food-service sector, particularly in eastern Canada, resulting in discounted products such as breast meat entering the western Canada market. The net outcome was a decline in the wholesale price of breast meat by 8 percent.
Total capital expenditures were \$11 million. Equity redemptions increased to \$2 million (up from \$1.6 million in 2000 and \$942,000 in 1999).
- 2002 Oversupply of chicken resulted in a significant increase in chicken inventory at the end of the year. The turkey segment also experienced a difficult year.
The co-operative incurred a loss of \$993,000 at their South Edmonton plant.
- 2003 Lilydale exited the poultry farm production business by selling corporate farms and associated quota assets (Chinook farm: \$702,000, quota assets \$3.985 million; Conrich farm: \$4.6 million).
Calgary hatchery net earnings improved by more than \$200,000.
In September, the co-op sold the egg division to Burnbrae Farms and Sparks Farm Egg Supplies for \$719,000.
Sale of the rest of the farms in 2004 was expected to pay down debt. Plans were also put in place to sell the West Edmonton deboning facility.

The Lethbridge hatchery and plant were temporarily closed to gain efficiencies as a result of the national inventory over-supply issue.

The co-operative developed a Member Investment Program to encourage investment of \$15 million. It expected to raise \$10 million through a 2 percent revolving check-off program and a two-year prepaid member loan program. A further \$5 million was targeted to be raised through a voluntary investment program. As of 26 March, the 2 percent check-off program had raised \$1.5 million.

There was an operating loss of \$18.4 million.

- 2004 The co-operative secured a major business win by becoming the national poultry supplier for Costco, the largest warehouse club retailer in the country.

In addition to the sale of Conrich corporate farms (referred to in 2003 but operationalized in fiscal 2004), Pine Valley, Spruce Grove, and Wheatland corporate farms were sold for net proceeds (assets and quota) of \$20.1 million. There was an associated gain on the sale of \$18.6 million. Abbotsford turkey cut-up and further processing was consolidated to Edmonton North and South.

The board of directors removed the CEO from office.

On 29 January, there was a fire at the Edmonton South facility.

The co-operative introduced the standard costing system to help improve profitability even in down markets; this was a key tool in supporting improvements in both yield and labour performance.

The Lethbridge hatchery and plant were permanently closed in August.

Although the 2 percent check-off program was on track to raise its share of capital (it raised \$5.4 million through fiscal

2004), the targets on voluntary investment (a further \$3 million) were not met by the deadlines. This required Lilydale to make a commitment to the bank to implement alternate arrangements for raising capital. The member's revolving check-off program was discontinued in July.

For the first time, the annual report referred to the possibility of "changes to the structure of the Co-operative." A corporate structuring committee was formed following the annual general meeting on 27 April.

- 2005 The board of directors recommended changes to the equity payout policy of the co-operative, enabling members to exchange their member equity for shares and/or subordinated debt in the company.¹⁴

An information circular was prepared and distributed to members after approval by the board on 26 April. Delegates to the annual meeting in June voted to approve of the implementation plan. Lilydale ceased to be a co-operative.

Capital expenditures for the year totalled \$13.1 million. These included the purchase of the Mirabel facility and repayment of long-term debt in the amount of \$9.5 million.

Source: Compiled from Lilydale annual reports, 1980–2005.

Endnotes

1. Lilydale, annual reports, 1980–2004.
2. D. Finlayson, “Lilydale No Longer a Co-op after 65 Years. Corporate Format Helps in Raising Capital,” *Edmonton Journal* (23 June 2005), retrieved 9 July 2007 from http://www.lilydale.com/_bin/media/pressReleases/articles_05/05_06_23.cfm
3. Lilydale, annual reports, 1992–1995.
4. G. Lamphier, “Rejuvenated Lilydale Foods Co-op Considers Corporate Path to Growth. Structural Change Would Open Up Options for Financing Expansion,” *Edmonton Journal* (19 May 2005a), retrieved 9 July 2007 from http://www.lilydale.com/_bin/media/pressReleases/articles_05/05_05_19.cfm
5. Developed from Lilydale annual reports, 1980–2004.
6. Finlayson, “Lilydale No Longer a Co-op.”
7. *Ibid.*
8. Current ratio is calculated by dividing the current assets by the current liabilities. It is frequently used as an indicator of a company’s liquidity, its ability to meet short-term obligations. Assets are typically classified as either current assets or long-term assets. A current asset is expected to be sold or otherwise used within one business year. Current assets may include cash, cash equivalents, accounts receivable, inventory, the portion of prepaid accounts that will be used within a year, and short-term investments. Current liabilities are liabilities that are expected to be settled within the fiscal year.
9. Developed from Lilydale annual reports, 1980–2004, and Co-operatives Secretariat, *Co-operatives in Canada*, various issues, 1980–2006 (Ottawa: Government of Canada).
10. *Ibid.*
11. *Ibid.*

12. "Lilydale Cuts 100 Jobs: Prairie Pride's Arrival to Province Forces Firm's Move," Saskatoon *StarPhoenix*, 17 September 2005.
13. E.g., California Avocado Growers; see details at www.calavo.com/company.php
14. Lamphier, "Rejuvenated Lilydale Foods Co-op."

Coming Full Circle

Prudential Insurance Company

FABIO R. CHADDAD AND FERNANDO R. CHADDAD

Background¹

IN THE EARLY 2000s, THE UNITED STATES INSURANCE industry was experiencing a wave of structural changes as many property and casualty (P&C) and life and health (L&H) mutuals were converting to stock charters in a process known as demutualization. The then-largest life insurer in the United States, Prudential Insurance Co., completed the conversion process in December 2001; the second largest, MetLife, successfully demutualized in April 2000. This case study analyzes the conversion process of Prudential Insurance Co. and the subsequent initial public offering (IPO) of Prudential Financial Inc., the largest IPO in the insurance industry until then, valued at \$4 billion.

Prudential's origins trace back to 1873 with the incorporation of the Widows and Orphans Friendly Society under the leadership of a visionary called John Dryden. "Friendly societies" were common organizations in the eighteenth and nineteenth centuries; they were small, voluntary, mutual organizations providing health and life insurance mainly to the poor. In 1875, the friendly society changed its name

to Prudential Friendly Society and again in 1877 to Prudential Insurance Co. of America, the firm's identity until December 2001. Prudential was the first company to sell life insurance to working-class people in the United States. John Dryden led Prudential from 1875 until his death in 1911.

Meeting a rising demand for insurance, Prudential's business grew rapidly in the late 1800s — an 1882 account termed its growth “phenomenal.” Indeed, only ten years after its founding, Prudential issued its one-millionth policy to founder John Dryden. By then, Prudential's sales extended beyond its original New Jersey base into New York City and Philadelphia, as the company's customer base expanded to the newly emerging middle class. In 1890, to accommodate its growing business, the company broke ground for its new headquarters (known as the Prudential building) in downtown Newark, New Jersey. Opened in 1892, the eleven-storey skyscraper was New Jersey's largest office building. Prudential's famous logo, the Rock of Gibraltar, first appeared as the company's symbol in an advertisement in 1896. The Rock has been one of America's best-known icons since then.

Prudential continued to expand in the early 1900s. In 1909, the company opened its first international office in Canada. Beginning in 1912, Prudential's agents embarked on weekly visits to policyholders across the United States. According to company historians Earl May and Will Oursler, “An agent was sent out with a rate book on foot or bicycle. [More than just a policy,] they sold the idea of insurance to the people of America.”²

In 1915, Prudential converted from a stock into a mutual insurer after a majority of stockholders sold their stock back to the company. Back then, mutual insurance companies were regarded as a special organizational form that protected the collective capital of policyholders and kept premium prices low. The last privately held Prudential stock was sold back to the company in 1946, making Prudential a true mutual company owned and controlled by policyholders.

During the World War II era, Prudential created a special war section to expedite the processing of military claims. Through June 1946,

it paid over \$70 million in claims on some one hundred thousand policies. After the war, Prudential continued to expand geographically in the continental United States. In 1948, the company built its western home office in Los Angeles. By year's end, over one thousand employees and their families had relocated to the west coast, an experience that was repeated as Prudential established other regional offices across the country.

In 1951, Prudential diversified from its original life insurance roots by offering medical insurance policies in the United States. At that time, the company had begun decentralizing many administrative functions formerly carried out in its corporate office in Newark. In an age when electronic data processing was in its infancy, decentralization of operations was the best way to ensure that policyholders received fast, efficient, and personalized service. As Prudential established regional offices during the 1950s, it worked to strengthen its agents' presence throughout the United States. Regional offices supported this effort through targeted advertising campaigns. As Prudential's then president Carrol Shanks observed, Prudential was committed to remaining "essentially a home-town operation, serving thousands of local communities."³

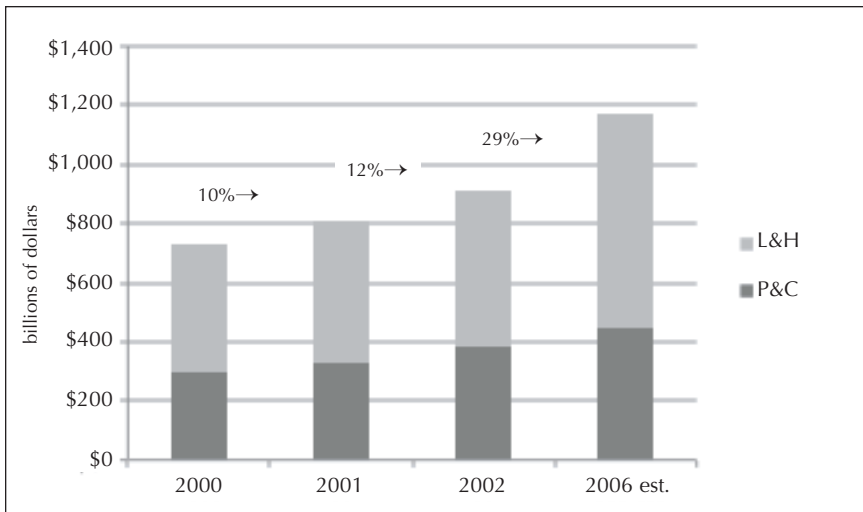
Prudential continued to experience rapid growth and diversification in the 1960s, surpassing Metropolitan Life as the largest insurance company in the United States in 1966. In 1970, Prudential became the first insurance company to offer variable annuities, and in 1981, it acquired the securities brokerage firm of Bache Halsey Stuart Shields and renamed it Prudential-Bache Securities, which later became simply Prudential Securities. In another diversification move, Prudential entered the residential realty business in 1987. Growth in core insurance underwritings added to the business volume brought in by the new business lines, and Prudential became one of the top ten United States insurers (see table 1, overleaf). By the early 1990s, Prudential's consolidated assets surpassed \$100 billion, and in 1995, the company was added to the "Fortune 500" list, which ranked the company fifth in assets.

Table 1: Largest Insurers in the United States⁴

Company	2004 Revenues in \$ billions	Percent Change from 2003	Ownership Structure	Industry Subgroup*
AIG	98.6	21	Stock	P&C
Berkshire Hathaway	74.4	17	Stock	P&C
State Farm	58.8	5	Mutual	P&C
MetLife	39.5	9	Stock	L&H
Allstate	33.9	6	Stock	P&C
Prudential	28.3	2	Stock	L&H
NY Life Insurance	27.1	6	Mutual	L&H
TIAA-CREF	23.4	-10	Mutual	L&H
Mass Mutual	23.1	10	Mutual	L&H
Hartford Financial	22.7	21	Stock	P&C

* P&C is property and casualty; L&H is life and health.

Figure 1: United States Insurance Industry Growth Trends⁵



On an industry level, insurance accounted for a significant portion of the national economic activity in most developed countries by the mid-1990s. In the United States, the sum of the L&H and P&C markets was a trillion-dollar industry, growing at more than 10 percent per year in the early 2000s (see figure 1).

In addition, the insurance industry was one of the biggest employers in the United States, with over 2 million employees. Demand for insurance in the United States was expected to keep rising as risks became more complex and abundant in the economy. The growth in the entire industry, according to the United States Bureau of Labor Statistics, was expected to be within 20 and 40 percent between 2000 and 2010.⁶

In the late 1990s, the United States insurance industry was unique in that several organizational forms coexisted within the industry. Insurance companies were generally organized as mutual or stock firms. In 1997, there were 1,046 stock and 92 mutual insurers in L&H and 1,827 stock and 466 mutual insurers in P&C insurance.⁷ The coexistence of stock and mutual insurers suggests that each achieved efficiency by trading off the costs and benefits specific to each organizational form. Historically, the emergence of mutual insurers had been attributed to limited competition and the inability of insurers to distinguish risk class. Insurers had originally adopted the mutual ownership structure as a special organizational form that protected the collective capital of policyholders. Such was also the early story of Prudential. By the 1990s, however, Prudential had changed dramatically (see table 2, overleaf), and so had the industry and competitive environment. Change would soon impact Prudential again as an outsider moved into the company's corner office.

Table 2: Major Events and Activities, 1873–2001⁸

Date	Activity
1873	Prudential is the first company to sell life insurance to working-class people in the United States
1877	Name changed to The Prudential Insurance Co. of America
1892	Opening of the company's headquarters, the Prudential Building, in Newark, New Jersey
1896	The Rock of Gibraltar first appears as Prudential's corporate symbol
1909	Prudential opens first office in Canada
1915	Prudential converts from a stock to a mutual insurer
1923	Prudential's assets reach \$1 billion mark
1946	Last privately held Prudential stock is sold back to the company
1951	Prudential pioneers medical insurance
1966	Prudential surpasses Metropolitan Life as the largest insurance company in the United States
1970	Prudential becomes the first insurance company to offer variable annuities in the United States
1981	Prudential acquires the securities brokerage firm of Bache Halsey Stuart Shields, Inc.
1987	Prudential enters the residential realty business
1994	Arthur Ryan replaces Robert Winters as Prudential's chairman and CEO
1995	<i>Fortune</i> magazine adds Prudential to its "Fortune 500" list, ranking the company fifth in assets
1996	Metlife surpasses Prudential as top industry writer of life and health insurance premiums

- 1998 Prudential's board of directors announces demutualization plans
- 2000 Prudential's board adopts reorganization plan, the framework for demutualization
- Mar. Prudential submits application to demutualize to the New
2001 Jersey Commissioner of Banking and Insurance
- July Voting period ends with policyholders approving the
2001 company's demutualization plan
- Oct. Commissioner approves Prudential's demutualization plan
2001
- Dec. Prudential Financial, Inc. common stock begins trading on
2001 the New York Stock Exchange

Reasons for the Conversion

In 1994, Robert Winters retired as Prudential's chairman and CEO. He was replaced by Arthur Ryan, who had been credited with rebuilding Chase Manhattan Bank. Ryan was the first CEO to be hired from outside the company's ranks. Once in charge, he replaced most top managers and started to revamp Prudential. It was under Arthur Ryan's leadership that Prudential decided to change its ownership structure, transforming itself from a mutual to a stock and publicly traded company. Several factors in the 1990s made demutualization interesting for insurance companies such as Prudential.

Falling Profitability

The United States insurance industry had a difficult decade in the 1990s as intense competition kept P&C insurance premium rate increases low. This was mainly due to significant casualty losses and other factors that hampered the ability of many firms to earn profits. Insurance companies paid out around \$100 billion in losses from weather-related natural disasters in the 1990s, close to four times the

amount for similar claims handed out during the 1980s. At \$15 billion, weather-related insured losses in 1998 were second only to the \$25 billion recorded in 1992, according to estimates from the German reinsurance⁹ company Munich Re. Another factor in the escalating cost of insured losses in the 1990s was the effort of governments and insurers in industrial nations to make inexpensive insurance protection more widely available, encouraging a coastal migration trend that dramatically increased the amount and value of property at risk to storm damages. Research by the reinsurance company Swiss Re indicated that the relatively catastrophe-free years of the 1960s and 1970s gave property owners a sense of complacency, leading them to build heavily in disaster-prone areas.¹⁰

Changing Consumer Behaviour

Interest shifted rapidly in the 1990s towards flexibility and transparency. This meant the rise of low-margin, long-term savings products. But this trend took off precisely as general insurance companies were battling with tighter pressures on margins and increasingly competing on price, as the industry consolidated, and as white-label products led to more product commoditization.

New Technology

The large US multi-line insurers had traditionally sold a broad line of coverage, offering all types of insurance to all types of customers. As a result, many of these companies found themselves becoming outdated and hampered by bloated management structures, in addition to expensive marketing systems, operating in an unfocussed manner. However, things started to change dramatically in the mid-1990s. Technology posed new challenges for the industry as a whole. According to industry observer and JCG Ltd. chairman Donald Jackson, "The Internet is, for insurance purposes, a new medium, and the industry has been trying to figure out a way to use it for years."¹¹ Insurance companies in the late 1990s used the Internet in two ways: first, for business-to-busi-

ness transactions with an underwriting company dedicated to the agency distribution channel; and second, as a consumer information medium to support branding. But it was used least of all for actual transactions with the processing of applications, binding, and the issuance of policies in real time. Insurers had long looked to the Internet as a prime way to cut distribution costs. According to industry observer George McKeon, “The opportunities for cost savings are there, especially for [insurers] that are able to reduce costs of the various pieces by using the Internet to deliver them.”¹²

Blurring Boundaries between Banking and Insurance

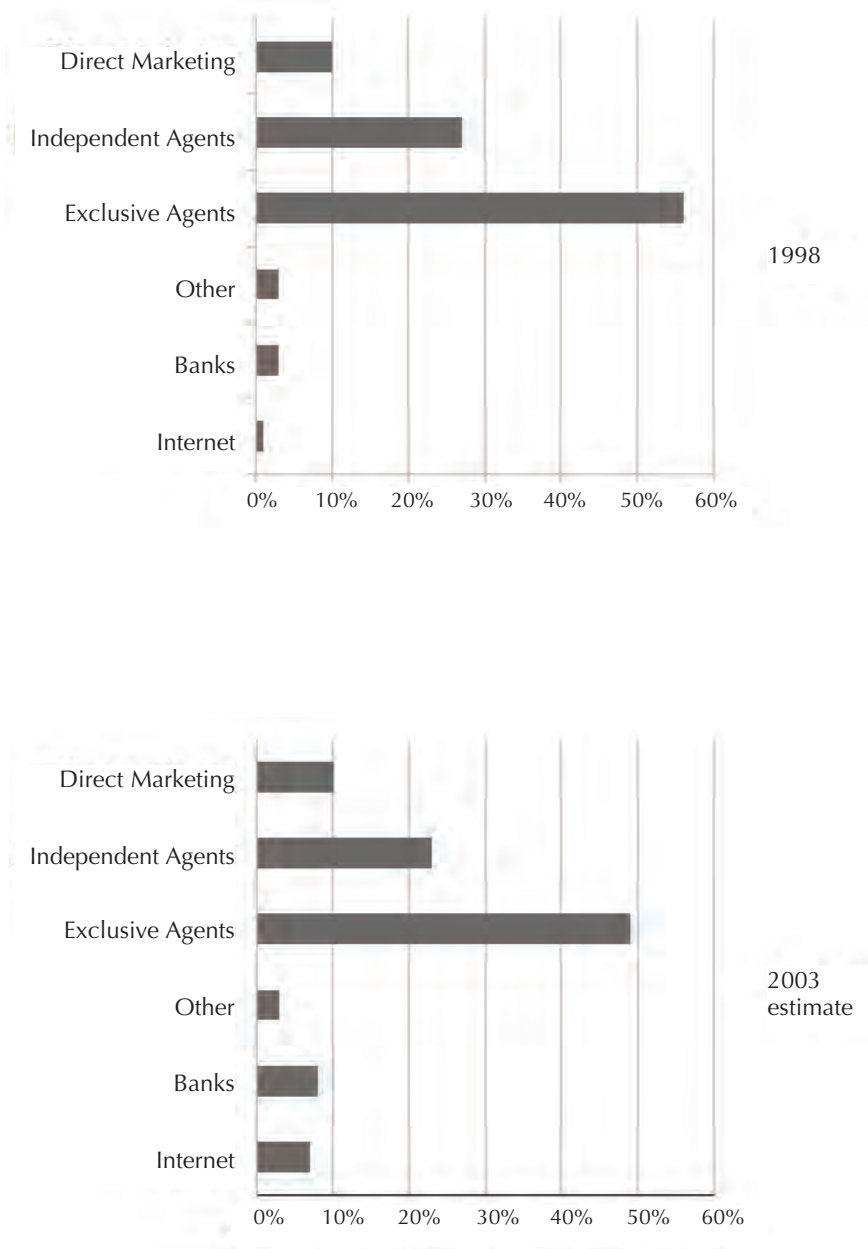
Around the world, the advent of banking “universalization” meant increasingly blurred boundaries between bank and nonbank financial services. In the late 1990s, this trend was well developed in Europe with “bancassurance,” the distribution of insurance products through bank branches. To some extent, this irreversible trend was confirmed in the United States by the 1990s mega-merger of Citicorp and the Travelers Group.¹³

Shifting Distribution Channels

The methods of selling insurance policies in the United States were changing rapidly in the late 1990s. The share of revenues created by traditional P&C insurance sales channels was shifting as blurring industry boundaries and new technology led to a rising market share commanded by commercial banks and e-commerce. The total share of insurance sold by traditional agents dropped in the process. In addition, direct marketing (including direct mail and other forms of advertising) continued to hold significant market share (see figure 2, overleaf).

These trends were only expected to accelerate in the late 1990s. In 1998, industry giant Allstate shook up its vast exclusive agent network when it announced that it would begin selling insurance directly to consumers online and through call centres. Customers acquired online

Figure 2: Shifting Channels in the United States Insurance Industry¹⁴



were later assigned to agents, who received a smaller commission rate on e-commerce sales. Another impact of technology and e-commerce was the integration of distribution channels, which threatened the role of intermediaries in the insurance marketplace.¹⁵

Rising Merger and Acquisition Activity

As a consequence of the drivers identified above, insurance merger and acquisition (M&A) activity accelerated in the 1990s and continued at a rapid pace in the early 2000s. SNL Financial reported 201 mergers across the industry during the first nine months of 2001, at a combined value of \$61.1 billion. This included P&C, L&H, broker and agency, and managed health care insurance deals (see tables 3 and 4, below).

Table 3: Merger and Acquisition Insurance Deals in 2001¹⁶

Buyer	Company Acquired
AIG	American General
Swiss Re	Lincoln National's reinsurance unit and Aurora National Life
Sun Life	Clarica Life, Keyport Life, and IFMG
AEGON	J.C. Penney Direct Marketing (life insurance)
Nationwide Financial	Provident Mutual
Old Mutual	Fidelity and Guaranty Life
GE	National Mutual Life
Hartford Financial	Fortis Financial
Allstate Life	American Maturity Life
Aid Association for Lutherans	(merger with) Lutheran Brotherhood

Table 4: Merger and Acquisition Insurance Deals in 2005¹⁷

Buyer	Company Acquired	Deal Value in \$ billions
MetLife Inc.	Travelers Life & Annuity Co./CitiInsurance	11.5
United Health	PacifiCare Health Systems Inc.	8.0
Lincoln National	Jefferson-Pilot Corp.	7.5
Swiss Re	P&C business of GE Insurance Solutions Corp.	6.8
Well Point	WellChoice Inc.	6.6

The total value was nearly three times the \$20.4 billion in mergers during the same period of 2000, which covered 247 deals. Fundamental changes in the insurance industry continued to cause M&A activity. However, consolidation among insurance firms was slower than in commercial banking. One hurdle was technology: insurance policies varied widely from one insurer to the next, while chequing accounts, in contrast, were largely the same from bank to bank. Furthermore, insurance companies ran their distribution, marketing, and claims processing in widely varying ways. For example, one company sold through thousands of independent agents, while another sold only through its own agents, and still another sold only through direct marketing. Generally, it was much easier to merge the operations of two banks than it was to merge those of two insurance companies.

In summary, the reasons for demutualization were plentiful and self-reinforcing. All pointed to the same effect — increased M&A activity, which was responsible for another accelerating trend in the United States insurance industry in the 1990s: demutualization, defined as the conversion of mutual companies into stock companies. Conversion enabled the insurer to distribute its assets in the form of shares and typically led to the company's IPO. According to industry commentators, "As walls tumble between financial industries and buy-or-bebought becomes the war cry, more mutual insurers are poised to make the leap from mutual to stock ownership."¹⁸

And so begun a wave of demutualization in the United States insurance industry. While the performance of most mutual insurers remained solid, market shares started to decrease, from 40 percent of all insurance premiums in 1992 to 37 percent in 1996. From 1990 to 1999, there were thirty-six conversions among P&C insurers and twenty-one between L&H insurers (see table 5).¹⁹

Table 5: Demutualization in the United States Insurance Industry, 1988–1999²⁰

Year	# of P&C cases	# of L&H cases
1988	2	1
1989	0	3
1990	0	0
1991	5	0
1992	1	1
1993	4	0
1994	3	1
1995	4	2
1996	3	1
1997	5	4
1998	5	7
1999	4	1
Total	36	21

Note: P&C is property and casualty; L&H is life and health.

The early 2000s would witness the largest life-insurer demutualizations recorded to date, followed by billion-dollar IPOs, including the ones by Prudential, MetLife, and John Hancock (see table 6, overleaf).

Table 6: Demutualization and Initial Public Offerings (IPO) in the United States Insurance Industry, 1996–2001²¹

Mutual Company	Stock Company	Date	IPO Size (\$ millions)
Prudential Insurance Co.	Prudential Financial, Inc.	Dec 2001	3,800
Phoenix Home	The Phoenix Companies	Jun 2001	854
Metropolitan Life	MetLife	Apr 2000	2,880
John Hancock	John Hancock	Jan 2000	1,734
MIIX Insurance	MIIX Group	Jul 1999	41
NCRIC	NCRIC Group	Jul 1999	10
Standard Insurance	StanCorp	Apr 1999	331
MONEY Life	MONEY Group	Nov 1998	283
Old Guard	Old Guard Group	Feb 1997	39
Trigon Insurance	Trigon Healthcare	Jan 1997	232
SCPIE Indemnity	SCPIE Holdings	Jan 1997	37
AmerUs Life	AmerUs Life Holdings	Jan 1997	77
Intermed Insurance	FPIC Insurance Group	Aug 1996	34
Farm Family Casualty	Farm Family Holdings	Jul 1996	40
Riscorp	RISCORP	Feb 1996	190

On the other hand, demutualization was seen to have many drawbacks, including a costly and lengthy process totalling millions of dollars and taking at least two years; the risk of arousing the wrath of policyholders and consumer groups in the form of lawsuits; exposure to the daily headaches of dealing with stock prices, securities analysts, and a fickle investment community; and, perhaps more importantly, the loss of control by policyholders. In addition, demutualization put pressure on management to make strategic choices and spend capital more wisely, which was considered to be a challenge for many mutual companies. This was summarized by industry observer and academic J.J. Wortman: “One can see how difficult the process is for mutual insur-

ance company boards and management to move an entire organization from a focus on enhancing capital to protect policyholder obligations to a new goal driven by stockholder motivation to increase return on equity.”²²

The Conversion Process

Under the leadership of Arthur Ryan, Prudential announced plans in February 1998 to convert from a mutual company into a publicly traded, stock-owned company. The stated reason for demutualization was to become more competitive and to have the flexibility to grow globally. It was thus a strategic move. Other reasons included the wish to compete more effectively and perhaps buy other companies. Prudential also wanted to diversify and was working on new financial service products. In 1997, the company had begun an aggressive strategy to grow globally and opened operations in Brazil and the Philippines in 1998. The company was also careful to state that it did not make the demutualization decision because of capital constraints: it had \$12.7 billion in capital and paid out \$2.5 billion in dividends to policyholders in 1996. Prudential thus demutualized from a position of financial strength.

In December 2000, Prudential’s board of directors unanimously approved a reorganization plan that provided the framework under which the company would convert from a mutual structure into stock ownership. CEO Arthur Ryan stated, “We are proud of the careful work and consideration that has gone into our plan. It accomplishes what we set out to do, which was to design a framework that distributes the value of the company to our policyholders in a fair and equitable manner.”²³

For the company to be able to demutualize, the reorganization plan needed the approval of both the New Jersey Commissioner of Banking and Insurance and the company’s policyholders who were qualified to vote. Prudential submitted its application to demutualize, including the reorganization plan, to the commissioner in March 2001.

A month later, the company completed its application by filing financial information with the New Jersey Department of Banking and Insurance. It also made its initial filing with the Securities and Exchange Commission (SEC).

Subsequently, in one of the largest mailings in the history of the United States Post Office, Prudential mailed information packages to approximately 11 million policyholders. The packages contained details about the company's reorganization plan, financial information, and other materials necessary to vote on the company's demutualization proposal. Packages were sent to one in ten US households and weighed 1.7 pounds each. The voting period concluded in July 2001, with policyholders overwhelmingly approving the company's demutualization plan. Prudential received more than 4 million votes, four times the amount required by the New Jersey demutualization statute, making it the largest demutualization vote on record. Nearly 92 percent of policyholders who cast their votes approved the reorganization plan.

In October 2001, the New Jersey Commissioner of Banking and Insurance approved the company's plan, and the reorganization process concluded on 13 December 2001, when Prudential Financial Inc. began trading on the New York Stock Exchange under the symbol PRU. The initial public offering, valued at approximately \$4 billion, closed on 18 December 2001, at which point Prudential converted from a mutual company to a publicly traded stock company. It was the largest demutualization in the insurance industry at the time.

According to industry observer Theresa Miller, Prudential made the decision to give its policyholders the full value of their ownership through stock, cash, or policy benefits.²⁴ About \$12 billion in surplus would go to 11 million policyholders. Analysts said Prudential would be watched closely to ensure policyholders were treated fairly and to avoid any risk of expropriation. According to then-Prudential spokesman Robert DeFillippo, "This better be the most consumer friendly demutualization on the face of the planet."²⁵

Impact of the Conversion

Following its demutualization, Prudential entered a period of flat revenue growth accompanied by a significant surge in profitability. Sales increased little between 2001 and 2004, rising from \$26.6 billion to \$28.3 billion (see table 7). Management estimated that the total number of customers in this period remained constant at 15 million.

Table 7: Prudential Property and Liability after the Demutualization
(Values in \$ billions)²⁶

	2001	2002	2003	2004
Premium revenues	11.9	13.0	13.2	12.6
Policy charges and fee income	2.0	1.8	2.0	2.3
Net investment income	9.1	8.8	8.7	9.1
Realized investment gains, net	-0.7	-1.3	0.3	0.7
Commissions and other income	4.3	4.0	3.7	3.6
Total revenues	26.6	26.3	27.9	28.3
Policyholder benefits	12.4	13.4	13.4	12.9
Demutualization costs	0.6	0.0	0.0	0.0
Other expenses	13.7	12.8	12.5	12.1
Total expenses	26.7	26.2	25.9	25.0
Income from operations	-0.1	0.1	2.0	3.3
Net income	-0.1	0.1	1.2	2.2

According to Prudential's 2004 annual report, the demutualization costs and expenses totalled a significant \$588 million. The company posted a net loss of \$154 million in 2001. The following years saw a consistent increase in net profits — from \$194 million in 2002, to \$1.26 billion in 2003, to \$2.25 billion in 2004. This positive performance was

delivered in difficult days for the US insurance industry. The September 2001 attack on the World Trade Center towers created the largest insured loss in history, with covered losses initially estimated to run from US\$30–70 billion, including US\$5–6 billion in life insurance claims.²⁷ Shortly after 11 September, there was a sharp spike in the sale of life insurance products. After the devastatingly expensive World Trade Center terrorist attacks, rates on many types of coverage increased dramatically. In the aftermath of 11 September, average rate increases of 16 percent or more were expected in 2002.

Many customers seeking to renew policies would find that insurance was no longer available under previous terms and rates, or would not be available at all due to changes in the market as a result of these factors.²⁸ As another consequence of its demutualization, Prudential joined the M&A activity in the industry and completed a number of business transactions. These included the acquisition of American Skandia, the largest distributor of variable annuities through independent financial planners in the US, and the creation of a retail brokerage business with Wachovia Corporation, forming one of the nation's largest retail financial advisory organizations, Wachovia Securities, LLC.

By early 2006, the process of demutualization of the United States insurance industry had enabled the creation of some of the country's largest corporations, and the process was likely not over yet. In the top-ten list of the country's P&C and L&H insurers, the only one that remained above Prudential (ranked sixth, with 2004 revenues of \$28.3 billion) was State Farm (ranked third, with 2004 revenues of \$58.8 billion).

Observations and Recommendations

The Prudential conversion from a mutual to a stock charter highlights the observation that waves of demutualization often follow disruptive institutional and market changes.²⁹ In industries where co-operative or mutual organizations have traditionally played important econom-

ic roles, many demutualizations have occurred in the wake of dramatic changes that fundamentally altered the “rules of the game.” These changes have increased the level of competition in these industries and negatively affected their margins. In the case of Prudential, falling profitability, changing consumer behaviour, new technologies, blurring boundaries between banking and insurance services, and shifting distribution channels put considerable pressure on traditional business models and spurred a wave of M&A activity and subsequent industry consolidation. Prudential hired a CEO from the banking sector to position the company as a potential industry consolidator by means of an aggressive growth strategy that could not be sustained within the mutual organizational model.

The Prudential case also suggests that changes in organizational structure can enhance efficiency. Prudential’s continued growth and increased profitability following the 2001 conversion suggests the company is well positioned to play a leadership role in the US insurance industry. Despite the fact that Prudential was not operating with binding financial constraints before demutualization, the conversion and subsequent IPO added significant financial flexibility, which allowed company managers to pursue growth-related strategies, including M&As. As well as providing access to additional sources of equity capital, demutualization decreased Prudential’s dependence on internally generated funds.

Finally, this study notes that conversion provides members with access to unallocated equity and reserves (surplus), in this case a \$12 billion windfall for Prudential’s policyholders. As other case-study evidence has shown, limited horizon co-operative members might have a positive perspective on demutualization as a means to accessing accumulated surplus and reserves.³⁰

Endnotes

1. Our research was compiled entirely from secondary, published sources. It is intended to be used as a basis for class discussion in a management education context, rather than to illustrate either effective or ineffective handling of a company-specific situation.
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Failing Members and Investors

Saskatchewan Wheat Pool

MURRAY FULTON AND KATHY LARSON

Background and Reasons for the Conversion

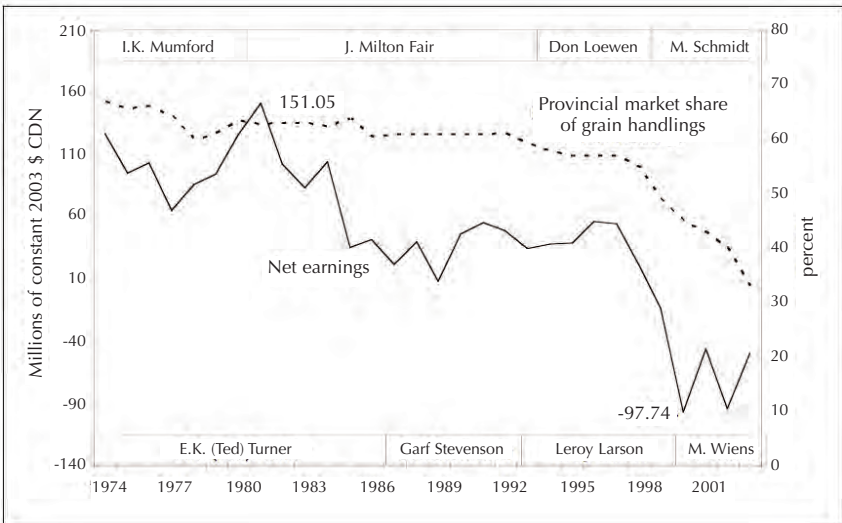
SASKATCHEWAN WHEAT POOL (SWP) SHARES BEGAN trading on the Toronto Stock Exchange (TSE) on 2 April 1996, making the co-operative one of but a handful in the world at the time with publicly traded shares. Shares opened at \$12 and rose to \$24.40 by 1998. The share value then declined, reaching approximately \$9 in 1999 and \$0.20 in 2003 (see figure 1, opposite). In February 2005, SWP's board of directors approved a recapitalization plan that completed the transformation of the Pool from a co-operative to a business corporation by consolidating the two share classes that had previously existed into a single common share with no ownership limit.¹

The share conversion in April 1996 marked the culmination of a concerted effort by SWP to reconfigure its financial structure. As early as the mid-1980s, Pool management recognized the need to raise additional capital. Although Pool earnings had reached an all-time high in 1981, they were slowly declining (see figure 2, opposite). The belief in the Pool — and indeed the grains industry in general at the time — was that the bulk grain handling business was going to be less and less

Figure 1: Price of Saskatchewan Wheat Pool Shares on the Toronto Stock Exchange, 1996–2004²



Figure 2: Saskatchewan Wheat Pool Grain Market Share in Saskatchewan and Net Earnings, 1974–2003³



Individuals noted across the top of the figure are Saskatchewan Wheat Pool CEOs; those at the bottom are board presidents.

profitable over time, and that investment in value-added processing was required if the Pool was going to remain financially strong. This investment would require capital.

In addition, it was believed that a major investment would be needed to upgrade and modernize the grain handling system — the core of the Pool's business. This upgrade was necessary for a number of reasons, including the need to replace the Pool's smaller wooden elevators with large concrete inland terminals (something that the Pool's competitors were doing) and thus better position the Pool in the anticipated deregulation of the grain handling system.

The Pool was particularly worried that its co-operative structure would not be able to provide the capital required to meet the challenges identified above. Not only were earnings expected to be lower in the coming years, but the Pool also faced the need to redeem a substantial amount of member equity during the 1990s, when nearly half its members were due to retire. The company anticipated having to pay out more than \$100 million in retained equity to these retiring members.⁴ The combination of the equity redemption and the demand for investment capital would result in a capital shortage.

Although the share conversion did not immediately provide the Pool with access to any more equity capital (a subsequent share offering in 1998 added \$110 million), the new financial structure did make available a significant amount of additional debt capital that the Pool used to fund investments. Capital investments in the 1990s were significant, outnumbering those in the previous two decades combined. One of the major capital investments in the 1990s was Project Horizon, a \$270 million upgrade and consolidation of the Pool's grain handling division.⁵ The company also made its first foreign direct investments in the 1990s, with the purchase of facilities in England, Poland, and Mexico.⁶

Within two years of the share conversion, the Pool's market share and earnings had dropped dramatically. In 1999, the organization posted its first net loss — \$14.3 million — a figure that swelled to \$97.7 million the following year (see figure 2, p. 95). The Pool's Saskatchewan

market share in its core grain handling business, which for most of the 1980s had been around 60 percent, fell to under 35 percent. The numerous acquisitions in the 1990s resulted in a rise in long-term debt from \$93.6 million in 1996 to more than \$518.7 million in 1999. A management change that same year resulted in the sale of several major business lines between 2001 and 2003, which decreased long-term debt by \$311 million.

The Pool's ongoing troubles led to major financial and governance restructuring. Faced with a large debt load, SWP announced a restructuring of \$405 million in debt in January 2003. This was accompanied by a governance restructuring that involved reducing the number of farmer-member directors from twelve to eight and adding four independent directors, one of whom was designated the lead director. (This person was vice-chair of the board with responsibility for managing the board and chair of the Strategic and Business Planning Committee.⁷) Continuing poor financial performance resulted in a further restructuring in 2005 in which SWP became a federal corporation governed by the *Canadian Business Corporations Act*.

The Conversion Process

Prior to the share conversion, SWP had a fairly traditional co-operative financial structure. Members were required to purchase a \$5 share at the time they joined the co-operative and built up equity through retained patronage allocations from the co-operative's earnings. The Pool used the remainder of its earnings to amass unallocated retained earnings and to redeem a portion of the accumulated member equity.⁸

At the time of the conversion, the Pool had a membership of approximately seventy-eight thousand and \$1.37 billion in total assets. Member equity accounted for \$452.88 million of the total assets — the result was a debt/equity ratio of 2.03. Of the total member equity, unallocated retained earnings amounted to \$147.52 million, while the remaining \$305.36 million was member share capital.⁹

The conversion into a publicly traded co-operative resulted in the

creation of two classes of shares: Class A (voting) and Class B (non-voting). Of the total member share capital, \$1.95 million was converted into Class A shares, with the remainder — \$ 303.41 million — converted into Class B shares.¹⁰

The dual share structure was chosen to allow the farmer members to retain control over the co-operative while allowing outside investors. Only active farmers were eligible to own Class A shares, with each farmer having one share worth a par value of \$25. Each Class A share provided the member with one vote in delegate elections; these delegates, in turn, elected the board members. Ownership of a Class A share also gave the member the right to participate in Pool committees.

Farmers were allocated Class B shares on the basis of their remaining equity balance, with each \$10 of equity corresponding to one Class B share. Prior to the conversion date, members had to advise the Pool if they wanted to retain, increase, or sell their shares based on their current equity balance. Internal trades were carried out at price of \$12 per share.¹¹ Class B shareholders were entitled to an annual dividend (if the board of directors declared one), an invitation to the annual shareholders' meeting, and a vote on issues such as amalgamation, sale of assets, and creation of new share classes.

Initially, Class B shareholders were not allowed to own more than 10 percent of the total issued and outstanding shares.¹² This limit was intended to keep majority control of the Pool with the farmer membership. An amendment in 2002 allowed for a higher ownership limit to be granted in special circumstances,¹³ a restriction that was removed in the February 2005 recapitalization plan.

The share conversion required a change in legislation by the Saskatchewan government, which approved the original act that created the Pool on 25 March 1924. Prior to the conversion, the organization was governed by *The Saskatchewan Wheat Pool Act, 1980*, which was amended by *The Saskatchewan Wheat Pool Act, 1995*, to allow the conversion to take place. This amendment was approved by the Saskatchewan legislature after a vote by Pool delegates on 14 July 1994 to proceed with the conversion. The Pool's bylaws required two-thirds

of the 137 delegates to approve the conversion.¹⁴ The vote was 110 in favour and 27 opposed.¹⁵

As mentioned above, SWP stock (SWP.B) began trading on the TSE on 2 April 1996 at \$12 per share, rising to its peak value of \$24.40 in early 1998. It then began to fall, reaching a low of \$0.20 per share in April 2003 (see figure 1, p. 95).

Impact of the Conversion

The following analysis is based on the concept of economic linkage, which is concerned with the degree to which the interests of the members are linked to those of the co-operative. As Fulton and Giannakas¹⁶ and Fairbairn¹⁷ argue, a co-operative will only be successful if its members trust it to be an effective agent for achieving their interests and those of other members. For instance, if the activities of the co-operative are structured so that its members benefit when it does well and it benefits when its members do well, then the economic linkage is said to be high. The degree of economic linkage is strongly correlated with the degree of member commitment. As Fairbairn notes, “A general hypothesis would be that a co-op that cannot form a close economic linkage with its members in at least one of these ways — shared operating success, products to meet specific needs, convenient format or location, or perhaps relational quality — will suffer from weak member commitment.”¹⁸

This hypothesis is particularly relevant when it comes to a consideration of a co-operative share conversion. From a legal vantage point, business corporations and co-operatives are considered in exactly the same way, in that the shareholders and members, respectively, do not have direct ownership in the corporate/co-operative property. Instead, the shares purchased by the shareholders/members give these individuals the right to a share in the profits (if any) of the organization and the right to provide some degree of control (e.g., through election of directors) over the organization. If the organization is dissolved, then shareholders have a proportionate right to the break-up value of the

corporation/co-operative, but no rights to any particular property owned by the corporate entity.

While there is an important reason for this particular legal structure (i.e., to ensure that the assets of the corporation/co-operative are owned by a single entity and cannot be split apart by the actions of individual shareholders/members), it has the effect of making investor/member confidence an extremely important element in the success of a business. To be willing to make an investment in a corporation or to become a member of a co-operative, shareholders/members must have confidence in the management of the organization. This confidence issue is one of the key reasons why corporate governance matters are so important. Without proper governance, the shareholders/members will not have sufficient confidence in the organization and the organization risks the loss of their support (e.g., shareholders will pull their money out, causing the stock to fall in value; co-operative members will take their business elsewhere).

Given this context, one can ask whether the transfer of ownership to the Class B shareholders allowed the Pool to maintain its economic linkage with its members, while at the same time creating confidence in the minds of the Class B shareholders that the organization would be well run. Put simply, is maintaining economic linkage with members compatible with creating Class B shareholder confidence? This is part of a larger question — namely, whether each of the groups is able to exert enough control over the organization's management to satisfy its own particular interests.

The effective control of management is directly linked to the principal-agent problem. An agency relationship occurs when a principal hires an agent to carry out a task on the principal's behalf. A classic example is when the shareholders (the principals) of an organization, represented by a board of directors, hire management (the agent) to carry out the day-to-day activities of the organization. This relationship can become a principal-agent problem if the agent's actions are not directly observable by the principal and if the agent has more information than the principal. The interests of the principal are to

ensure profitability of the organization, increase share value, and maximize the long-run value of the organization.¹⁹ The interests of the agent (management) are to pursue his/her own goals — these might be things such as “status, high salaries, expensive perks, and job security.”²⁰ A principal-agent problem emerges if the direction set forth by the board limits — in management’s view — the opportunities in which an organization can be involved, and management then chooses to fully or partially disregard the direction so as to undertake investments of interest to itself.

The divergence of interests between a principal and agent has also been referred to as the control problem in agricultural co-operatives.²¹ Staatz noted that co-operatives will reach a point in size and complexity that makes it impossible to fully monitor managerial behaviour, regardless of the board members’ talents.²² The problem is particularly acute in co-ops because they lack a publicly traded share that serves as an indicator of financial health. Featherstone and Al-Kheraiji,²³ as well as Hailu,²⁴ present a test of the agency problem in co-operatives.

Observations and Recommendations

There is considerable evidence that a principal-agent problem was at work in SWP. The share conversion marked a significant shift in decision-making power from the board to senior management. The conversion dramatically changed the skill set required by board members; one of the commonly expressed views was that the board did not have the expertise to run a publicly traded co-operative. In addition, the share conversion itself can be seen as a vehicle introduced by management to both change the corporate culture at the Pool and speed up the decision-making process. One of the conclusions that can be drawn is that the share conversion acted to sever the economic linkage between the Pool and its membership. At the same time, the Pool’s governance did not ultimately generate adequate investor confidence.

The following analysis of the impact of the share conversion on the Pool’s market and financial performance was carried out using evi-

dence obtained from twenty-one interviews with senior grain industry officials and past SWP management and board members between September 2004 and April 2005.²⁵ Each interview focussed on a common set of questions pertaining to the challenges faced by the Pool during the 1980–2000 period, the nature of decision making in the organization, the role of the board and management in the decision-making process, and the view that the Pool and other grain companies had of the Pool’s role in the western Canadian grain industry. The individuals interviewed who were directly associated with the Pool occupied positions in the organization that would have allowed them access to internal discussions and decisions and hence provided them with insights into what happened during the 1980–2000 period.

The Lead-Up to the Share Conversion

A common view expressed in the interviews was that the grain handling system in western Canada in the mid-1980s was about to undergo a dramatic change. Although immediate changes to the Crow Rate — the subsidy provided to railways to transport grain from the Prairies to port — had been ruled out (it was not until 1995 that the Crow rate was changed), it was also known that a consolidation of the branch line system that allowed SWP to provide elevator service to a large number of small communities was inevitable. The construction of the Weyburn Inland Terminal by local farmers indicated that some of them were interested in investing in the larger inland terminal model, particularly if that meant they could bypass the Pool. Many farmers saw the Pool as slow-footed and a supporter of the status quo (this included the dominant role played by the Canadian Wheat Board) in the grain industry.²⁶

As well, the prevailing attitude among grain industry personnel was that commodity grain handling was a thing of the past and that companies had to vertically integrate into value-added activities if they were to survive. Evidence of this view can be found in the strategy undertaken by the Rice Growers’ Association of California. In 1985, the newly appointed CEO, Mike Cook, stated that “bulk handling of

rice [is] not going to be cost effective for members and the options [are] either to diversify or declare bankruptcy.”²⁷ A number of the interviewees expressed the view that the Pool had to either diversify or be gobbled up by the likes of ConAgra.²⁸

The mindset in the 1980s and early 1990s is nicely captured by the following quote from one of the Pool’s board members:

We long and hard argued against changes to the Crow or loss of the Crow. We knew that it was probably going to happen; the federal government was determined to get rid of the Crow Benefit. We were constantly deciding on these investments with that in the back of our mind. We didn’t want to lose the Crow Benefit but we believed politically that we could not save it so we better be prepared if that happens. The other thing that was constantly in the back of our minds that was brought to the table by management was the fact that, with some of the changes that would happen when the Crow was lost, we would have to be big enough to take on the multinationals, and if we weren’t, we wouldn’t survive. So we were preparing ourselves for that day when we would have to face the Louis Dreyfuses and the ConAgras of the world and be competitive with them. That was one of the driving reasons the Pool made the step to establish AgPro back in the mid-eighties and to buy those grain terminals, and eventually Project Horizon was part of that.²⁹

The need to reposition the Pool in the grain handling industry would require capital, and there were concerns that the traditional cooperative structure would not provide enough funds for the needed investments. There was a recognition that earnings were declining (as figure 1 shows, earnings peaked in 1981).³⁰ As well, “[t]here were concerns about generating sufficient earnings to deal with increased equity repayments, the eventual retirement bulge that would come in the mid- or latter 1990s.”³¹ As one board member recalled,

Milt Fair was the chief executive officer and when I first came on the board he was saying that for “SWP to survive ... [it] is going to

have to find another source of capital.” It would not be able to adapt to the new world on retained earnings from the membership and that was our Achilles’ heel, I might call it. You needed capital and Milt Fair mentioned this way back in the 1980s that SWP was going to have to find a source of capital to regenerate itself.³²

Another board member also noted,

We had this constant drain on the equity of the organization because we had set up a plan to revolve the equity, so when you reached sixty-five years old you could apply to get your equity out and at seventy it was automatic. And if you continued to farm, you would always get your earnings back out. That was pulling money out of our equity base. In other organizations they keep the equity separate and trade it and people have lots of fun buying it and selling it and they seem to have an advantage over us. Milt said we should be able to protect that equity from revolving and still maintain the integrity of the organization.³³

As early as the 1980s, the Pool saw its financial structure as a major impediment to its future competitiveness. To address this challenge, the Financial Resources Division carried out an analysis of SWP’s financial situation. Begun while Milt Fair was CEO (Fair’s tenure lasted from 1981 to 1993), the analysis included an examination of the Pool’s current strengths, its weaknesses, the financial environment in which it was operating, and its financial future.³⁴

The report presented to the board of directors in January 1994 laid out four options for addressing the Pool’s financial situation. Of these, the board chose and eventually implemented the A–B share model. Evidence from the interviews indicates that a number of people at the Pool believed the board did not seriously consider other options that would have allowed SWP to retain more of its co-operative structure. For instance, little discussion focussed on an alternative that would have seen SWP bundle the non-grain-handling assets — the value-added assets — into an entity and make that public. Some interviewees felt that senior management and some of the board had decided that equity conversion was the way to go and that little effort was

made to examine other options — i.e., “some of the options put on the table were no more than ‘straw men’ that could be knocked down.”³⁵

With an option chosen by the board and management, the Pool moved to get approval for the change from the membership. Under SWP’s bylaws at the time, a change in the financial structure of the co-operative required the consent of 80 percent of the delegates, who approved the new share structure at a vote held in Saskatoon on 14 July 1994.

The Share Conversion

The share conversion had a number of important impacts on SWP. The most obvious, and one of the key drivers of the conversion, was an increase in available capital. Although SWP did not have immediate access to new equity capital, the existence of permanent equity in the form of the new Class B shares — rather than the retained member equity that had to be repaid under the old financial structure — meant that financial institutions were willing to lend significantly more money to the Pool than they had before. This access to capital allowed the Pool to undertake a large number of major investments, and between 1996 and 1999, the organization directed funds to twenty-five new or expanded ventures. The speed at which these investments were embarked upon is a clear indication of the urgency the Pool believed was needed in order to survive in the industry.

Three investments were mentioned during nearly every interview: Project Horizon; the investments in international grain handling operations, specifically Poland, Mexico, and England in 1997; and the 1998 investment in Humboldt Flour Mills. Other investments included the building of hog barns and the purchase of Fletcher’s, a hog processor.

These investments are important because they indicate a number of things about the decisions made by the Pool after the share conversion. First, and perhaps most important, these investments highlight the scope of what the Pool took on. Project Horizon was the \$270 million elevator transition plan begun in 1997 that involved the simulta-

neous construction of twenty-two high-throughput elevators (the actual cost was higher because of additional expenditures incurred at the end to speed up implementation³⁶). This project not only required a significant amount of capital but, since its purpose was to replace the large number of small wooden elevators that dotted Saskatchewan with a small number of large concrete inland terminals, also fundamentally altered the way in which the members dealt with their cooperative. Although the building and operation of elevators was what the Pool knew best, the sheer magnitude of what they undertook was without comparison in the Canadian grains industry.

The international investments represented major new activities well outside the company's expertise. Although the Pool had experience in operating grain handling facilities at port positions in Canada, these skills had limited carryover to new areas. As one manager put it, the Pool made "investments in Mexico and Poland ... they had no idea how business was done in those countries."³⁷ Not surprisingly, all of these investments led to significant losses for the Pool; it took a \$35 million provision for the terminal in Gdansk in 2000, an \$11.1 million provision for SWP Matrix project in the United Kingdom, and a \$24.6 million provision for the terminal in Mexico in 2002–03.³⁸

The investment in Humboldt Flour Mills (HFM) highlights a second observation about the decisions made after the share conversion, namely that in many cases profitability per se was not the major goal. Although the \$18.5 million investment in HFM was not overly large compared to others the Pool had made, and HFM gave the Pool ownership of an additional line of farm supply outlets that could be integrated with its own farm supply business,³⁹ the manner in which the investment took place is what received attention. The Pool's final offer of \$1.20 per share was significantly higher than the next highest bid of \$0.85 per share by Alberta Wheat Pool and Manitoba Pool Elevators, which had joined together to try and purchase HFM in an attempt to get a foothold in the Saskatchewan market.⁴⁰ The view in the industry was that the Pool had paid too much for HFM. As one manager commented, "I can remember talking to people outside, and they would say 'What did you pay for that? Why did you pay...?'"⁴¹ As well, the

Pool did not seem to pay attention to what they had purchased — the goal was simply to keep out the other two pools. This perspective is nicely captured in the following comments: Pool management “didn’t even do the most basic things that should have been done when they took it over. The day after they signed the paper and got the keys to the premises, the Humboldt guys were out on the street competing against them;”⁴² and “in terms of the due diligence, by the time [the Pool] got out there they didn’t know what they had acquired. There were a number of sprayers, physical assets, trucks, fertilizer equipment, stuff like that, that they thought they had bought that turned out to be rental units.”⁴³

Project Horizon also exhibited a similar focus on other goals besides profitability. Several interviewees described constructing the elevators all at once as an attempt to lock up the contractors before others could build.⁴⁴ The Pool “firmly believed [it could] stop the competition from investing ... by tying up all the construction capacity for these high throughput elevators in the short-run.” Project Horizon was based on a “first mover advantage” wherein the Pool “firmly believed they could stop the competition,” but SWP “didn’t understand the second, third, or fourth moves in a competitive dance.”⁴⁵ This aggressive approach did not work. At least one board member expressed his astonishment that “companies would build a couple of miles down the road.”⁴⁶

As can be seen from these examples, the share conversion was coincidental with a number of changes in the Pool and also with the way decisions were made. The Pool became much more assertive with its investments and the objective appeared to have been increasingly one of industry dominance. The reasons for these decisions can be examined under two headings: decision-making style and principal-agent relationships. As will be argued, the share conversion coincided with a change in culture and decision-making style led by the CEO at the time, Don Loewen. Under this new culture, the Pool became much more aggressive in pursuing investment opportunities, and while an analysis of these activities was carried out, the analysis was often shaded so that it resulted in projects going ahead. In addition to this new

culture, there was also a shift in power from the board of directors to senior management, a shift closely linked to the relative information possessed by the board and management.

Decision-Making Style

Many people observed a change in culture at the Pool when Don Loewen took over as CEO in 1993, a position he held until he was removed by the board in June 1999. One board member described the Pool as “invincible,” a feeling “that was driven by Don Loewen’s personality and a number of people around him who just felt [the Pool] couldn’t be stopped.”⁴⁷ According to one former manager, Loewen’s strong leadership “was going to push through the vision ... [and] stop internal dissent.”⁴⁸ One interviewee described Loewen’s decision-making style as “shoot from the hip,” with gut feelings determining investment decisions.⁴⁹

A commonly expressed view was that, while an analysis of all the investments was carried out, the assumptions behind the analyses often appeared to be chosen so that the desired outcome was obtained.⁵⁰ As one interviewee expressed it, “Obviously, it was very simple — you didn’t spend a whole lot of time raising issues because it wouldn’t have been good for career advancement. That is not a new concept.”⁵¹ Similarly, interviewees provided evidence of the importance of small-p politics in the operation of the board and its relationship with senior management. For instance, it was noted that, as in many organizations, board politics were important and the CEO made “sure he had his supporters on certain committees; if you wanted to get some of the perks of office it was good to be on [his] side.”⁵²

This decision-making style was not entirely unexpected. As one board member indicates,

We hired Don Loewen; we knew that he was that type of individual who moved fast. I remember people saying that “if anything, we were going to have to make sure we keep the reins on this indi-

vidual because he will be very aggressive and so the Pool board will have to be the balance.” And unfortunately, we didn’t balance that very well. I think there was a distinct attempt to change the culture.⁵³

The outcome of this type of decision-making process was as might be expected — the investments did not turn out to be as profitable as forecasted. As one board member said, “I think some of the assumptions were wrong. Those reports came from management to the board of directors; we identify on a project the market share we would get and the earnings we would have, and they turned out wrong. And this was the decision that the board of directors made in letting Don Loewen [go]. We just said, ‘You’ve made too many mistakes along the way.’”⁵⁴

Principal-Agent Relationship

There is considerable evidence from the interviews that the share conversion was associated not only with a change in culture, but with a change in the board-management relationship. One of the immediate impacts was that the “need for confidentiality increased when [the Pool] went to a share offering.”⁵⁵ While “the delegates wanted to be kept aware of areas where we had a business activity in mind, we had to become less specific about those things because of corporate governance and the risk of insider trading.”⁵⁶ This was a starting point for the information asymmetry that is a key attribute of the principal-agent problem — the risk of insider trading became a valid reason for not adequately sharing information. The CEO, Don Loewen, was said to have threatened that a leak would lead to dismissal.⁵⁷ Further evidence of information asymmetry can be found in the following comment by a board member: “There were a lot of things shared with the president that never got adequately shared with the rest of the board. Getting things done became more important than sharing the information.”⁵⁸

A shift in power from the board to the CEO created a second

impact. With Loewen as CEO and Leroy Larsen as president, there was “the quickest transformation of power from a president’s office to a CEO’s office.”⁵⁹ This shift closely aligns with comments made by industry affiliates who noticed a shift in power occurring after the conversion and had a sense that “management was running astray with the company.”⁶⁰

Interviewees suggested a number of possibilities that might explain how and why this power shift occurred. One reason was that the board “trusted the management ... they had grown to trust management from Milt’s days because he would not lead them astray,” even if this meant introducing ideas to the board three or four times. Milt Fair “did not push his weight around; he was respected in the business community, extremely solid, and I think that is what brought on a lot of the dedication.”⁶¹ When Fair was CEO, he “worked effectively with the president and the board.”⁶² “Management was always available for discussions with board members.”⁶³ During his tenure as CEO from 1981 until 1993, Fair orchestrated acquisitions, such as the purchase of Elders Grain and Northern Sales Terminal, which solidified the Pool’s market share dominance. This ability to make successful investments led the board to trust management’s insight.

There was trust in Loewen as well, particularly during the period immediately before and after the share conversion. As one board member stated, the “board and the CEOs were very much in tune with each other’s needs ... there was a good deal of trust.”⁶⁴ Another person noted that Loewen “had the confidence of the board of directors ... there were really no impediments in his path.”⁶⁵

A second reason for the shift in power was that the expanding breadth of investments made the board increasingly reliant on management for an explanation of what was taking place in the organization. The move to a publicly traded company was viewed as “a quantum shift in how to run an organization under a public share structure, which [the board] had no experience with and very little knowledge of prior to 1996,” and “as the business got more sophisticated and more complicated and moved further away from the farm gate, it got

tougher” for board members to assess proposals.⁶⁶ The volume of proposals and expectation of prompt decisions “would have been difficult even for a competent board to stay abreast of and do a fair job of assessing what was coming.”⁶⁷

Board members had “no legal expertise, no marketing expertise, and no financial expertise,” so management had to provide the expertise for the board.⁶⁸ The “board of directors is there to be guidance, experience, and wisdom,” but as the Pool expanded, it became more difficult to provide that expertise.⁶⁹ Board members “could ask far more informed questions about whether or not to build grain elevators” than they could about international grain terminals.⁷⁰ A board member admitted, “As we got more external, we had to rely more and more on our CEO and CFO [Chief Financial Officer] and others to provide us with the types of insights and analysis we needed to make decisions.”⁷¹ Other interviewees were also well aware of the board’s dependence on management and its inability to challenge the CEO’s assumptions.⁷²

Some senior managers said that, with the move to go international, the board was “stepping away from their comfort zone”; “they were good small businessmen and they were politically adept, but when it came to managing an entity that was worth close to a billion dollars in assets, they were a little out of their league.”⁷³ Others said the board did not receive “full analysis.”⁷⁴ In hindsight, one board member said the board had “to accept some very heavy responsibility for not having tighter control over management and investment.”⁷⁵ Board members believed they were ultimately responsible; as one board member admitted, they “didn’t understand the impact that change was going to have on the whole operation.”⁷⁶

Senior management, of course, did not share the view that information was not provided to the board, although there was agreement that the board did not have the capacity to analyze the information that was provided. As one senior management person said:

We tried very hard to provide as much information as possible and

I thought quite often that the amount of information we supplied was information overload ... We took a lot of time to go through a decision — the documentation that was prepared was a lot of paper — and then step-by-step follow it all the way through. If there was some information lacking, they usually would ask for it and we would postpone the decision because we had multiple days in the week to do this. So we would go back and get the information ... [T]here was certainly no deliberate intention of not supplying any information, that is for sure.⁷⁷

The board's reliance on information supplied by senior management is indicative of a major information asymmetry in the board-management relationship — senior management had significantly more information than the board. Agency theory suggests that under such a situation the agents — i.e., senior management — can be expected to pursue their own interests rather than those of the principals, namely the board. The evidence presented earlier regarding the investments undertaken by the Pool suggests that this expected pattern of behaviour did occur.

A third reason for the shift in power can be linked to the manner in which the board was elected and operated. Several interviewees commented that the board lacked people who could serve as the final check and balance to senior management. As one senior manager commented, the board seemed to be missing the individual “who was just a cynic [and not] afraid to ask the simple hard questions,” or the critic who would “force [managers] to think it through and come better prepared” with proposals.⁷⁸

Part of this lack of ability to serve as the final check is attributed to the process of board election — increased board appointments by acclamation had “a major impact on the types of people ... put forward as board members.”⁷⁹ The quality of board member falls as competition for positions decreases. As well, to be elected, board members had to be particularly well versed in the policy issues of the day — the issues that were debated and discussed in local committee and delegate meetings as well as at the annual meeting. (The week-long gathering

held every fall, shortened considerably after the share conversion, was referred to as the “Farmers’ Parliament.”) Candidates’ views on policy issues were often critical to their electoral success and, as a consequence, board members were not necessarily elected on their ability to oversee a large and increasingly complex business.

In addition, the board was “very, very hands on. If you look at how we structured our board meetings, for example, back in the early 1980s and late 1970s we had a week of board meetings every month starting Monday morning and ending Friday night. So the board was extremely hands on; we debated the issues long and hard and had analysis presented to the board a lot.”⁸⁰ In addition, by the late 1980s, the president and vice-presidents were full-time positions. Both of these board policies had the potential to create dependence between the board and senior management, a dependence that could result in a loss of perspective and oversight by the board. As one interviewee indicated,

I think Garf and Ted were pretty hard-headed, tough people. They kept an appropriate independence from management; it was more of a professional relationship. After that, it was lost and was more of a cozy relationship. That does bring up another issue in terms of corporate structure about having full-time presidents; having these folks one floor removed from the senior managers ... what level of independence and decision making can you expect from that? If senior managers can run upstairs and coax or coerce or otherwise influence the thinking of the senior executive, I think that in itself probably skews the decision making of the board in a direction that might not be healthy at times. That was a systemic problem in all three pools for many years. Having a full-time president and vice-president sitting there, probably under-occupied in terms of day-to-day activity and therefore amenable to this “gotta get into the business” mentality — that is not a real healthy set-up.⁸¹

The agency problem that existed at the Pool is nicely summed up in the words of one of the former employees:

I think after that, in the eighties and nineties, that is when the quintessential struggle between the board and management started. This is an issue for every organization that has boards, whether appointed, elected,... you have the board and then have your senior management. Senior management are always in a better position information-wise; the management staff were usually higher-trained, educated people with all sorts of skills, everything from being able to do social research, to accounting, to all those things. It was at that point, too, and probably population had also changed and you were getting people elected who had degrees in agriculture and so forth, but management had better capability information-wise. You could see the gradual change where the board became almost dependent as opposed to being the final decision-making body. They basically became dependent on management to tell them, "Here's what you should do and here's why you should do it." At the board level, there probably wasn't the capability to be able to ascertain, when Project Horizon came [along at] \$300 million, these elevators are going to cost \$10–20 million, here's the market share.... You do not want a board to get into micro-management, but in terms of being able to make some of these major decisions around that, they pretty much had no choice but to go with what management put before them and, as best as they could, make decisions on it.⁸²

Economic Linkage

The question posed earlier in the discussion of economic linkage was whether the Pool's share conversion was able to give members and investors enough control over the organization's management to satisfy their own particular interests. From a conceptual perspective, it is clear that the cultural change and shift in power in the Pool had the potential to create a situation in which the interests of neither members nor investors were met. Simply put, the senior management — and particularly the CEO — had a well-defined vision for the co-operative that did not necessarily correspond with the needs of either

investors or members. Moreover, board members' lack of information and experience resulted in limited checks on senior management's power. In short, the two major changes worked together and reinforced each other in establishing a milieu that could not support the interests of two key groups — the members and the investors.

Empirically, the evidence presented above suggests that the share conversion addressed the interests of neither the members nor the investors. On the investor front, the evidence is obvious — the significant decline in share value, a direct reflection of the losses incurred, is perhaps the best indicator; the lack of profitability from most of the investments also confirms that the Pool was not paying attention to the needs of its investors.

Member needs went unmet as well. The best evidence for this is the Pool's loss of market share, which fell from nearly 60 percent to under 35 percent in Saskatchewan over a five-year period — a clear indication that its members (most farmers were SWP members) did not see an advantage to doing business with the Pool. Lang and Fulton connect the loss in market share to a reduction in member commitment.⁸³ As noted earlier, since economic linkage is highly correlated with member commitment, this loss of commitment can be viewed as a drop in economic linkage.

In addition to reducing their patronage of the Pool, members also reduced their ownership. After equity conversion occurred, members held about 54 percent of the equity.⁸⁴ By 1999, just three years later, internal estimates revealed that figure had dropped to about 30 percent.⁸⁵ The reduction in ownership further weakened the economic linkage between the members and their co-operative.

It is also important to note that few, if any, of the Pool's investments after the share conversion were explicitly targeted towards increasing economic linkage with members. In contrast to the producer-owned terminals created across the province during the 1990s,⁸⁶ the Pool did not involve its members in local ownership of elevator facilities. The terminals built as part of Project Horizon were all fully owned and centrally run by the Pool. A similar pattern occurred with the

Pool's investment in hog operations. Although the organization adopted a model that envisaged investment by community members, no attempt was made to specifically target farmers as owners. Indeed, a proposal to structure the local hog operations as New Generation Co-operatives was dismissed as unworkable. Interestingly, the Pool's attempt to achieve local investment in its hog facilities was not a success, forcing it to provide a greater percentage of the investment capital than it had planned in order to finance the operations.

The Pool's failure to structure its operations to create a stronger economic linkage with its members had at least two impacts. The first is discussed above — economic linkages with members were weakened, which in turn diminished member commitment to the Pool and resulted in a poor economic performance for the organization. The second impact is that many of the people who could have been champions for the Pool were instead focussed on creating farmer-owned businesses independently of and often in competition with the Pool. In addition to inland terminals, farmers were also active in establishing short-line railways and in erecting loading platforms that could be used to load producer cars, thus bypassing the elevator system and reducing the grain that the Pool could handle.

The reluctance of the proponents of these new farmer-owned enterprises to partner with the Pool suggests farmers did not see the Pool as a company with which they could co-operate and establish joint ventures. In contrast, a number of the producer-owned terminals were created as partnerships between local farmer groups and major grain companies such as Cargill and United Grain Growers.⁸⁷

Some of the people at the Pool remarked on the connection between linkage and the failure of the organization to address the members' interests. A former manager commented, "If you are going to go public and remove the co-operative thing, you better replace this core strength with something else because you are going to lose it when you go public. You are going to lose the membership loyalty for lots of reasons, and if you do not replace it with something else you are going to be in trouble."⁸⁸ Another interviewee remarked,

We did polling at the time [of the equity conversion]; I think it was 22 percent of our members who were opposed to equity conversion on co-operative principle and philosophy basis. They said, “If you do this, it will no longer be a co-operative and it will no longer have that connection.” I think probably the other 80 percent had a view of, “We’ll see, maybe it can work, and maybe this will be good.” But at the end of the day, when the change occurred and they saw the investment going towards Project Horizon and Fletcher’s Pork, which didn’t necessarily relate to the service they felt they needed from the co-operative, I think the percentage had increased.⁸⁹

The picture that emerges is one that shows the Pool’s share conversion leading to a weakening of the economic linkage with both investors and members — neither group had widespread trust in the decisions being made. As a result, both members and investors effectively left the organization — the members voting with their business (and to some extent their shares) and the investors voting with their money.

Conclusion

One must be careful about attributing cause when examining the role played by share conversion in eroding investor and member confidence. Given the evidence suggested above, it would be incorrect to say that the share conversion itself caused this decline in economic linkage. The share conversion must be seen in the context of an organization attempting to undergo massive and rapid changes in order to address what it perceived as significant challenges. Specifically, the share conversion can be viewed as a way of providing senior Pool management with both the resources and the power to push the organization into new areas. The poor investment decisions made after the conversion should be viewed, therefore, not *as a result of* the share conversion but *along with* the share conversion, as strategies undertaken to reposition the Pool.

In retrospect, it is clear that the Pool did not have the expertise — either at the senior management level or the board level — to successfully complete the experiment they undertook. Senior management appears to have been highly focussed on achieving a grand vision for the Pool rather than serving the interests of members or investors. At the same time, the board lacked the ability and the knowledge to rein in senior management. The result was as might be expected — the investments were not successful for either members or investors.

While the share conversion in SWP's case was clearly not successful, one cannot conclude that share conversions are always going to lead to this same outcome. It might have been successful had the senior management, and particularly the CEO, been more conservative and had the board been given the time to learn how to oversee the operation of a publicly traded co-operative. A slow, managed process that developed investor confidence while maintaining member trust might have been possible, but only if the organization had not been so driven by the need to change and to change dramatically.

One conclusion from this line of reasoning is that a co-operative — like any other organization — is complex and changes must be made carefully and thoughtfully. This is particularly the case when the economic environment is changing rapidly and the organization feels it needs to change significantly in order to survive; it is under these conditions that established decision-making patterns are broken down. While this breakdown is often necessary, it creates the potential for dramatic shifts in power relations and the removal of checks and balances that, in the case of SWP, played a critical role in the success of the organization. The elimination of the checks and balances and the creation of new power relations resulted in a lack of discipline in decision making that failed to create and maintain the trust of both members and investors.

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Section Two

Mutualizations

A Model for Social Housing

The Atkinson Housing Co-operative

JORGE SOUSA

THE ATKINSON HOUSING CO-OPERATIVE WAS THE FIRST public housing co-operative in Canada. The conversion was the result of negotiations among community leaders, the co-op sector, and the government between 1992 to 2003. Originally known as Alexandra Park, the community began operating as a co-operative on 1 April 2003.

Background

Alexandra Park, opened in 1968, was one of the many public housing projects built between 1940 and 1975 in Canada.¹ The development was part of the City of Toronto's urban renewal plans initiated in the mid-1950s.² The original grid-pattern design of the area was replaced with winding pedestrian walkways that separate the residences from the outer neighbourhood. There are five parking lots dedicated to residents, who pay a monthly charge to park there. The lots are located in different parts of the community but within easy access of the residents' homes. Over time, the design of the property has made it difficult for residents to interact with one another and with the wider

neighbourhood. The design has also been implicated as a contributing factor in different social problems that exist in the community.

The property is a mixed-unit-complex located in downtown Toronto,³ a diverse area with a high proportion of immigrant settlers. The property includes 140 apartments in two medium-rise buildings and 270 townhouses. The residents are all low-income, and the size of their units is directly related to the size of the family. Consequently, all residents must qualify for a housing subsidy, and there is no security of tenure should a household's composition change.

In 1969, occupants of the complex formed the Alexandra Park Residents' Association. The association was responsible for representing the interests of the wider community and for managing the local community centre, a key feature of the neighbourhood that provided access to recreational and educational activities.

Membership

The population of Alexandra Park has been quite stable since 1968, which is one reason the community was considered a prime candidate to become a co-operative.⁴ Any changes are representative of those observed generally in public housing in Toronto and not of a desire by the residents to move away. The one characteristic members share is low-income status.

As shown in table 1, the co-operative is home to 332 families, who make up 81 percent of the households. These numbers clearly reflect the major orientation of the co-operative. Seniors account for 10 percent of the households while singles and childless couples account for 9 percent.

Table 2 provides a distribution of the population by age. There is a relatively high concentration of young children and youth, which makes up 38 percent of the population. Fifty-one percent are between nineteen and fifty-nine years of age, while 11 percent are sixty years or older.

Table 1: Composition of Households⁵

Composition	Number of Households	Percentage of Households
Families	332	81
Seniors	41	10
Singles/Childless couples	37	9
Total	410	100

Table 2: Age Distribution⁶

Age Group	Number of Residents	Percentage of Total
Preschool (0–5)	132	6.6
Primary (6–12)	331	16.6
Teenagers (13–18)	299	15.0
Young Adults (19–20)	92	4.6
Adults (21–59)	935	46.8
Seniors 60+	209	10.4
Total	1998	100.0

Table 3: Sources of Income⁷

Income Type	Number of Households	Percentage of Households
Pension	12	3
Ontario Assistance Plan	62	15
Family Benefits	123	30
Employment	111	27
General Welfare	90	22
Other	12	3
Total	410	100

Table 3 presents some details about the income distribution of the membership. The majority of tenants (52 percent) are on family benefits or general welfare. Just over a quarter (27 percent) are employed, and 18 percent have some form of pension income.

The Atkinson Housing Co-operative is extremely diverse in terms of ethnicity, and a substantial proportion of the population is comprised of visible minorities. In 1998, according to figures provided by the Co-operative Housing Federation of Toronto (see table 4), 48 percent of households spoke one of five major non-English language groups.

Table 4: Households Represented by the Five Major Non-English Language Groups⁸

Language Group	Number of Households	Percentage of Households
Vietnamese	62	15
Spanish	45	11
Chinese	37	9
Portuguese	29	7
Somali	25	6
Total	198	48

Though quite diverse, the co-operative membership is predominantly a family-based population. Household incomes tend to be low, reflecting the high proportion of tenants who are not working full time.

Reasons for the Conversion

Momentum to gain control of the community emerged in 1990 in response to a growing sense of fear among the residents.⁹ There had

been a substantial increase in crime, including drug-related activity by residents and nonresidents. Other problems included high incidences of physical violence, prostitution, and vandalism. Although the housing agency¹⁰ implemented various strategies to combat the growing crime rate and deal with the existing criminal activity,¹¹ the residents were neither involved nor consulted, even though they had an official representative body in the form the residents' association. The association believed the community should have hired an independent security company that was knowledgeable and sensitive to the needs of the residents to patrol the community.

There was widespread belief among the residents that the housing agency was not effectively addressing their security needs. As a result, the president of the Alexandra Park Residents' Association, Sonny Atkinson, started foot patrols with the local police division in 1988 in order to create a sense of safety among the residents and deter criminal activity. According to the residents, the street patrols were quite effective in decreasing the level of crime. And in the early 1990s, when Atkinson managed to convince the government that the design of the project encouraged criminal activity and other social problems, workers demolished several walls used by criminals as hiding places. For the residents, tearing down the walls was a symbolic action, revealing a community trying to open itself to the wider neighbourhood.

Atkinson often stated that the drug issue was the prime motivator that led to the call for more local control, but there were other quality-of-life issues. For instance, residents were concerned about security of tenure because rent was contingent on household income. For many residents, there was little motivation to increase household income since there would be comparable increases to their monthly rent, thereby offsetting any benefit of having a greater income. In many cases, increases to a household's income were unstable from month to month. There was also a general concern that if a household was under- or over-housed due to a change in composition, the family would have to move to another community if an appropriately sized unit was not available. This concern was particularly real for older residents whose children had moved out.

The Alexandra Park Residents' Association was disappointed with the housing agency's efforts to improve the community and keep it safe. Atkinson spoke about the slow response to maintenance requests and argued that not only did the residents have the ability to make some of the repairs themselves, they could be paid for their efforts. In 1992, in response to the lack of change by the housing agency, Atkinson started calling for local control over four key areas:

- safety and security
- processing and undertaking maintenance requests
- tenant selection
- security of tenure

Atkinson soon realized that these four areas were consistent with how housing co-operatives are maintained. As a result, he started to pursue the tenant self-management option with greater vigour.

The Conversion Process

The Alexandra Park Residents' Association believed residents would feel safer and a healthier community would emerge if tenants participated more in the management of their community. The association also believed security and maintenance concerns could only be resolved through the implementation of local decisions by a group of concerned residents. In 1992, the local MPP (member of the provincial parliament) and a group of leading housing advocates and activists — referred to as the Public Housing to Co-op Conversion (PHCC) working group — introduced the association to two models that focus on resident control in the management of communities.¹²

The first model was tenant self-management, which is more common in the United States; it emphasizes establishing a relationship with the government. The second model was a non-profit co-operative, which is more common in Canada and Europe. It operates as an autonomous organization that receives some funding from the government and from the membership. The Alexandra Park Residents' Association decided to pursue the option of converting to a non-profit

co-operative because the needs of the community converged with the practices found in co-operative housing.

In the spring of 1993, the residents' association organized an information session for the residents and the wider community. Representatives of the PHCC working group and local politicians provided details about residential co-operatives and co-op conversions. The outcome of the meeting demonstrated that there was enough interest to officially embark on the goal of becoming Canada's first public housing co-operative.

Atkinson worked with Mark Goldblatt, a member of the PHCC working group and a leading co-operative housing consultant, to develop a plan to convert the Alexandra Park housing project to a housing co-operative. The plan was supported by municipal and provincial politicians who wanted to deal with the complex issues found in Alexandra Park and in the broader public housing system.

Since this was the first conversion of its kind in Canada, a process balancing the community's need to gain control of the property and the need to protect a public asset did not exist. According to one source in the co-operative sector, "There was no blueprint. Every step had to be created based on existing conversion experiences. . . ." ¹³ Consequently, there were many obstacles and great uncertainty throughout the process. The government supported the initiative in principle, but did not provide the financial resources for community development work and other costs that would enable the conversion process to go ahead. Despite the lack of financial resources, the Alexandra Park Residents' Association worked with Goldblatt and other representatives of the co-op sector to raise the funds and pursue the conversion.

The initial step in the process was to hold a referendum to gauge overall community support for the initiative. This took place on 22 April 1995, with the question, "Do you support Alexandra Park becoming a housing co-op?" The residents expressed significant support for conversion, with 72 percent in favour. The result gave the leadership a strong mandate to become a housing co-operative. Following

the referendum, the residents' association hired the local co-operative resource organization, the Co-operative Housing Federation of Toronto (CHFT), which then became actively involved in assisting with the conversion process.

Following the referendum, there were many complex steps on the road to fully fledged co-op status. First, the Alexandra Park Residents' Association and CHFT started to meet regularly with government representatives. Second, the Atkinson Housing Co-operative became incorporated in 1997. The first board of directors of the co-op was composed of the same individuals who formed the Alexandra Park Residents' Association board. Thus, the Atkinson Housing Co-operative too was now meeting with government representatives to develop a work plan specifying the process of transferring management responsibility to the residents.¹⁴

The Alexandra Park Residents' Association and CHFT created a business plan to demonstrate to the government that the community was serious about the conversion. The business plan outlined how the new co-operative would function¹⁵ and contained the following nine key elements:

1. The co-operative will follow the basic organization of other non-profit housing co-operatives in Ontario, with members' meetings, committees, a board of directors, and paid management for day-to-day administration and maintenance.
2. The co-operative will offer co-operative membership to every resident over sixteen years of age. Current residents who do not choose to become members will become tenants of the co-operative. Their relationship with the co-operative will be defined by the *Tenant Protection Act*.
3. The co-operative's units will be targeted to low-income households receiving rent-geared-to-income assistance, with the exception of "ceiling rents." Ceiling rents will apply when the rent a household must pay is the same as or more than the market rent for a similar unit in the surrounding neighbourhood.

4. All vacancies in the co-operative will be filled by referrals from the public housing waiting list.
5. The co-operative proposes to lease the land and buildings for forty-nine years at two dollars per year. The lease will set out the operating relationship between the government and the co-operative, including basic standards in areas such as building maintenance. The lease will provide for the property to revert to government management if the co-operative fails to correct a major fault.
6. Before the conversion, the co-operative will secure a financial commitment from the government to bring the property up to current standards over the first three to five years of the co-operative's operation.
7. The co-operative will negotiate an operating budget with the public housing agency at the start of each budget year.
8. The co-operative will have its own security plan that will include trained, on-call staff that will be on duty when the office is closed.
9. The co-operative will provide continuing education and training for directors and committee members.

Despite the work of the resident's association and CHFT, government representatives did not take any substantive action. In fact, they insisted on further proof that the community was ready to become a housing co-operative. In late November, early December 1998, the association and CHFT held a second referendum, referred to as a community vote. The purpose was to have as many residents as possible voice their support for or opposition to the co-operative conversion. The ballots were translated into nineteen languages.

The outcome of the second vote saw an increase in the level of resident support for the co-operative. Of the 409 units that could vote, 268 households voted, or 65 percent of the total. Of those 268 votes, 213 voted in favour of the conversion and 52 against (there were three spoiled ballots). Thus, of those who voted, 79 percent were in favour of the co-operative conversion. According to CHFT, of the 268 households that voted, 122 votes (45.5 percent) were submitted in a language other than English.

The residents' association and CHFT believed the result of the second vote was convincing enough to push government representatives to allow the conversion to proceed. Thus, in 1999, they established a working group of key stakeholders with two purposes: to determine the legal steps required to take the stakeholders through the conversion process, and to construct an operating agreement laying out the management responsibilities the community would have once the conversion was completed. The working group met for more than four years. The government, however, introduced more obstacles for community leadership rather than assistance in putting together the operating agreement. Consequently, the discussions appeared to be more a round of negotiations than a working group.

Government representatives continued to express concerns about the community's ability to manage the property. In order to address those concerns, further education of the residents, in the form of additional community development, was deemed necessary. Although the housing agency had maintained that no funds would be available, the organization started to commit token resources to the conversion process that enhanced some of the effectiveness of training and education activities. In 1998, despite the lack of funds, the new co-operative board and CHFT initiated a comprehensive community development program and membership recruitment drive. The program had the following goals:

- to educate the community about co-operative living
- to raise awareness of the ongoing conversion process
- to maintain momentum for the conversion to occur
- to recruit members

The community development program targeted the six major language groups identified during the second vote: English, Vietnamese, Spanish, Chinese, Portuguese, and Somali. Individual meetings were held in each of the six groups and newsletters were printed in the six languages and distributed to each of the households.

The program varied in intensity over five years and overall was quite successful in informing residents of the criteria and the process

of becoming members. At the time of transferring management responsibilities, 80 percent of the households were members of the co-operative, which is consistent with the results of the second vote. Those residents who chose not to become members remained in the community as tenants of the co-operative and were protected under the *Tenant Protection Act*.

On 15 August 2001, at a meeting of the government housing agency's board of directors, the stakeholder working group presented a report detailing the conversion process and the proposal to convert Alexandra Park to the Atkinson Housing Co-operative. Although the report was unanimously approved and final preparations were initiated, it was almost two years before the Atkinson Housing Co-operative became functional.

Creating a Co-operative Structure

Since the Atkinson Housing Co-operative was the first public housing project to be converted to a co-operative in Canada, competing interests between the co-op and the government were apparent in the early stages of the conversion process. Ultimately, both groups decided that the mutual goals of having a cost-effective model of low-income housing and of having membership control over decision-making practices had to be maintained. As a result, they created several documents to ensure that the conversion would meet the interests of all stakeholders.

The Atkinson Co-operative is different from most housing co-operatives because all members and non-members pay rent on a geared-to-income basis, and the housing agency has input in creating the operating and capital budgets. The following section will highlight the three areas involved in formalizing the public housing co-operative model.

Developing the Bylaws Like other co-operatives, the members of the Atkinson Co-operative have control of the community through the creation and implementation of bylaws that set out the conditions for living and participating in the community's governance. The first

organizational bylaw was approved by the membership in November 1999. It outlines the rules for, among other things, membership, elections procedures, and evictions, thereby ensuring the co-op has a document outlining the election process and an accountability structure.

Shortly after developing the organizational bylaw, the co-operative created an occupancy bylaw, which is similar to a lease in that it outlines the standards under which individual members are able to reside in the co-operative. The process of establishing the occupancy bylaw was similar to the creation of the organizational bylaw. It was in place by spring 2000.

Other bylaws that have since been created by different committees cover conflict of interest, spending, maintenance improvement, parking, arrears, and subsidies.

The Operating Agreement Although the original proposal in the business plan was to lease the property from the government, those involved decided that an operating agreement was the more appropriate way to establish the business practices of the co-operative. It was also the best way to account for different stakeholder interests. The agreement outlines the expectations of the two parties by laying out the obligations of the co-operative to the government and vice versa.

The operating agreement was created according to four principles. The first requires that the community associate itself with a resource group, such as CHFT, in order to gain credibility. A second principle establishes rent ceilings, or rent caps, which are analogous to the market rent. (At the time of publication, the rent caps were still set by the government authority.) The third principle relates to the tenant selection process; new tenants will come from the existing waiting list of the Toronto Social Housing Connections, and new residents will be required to become members of the co-op. The fourth principle relates to establishing an annual budget and generating revenue. Specifically, a budget will be negotiated with the housing agency on an annual basis. Using these four principles as guidelines, the final agreement provides a template for other public housing projects that wish to convert to a co-operative.

The Operating and Capital Budgets Like other housing co-operatives, Atkinson has its own operating budget, and the board and property management decide budget allocations. The Atkinson board is expected to meet monthly revenue benchmarks set by the provincial Ministry of Municipal Affairs and Housing. In most housing co-operatives, the bulk of the revenue generally comes from three sources: subsidy top-ups, housing charges, and small fees associated with parking and laundry. The Atkinson Co-operative has access to the same sources of revenue as other co-ops, but because its membership is 100 percent rent-gear-to-income, revenue from housing charges can vary from month to month. The co-operative cannot establish market rents or the rent ceiling as an alternate source of revenue. Atkinson does have one additional source of revenue in lieu of a capital reserve fund, and that is its ability to keep surplus funds from the operating budget in the community to be used for capital repairs.

The operating budget distinguishes between operating and fixed costs. The co-operative has some control over operating costs in terms of how to spend the money and when (e.g., staffing and maintenance materials). Fixed costs are beyond its control (e.g., realty taxes and utilities). The budget is negotiated annually between the co-operative and the housing agency and must be approved by the membership. Once it is approved, there is a steady stream of monthly revenue from the housing agency and from housing charges.

The process the co-operative uses to create and approve the budget is similar to that of other housing co-ops. The finance committee works with property management to establish a draft budget, which then goes to the Atkinson board of directors for approval, and then to the membership for final approval. However, unlike other housing co-operatives, the annual budget must also be approved by the housing agency, which reflects a lack of confidence on the part of government in the ability of the residents to self-manage.

It is common practice for individual housing co-operatives to have a capital reserve fund for property rehabilitation and maintenance work. The fund is replenished annually from housing charges and

other sources of revenue. Like other public housing projects, however, Atkinson has no capital reserve fund, which limits the co-op's ability to make the improvements deemed necessary by the residents. Because it is a public asset, it is the housing agency that funds and establishes the capital priorities at the co-op. The property is over thirty years old and requires a significant amount of repair, and within the priorities and funds provided by the housing agency, the co-op is expected to maintain the property in order to maximize the life expectancy of the buildings. The housing agency encourages the Atkinson membership to become involved in the agency's participatory budgeting practices, but because it is a system-wide process, Atkinson is competing with all the other public housing projects for a common pool of resources.

Special Issues

The following section highlights four issues that had a significant impact on the stakeholders in the Atkinson case and that should be considered by other communities considering a conversion to a co-operative.

Local Champion and Leadership Development Sonny Atkinson was the leader most closely associated with the call for increased resident involvement at Alexandra Park. In 1997, the Alexandra Park Residents' Association held a contest with the dual purpose of raising momentum for the conversion as well as finding a new name for the community. The residents decided to honour Atkinson's contribution by naming the co-operative after him. Unfortunately, Atkinson died in 1998 and was never able to witness the increased resident involvement he so passionately sought.

Identifying leaders in the community has always been difficult, although the Atkinson group has had some with considerable charisma. Atkinson's death created a leadership vacuum in the community that continues to the present day. Several residents expressed concern that they could not live up to Sonny Atkinson's legacy. Those who followed him as president assumed the position reluctantly, and two

of the four presidents have moved outside the city to become homeowners.

Several sources have indicated that there are potential leaders in the community, but that these individuals do not know how to become involved. However, it is believed that finding new leaders will be possible given the governance structure and increased opportunities for members to be involved in the community.

Role of External Agents As a former public housing project, the Atkinson Co-operative required significant resource support from the co-op housing sector to achieve the conversion. The combined vision and determination of the residents and the members of the co-operative movement to see improvements to the quality of life of public housing residents contributed to the successful completion of the conversion process.

Various individuals and organizations have approached the Atkinson Co-operative since 1992, proposing to provide different services for the board of directors and the community at large. The Co-operative Housing Federation of Toronto, the first organization to express a commitment and understanding of what the community was attempting to accomplish, is a unique second-tier co-operative comprised of individual housing co-ops. It remains one of the few resource co-operatives to provide services ranging from community and business development to planning for co-operatives.

CHFT took a more active role in the creation of the Atkinson Co-operative than it did with other housing co-ops. It has been an invaluable resource, donating time, materials, and money to the Atkinson Co-op. The residents accessed CHFT services such as conflict resolution and board training throughout the conversion process, and since CHFT is the third-party resource group advising the Atkinson Co-operative, residents will continue to access their services.

When the government was not willing to provide the funds to convert Alexandra Park to the Atkinson Housing Co-operative, CHFT and the co-operative board decided to raise the funds themselves. Funding the conversion was a major cause of concern; one early estimate put

the cost at approximately \$300,000. The co-op sector was not deterred by the lack of funding or the challenge and decided to pursue the conversion regardless. CHFT assumed financial liability for the conversion process, and no funds were taken out of the community for conversion expenses. However, no one expected that it would take more than ten years for the conversion to be completed.

There have been a number of different costs associated with the conversion process. According to several sources, costs have been primarily in two areas: the consulting services provided by CHFT and legal fees. Additional costs included printing, translation of printed materials, translators for meetings and community outreach, and various meeting expenses. In a number of instances, volunteers from the community and the co-op sector have offered a variety of services.

Various initiatives contributed to raising funds for the conversion. In 1998, the Canadian Co-operative Association (Ontario Region) organized a funders' forum, and CHFT applied to a number of organizations and foundations for funding. The following donors contributed significant amounts of money to conversion expenses.

- Co-operative Housing Federation of Canada
- Atkinson Foundation
- Co-operators Insurance Company
- Metro Credit Union
- Co-operative Housing Federation of Toronto

Over the past ten years, CHFT has waived many of the fees they would normally charge to other housing co-operatives. Whenever funds were raised for the conversion, CHFT received payment, but fundraising was limited to a few sources, and the length of time it took to complete the conversion meant that CHFT maintained its commitment at considerable cost. The same dedication and commitment does not normally occur in the public or private sectors.

Composition of the Board of Directors and Ethnic Divisions

CHFT organized the first elections of the Atkinson Co-operative board of directors in November 1999. Since the election was only for the co-op board, only members of the co-operative were eligible to vote, even

though the Atkinson board subsumed the Alexandra Park Residents' Association's responsibility for the community centre. As a result, the residents' association's former mandate of working on behalf of all residents was compromised and the interests of the non-members were perceived as having a lower priority, which upset those residents who chose not to become members of the co-operative.

While ethnic diversity has always been a characteristic of the neighbourhood, the diversity within Atkinson has become more pronounced in recent years and has resulted in many challenges for the community leadership. A number of divisions along ethnic, cultural, and even religious lines have emerged over the years, and those divisions were most noticeable in those who chose to participate in the governance process. Earlier efforts by CHFT and the co-operative board to increase ethnic and language representation on the board of directors were unsuccessful. The main obstacle to improving the representative character of the board of directors was the decision to maintain the Atkinson Co-operative board and Alexandra Park Residents' Association as two separate legal entities, which left many issues within the community unresolved.

The implicit understanding was that the community centre would continue to be managed by the residents through the co-operative board of directors. However, many residents believed that since there was an imbalance of ethnic representation on the board of directors, only one group's needs would be addressed. In the summer of 2001, as a result of these concerns, the co-op board and Alexandra Park Residents' Association severed links and became two distinct organizations. Since the official community representatives are now the co-operative board, the sole responsibility of the Alexandra Park Residents' Association is to manage the community centre. Despite these changes, however, divisions within the community persist.

At the time of publication, the board of directors was closer to being representative of the community's ethnic diversity. Although the board had eleven residents elected by the membership, however, a lack of knowledge and experience was a barrier to growth. CHFT and the

board of directors determined that one way to overcome obstacles was to add three non-resident advisors to the board, which many residents believe adds one more layer of accountability.

The membership approved the addition of three advisors, who are appointed by the board every two years. The board now consists of eleven resident members and three non-resident directors, all of whom have voting rights and are on the board for a two-year term. The notion of having non-resident advisors on a co-operative board is an innovation for housing co-operatives, but it is too early to determine its efficacy.

Education and Training Public housing projects do not normally have formal education and training opportunities to teach people how to manage a community. Such opportunities usually come from municipal agencies and various funding bodies. Before the conversion into a co-operative, the Alexandra Park Residents' Association ensured programs and events were occurring in the community by maintaining an independent financial structure. The association had charitable status and operated much like a housing co-operative, which eased the conversion process in the early stages.

Over the past ten years, the importance of education and training, for both the board and the membership at large, has been integrated into the collective psyche of the community. CHFT has provided these opportunities and the current operating agreement stipulates that a third-party organization such as CHFT will continue to provide education workshops and community development initiatives at Atkinson over an extended period of time. The educational opportunities include training for the board of directors, literacy programs to enable residents to read the co-op's documents, race relations programs to help members become more understanding of and sensitive to the needs of a diverse community, and excellent computer training classes.

In addition to the services provided by CHFT, the membership continues to develop community programs with the support of outside groups and funders. The funders want the community to be successful and see their role as promoting community development and

inclusive values. Although municipal representatives did not see themselves as formally involved in Atkinson beyond the capacity of funder, the city's support and understanding has ensured a base-level of programs and events for the community throughout the conversion process.

Impact of the Conversion

Atkinson is not a typical co-operative for a variety of reasons. Unlike other housing co-operatives that have a mixed-income community, Atkinson is 100 percent low-income. As well, the residents are still limited in terms of the actual amount of control they have in the decision-making process. The differences between Atkinson and other co-operatives will likely have an impact on the stability of the membership in terms of their willingness to remain in the community and to be actively involved in its operations. The goal for many residents has been to move out as quickly as possible and it is too early to determine whether its becoming a co-operative will be enough incentive for them to remain in the community. This section describes the impact of the Atkinson Co-operative on the membership and on housing policy.

Roles and Responsibilities of the Membership

The Atkinson Housing Co-operative operates as a typical co-operative in a number of areas. The system of governance includes a democratically elected board of directors and a strong committee structure involving the membership. The board of directors is ultimately responsible for developing and approving bylaws or legal agreements. Hence, the board makes all major policy decisions and then seeks approval from the general membership. CHFT was integral in assisting the board in clarifying the roles and responsibilities of the membership versus the board of directors.

A committee structure was established shortly after the 1999 elections. There are now several committees with responsibilities ranging

from monitoring the co-operative's finances and managing maintenance contracts, to handling the orientation of new members and the process of continuing member education. Following are the committees that have clear job descriptions:

- rehab/maintenance and finance
- parking and security
- welcoming and member education
- landscape
- newsletter
- co-operative conversion

The Atkinson Co-operative has a vibrant committee structure that provides advice to the board of directors as well as a pool of volunteers for various activities. The members recognize that the committees are integral in developing many of the policies approved by the board. Many members actively participate in the day-to-day operations of the community through the committees.

Despite numerous challenges and varying degrees of experience on the board, the organizational structure is transparent and accountable. The committees continue to do valuable work and have been extremely successful in working within their various mandates. Several key areas highlight the success of the committee structure:

- increased community consultation
- more residents voicing concerns in a constructive manner
- increased awareness of the role of the committees in the community

During the conversion process, residents and government representatives were concerned about whether the board of directors could become familiar with the intricacies of managing a multimillion dollar property. In general, the concern was whether public housing residents could be responsible enough to maintain the property and protect the interests of the residents and the public. The co-operative board and CHFT worked to ensure stability within the community after the conversion.

One of the strengths of the Atkinson Co-operative was the associ-

ation already in place that acted on behalf of the residents. The Alexandra Park Residents' Association was involved in improving the residents' quality of life and in managing the community centre. Quality of life refers to the activities occurring at the community centre and other community events. The community centre has always been a hub of activity, a gathering place for residents as well as providing activities and educational programming for the community in general.

Beginning in the mid-1990s, the community centre was having great difficulty establishing stable funding and staff had either been laid off or quit. One community centre director resigned in 1997 because there was no stable funding to support her position. In addition, the residents' association's visibility in the community diminished because of the conversion. As a result, the association neglected its supervisory responsibilities and thus compromised its ability to effectively manage the community centre. The centre was without on-site supervision for approximately two years.

In order to address the funding and organizational concerns of the community centre, the Atkinson Co-operative board worked with the City of Toronto to develop a plan to maintain a stable funding base. The group hired a community development worker to establish an organizational plan for the community centre as well as to operate the community centre and promote co-operative education. Despite the co-op board's actions with respect to the community centre, it had little success in establishing an effective link between the co-op board and the centre.

The issues surrounding the operation of the community centre reached a climax in the summer of 2001, when a number of members and non-members of the co-operative called for an improved system of accountability and representation from the board of directors. As a result, the Alexandra Park Residents' Association was re-established with a mandate to manage the community centre on behalf of all members and tenants of the co-operative. The community centre is serving the same function for all the residents, but the co-op's board is

not directly involved in the management, which has resulted in some concern about the future of the community centre. The presence of the co-operative is creating a greater understanding of the need to have accountable and transparent business practices, which has left many hopeful that the community centre will once again flourish and regain its prominent place in the community.

Impact on Broader Housing Policy

In Toronto, there is a considerable amount of support for housing co-operatives. There are approximately 160 of them in the greater Toronto area, although the stigma associated with public housing persists because of the high concentration of low-income earners, a prevalence of social problems, and the general design of housing projects.

Throughout the conversion process, the social housing system underwent a series of changes. The introduction of neo-conservative policies in the 1990s caused all levels of government to reconsider their role in providing social housing. In fact, the federal and provincial governments started to divest themselves of the responsibility for managing housing for low-income earners. In spite of the challenges facing the social housing system, however, the conversion of Atkinson continued. Through persistent political lobbying by members of the co-operative sector, the newly elected Conservative government looked favourably on the conversion because it was in line with its downsizing and divestment agenda.

Another change occurring within the social housing system was the introduction of the *Social Housing Reform Act* in January 2001. The new legislation effectively devolved the ownership, financing, and management for all forms of government-funded housing onto the municipalities. The legislation also outlined a new relationship between non-profits and co-operatives and the government. In spite of changes in government focus, the Atkinson conversion remained in place. However, the negotiations determining precisely which responsibilities could be vested within the Atkinson Co-operative

and which should remain with the government housing agency were extremely challenging. The result of this conversion has led to a unique hybrid arrangement that differs not only from other housing co-operatives, but also from other public housing projects. In essence, the Atkinson Housing Co-operative represents a new model of social housing.

Tom Clement, executive director of CHFT, stated that “The motive behind the conversion is to improve the lives of the residents and the condition of the community. Although we will not immediately see all that we had hoped for in this conversion, the lives of the residents will gradually improve.”¹⁶ For many involved in the process, a sense of control and security of tenure will establish a feeling of hope by giving all members a reason to feel pride in their accomplishments.

Changes within the community will have an impact on the perception of Atkinson outside the community. Several board directors and a number of members have established links with local agencies to address issues that concern residents within Atkinson and in the surrounding neighbourhood. It is too early to tell whether the Atkinson conversion will reduce the stigma associated with public housing, but the initiatives demonstrate the early stages of change.

Since the Atkinson Co-operative represents the first conversion of its kind in Canada, the community has had a considerable amount of public exposure over the past ten years. Community agencies continue to offer support to the community in order to ensure the conversion is successful. The principal of a local elementary school, for example, has encouraged the integration of the seven co-operative principles into the curriculum of all grades. There are instances where previous residents have maintained a connection to the community because of the conversion. And the high level of public awareness and support for the conversion has culminated in a municipal bylaw that explicitly encourages future conversions of public housing stock into co-operative housing.

Observations and Recommendations

This unique experiment has demonstrated that a public housing project can be converted into a housing co-operative within the public housing sector. The process has yielded a number of lessons for future public housing communities or agencies wishing to explore conversion into a co-op as an alternative to the direct government management model. This section highlights five elements of the experience.

Considering Alternative Models

In the case of this community, a small group of residents decided the co-operative route was appropriate after briefly considering tenant self-management. Community development and education during the process involved explaining the benefits of co-operatives but not necessarily the social outcomes of co-operation or alternative management models. Residents never really had a chance to assess whether or not there were other ways of obtaining more control without converting to a co-operative.

For the government housing agency, meaningful resident participation and community control were foreign concepts. The decision to pursue the co-op alternative created a concern for government representatives because there were no similar cases to refer to and they needed to rely on CHFT to assist them in understanding the implications of such a change. Some believed it would have been much easier for Alexandra Park to pursue tenant self-management. The multi-stakeholders model suggests the community was not quite ready to become a co-operative.

A community-needs assessment should be the first step in determining whether or not a public housing community should undertake a co-operative conversion or some other type of tenant involvement in decision making. The assessment should also address potential costs and benefits of the conversion. For example, the conversion may result in residents learning new skills and increasing their employability. There is also the potential for lower maintenance costs because of local

management control, as well as reduced crime and associated community impacts because of the formation of social capital.

Informed Residents: Co-operative Management and Living

The initial discussions that led to the decision to convert to a housing co-operative were based upon exploring that possibility; however, no one knew what the final model would be. Even after the co-operative concept was explained, many residents continued to have difficulty understanding the implications of converting to a co-op—for example, that rents would not change and that community life might improve once the government housing agency was no longer involved in managing the community. Nevertheless, a majority did understand that they would have more control over their housing and its management and that living in a co-operative would require member participation in decision making and also contributions to maintaining their housing community. Although CHFT spent a lot of time explaining the meaning of co-operative management, there appeared to be a significant level of misunderstanding and confusion. The co-op board members went through extensive training in co-operative management, but how many other residents have taken advantage of those opportunities is unknown.

Because this was the first co-operative conversion of a public housing development in Canada, it was difficult for the process to be transparent. The board did try to communicate key issues to members and, generally speaking, those residents involved in the decision-making process were accountable to the residents through public meetings. During the conversion, more than thirty-three newsletters, in addition to bylaws, were prepared in plain language in four different languages. However, a number of residents noted the lack of consistency and the infrequency of the information pieces. And despite the attempt to use plain language, some residents also felt the language in the material was quite dense.

All major conversions to some form of tenant self-management

have had a leader calling for and sustaining the momentum for change. Sonny Atkinson's death created a leadership vacuum in the community. Some residents felt they could not live up to his legacy, and the presidents who followed went into the position hesitantly. Identifying leaders in the community has been a chronic problem, and those who have been singled out have been reluctant to become involved. A program to develop new leaders must therefore be part of any future conversion process in order to identify potential board members. The existing committee structure can be used for this purpose as well as for promoting greater youth involvement.

Including Different Ethnic and Cultural Groups

Facilitators used the community's primary languages (Spanish, Portuguese, Chinese, Somali, Vietnamese, and English) in their initial outreach efforts. Despite the lack of resources, CHFT provided translators in four languages at community meetings. However, a number of residents noted that they still did not understand what was going on.

Lack of involvement by certain ethnic groups has shown the need for particular attention to outreach activities. The challenge is to bring people together despite their differing backgrounds and experiences. This requires both additional funding — for outreach, translation of materials, and translation services at meetings — and also expertise in managing divisions. One of the first steps in the needs-assessment phase should be to identify language needs and cultural diversity issues in the community.

Conversion Resources: Funding and Type of External Support

Inadequate funding was one limitation of the conversion. While funds were initially allocated for community development and education, the lack of funds created complications once the conversion began. Almost everyone involved agreed there was insufficient funding to support the kind of community development required. Funds were raised

privately or from charitable organizations, and CHFT did a lot of the work on an unpaid basis as well as bearing the bulk of the liability for the conversion, both financially and professionally. Future co-operative conversions need to be adequately funded if training and education are to be effective.

Another issue was whether CHFT sufficiently understood the needs of public housing residents. Housing co-operatives usually include a mix of incomes, and many projects have up to 70 percent of residents paying rent-geared-to-income. However, public housing projects consist of 100 percent low-income households, require deeper subsidies, and accommodate more recent immigrants than other forms of social housing (non-profits and co-operatives). The co-op sector is used to dealing with residents who have chosen to live in a co-operative. In a public housing conversion, however, the residents already live there and are trying to choose a management model that will meet their need for greater control over their living environment. The co-op sector was not accustomed to dealing with public housing communities and has learned many lessons through this experience.

In future co-operative conversions, community development activities need to comprise a broader notion of participation and development. The co-op sector tends to focus on training in the “mechanics” of operating a co-operative, particularly the board and its committees. The needs of public housing communities, however, are often more complex than those of typical co-operatives, so there is a necessity for broader community-building exercises. This means working with the existing strengths in the community, including services and leadership, identifying areas for development, and developing a training and education program to address identified needs. For future conversions of public housing, it is recommended that the government provide explicit support throughout the process and facilitate the conversion in order to avoid the many bureaucratic delays encountered in the Alexandra Park experience. In addition, the government should be prepared to commit itself to the considerable funding required for purposes such as the initial feasibility study and education and training.

Celebrating the Achievements

Although it was the first conversion of its kind in Canada, there was little celebration of the successful outcome. The time involved in completing the conversion seemed to reduce any excitement among the residents that something groundbreaking was occurring within their community. With the exception of the board of directors and some member volunteers, few people were celebrating. And because no one showcased achievements during the conversion process, there was an entrenched skepticism that the conversion would actually take place. This fuelled divisions among residents and contributed to the government housing agency's lack of faith in the board of directors. Thus, the final key event — the transfer of management authority — was viewed simply as another day.

Future conversions should focus on the social aspect of the process by encouraging gatherings that celebrate achievements, as large as a festival or simply a community meeting. Celebrations can be empowering and act as unifying or consciousness-raising events. They help sustain momentum and faith that a complex community-change process can lead to a beneficial outcome.

Conclusion

The hybrid structure of the Atkinson Co-operative represents a balance between government control and community autonomy. The Atkinson case is unique, but it is part of a tradition of conversion from public housing. And although the co-op is not far removed from the conversion process, it does demonstrate a potential to increase its distance from government control and to develop in ways that conform more closely to other housing co-operatives. Government and co-op groups are monitoring the experiment, and if it proves successful, the process of weaning Atkinson from government involvement could proceed further.

Endnotes

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2. Social Planning Council of Metropolitan Toronto, *Alexandra Park Relocation After Relocation, Part I* (Toronto: Social Planning Council of Metropolitan Toronto, 1970).
3. Co-operative Housing Federation of Toronto, *The Alexandra Park Conversion to Atkinson Co-op: A Community Development Plan* (Toronto: Co-operative Housing Federation of Toronto, 2003).
4. Metro Toronto Housing Corporation, *Quarterly Report* (Toronto: Metro Toronto Housing Corporation, 2001).
5. Ibid.
6. Metro Toronto Housing Authority, *Tenant Income Profiles of Alexandra Park* (Toronto: Metro Toronto Housing Authority, 1995).
7. Metro Toronto Housing Corporation, *Quarterly Report*.
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9. N. White, "Co-op Fight Could Make History," *The Toronto Star*, 23 July 1993.
10. The Ontario government agency associated with managing the public housing stock has had three different names and mandates over the years: Metro Toronto Housing Authority; Metro Toronto Housing Corporation; and, more recently, the Toronto Community Housing Corporation. In this document, the term housing agency will be used to refer to the government agency associated with providing public housing in Ontario.
11. C. Carder, "MTHA Embraces New Community-building Outlook," *The Toronto Star*, 23 July 1994.
12. L. Lapointe and J. Sousa, "The Conversion of Alexandra Park to

- Atkinson Housing Co-operative: An Evaluation of the Process,” report prepared for the Canada Mortgage and Housing Corporation, 2003.
13. J. Sousa, “Building Community Capacity: Assessing Member Satisfaction in the Atkinson Housing Co-operative,” report commissioned by the Toronto Community Housing Corporation, 2007, p. 17.
 14. To avoid confusion, it should be kept in mind that although the following paragraphs refer to the Alexandra Park Residents’ Association working with Co-operative Housing Federation of Toronto and the government around the conversion, the residents’ association and the co-op are at this point effectively one and the same thing. In 2001, the organizations formally split into two distinct legal entities.
 15. Atkinson Co-operative, “Business Plan Submitted to the Ontario Government,” 1996.
 16. Lapointe and Sousa, “The Conversion of Alexandra Park,” p. 34.

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More Than Just a Band-Aid Solution

Coop Santé Aylmer Health Co-op

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TRANSLATED FROM THE FRENCH BY IVAN CHOW

Background

THE FOLLOWING CO-OPERATIVE PROJECT TOOK PLACE IN Aylmer, a city that merged with the cities of Hull and Gatineau in 2002. Aylmer is located in the Québécois region of Outaouais and is a part of the urban community designated as the National Capital Region, referred to as Ottawa-Gatineau. Situated west of what was the City of Hull until 2002, Aylmer had a population of thirty-nine thousand in 2001 and was steadily growing. The area's population consists predominantly of government employees with a relatively high standard of living, although there are also several low-income residential neighbourhoods. Compared to the former cities of Hull and Gatineau, Aylmer has a large proportion of Anglophone residents.

For several years, Aylmer had few health resources compared to Hull and Gatineau, and the situation was even worse compared to that of Ottawa. The doctor-per-resident rate in Aylmer was low — there were only fifteen full-time doctor-equivalents in the entire city — and

the lack of a hospital forced Aylmer residents to drive to Hull, which takes more than twenty minutes; travelling time doubles on public transit. As a result, the locals frequent the three private clinics and one public clinic, a local Community Services Centre (CLSC).² Those who are patients of a doctor at the centre have to wait twelve to twenty-four months for an annual physical examination. In addition to the shortage of doctors, there is also a shortage of nurses, who play an important role in supporting the doctor. To date, there is no real integrated health-care network,³ which means that the various health-care establishments have been functioning in isolation.

In 2001, the situation appeared to be deteriorating and doctors were threatening to leave Aylmer. Hoping to come up with a solution, Doctors Gélinas and Archambault of the Aylmer-Lucerne Medical Centre took the initiative to organize a meeting. A representative of the Outaouais-Laurentides Regional Development Co-operative (CDR-OL — Coopérative de développement régional Outaouais-Laurentides) suggested that they visit the Les-Grès Health Services Co-op in Saint-Étienne-des-Grès in the Mauricie region, about 350 km. from Aylmer. Travelling there in March 2001, soon after the meeting, the visitors came back with positive impressions. Touring the health-care facilities — a clinic, a service centre, a seniors' residence, and a foundation, all built by the citizens of a small municipality of thirty-six hundred residents — the visitors learned a lot from these co-operative pioneers about the establishment and operation of a health-services co-op in Québec.⁴ They questioned why they couldn't apply a similar model in Aylmer.

Reasons for the Conversion

After seeing the example of Saint-Étienne-des-Grès, which has about two thousand members, the organizers quickly realized that it would be possible to get local residents involved in the project, which could help develop a sense of belonging in the community. Moreover, organizers understood that the more citizens they could get to become members, the louder their voice would be with authorities. The voices of

several doctors would become much stronger when backed by those of thousands of citizens. Citizen participation would also help develop services that responded to the particular needs of local residents. The organizers were therefore motivated and ready to undertake the project and to develop a health services co-operative in Aylmer — a co-operative equipped with a dynamic organization that would have a significant impact on the area.

In the spring of 2001, organizers formed a provisional committee consisting of nine members (including Doctor Gélinas). Volunteers involved on the committee were locally known. Jacques Coulombe was elected president. He is a former deputy minister of the federal government, a former municipality mayor, and prefect of a county regional municipality — someone who is well connected and has a lot of experience in politics. Guy Benoît was elected as a member of the committee. He is a former director of the school commission and, through him, a relative who is a former school commissioner got involved in the project as well. The committee came up with the following plan:

- define the urgency with which the people would need to help one another
- identify the values, principles, and objectives of a health co-operative
- study the organizational and financial feasibility and viability of a health co-operative in Aylmer with reference to other health co-operatives
- combine all health-care professionals in Aylmer and make the services they provide part of the Aylmer health co-operative
- prepare a constitution and regulations
- recruit founding members

Through discussions and meetings, the committee gradually came to agree upon the objectives of the new co-operative:

- ensure collaboration among health partners
- recruit doctors and nurses
- provide necessary infrastructure and supporting equipment to health services

- ensure second- and third-line support services are constantly available for front-line health service providers
- allow health professionals to follow up with their patients
- ensure the co-op operations are based on providing care and not on business logic
- provide financial aid for low-income families in obtaining co-operative membership
- ensure the co-operative turns out to be an organization of substance
- foster partnerships with existing medical resources
- favour home visits
- favour holistic approaches

After considering different types of co-operatives, such as consumer co-ops, worker co-ops, producer co-ops, multistakeholder co-ops (referred to as solidarity co-operatives in Québec), the committee came to recognize the many potential advantages of a solidarity co-operative, and decided to establish one.

The Conversion Process

The co-operative obtained its constitutional status from the Government of Québec in September 2001 under the name Aylmer Health Care Solidarity Co-op. It would operate under the name Coop santé Aylmer, or in English, Aylmer Health Co-op. In autumn 2001, the provisional council began studying its regulations — the internal government regulations and the loan and guarantee grant regulations — to ensure the co-op operated smoothly.⁵ They agreed on four member categories:

1. User Member: a person or moral organization that uses the services offered by the co-operative
2. Worker Member: a person other than a medical doctor who works for the co-operative
3. Supporting Member: a person or organization with an economic

or social interest that coincides with the objectives of the co-operative (this category also applies to doctors)

4. Auxiliary Member: a person under eighteen years of age who has no right to vote or to be elected to official functions in the co-operative (auxiliary membership is free; the auxiliary member's parent or guardian must be a member of the co-operative)

Membership fees of fifty dollars are charged in five instalments of ten dollars. Co-operative expenses include maintenance (of the building, examination rooms, and the administrative office) and employee salaries (with the exception of doctors' salaries). Revenues include rental income from health professionals practising at the co-operative, service fees paid by the public, co-operative membership subscriptions, revenue from the Aylmer Health Co-op Foundation, and subsidies.

The details of the organization were defined by the members of the provisional committee, who established priorities, confirmed the health services to be offered by Aylmer, discussed relevant media articles, and recruited fifty founding members to participate in the first general assembly.

Two \$7,500 subsidies, one from the local development centre and one from the City of Aylmer, enabled the co-operative to carry out a preliminary feasibility study in February 2002. This study explored different parameters that would help to define the goals of the project: prioritizing equipment to purchase, selecting personnel to be hired, recruiting health professionals, and applying for subsidies. The co-op conducted more than twenty interviews with individuals from the health-care professions and more than fifty with the general public. Four scenarios arose from the results of the study:

1. Collaborating with an existing clinic to provide direct health services to the public
2. Developing direct services at existing clinics or grouping these clinics together and putting them under the governance of a single co-operative organization
3. Establishing a multi-service health centre that provides services to

the public and rents spaces to practitioners and professionals not directly affiliated with the clinic

4. Following the example of a collaborative project in another region in Québec, financially supported by the Canada-Québec Infrastructure Programme,⁶ grouping together a variety of health-care establishments, long-term care facilities (centre d'hébergement de soins de longue durée — CHSLD), CLSCs, and clinics

The committee decided on the third scenario, which proved to be the most realistic given their circumstances. Next, they needed to determine whether they should construct a new building or rent or purchase an existing building. They chose the last option, which corresponded to the situation they explored in the first study, and purchased an existing clinic, the Aylmer-Lucerne Medical Centre. The clinic belonged to Doctors Gélinas and Archambault, the men who called upon the citizens to participate in the first meeting in the winter of 2001.

In March 2002, the co-op elected a permanent administrative council consisting of ten people, seven of whom were members of the provisional council of 2001. Jacques Coulombe remained president. Shortly afterwards, the council recruited a new member, François Juneau, who did his graduate studies in co-operative management, focussed specifically on health-service co-operatives, at the University of Sherbrooke. The council then divided its mandates among five working committees:

- business planning
- recruitment and communications
- public relations
- foundation
- finance

Before going any further, the council needed to seek professional assistance with their working plan. In March 2003, the co-operative filed an application to the Community Economic Development Technical Assistance Program for financial support to hire a team of consultants to carry out their business plan. The team consisted of one

person from the region and two from Montréal — one a well-known specialist in health-service co-operatives and the other in real estate. The framework of the business plan is as follows:

- demand analysis
- finance and operation plan
- member recruitment, communication, and financial participation

The second element was especially important because it highlighted key elements to carrying out the project. It helped define planning and equipment needs; described procedures, the structure of the organization, and collaborations with the health network; evaluated project costs; and cited other human resource planning considerations. Essentially, the co-operative had to validate and, when needed, to specify certain related hypotheses in terms of the purchase and running of Aylmer-Lucerne Medical Centre.

The plan was set out in the summer of 2003 and, on the whole, agreed with the original hypotheses. In the meantime, the administrative council needed to come to terms with the discussions they had with the doctors involved with the project. The purchase of the clinic was concluded in autumn 2003 and the co-operative took possession of the building in January 2004. The purchase agreement included the following key elements:

- The property owners (the three doctors) agreed to sell the clinic to the co-operative.
- The purchase would be financed by the doctors over fifteen years, guaranteed by a mortgage contract with the co-operative. The co-op is expected to pay down the mortgage within this period.
- All current clinic personnel would remain in their positions, including the doctors.
- Personnel would become worker members of the co-operative.
- The doctors would become supporting members of the co-operative.

The co-operative also faced several challenges, one of which was the recruitment of user members, so it launched a campaign that relied notably on collaboration with the local Caisse Populaire Desjardins. The number of user members quickly reached one thousand, then two thousand, and in December 2005, the number of members broke the four thousand mark. It is worth mentioning that this significant growth was attained thanks to excellent media coverage from the beginning of the project. In the forefront was the local weekly newspaper and *Le droit*, the only Francophone daily newspaper in the National Capital Region.

In 2004, the co-operative had twenty-eight thousand emergency visits in addition to eleven thousand scheduled visits.

At the 2004 assembly, Jacques Coulombe stepped down after having presided over the co-operative for several years; Guy Benoît assumed the position of president. The administrative council also recruited two new high-calibre members: the general manager of the Canadian Co-operative Association and the executive director of the Co-operative Bureau of the Government of Canada. The composition of the administrative council proved to be a key element in the co-operative's success.

Impact of the Conversion

Although it is still in its infancy, the Aylmer Health Co-op has had a significant impact on the community. Several elements have contributed to the co-operative's success. First, the citizens of Aylmer were strongly motivated — more than 10 percent of them showed great interest in and preoccupation with the health of the population. Access to bilingual services ensured the involvement of Anglophones in the project. The membership cost was only fifty dollars and subscriptions were accepted on a voluntary basis. In terms of funding, the subscription capital of more than \$225,000 to date has provided the co-operative with the resources to carry out various priority projects, such as renewal of equipment. Subsidies from social clubs have also helped the

Aylmer Health Co-op improve the technological standards of the clinic and purchase equipment to improve diagnosis and treat illnesses.

Among the project's accomplishments is the significant expansion of clinic services. In 2005, thanks to financial support from the Co-operative Development Initiative, the Aylmer Health Co-op obtained the resources to carry out various development projects.⁷ One was a campaign to promote chronic-illness prevention among immigrants from Latin America, funded in part by Health Canada, with the collaboration of two other co-operatives in western Canada — the Multicultural Health Brokers Co-op in Edmonton and another co-op in Vancouver. The co-operative also developed defibrillation and neighbourhood-watch programs in collaboration with the Coopérative des paramédics de l'Outaouais (the Outaouais Ambulance Driver and Technician Co-operative). In addition, the Aylmer Health Co-op organized workshops on diabetes and high blood pressure in order to foster connections among participants; many studies show that such connections help promote healthier lifestyles. The co-op puts itself at the heart of initiatives in order to influence the well-being of the community, behaviour that has been the subject of experiments in various countries, including Sweden and Japan.

It should also be mentioned that the Aylmer Health Co-op put together a project involving a front-line clinic that treats minor emergency cases (minor wounds, ear infections, etc.). This initiative, which saves patients hours of waiting at hospital emergency rooms, was endorsed by the Regional Health Agency and the Gatineau Health Centre, both of which agreed to collaborate with the co-op on the project.

Finally, the recruitment of two new doctors on 1 July 2006 gave an additional two thousand people access to a family doctor of their own. At the time of writing in 2006, the total membership of the Aylmer Health Co-op had increased to over 5,000.⁸ The project also created some ripples, not only in the local and regional media, but also in the specialized media in the field of medicine (including one of the most popular publications for the medical profession, *Doctors of Québec*). The Federation of Medical Practitioners of Québec honoured Doctor

Gélinas for his commitment to community projects, and obviously for his commitment to the health co-operative.

The Aylmer Health Co-op also had an impact on the co-operative movement. At the local level, the project involved other co-operatives in its success — first, the support of the Outaouais-Laurentides Regional Development Co-operative (CDR-OL), the logistical support of the Caisse Populaire Desjardins, and, on a more ad hoc basis, the support of the funerary co-op; and second, the support of the Province of Quebec with its business volume and housing co-operatives.

As you can see, this project has a different framework from other co-operative projects in Québec. It is not just about constructing a building and recruiting doctors, but about purchasing an existing clinic. In fact, it was the first case of its kind in Canada and people from other regions are interested in learning more about it. Representatives of the Aylmer Health Co-op made a presentation to the health committee of the Co-operative Council of Québec. They were also invited, with others, to make a presentation at a conference on the modelling of health co-operatives in Nova Scotia. In June 2004, benefiting from a meeting in Ottawa, the Aylmer Health Co-op was honoured to receive members of the International Health Co-operative Organisation's (IHCO) board of directors at a dinner. IHCO is a co-op sector organization specializing in health care and closely connected to the International Co-operative Alliance. Although Aylmer's experience was modest compared to the large health-service networks in Spain and Japan, the international delegates certainly appreciated the dynamism of the project. The following year, the Espriu Foundation of Spain, a driving force behind international health co-operation, invited a representative of the Aylmer Health Co-op to present at a large conference on health co-operatives in Barcelona.

Observations and Recommendations

The Aylmer Health Co-op case draws interest not only because it was a success, but also because it set a precedent as the first of its kind in the country. Following are a few concluding observations.

- The project took shape gradually; it was not the product of a fortuitous event. As a result, the main collaborators have had some time to gain a full understanding of the needs of the project and to develop a sense of confidence.
- The composition of the administrative council — well-known individuals with good reputations and a lot of experience — was a key element in the success of the project. The presence of such people also facilitated discussions with the doctors, who were able to negotiate with people of their own age or older — people in their sixties — who shared a common generational experience.⁹
- The key organizers' experience and network of contacts also contributed to the co-op's success in obtaining financial support to carry out tasks such as the preliminary feasibility study and the business plan.
- The stability and continuity of the administrative council also contributed to the success of the project.
- The level of volunteer work in this project was remarkable, amounting to thousands of hours.¹⁰ The fact that the two successive presidents, Jacques Coulombes and Guy Benoît, were retirees and had more time than someone still in the workforce contributed tremendously to the results.
- The Outaouais-Laurentides Regional Development Co-operative provided expertise, competence, and the necessary connections to play a major role in this project. A CDR-OL representative helped at every stage of development, particularly with the feasibility study, and became the first project co-ordinator. CDR-OL also provided a connection to a pilot project in Québec (Les-Grès Health Services Co-op) in 2001.
- The project also benefited from the open minds of the doctors at the Aylmer-Lucerne Medical Centre. In the end, the doctors were the big winners because they were able to sell their clinic despite the fact that the transactions and methods

of payment were not all clear.¹¹ However, the purchase price and payment agreement turned out to be a win-win formula.

- The doctors' decision to voluntarily sell their clinic to a co-operative and to remain involved in the project contributes to positive results that we have yet to measure and appreciate. In fact, through their actions, the doctors sent a message to the medical profession — "You see, we can be involved with the people in a winning formula, a solidarity co-operative!"
- Despite the overall success of the project, two doctors left the co-operative during the first year of operation, exposing it to a certain financial instability (loss of rental revenue). This put pressure on the co-operative to either recruit new doctors, develop new services, or obtain subsidies.
- Like all other health services co-operatives in Québec, this project faces the challenge of convincing users to become members. Because doctors subscribe to the public health insurance system, it is not possible to compel the public to become co-op members as a precondition to providing medical services. This would constitute a violation of Canadian health laws, in particular, the universality and accessibility principles.

Endnotes

1. Guy Benoît, president of the Aylmer Health Co-op, collaborated in revising the text.
2. Centre local de services communautaires, or CLSCs, are local community service centres in Quebec where free clinics are run and maintained by the provincial government.
3. The Liberal Party of Québec made the integration and networking of resources, health centres, and social services a priority after its election in April 2003. The minister of Health and Social Services, Philippe Couillard, was in charge of the project.
4. Les-Grès was the first health service co-operative founded in Québec. It came into service in 1995 and has been expanding ever since by recruiting new members and offering new services.
5. In the process of establishing the co-operative, two other regulations were added, which concern the creation of privileged parties.
6. The idea, which did not materialize, was to divide financial support equally among the three levels of government, including the municipal level. The regrouping of organizations would allow CHSLD to save the cost of constructing a new facility.
7. Financial support was provided by the development agent of the CDR-OL, which has been helping out with the project since the beginning.
8. As of 4 July 2007, the co-operative had 7,570 members. Retrieved 4 July 2007 from <http://www.coopsa.org/en/welcome.php>
9. It is not certain whether such a good outcome would have been achieved had there been an age difference of one or two generations between the participants.
10. Following discussions with certain project promoters, it was suggested that the level of volunteer work was perhaps too high. There was a fear of the workers being “burned out.”
11. Several clinics in Québec have closed during the last several years, either taken over or sold.

For More Information

For more information about health-care co-operatives, and the Aylmer Health Co-op in particular, please consult the following documents.

Aylmer Health Co-op. Website: <http://www.coopsa.org>

Beaudry, P. "Un partenariat avec la communauté dans l'offre des soins de santé à la population du Québec. Le cas de la coopérative de solidarité de soins de santé d'Aylmer (Coop santé Aylmer/ Aylmer Health Co-op) (A Partnership with the Community in Offering Health Care to the Population of Québec. The Case of the Aylmer Health Care Solidarity Co-operative (Aylmer Health Co-op))." Paper presented at the conference of the Latin Association for Health System Analysis, Montréal, Quebec, October 2005.

LPS Productions. "Plan d'affaires coopérative de solidarité de soins de santé d'Aylmer (Business Plan, Aylmer Health Care Solidarity Co-op)." Montréal: Aylmer Health Care Solidarity Co-op, 2003.

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Co-ordination among Co-operatives Dakota Carrier Network

SUSAN DAVIS AND WILLIAM PATRIE

DAKOTA CARRIER NETWORK LLC (DCN) WAS CREATED in 1996 by fifteen independent rural telecommunications co-operatives and companies. They represent 85 percent of all the telephone exchanges in North Dakota and more than 90 percent of the state's total surface area.

DCN's fifteen owners now serve more than 164,000 customers in 244 communities with the most contemporary hardware and software. In fact, DCN's network is so highly regarded that the State of North Dakota runs a virtual private network on the DCN system, bringing high-speed network technologies to every school district and government body in the state.

DCN is not standing still. In a Fargo, North Dakota, field that in 2004 grew a crop of soybeans, a new eleven-thousand-square-foot building has sprouted.¹ This DCN hub will provide space for terminating the DCN fibre-optic rings that serve all of North Dakota and connect to surrounding areas. It will also be the centre of a multi-building technology park that will provide tenants easy and secure access to

worldwide telecommunications. According to David Dunning, DCN's board president, the new building "will allow us the space to stay on the leading edge of high-speed networking options that we can offer North Dakota business."

The new building site in Fargo means DCN can offer co-location of equipment for the customers it serves. "It paves the way ... for the next generation of information technology, including Internet Protocol (IP)-based networks served by a dense wave division multiplexing infrastructure," says Evan Hass.

In addition, the secured, tornado-resistant building is expected to become a fibre-optic hub for organizations that build on the DCN campus. At the time of writing in 2006, DCN had \$30 million in assets. That was expected to grow to \$36 million by the end of the year. There were fourteen employees (nine in Bismarck and five in Fargo), and revenue per employee was more than \$1 million.

The State of North Dakota is 28 percent of the business mix. Major customers are cellular companies and regional banks (twelve to fifteen). All North Dakota hospitals are able to be on a video network, and DCN can bridge them all together if needed.

A fifteen-member board — one from each independent company — meets every other month. At the end of each year, the board determines what gets sent back to the owners/companies. A total of \$1.1 million in revenue was distributed back in 2005. The board keeps some profits for expansions and operations. "The owners are getting a good return on their investment," says Evan Hass.

Total debt is \$3.3 million with CoBank. Network expense is currently funded out of the chequebook. "We don't borrow any more money," Hass says. The land the new building sits on in Fargo — immediately north of the new Microsoft complex — was purchased for \$1 million and the property has doubled in value.

In 2000, DCN won a three-year contract with the State of North Dakota and was then able to extend it for three years, essentially getting a six-year contract out of a three-year request for proposals. A new

seven-year contract with the state with three one-year options started in July 2006.

Background

The company now known as Qwest, formerly U S West Communications Inc., decided in the mid-1990s to exit large portions of rural North Dakota by selling sixty-eight exchanges or service territories and assets to other telephone service providers. Fifteen organizations — telephone co-operatives and independent companies — in North Dakota agreed to meet and produce one common bid for this extremely diverse array of properties.

The bid-preparation process took more than two years to formalize. The ability of co-operatives to co-operate was severely tested, since there was a large appetite for acquisition by some of the telephone co-ops (one or two of the co-operatives were interested in most of properties that were for sale). There was no common method of determining the value of a given U S West property, and each of the fifteen companies had to determine the price they were individually willing to pay. They also had to develop some internal method of determining which one of them was entitled to bid on a particular property.

The transaction was completed for \$136 million. The resulting ownership of these properties created a jigsaw puzzle of glass-fibre lines which — when put together — revealed the backbone for an interstate and intrastate voice and data network. Buoyed by their recent achievement in becoming the successful bidder, the telephone co-operatives and independent companies quickly formed a new company called Dakota Carrier Network (DCN). They built out the few missing pieces to connect themselves together into a seamless system.

These telephone co-operatives and independent companies — through DCN — now operate an interstate and intrastate system for transporting data and voice with world-class equipment and technology. They also individually operate sophisticated information and dial-tone services in their individual service territories. Several of these co-

operatives and companies have formed additional operating companies that have overbuilt major North Dakota cities and operate as competitive local exchange carriers (CLEC) in direct competition with Qwest.

Because these service territories were added to existing co-operatives, thousands of additional North Dakotans have become co-operative members. This inculcation process was made more complicated by federal and state regulators, financial covenants with lenders, technology harmonization, and billing procedures.

Reasons for the Conversion

The United States government was being swept by the idea of deregulation in the 1990s. U S West Communications had operations in sixteen or seventeen countries and, like many multinational corporations, sought to restructure its operations for the new world of communications that was just around the corner. No one was exactly sure what that world would look like, but the expectation was that it wouldn't be the same as the 1980s. U S West wanted to exchange low-tech and low-revenue lines in rural places for cash to invest in this anticipated new environment that would yield higher profits.

David Crothers,² executive director of the North Dakota Association of Telecommunications Co-operatives, explains that in the late 1980s, U S West was in the process of deciding what it was going to become.

They [U S West] had money all over the world. They were building fibre. They were putting in telephone networks. We were all looking through a foggy lens of what we thought the future was going to be. Their wireless was just getting off the ground, and the federal *Telecommunications Act* was signed by the President in February 1996. But there had been many false starts and unsuccessful introductions of comprehensive telecom reform. So there was this big swirl of "What's the future going to be?" and "We need to be

at the cutting edge of the future” and “If we’re going to be deregulated as much as this provision of telecommunications has envisioned, we need to be national competitors.” Well, at the very, very bottom of the totem pole, the least sophisticated people (in terms of technology and business) were their rural customers and, on top of that, they were the most expensive to serve. That was instrumental. Everyone wanted to be a big shot and be a dominant telecom player in the new environment; plus rural was never going to be an attractive place to serve.

At the same time that U S West was rethinking its strategy, telephone co-operatives and independent telephone companies in North Dakota were losing customers due to shrinking rural populations and were looking aggressively for a way to spread their fixed operating costs over more customers.

In addition, these co-operatives and companies wanted to make sure that the “telecommunications revolution” didn’t bypass rural North Dakota. Smaller rural phone co-operatives and companies have long served areas that didn’t interest larger, profit-driven businesses, and they wanted to continue this tradition. They saw a future for North Dakota that included high-speed, broadband access to North Dakota businesses, homes, schools, and government. And they were certain that the “local” co-operatives and companies could provide these services better than a large corporation.

Key Individuals and Their Roles

Key leaders at the time of the demutualization (and the positions they held) included Warren Hight, general manager of SRT Communications; L. Dan Wilhelmson, general manager of Consolidated Telecom; Gene Sloan, general manager of Reservation Telephone Co-operative; Wally Goulet, attorney; Evan Hass, a manager for U S West; and Jim Howard, vice-president of business services for John Staurulakis Inc. of Maryland (with offices in Minneapolis).

Of all these and many others, Wilhelmson won the biggest role. As

a Northwestern Bell employee for twenty-seven years, he had the inside track on the direction U S West was heading, and he saw that direction veering away from rural properties to more heavily populated areas such as Minneapolis. After an early retirement from U S West in 1986, he was hired as the general manager of Consolidated Telecom in Dickinson. He was forty-seven at the time.

According to the now sixty-seven-year-old Wilhelmson,³ he knew in 1991 that U S West was going to shed rural property — property that was not conducive to what the company wanted to do. And, as further proof, Montana's rural exchanges had come up for sale. "I wrote a letter to U S West and said Consolidated [Telecom] was interested in buying property, including Dickinson," Wilhelmson explains. "I did not hear back from them [U S West]."

Not one to give up or wait, Wilhelmson began organizing a group of North Dakota telephone co-operatives and companies to look at the prospect of buying rural exchanges from U S West. That group, the Independent Telephone Company Group (ITCG), quickly named Wilhelmson its chair, put together an executive bid, and set up a meeting with U S West in Bismarck. However, "U S West said they were not going to do that [sell North Dakota exchanges]," Wilhelmson says.

Three years later — in 1994 — Wilhelmson reunited the group when U S West finally admitted to having a list of North Dakota properties it would sell. He then successfully led the group as they meandered through the mazes of negotiations and due diligence, turning a deaf ear to those who said they'd become lost — that it couldn't be done. While doing so, he racked up thousands of miles by car and by plane and gained thirty pounds from stress and fast food.

Some of those who were involved with the acquisition call Wilhelmson "a master at getting things done." Crothers says the main reason the deal was successful was Wilhelmson's dominant personality and the fact that he was part of the process. "And where inertia would have grabbed such a big project, Dan kept whipsawing it through," he says.

Involvement of the Membership

Wilhelmson and other telephone co-operative and company leaders began meeting with U S West customers, who wanted to know if and when they would become co-operative members. The fifteen independents held informational meetings to let co-op members and company customers know about the acquisitions plans. According to Wilhelmson, U S West rates were higher at the time and rural residents were excited about the prospect of lower rates and becoming part of a member-owned entity. They liked the idea of having a voice in the future. There was little opposition and few issues came up. The co-ops and companies also met with city commissions and easily gained the necessary certificates of authority.

Existing co-op members were repeatedly reassured that their rates would not go up because of these acquisitions. In fact, many rural members of telephone co-operatives understood the need to stabilize or grow the co-operative.

The Conversion Process

The process began in 1991 and culminated in 1996. It involved a startling combination of talent from local co-operatives and independent telephone companies and a willingness to co-operate with each other that may have neither a precedent nor an antecedent. As many as eighty people met as many as ten times representing the local telephone co-operatives and companies. Several times there were up to eleven attorneys in the same room at the same time representing just the local telecoms. Few have ever seen a project with such complexity and such successful outcomes. The process and the outcomes benefited from a nearly miraculous coming together of leadership and technical skills, the combination of which is most likely not replicable. Smaller-scale versions of co-op acquisitions of investor-owned properties are certainly possible and will benefit from the lessons learned in this case. But the actual accomplishments of this association of local telephone co-operatives and independent companies are so start-

ling and so remarkable that simply telling this story factually sounds like fiction. Although it now seems the deal came together rather quickly, the deal took only baby steps during the first several years.

Table 1: Major Events and Activities

Date	Activity
1991	L. Dan Wilhelmson, general manager of Consolidated and former long-time employee of U S West, sends a letter to U S West stating that Consolidated would be interested in buying some of its exchanges in North Dakota. He receives no reply. Other co-operative and company managers also write letters to U S West. Only silence answers them.
1991–1992	Wilhelmson unites fifteen North Dakota telephone co-operatives and companies to look at acquiring U S West rural properties in North Dakota. The end result is called the Independent Telephone Company Group (ITCG). The group remains idle as U S West decides if and when to sell its North Dakota exchanges.
1994	After hearing that U S West finally had a list of North Dakota properties it would sell, ITCG members reunite to hammer out a wish list of exchanges they want. This takes about four to five months and includes about sixty to eighty people at meetings to determine who will get what. Unable to agree, they eventually go to a bidding process. This same year, the group brings U S West an offer of \$100 million for sixty-eight exchanges. “They laughed us out of the room,” Wilhelmson says.
Early to mid-1994	The group goes into serious discussions on price per access line. U S West says it wants \$150 million for everything. “We weren’t going to pay that,” Wilhelm-

son says. The group goes back with an offer of approximately \$125 million. U S West takes the deal off the table, indicating the offer isn't sufficient to continue negotiations.

Wilhelmson, who has established a good rapport with Teresa Walette of U S West, refuses to let the deal die. He keeps in contact with Walette, who indicates U S West will look "outside" North Dakota for a buyer. The deal then goes dormant for four months. Wilhelmson reminds Walette that U S West will "pay a price" for going outside the state.

U S West then comes back to the table and — even with a \$130 million offer — the ITCG is "still getting beat up in meetings," Wilhelmson says.

Late 1994 Just before a North Dakota Telephone Association meeting in Minot, ND, Wilhelmson sends U S West what he thinks is an offer of \$135 million. However, his five looks like a six and his secretary types \$136 million instead, which is offered. Wilhelmson sweats his \$1 million mistake all the way to the meeting. However, the managers are okay with the mistake and stand behind the \$136 million offer.

January 1995 The deal is closed for \$136 million.

1995–1996 Due-diligence work begins. According to Evan Hass,⁴ then a U S West network planner, this is the longest, most drawn-out part. "The independent companies wanted to look at everything," he explains. "There was a lot of kicking of the tires. People were looking into copper terminals and discovering mice." Because of the complexity of working with so many buyers, Hass says U S West decided not to sell to multiple companies again.

1995–1996 Souris River Telephone, led by Warren Hight, backs

out of the deal because that co-operative buys the Minot exchange. North Dakota Telephone Company picks up what Souris River was going to acquire, so the deal goes forward.

1996 The paperwork phase starts, and the property changes hands. Because some of the independents want extra cable, the total price paid ends up at \$137.5 million.

The Role of External Agents

Without Wally Goulet and James Howard helping ITCG muscle its way through the many blocks, it may not have scored such a decisive victory in its quest for additional access lines.

Goulet,⁵ now vice-president and chief legal counsel for the National Information Solutions Co-operative, Missouri and North Dakota, was a private attorney when ITCG chose him over other lawyers to put the U S West deal together. North Dakota's telephone co-operatives were already familiar with and pleased with Goulet's work as he had represented many of them since 1982. In 1993, he was the lead attorney when United Telephone Mutual Aid Corporation, Dakota Central Telecommunications, and Polar Communications created North Dakota Telephone Company and put in a successful bid to buy fifteen exchanges from Contel of North Dakota.

His work for the North Dakota Telephone Company gave Goulet some good experience and helped prepare and strengthen him for the monumental task of the \$136 million U S West deal. "I burned a few fax machines up doing this project," he says. "It took about two-and-a-half years to put the U S West deal together" and involved piles of paperwork and many miles of travel.

Part of what made the deal difficult is that no one company or co-operative paid the same amount for exchanges. Bids ranged from \$1,600 to \$3,300 per access line. This lack of a formula for access lines created tension among companies. "U S West had us bidding blindly

and we may have been bidding against ourselves,” Goulet explains. In addition, due diligence on each site was done differently since environmental factors (such as asbestos) were different at each site.

Despite all the solid blocks and the resulting bruises, Goulet and the co-ops and independent companies pushed on to a hard-won victory. And it was worth it. “It [the purchase] filled in big gaps in North Dakota, and the co-operatives and companies could not be interconnected with just a small amount of fibre,” he says. “They [the co-ops and companies] were previously geographical islands unto themselves.”

Helping Goulet unite those “islands” was James Howard, vice-president of business services for John Staurulakis Inc. (JSI).⁶ JSI was the lead consultant in trying to set up a “buy” between U S West and the North Dakota co-operatives and companies. JSI provides financial, management, regulatory, business development, marketing/public relations, and strategic services, as well as education and software. Established in 1962, the company also offers analysis and review of such competitive-focussed issues as pricing and bundling, VoIP (voice over Internet protocol) analysis, CLEC and video/cable operations, strategic partnerships, image and identity, and mergers/acquisitions. In addition to its Maryland headquarters, JSI has regional offices in Georgia, Minnesota, Texas, and Utah. Howard, who works out of Minneapolis, is one of almost one hundred employees throughout the United States.

Reaction to the Proposed Conversion

Reaction to the proposed conversion was mainly positive. The North Dakota Public Service Commission, the regulatory agency whose approval of the sale was required, looked favourably upon it. In addition, Wilhelmson said Consolidated started getting calls from people wanting to know if they could join the co-operative.

Opposition was small and diverse. It came mostly from a community that wanted to create a municipal telecommunications service

business, a state legislator, a Native American First Nation that claimed pre-ownership, and several individuals.

- According to Wilhelmson, one town “was the biggest thorn in our side.” This North Dakota community of about seven hundred had been looking at creating a municipal corporation to provide services and regarded Consolidated buying the exchange as detrimental to its plans and potential profit source.
- A North Dakota state senator fought against the acquisition in the North Dakota legislature.
- A North Dakota First Nation held up one co-operative’s purchase by claiming it owned all of the infrastructure in the area. It took another year to negotiate this portion, and it put the entire U S West deal in jeopardy.
- Myer Shark and K.W. Simons brought a lawsuit against U S West, the independent telephone companies, and their affiliates.⁷ They claimed that their service would be affected by the sale and transfer of telephone exchanges. The case was dismissed and then appealed to the North Dakota Supreme Court. In March 1996, the state’s supreme court affirmed the dismissals.

Impact of the Conversion

On the Ownership

The socio-economic benefits of this conversion have been lopsidedly positive for North Dakota. Millions of dollars of new revenue have been generated in the state, as have hundreds of jobs. Technology has been dramatically upgraded, creating some of the highest level telecommunications infrastructure in the world. Political and public perceptions of this conversion are overwhelmingly positive. The public’s perception of the technological competence of telephone co-operatives and local independent phone companies has increased. Telephone cus-

tomers of the acquired lines have noticed and commented publicly on the improved service. Since the acquisition, several telephone co-operatives have formed competitive local exchange carriers in direct competition with U S West (now Qwest) community exchanges that were not for sale. These CLECs have found profitable numbers of subscribers who have switched to the co-operatively-owned companies. One telephone co-op in western North Dakota had three thousand customers in 1986, and that number was shrinking. In 2003, the co-op had thirty thousand customers.

David Dircks,⁸ manager of North Dakota Telephone Company, which bought three exchanges, says he can't recollect a negative thing about it. "People were glad to see more employees back in their communities, more kids going to school, and being able to call somebody or come in and talk to someone if they wanted to," he says. "It was mostly positive. You're not going to please all eleven thousand customers, but as a general rule it was very positive."

On the Business Sector

As mentioned above, the fifteen co-operatives and companies that purchased U S West exchanges in North Dakota banded together in 1996 to form DCN.⁹ This limited-liability company represents 85 percent of all the telephone exchanges in North Dakota and more than 90 percent of the state's total surface area. When DCN was created, the most promising technology for high-speed, broadband communications consisted of fibre-optic cables.

"We staked our future on it and have been more than pleased with the performance characteristics of the backbone," Evan Hass says. "We understand the demands of business and we help them anticipate the potential of the broadband network technology so they can compete in a global market. Our customers deserve that advantage and we're pleased to provide it."

Businesses have been pleased, too. They are streaming in to join the ranks of DCN customers.

“Our cross section of customers is like a Who’s Who from North Dakota — regional banks, engineering firms, equipment companies,” says Hass. DCN’s local people handling the ordering, billing, and service make the difference to these companies.

One of those customers is First Community Credit Union, headquartered in Jamestown, North Dakota,¹⁰ which began its business relationship with DCN in 2002. This co-operative is the largest credit union in North Dakota, owned by 27,519 members, with assets of more than \$218 million. It has twelve offices in ten locations. Jim Vollrath, vice-president of the company’s information systems, says the co-operative uses DCN to connect all twelve locations to the data-processing centre. The lines are used for phone, fax, and data traffic. The credit union was able to reduce costs, increase speed, and improve reliability when it switched to DCN. “DCN has the unique ability to resolve problems,” Vollrath says. “The local co-ops know the DCN techs by name and have met most of them. This relationship helps the communication between the two groups.”¹¹

On the Broader Co-operative Movement

According to Evan Hass, the successful deal changed the perception in North Dakota of what co-operatives can do. He said some thought the telephone co-operatives didn’t have the capabilities to provide all the latest and fastest telecommunications technology. “Local companies are able to handle technology that others can,” he says. This success story ended up in the *Wall Street Journal*, mainly because of the work of Consolidated’s manager on the project. This gave co-operatives — and what people can accomplish by working together — a much wider audience.

David Crothers argues that, despite the sheer success of the state’s telephone co-operative and independent companies, the media and government still aren’t paying enough attention. “We have eight hundred employees [at telephone co-operatives]. We invest \$30 million a year in infrastructure — new and upgrades — and we have a payroll

of \$30 million, and we're talking about towns like Ray, Ellendale, Hazen, Stanley, Carrington, Langdon, and Park River," he says. "I open up the *Fargo Forum* and I see new \$1 million projects and the governor is standing out there and I think I'm going to pull the rest of my hair out."

This lack of recognition may be due to co-operatives being taken a bit for granted because they're there, they're not new, and they can't be recruited. At the same time, North Dakotans appreciate "local," and, as a consequence, they understand that local has higher-quality technology than the bigger investor-owned company. The image of the co-operatives in the U S West acquisition case went from "sleepy little company" to "My God, these people pulled this off!" Crothers says that it goes beyond even the fact that the telephone co-operatives involved are locally owned and don't need regulatory burdens. "It's that everyone's an owner, so they have a voice in the operation of the company," he says. "And the board exists and the management exists at the members' pleasure."

David Dircks is happy to be working for co-operatives. "I've worked for a huge corporation and I've never been a co-op member for services or worked for one," he says. "But just based on the U S West purchase and DCN, what more amazing story is there than that? The best thing about it was North Dakota Telephone Co-operative didn't buy it [the exchanges] to take all the money out of here; they bought it to grow the company for future revenues for their members. That's a great feeling to have when you're running a place."

Observations and Recommendations

The success of a rain dance has a great deal to do with timing. This coming together of talent, resources, deregulation, pressures to grow local companies, and pressure to sell rural exchanges could not have been planned or orchestrated. There are very few negative lessons to be learned from this conversion. Future conversion at this scale, however, may not be replicable. This acquisition is remarkable primarily because

the local co-operatives demonstrated their ability to make significant investment in rural communications technology pay off handsomely when investor-owned companies could not. “Of the fifteen companies, no one went broke,” Goulet says. “And the acquisition filled in big gaps in North Dakota, and they all interconnect now with just a small amount of fibre.” As an added benefit, the acquisitions put into play much more work for the National Information Solutions Co-operative, which does billing work for the telecommunications and electric co-operatives around the United States.

According to Wilhelmson, Consolidated and the other co-operatives know and understand the business like U S West used to. U S West, he says, used to be service oriented. “It was a great feeling to go back to working for someone [a co-operative] that understands customers,” he adds.

Dircks says, “It’s hard to come up with anything we did wrong. I think the key to anybody who is looking at doing something like this is to do your due diligence — all the things that are involved: plant value, the age of switches, the availability of any cellular licences and wireless opportunities, and other things like this. Due diligence, I think, would be the most important thing.”

According to Evan Hass, DCN’s initial premise of long-haul business was short sighted. They hadn’t identified all the other possibilities and overlooked North Dakota. If Hass had it to do over, he would focus more on North Dakota right away. He also admits the group started out undercapitalized. Each of the fifteen companies kicked in \$50,000 to start, for a total of \$750,000. But this was not enough, and rural telephone co-operatives have not been afraid to invest. “Jelling working relationships was critical,” Hass says. “The board showed consensus.”

According to Hass, DCN operates by managing the bottom line. There is no difference between co-operatives and companies in this aspect. This deal and the resulting DCN “elevated in North Dakota what co-operatives can do,” he says.

Appendix 1

“Agreement for Purchase and Sale of Exchanges

“This agreement for purchase and sale of exchanges (“Agreement”) is made and entered into as of the 24th of January, 1995, by and between U S West Communications, Inc., a Colorado corporation (“Seller”), and BEK Communications Co-operative, BEK Communications, Inc. I and BEK Communications, Inc. II, corporations organized and existing under the laws of the State of North Dakota (“Buyer”).

“Recitals

“Seller currently has certain rights to provide and operate wireline telecommunications services and owns certain assets used to provide such services in North Dakota, pursuant to a grant of operating authority issued by the Public Service Commission (“PSC”), which have been offered for sale.

“Buyer desires to acquire Seller’s Assets and the right to provide and operate wireline telecommunications services in the telephone exchanges, listed in Exhibit A, in the State of North Dakota (the “Exchanges”), and Seller wishes to sell, assign and transfer the aforesaid right to provide and operate the wireline telecommunications service and Assets in the Exchanges to Buyer.

“Each defined term shall have the meaning set forth in this Agreement where such term is first used or, if no definition is so set forth, the meaning set forth in the “Glossary of Terms,” attached hereto and incorporated herein by this reference.

“NOW, THEREFORE, for and in consideration of the foregoing and mutual covenants and agreements set forth in this Agreement, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Seller and Buyer, agree as follows:”

So began a fifty-six-page agreement¹² by BEK Communications Co-operative and repeated by fourteen other co-operatives and companies for the payment of \$136 million to U S West Communications for sixty-eight North Dakota telephone exchanges. The co-operatives and companies, their signers, and the exchanges they acquired are as follows:

Co-operative/Company	Signer/Title	Exchanges
BEK Communications Co-operative	Jerome Tishmack, general manager	Linton, Steele, Lehr, Napoleon, Wishek, and Zeeland
Consolidated Telephone Co-operative	L. Dan Wilhelmson, general manager	Hettinger, Mott, Bowman, Killdeer, and New England
Dakota Central Telecom- munications Co-operative	Robert Hill, general manager	Carrington, Courtenay, Gackle, and Streeter
Dickey Rural Telephone Co-operative	Roger Johnson, general manager	Ashley, Edgeley, Ellendale, Forman, Kulm, LaMoure, and Oakes
Griggs County Telephone Company	Ray Brown, president	Finley
Inter-Community Telephone Company	Bruce H. Henrickson, general manager	Hope, Page, Sanborn, and Tower City
Midstate Telephone Company	James Wilhelmi, general manager	Beach
Moore & Liberty Telephone Company	Ray Brown, president	Sheldon
North Dakota Telephone Company	David Dircks, general manager	Balta, Drake, Esmond, Fessenden, Harvey, Knox, Leeds, Maddock, Minnewaukan, Rugby, and Velva
Northwest Communications	Kenneth Lund, Jr., general manager	Crosby and Tioga

Polar Communications Mutual Aid Corp.	Larry Deutz, general manager	Adams, Edmore, Fordville, and Lakota
Red River Rural Telephone Association	Ardon Doran, general manager	Hankinson and Lidgerwood
Reservation Telephone Co-operative	Gene Sloan, general manager	Garrison, Kenmare, and Max
United Telephone Mutual Aid Corp.	Kenneth Carlson, general manager	Rolla, Bottineau, Bisbee, Dunseith, Kramer, Rolette, Souris, and Willow City
West River Telecommunications Co-operative	Bob Barfield, general manager	Carson, Elgin, Flasher, Glen Ullin, Goodrich, Hebron, McClusky, New Salem, and Underwood

Endnotes

1. "DCN Breaks Ground in Fargo," *Dakota Carrier Network Business Connection* (September 2005): 4.
2. Davis Crothers, personal interview, 26 May 2006. All future quotations by Crothers are from this interview.
3. L. Dan Wilhelmson, personal interview, 23 May 2006. All future quotations by Wilhelmson are from this interview.
4. Evan Hass, personal interview, 17 May 2006. All future quotations by Hass are from this interview.
5. Wally Goulet, personal interview, 9 March 2006. All future quotations by Goulet are from this interview.
6. Retrieved 5 June 2006 from http://www.jsitel.com/meet_12_history.html
7. *Shark v. U S WEST*, 545 N.W.2d 194 (N.D. 1996).
8. David Dircks, personal interview, 19 May 2006. All future quotations by Dircks are from this interview.
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Solidarity Co-op Works for Ski Community

The Mount Adstock Recreational and Tourism Centre Solidarity Co-operative

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IN COLLABORATION WITH GENEVIÈVE LANGLOIS

TRANSLATED FROM THE FRENCH BY IVAN CHOW

IN 1998, THE PEOPLE OF L'AMIANTE, QUÉBEC, TOOK the initiative to rescue an alpine ski resort, buying the infrastructure from its private owner and turning the resort into a winning proposition. Under the dynamic leadership of a local businessman and the mayor of the town, the community was quickly mobilized, which contributed to the success of this project. It was the first case of its kind in Québec and has become a model for solidarity co-operatives in the recreation and tourism industry.

The Coop de solidarité récréotouristique du Mont Adstock (Mount Adstock Recreational and Tourism Centre Solidarity Co-operative (MARCS)) is located in the municipality of Adstock, sixteen kilometres from Thetford Mines within the regional county municipality (MRC) of L'Amiante, just over one hundred kilometres southwest of Québec City. With 2,399 residents, Adstock is the fourth most populated municipality in L'Amiante, surpassed by Thetford Mines, with a population of 26,861. The total population of the L'Amiante region is 43,968.

Mount Adstock is a recreational and tourism centre dedicated to alpine skiing, snowboarding, tube sliding, and dogsledding. There are also snowshoe, snowmobile, and hiking trails; observation points; as well as launching areas for hang-gliders and paragliders. Mount Adstock's main attraction is the 335-metre slope. The facility has a lifting capacity of four thousand skiers per hour and sixteen runs, two of which meet the standard for sport competitions.

Background

In the late 1930s, an alpine ski club was built to serve the Adstock region. Public demand quickly surpassed the capacity of the centre. The owners turned to Mount Adstock in the 1950s for its favourable slopes; tree cutting and fitting out the runs began after the land was purchased in 1954. In the early 1960s, workers constructed the first chalet and a double chairlift line.

In the early 1970s, a separate group began building a golf course at the foot of the slopes. This project began with nine holes, doubling its size a few years later due to increasing demand.

In 1980, the owners installed an artificial snow maker at the ski slopes. Despite the fact that the chalet was used by golfers and skiers alike, operation of the golf course and the chalet were separate from that of the ski station. The properties changed hands a few times before M. Blais, owner of the alpine ski facilities in 1998, faced serious financial difficulties.¹

Reasons for the Conversion

Blais was substantially in debt and on the verge of bankruptcy. Selling the ski centre was inevitable and could result in the dismantling of the equipment and suspension of any development activities at Mount Adstock. Blais contacted the mayors of Thetford Mines and Adstock to inform them of the situation. Gérard Binet, mayor of Adstock, was deeply concerned. Not only was he an avid skier, he also knew that

closing the centre would have several negative impacts on the community. It would create a lack of infrastructure for residents, especially young people; more than thirty seasonal jobs would be lost; and the region's tourism industry would suffer from the loss of a major attraction. Symbolically, closing the ski centre would be one more piece of bad news in a region already hard hit by the closure of the asbestos mines, from which many workers were laid off. It felt as if the region was doomed.

The Conversion Process

Binet soon found two other supporters, the manager of the Caisse Populaire Desjardins from Black Lake and a dentist. The bank manager proposed mobilizing the public with a project named "Operation Pride." With the help of the local newspaper, a meeting was held on 19 May 1998 at the ski chalet. Binet believed that if the people did not respond positively to the project at the meeting, it would not be worthwhile to continue. The results were surprisingly good: more than two hundred people attended the meeting. People *did* care about the ski station and wanted to save it.

Encouraged by community support, the organizers proceeded to the next step — to find key promoters, as set out in Blais's plans. Pressure was high; other potential buyers showed up, but Blais wanted to sell the centre to the local people to avoid dismantling the infrastructure. Binet, who is also a businessman, negotiated briskly and entered into an agreement with Blais. The centre would be sold for \$450,000, which would allow Blais to settle his debts. He would also have the right to run the centre and its sports store for three years.

Before making any financial arrangements, organizers needed to determine the legal status of the new entity. They put the councillor of the Québec-Appalaches Co-operative Development Region (CDR)² in charge and held a first meeting. Despite the fact that the formula for a solidarity co-operative was new and there was no precedent in the recreational and tourism industry, they continued with the plan.

This type of co-operative would include three member categories: consumer members, worker members, and supporting members. The National Assembly of Québec had only recently, in June 1997, recognized solidarity co-operatives. Although multi-organization co-op formulas had been implemented elsewhere,³ Adstock would be the first case in North America where the legislature acknowledged this type of co-operative.

According to the report of a local journalist, residents responded favourably to the proposal for a solidarity co-operative. The report was published in *le Courrier Frontenac* (May 1998), an extremely popular newspaper in the region that is read by 92–95 percent of the local population. Another meeting with the CDR representative explored the implications of establishing a solidarity co-operative. Many creative ideas came up during this phase, particularly in terms of financing the project. Locals favoured the idea of a solidarity co-operative because the financial risks were limited by individual capitalization and because it meant everyone could own the mountain. Mount Adstock was (and is) considered a collective resource by the public, and the proposal of a solidarity co-operative proved to be successful.

There were many discussions concerning the amount of money people would have to pay to become members. It was eventually decided that there would be two consumer categories: leisure members and business members. Business members would have to invest a minimum of \$5,000; anything less than \$5,000 would be considered a donation. In order to encourage investment, it was decided that business members would enjoy varying levels of privilege depending on the amount they invested.

The cost of leisure membership was set at a reasonable \$50, but the initial \$2,000 fee for worker members was thought to be too high, considering the financial resources available to the workers. The worker membership was lowered to \$1,000 in 1999 without changing the payment method. Workers could pay in instalments over a period of several weeks, combined with a system of deduction at source (automatic salary deduction), though these arrangements were largely symbolic

because there was only one worker member. The unbalanced number of members in different categories posed administrative challenges.

Finally, the supporting members' fee was set at \$10,000.

The next step was fundraising. Capitalizing again on the positive results brought about by the regional media, namely the newspaper and the radio station, the promoters were able to raise a remarkable \$480,000 in two weeks, including a contribution of \$100,000 from a local businessman and philanthropist. This significant contribution ensured the success of the campaign, and it was thanks to a contact made by Binet. Organizers also formed a youth committee and amassed \$2,000. This committee would be involved in many activities designed to encourage young workers to stay in the region. The money raised by the promoters was used to buy the ski station (\$450,000) and to cover the operating costs of the centre (\$30,000).

The solidarity co-operative was formally established on 6 July 1998. It would undoubtedly not have been successful without the project that saved the ski station from being demolished. The fact that Blais favoured the local community as a buyer also played a significant role in the preservation of the centre.

At the founding ceremony, Binet retired as planned and would not participate again until the first co-operative administrative council meeting. Many new developments have taken place since the establishment of the co-operative. By 1998, the snowmobile trails had been overhauled; this was followed by the renovation of the chalet. In 2002, workers constructed a snow park for patrons to practise snowboarding. This was followed by the addition of a nursery, which was greatly appreciated by parents of younger children. In order to communicate with the public, the co-operative started publishing a column in the local newspaper and broadcasting periodic radio bulletins; it also devoted 30–40 percent of its advertising budget to ads in the weekly newspaper, *le Courrier Frontenac*. In 2003, the co-op launched an information bulletin for centre customers; this was extended to the general public in 2006. Once a year, the municipality of Adstock invites its citizens to ski at the centre free of charge.

Despite all of these accomplishments, the co-operative's precarious financial situation forced it to postpone certain projects, such as the construction of a new snow-making system to replace the one currently in use, which has become obsolete. The operating costs — between \$400,000 and \$500,000 — were a bit too high for the organization.

Impact of the Conversion

The project was, without a doubt, a great success. It saved the ski centre and kept it in operation, making it possible for customers to continue their favourite sport and for workers to keep their jobs.

Although the centre had a significant and positive social impact, it was not generating enough income. In other words, the project was not financially sound.⁴ In 2003, the co-operative had an income of \$512,000, with a general reserve of minus \$156,284. On the positive side, the co-op was able to capitalize \$542,550. The exceptionally high capitalization was a good indicator of the people's attachment to the organization. It is worth pointing out that the region's MRC also injected \$25,000 per year for three years after the co-op opened. The promoters succeeded in adequately maintaining the centre and developing new attractions, such as the snowboarding park.

The region was also able to preserve a key element of its tourism industry and, in turn, revive its hotels and restaurants. The success of this project and the collective initiative and support of the people contributed to helping the region rise above the sense of futility that followed the closure of the mines and other businesses. Local residents have demonstrated their desire and ability to prevent the closure of more businesses and establishments.

The co-operative was not so successful, however, in terms of administration. On 17 June 2003, the co-op had a total of 411 members, including 371 leisure members, 34 business members, 5 supporting members (the Local Development Centre, under its *Société locale d'investissement pour le développement de l'emploi* — Local Investment Society for Employment — programme; *La Société d'aide au dével-*

oppement des collectivités — Community Futures Development Corporation; Fonds de développement industriel regional de Thetford — Industrial Development Fund of Thetford; the Desjardins Corporation; and the MRC of L'Amiante), and 1 worker member. Business members include Grenco, a financial firm; the Saint-Méthode Bakery; and Donat Grenier, a philanthropist.

Attendance at the administrative council meetings was strictly voluntary, as was patrolling the ski runs, even though patrolling was a general practice of the ski station. However, participation in the general meetings was low. In 2003, only 6 percent of leisure members (around twenty people) participated in the general meeting, down from 11 percent in 2002. Although the leisure group constitutes the majority of members, it is represented by only one member in the cooperative's administrative council. In general, the low number of members in this category on the co-op's administrative council can be attributed to two main factors: leisure members do not enjoy any particular advantages, such as reduced service fees, and there are no privileged communications between the centre and its leisure members. In other words, initiatives to attract leisure members, if any, were weak. As well, the project did not make a significant impact in the field of co-operative businesses. With the exception of a small number of experts familiar with co-op development, few people know about the organization's status as a co-op.⁵ In addition, the co-operative does not make an effort to develop business relations with other co-operatives, as is the case elsewhere in Québec.⁶

Observations and Recommendations

One of the main promoters mentioned that establishing a co-operative would make it easier to apply for subsidies. Although this was true in certain respects, it was not the case in others,⁷ since the Mount Adstock co-op deviated from the traditional co-operative model. Moreover, the directors and management lacked the formal training and resources to run a co-operative. The public is not familiar with the operation of this type of organization, and running a solidarity co-

operative with several different member categories proved to be a demanding task in terms of management skills and knowledge.

Mount Adstock has one more member category (business members) than other solidarity co-operatives. In order to succeed, the promoters had to satisfy different interests, settle disputes, and find compromises without neglecting the needs of one member group in favour of another. The integration process for the worker members was rather easy. In time, the leadership of the administrative council was taken over by business-member representatives, and the administration adopted a traditional management style.

Taking a step back and looking at it from a co-operative point of view, one can suggest the following changes if this project were to begin again:

- Support from the CDR and other specialized professional resources in co-op management should continue to be provided after establishment.
- The administrative council should include members who are familiar with the operation of co-operatives.
- Specific training concerning co-operative administration should be offered regularly to the members of the administrative council.
- An intervention plan should be implemented from the beginning in terms of information, recruitment objectives, and collaboration with other co-operatives.
- Special attention should be given to attracting worker members and encouraging their participation.
- Member privileges should be considered at the beginning. For example, a rebate or reduction of service charges should have been considered. These actions would not only reinforce members' sense of belonging, but would generate more capital for the co-operative.

Endnotes

1. In the 1980s, the number of customers using the ski station was higher than in the 1990s and the government was able to support the development of the infrastructure. In the 1990s, financing in the public sector had dried up. To make things worse, bad weather caused a drop in the number of customers.
2. In Québec, there are about a dozen regional development co-operatives. Seventy-five to 80 percent of their budget is publicly financed, so they rely on creating and maintaining jobs through co-operative practice. As members of the territorial co-operative, these co-ops participate in inter-co-operative activities, co-operative weeks, co-operative relief weeks, and co-operative recognition galas.
3. Multi-organization co-operative regulations have long been in place in developing and developed countries. The first example of a social co-operative was in Brescia, Lombardia, Italy, in the late 1960s, and provides a shining example of the type. In 2001, there were roughly fifty-six hundred solidarity co-operatives throughout Italy. These co-operatives are often divided into two or three large categories with subcategories. With the increasing success rate and potential for positive social impacts, this model was adapted in different forms in other countries of the European Union. In France, for example, these types of co-operatives are called Collective Interest Co-operative Societies.
4. The ski centre has been somewhat run down since the establishment of the co-operative. Because of unsound financial return, subsequent promoters of Mount Adstock did not carry out emergency repairs and could not afford to maintain the equipment. As a result, the co-operative had to pay for a series of repairs. Moreover, since the death of a thirteen-year-old skier in 2000, co-op directors have been placing great emphasis on customer safety, which increases operating costs. For example, in the 2002–2003 season, they invested \$20,000 to repair pumps to reduce snow damage. Repair of the chairlift in 2003 cost \$25,000. As outlined in the

2002–2007 Regional Strategic Plan for the Chaudière-Appalaches region, the general director of the co-operative plans to invest \$592,000 – \$690,000 to improve the infrastructure and assure further development of Mount Adstock. Other causes for the difficult financial situation include temperature fluctuations and increased running costs.

5. There was no mention of the ski centre's status as a co-operative anywhere on their website (<http://www.montadstock.com/contenu/index.cfm>), nor was there any information on how customers could become members.
6. In the Saguenay region, Mont Édouard is owned by a worker co-op.
7. The co-operative obtained financial support from Emploie-Québec under its employment measures to provide jobs for individuals who have been unemployed for a certain period.

For More Information

For more information, please consult the following sources:

Langlois, Geneviève (in collaboration with Patrick de Bortoli, under the direction of Jean-Pierre Girard and Benoît Lévesque). *La coopérative de solidarité récréotouristique du Mont Adstock et son impact sur la cohésion sociale*. Montréal: Université du Québec, Cahiers du CRISES, collection Études de cas d'entreprises d'économie sociale, cahier ESO 601 Research Centre for Social Innovations, 2006.

Coop de solidarité récréotouristique du Mont-Adstock website:
<http://www.montadstock.com/contenu/index.cfm>

The “New” Credit Union

Sunova Credit Union

BRETT FAIRBAIRN

WITH THE ASSISTANCE OF ROB DOBROHOCZKI

Background

THERE ARE A VARIETY OF CIRCUMSTANCES IN WHICH co-operatives have bought out profit-seeking firms. Historical examples include friendly buy-outs of retail merchants by consumer co-operatives¹ and worker buyouts of firms threatened with closure.² In recent years, a common example in western Canada has been purchases by credit unions of branches that were being divested by chartered banks. These bank-branch buyouts differ from earlier instances in that they are not purchases of independent, typically small businesses, but rather deals negotiated with large companies. As such, they represent a significant development in the era of globalization.

As large firms orient themselves towards global business, they sometimes reduce services in local, particularly rural, communities. This creates needs that can be met by the expansion of co-operatives. Credit union buyouts represent one of the ways in which co-operatives, attuned to their own business success and the needs of their communities, respond to globalization. At the same time, they provide a

fresh opportunity to ask what changes when an existing business is converted from a for-profit to a co-operative form; and how co-operatives change when they expand their business and take in new communities and new customers previously unaccustomed to the co-operative model.

Sunova Credit Union³ is a multibranch credit union operating in a rural region north and northeast of the city of Winnipeg. Like most contemporary credit unions in Canada, Sunova provides a full range of banking services, including deposits, consumer loans, mortgages, commercial and farm loans, and (in part through allied businesses) brokerage of insurance and investments.

Sunova started decades ago as a single-branch credit union based near Stonewall, Manitoba. After encountering a rocky period, the credit union began to grow through mergers and acquisitions of branches in nearby communities. A critical aspect of its most recent phase of expansion (since 2000) has been the acquisition of several branches from a chartered bank. These takeovers are one aspect of the growth, regionalization, and commercial success of a highly competitive “new” credit union.⁴

Reasons for the Conversion

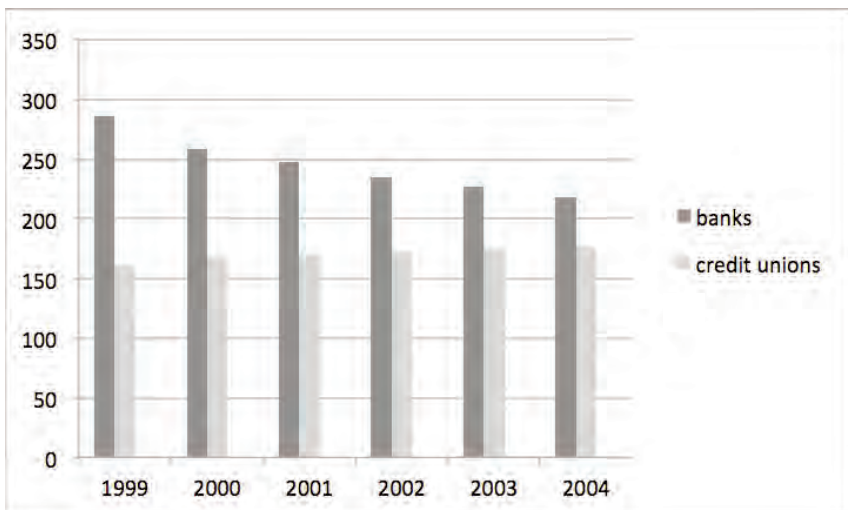
From 1999 to 2004, banks reduced their number of service points in Manitoba by nearly 24 percent (see figure 1, opposite). Credit unions, although already present in many or most of the same locations as the banks, increased their total number of branches by about 10 percent. Not surprisingly, Manitoba is said to be one of the provinces where the market share of credit unions is growing most quickly at the expense of banks.

The Sunova case is an illustration of this trend and of the ways in which the growth of credit unions has so far intersected with changing policies and approaches of the major banks. While we can distinguish several different motivations for bank branch conversions, the root cause appears to be the changing priorities and management approaches of globalizing enterprises, and in particular, the desire of chartered

banks to divest themselves of small branches in order to focus on more profitable national and international business. The logic of a profit-maximizing firm is to shift resources into those activities within its scope of business that have the highest rates of return. In a national/global entity, this means that small local branches may be curtailed or eliminated, even if profitable, in favour of more profitable activities elsewhere.

In the Sunova case, the desire of a bank to divest itself of a local service was complemented by the ambition of a successful credit union to expand geographically and commercially. Leaders, staff, and members characterize this particular credit union as dynamic, growing, efficient, and competitive. Sunova's mission statement declares that the organization is dedicated to "superior service"; its vision is to be the "premiere financial institution in every community in which we have a branch and to increase market share through strategic development, innovation and technology."⁶ Within this context, it aims to excel in member service, product and service development, financial performance, community investment, and co-operative member relations. The

Figure 1: Bank and Credit Union Branches in Manitoba, 1999–2004⁵



organization's "values" include not only member service, innovation, integrity, and community involvement, but also "success." Given this orientation, the desire of the credit union to expand matched the desire of major banks to downsize. This is a case where two ambitious organizations have opposite interests: a large, profit-seeking enterprise sought to leave local communities; a competitive, community-based local business wanted to serve more of them.

Becoming the New Entity

From the credit union's point of view, the acquisition of bank branches is part of a continuous long-term strategy of geographic expansion. Currently, Sunova does business in ten branches located in nine towns north and northeast of Winnipeg, though only eight of these have stand-alone branches with regular hours and services.

Half of the credit union's full-service branches were created or substantially expanded due to sale or closure of bank branches. The Whitemouth branch opened as a result of the withdrawal of the Royal Bank, which had been in that community for many decades. More recently, the credit union purchased branches in Pinawa, Beausejour, and Lac du Bonnet from the Bank of Montreal in a deal arranged by Credit Union Central of Manitoba. In all three communities, the credit union took over the bank's former client list, but the competitive circumstances and the history of the credit union in the communities was different in each case. In Beausejour, the credit union was long established as a local presence and grew as a result of the purchase. In Lac du Bonnet, the credit union had established a new branch in the community in the late 1990s, but the purchase of the Bank of Montreal branch doubled the size of the credit union branch and established it suddenly as a major local financial institution. The credit union still faces one remaining bank competitor in each of these two communities. In Pinawa, by contrast, the Bank of Montreal was the sole financial institution, now replaced by the credit union.

Reaction to the takeovers seems to have been primarily positive.⁷

Community leaders and members in our focus groups recalled significant frustration with the banks. While some of them were not familiar with credit unions at that time, it seems as though unhappiness with rates, fees, terms, hours of service, and lack of on-the-spot decision making (for loans) all contributed to a willingness to try the credit union option. In one case (Lac du Bonnet), community leaders worked for years to get the credit union to open a branch to compete with the banks; naturally the residents behind this initiative were not displeased to see the bank branch close. A credit union manager told us that in one case “the community wanted to run the Bank of Montreal out on a rail” for years prior to the sale.⁸ In many respects the credit union had the experience of being “invited” into the new communities rather than pushing its way in from outside. This experience was aided by Sunova’s strategy of working with prominent local residents to prepare the way for its expansions. Often, one of the original local leaders went on to become the first local representative to Sunova’s board of directors.⁹

The decision by the banks to divest themselves of local branches and services also contributed to a sense that the bank was abandoning the community. One member put it as follows in response to a credit union survey:

When the Royal Bank decided they weren’t making enough money at their branch in Whitemouth, it was the Credit Union who stepped in and offered their services to our community. They are willing to provide service to small communities. They are interested in helping people and not just making big profits. Thank you [Sunova] for doing what the Royal wouldn’t.¹⁰

In some of Sunova’s communities, people were receptive to the credit union because of prior experience with other co-operatives; this appears to have been true in Beausejour and Lac du Bonnet. But the more immediate reason was the perception that the strategy of the banks was a threat to their community services. “The chartereds were letting them down and they realized that they could end up with no financial institutions here unless they started something that was based

on their own support,” a knowledgeable manager told us.¹¹ We heard the same thing in a member focus group: the banks were seen to be shutting down services, and the credit union came across well because it was filling the gap. “I sincerely think they picked up the slack when others closed, and [provided] an alternative choice,” a member told us.¹²

Our research indicates that at least some members and community leaders felt positively towards the credit union before and at the time of the purchases; however, we have no basis for saying that all did so. The generally positive story of the credit union coming into the community (or investing and expanding as a result of a purchase) may not be the same as the individual stories of bank customers, used to dealing with a familiar institution and its staff, who now found themselves members of a new organization that was strange to them. They more or less automatically became credit union members, and if they wanted to keep banking at their new institution, they had to learn its ways: paying in share capital, dealing with new staff, trusting an elected committee of members to make decisions on their behalf, and so on.

A member-services employee who worked with the new members after the purchase recalled:

I think the perception of it was almost that they felt that we just took them over. Which, I mean, we did; but the Bank of Montreal was going to close its doors. So, technically, if we didn't do that then all the Bank of Montreal customers would have been driving to Selkirk or Winnipeg to do their banking. Maybe they didn't see it that way originally.... We still have most of those members. There were a few that ended up transferring over to Selkirk or they decided to go to the Royal Bank instead, but the majority of those members we just kept. I think we have kept them happy and satisfied.¹³

Likely an important part of keeping the new members was the credit union's dedication to competitive products and convenient service: viewed strictly as a banking experience, the new members didn't have to feel they were losing anything. “I think they realized that we're

a good place to do business,” the same member-service representative recalled. “We’ve got friendly staff and we’ve got really good banking hours. We’re open six days a week here whereas the Bank of Montreal was open Tuesday to Saturday. [And] we were able to offer anything the banks can offer.”¹⁴

Perhaps it is not surprising that the front page of Sunova’s website declares, “We’re Not a Bank. We’re Better.... We work towards providing our membership with superior financial service that exceeds all expectations.... Superior financial service is what we are all about.”¹⁵ The superior service is delivered within a framework that includes community involvement and member relations, but these are more like means to an end than ends in themselves. A senior employee recalled that “word of mouth” was the key: people heard from other members about service at the credit union, and were willing to give it a chance.¹⁶

Managers explained that an important challenge was to establish that the credit union was professional, competent, and capable:

We spent an inordinate amount of time [explaining], especially among the small business clients, members,... what a credit union entailed, what we could do, what we couldn’t do, and the difference that they could expect.... Also to change ... the perception of credit unions in general,... that we’re archaic, that we can’t compete with the “big boys” technology, that our training is not as good as the banks’, that we couldn’t offer the level of credit that they’re used to or the rates. They knew that our fees would be better, they knew that our service would be better, but a lot of those misconceptions — we had to educate our membership.¹⁷

Another manager agreed, and added:

One of the key issues ... that we found was the decision-making process; we had to clarify it. They felt that the decision making was geared through the board of directors and the sense of privacy relative to their affairs would be lost. We had to assure them that our

board of directors provides governance; it does not provide approval,... that our directors didn't even know who [the client] was or never ... see the credit files.¹⁸

One thing the credit union staff had to explain was the credit union's share-purchase program. Sunova has an atypical share-investment program that requires members to buy initial \$25 shares (for individuals) or \$40 shares (for joint accounts), and to continue purchasing a one-half investment share every month until a specified plateau is reached. At year-end, a portion of earnings is distributed on the basis of share investment. The result is that Sunova members invest more and see a more tangible benefit from their investment than do members in many credit unions. While this is a clear difference from a bank, it required explaining. "They all felt it was some sort of fee," one of the employees quoted earlier told us, "so we actually changed it a little bit" and allowed all the shares to be purchased gradually over time rather than to have any deduction up front. Many new members probably reasoned that the required share purchases (which would eventually come to an end) were no more onerous than banking fees that would go on indefinitely. Those who paid attention would also realize that the shares represent ownership and earn income.

Over time it may be that the shares will have an educative effect, precisely because they require the staff to explain ownership. "Some members, if they're brand new, they don't know credit unions, and you have to try to explain the share policy to them," a member-services employee told us.¹⁹

We use the word ownership: you get this \$25 share; you have ownership. You can vote on the director; you have a say. If there's something that you don't like, we have surveys to find out — you know, this is what our members wanted, so this is why we introduced a really good savings account: because our members asked for it.... We really try and tell them that. I've had people that don't understand the share program and I've actually had an account close because they asked, "Well, why are you taking \$2.50 a month out of my account?" ... Not everyone gets it.²⁰

A member-services staff person at a different branch told us that she explained ownership in much the same way — “You’re a member and you have voting privileges” — but she expressed disappointment at how few members actually made use of their right to vote. “Unfortunately, when we have our annual meetings we don’t have a very good turnout any year.... [Members] can have a say in what goes on in the credit union but a lot of people don’t take advantage of it.”²¹

Sunova’s CEO, Ed Bergen, recalled that of twenty-five hundred accounts they purchased from the Bank of Montreal, they ultimately kept virtually all of them. He particularly remembered “two old people who were adamantly opposed to credit unions, period. We got both of those accounts back after a year.” Bergen stressed that it was the service that won people over, whether or not they were philosophically for or against credit unions in the first place.²²

Impact of the Conversion

There seems little doubt that the branch conversions have been a success for Sunova as an organization. The credit union is financially healthy and still interested in expansion. Its new accounts mean a larger volume of business, which has improved its ability to serve its members. The Pinawa purchase, like the earlier expansion into White-mouth, added an entirely new community to the Sunova system. The Beausejour and, even more so, the Lac du Bonnet purchase reinforced an existing branch. Overall, the purchases both extended Sunova’s network and strengthened important nodes within it.

Besides strengthening the long-term financial base of the credit union, the branch conversions also made a difference to members, communities, and staff. Since many of the tangible services remained the same, these changes could be characterized as subtle but significant, a shift in values rather than a revolution.

Impact for Members

As a result of the conversions, members continue to have access to a service they would otherwise have lost, or to a competitive choice that

would otherwise have been reduced. As indicated in the comments above, they also have longer hours of service than previously. These are effectively convenience issues that are important to members in terms of time saved or distance travelled. However, some members also perceive a different *kind* of service and a different relationship than they previously had with the bank.

In focus groups, ordinary members typically referred both to practical dollars-and-cents issues, and to other aspects that made the organization attractive. The following are comments from a retiree who dealt with banks most of his life before discovering Sunova several years ago:

Unlike the other banks, they give you shares, like from your chequing and your savings account and so on. And by golly, I didn't know how much I saved up until she [indicating his wife] wanted to go to Cancun, Mexico, and I went and inquired about it and good Lord, here I had an extra, you know, thousand dollars that I didn't know I had [from earnings allocations]. And that really came in handy. So they give you some perks and excellent service and I would [say], they're second to none — as simple as that.²³

There's a different feel going into the credit union:

Absolutely. I own that bank, I own that bank, and that's a good statement. I'm part owner of that bank in a very small way.... I sincerely think, like all the banks, they go out of their way to give you extra good service; but it's sort of like a family, walking in and say, hey, do you know what?... I like the friendly atmosphere.... And ... you don't have to wait a week or three days to get your loan approved. I just bought a fairly new car the other day and in half an hour you've got your loan approved. I mean, that's really great.²⁴

By contrast, the banks did not come across as being locally oriented businesses. A common complaint, which we heard from this member and from others, was that members disliked phoning the bank and getting an automated answering system or a distant call centre. By con-

trast, when you phone the local credit union “you get the credit union, and you can ask for any teller or the manager or whoever you want, as long as they’re not tied up with somebody else. If they are, they’ll call you back, and they call you back within a reasonable amount of time, like a half an hour.”²⁵ “We don’t have to wait,” another member told us. The organization seems more personal and distinct: “At the Royal Bank, at the Montreal, it’s all one, but ... every co-op is within themselves.”²⁶

Impact for Communities

In three cases, Sunova has not only kept open a bank branch that would otherwise have been closed, it has made significant and sometimes dramatic new investments. The credit union constructed a new building in Whitemouth, the most attractive building on the main street, decorated with farm equipment in a reference to the locality’s agricultural heritage. It constructed a new building in Lac du Bonnet, and not just any building, an eye-catching structure outwardly resembling a lighthouse on the lakeshore. Inside, the branch has a distinctive architecture of open wooden beams meant to recall the cabins that are common in the area; it offers members a cozy area with a fireplace and television. In Beausejour, the branch was under major renovations when we visited in 2005. The credit union is proud of these investments in bricks and mortar, and intends them as statements to the communities concerned.

A local member and community leader put it as follows.

I think right now [the branch is] like a pillar in the community, almost like a cornerstone. It’s proof that this is a growing community, that it’s economically viable and that there’s services to be offered here. I see that branch as being [a] representation of what the members want. When we built that building, we went to the members and asked them what they wanted and we talked to the staff and asked them what they wanted. We tried to develop a building that was going to make sense architecturally in the area

... People look at that and they see the Bank of Montreal left town here a while back. They see our Royal Bank not getting any bigger and offering fewer services. They see the credit union offering all these great services.... They see smiling faces and they see a beautiful building going up. They want to buy into that ... and that's why our membership has grown, because people know that we're here to stay.... We've invested in the community and that means something to people.²⁷

Investment by the credit union, particularly when other businesses are downsizing, can be a shot of confidence for the local business community. As one person explained to us, "Well, you see the Bank of Montreal closed down. You see several small businesses around town closing.... You don't see any of the local food stores getting any bigger. You don't see any real new growth in town. People get shaky and they get worried about things like that."²⁸ The bank closure and the credit-union expansion happened at a moment when this "shaky" environment changed to something more positive. "The credit union was the first one to really do something big in town here" with its investment. "Then all of a sudden bam, bam, bam, bam"—the credit union was followed by a new food store, a new recreation facility, a new co-op service centre, and new tourism development. "Where did that all come from? Were we the impetus of that? I don't know," this person said honestly. But it was the credit union that went first.

Impact for Employees

We were surprised how many employees reported that they had previously worked for chartered banks: in some cases, main branches in cities; in others, the local branch purchased by the credit union. Of twenty-eight managers, member-services staff, and lenders whom we interviewed (not selected with this in mind), we came across seven, or 25 percent, who had extensive prior careers, generally from one to three decades, as bank employees. This unexpected finding provided an opportunity to compare directly the experiences of individuals who had worked in both environments.

After many years with the Bank of Montreal, a manager told us, “The reason I came to [Sunova] Credit Union ... is because I felt that after a period of time and a dramatic change in the banking industry, we were neglecting our clientele. I sought out an organization that really values people.”²⁹

“When I joined the bank here [in the 1990s],” a lender agreed, “it probably was run closer to the way the credit unions are now: more gentlemanliness about the way of conducting business and approaching other staff or clientele.”³⁰ This lender described constant short-term target changes at the bank — “change for the sake of change,” it seemed to her — with constant emphasis on profitability while forgetting that satisfied employees and clients are also important. “Yes, credit unions have to make a profit. We don’t do business unless we make a profit. But it comes down to what is a reasonable profit.... It comes back to the individual staff member and how they meet the expectations of the member/client.”

Another lender with a bank background concurred:

I’ve been working in financial institutions, or in finance, since I started my career. The majority of it was with a major bank. I very much enjoyed what I was doing; however, I felt very confined in being able to be myself in my position. It seemed that there was always a pattern you had to fit. There were too many changes.... I felt that I had lost myself.³¹

This lender found herself again — found the kind of banker she wanted to be — in the credit union. “Jokingly, a lot of the people that work for major financial institutions say that we’ve gone to banker’s heaven.”³²

Lenders explained to us that the credit union’s policies offered them more flexibility in presenting a range of options to meet members’ needs; in the banks, their experiences in the last decade or so involved more and more stringent guidelines and limitations conveyed from head office. “We follow policies that allow us to tailor solutions to assist our members’ needs — whereas in the conventional banking

system, it's more cookie-cutter."³³ The banks' approach led to mounting frustration:

I knew my clients very, very well. In too many situations, I had to say, "I'm sorry we can't do this for you." My frustration came in the fact that I was unable to relay to whoever was making that decision that they should listen to me because I understood the case.... I was nothing more than an order-taker. I had worked too long and put too much effort into what I thought was the important part of lending: understanding and being able to communicate. I couldn't do it any more.³⁴

This lender described how her job at the bank had changed as "de-skilling."

Similarly, member-services staff told us that the credit union gave them more time and encouragement to talk to members, identify their needs, and provide multiple services or referrals to specialist staff. A member-service representative who joined the credit union a few years ago told us:

One of the reasons I left the chartered bank was because ... they're moving so far away from customer service and they shortchange you so much; you have no time; they want you to be pleasant and push the people through — there were times when I would be the only teller waiting at the chartered bank. And that's not me. I'm very outgoing. I'm very pleasant. I'm really curious: I want to know what's going on in people's lives; I want to know, okay, your grandchild, you're opening up an account for your grandchild, how old is it? — I'm really bad that way. But when you come to the credit union, that's what helps you at the credit union.... We talk. I know what's going on in their families, I know their kids ... a lot of it I know through the community. I've known either the parents or the grandparents, or been on the parent council with them.³⁵

This person remembered having, as a bank teller, a strictly limited

job with narrow duties. She remembered serving long line-ups of people for hours on end, standing the whole time as the stool provided was too uncomfortable to use. With the relentless pressure, there was little time for chat or even for bathroom breaks. By contrast, at the credit union she has more tasks, a comfortable chair to sit in, and feels she is more productive.

Another member-services representative put it this way:

My biggest concern [at the bank] was that they were treating clients like numbers or letters ... A, B, C clients. Unless you were an A or a high potential B, you really didn't get the service that you deserved; they were just sloughing you off to people who had little or no experience. That really bothered me because my point was you don't know which C, D, E, F client is tomorrow's potential A client. If you treat them badly now, they're not going to come back.... I just thought it was unfair. With the credit unions, I find that everybody gets treated the same no matter what. They treat everybody as if they all have the same potential. So I think it's a lot fairer.³⁶

The staff also talked about training, development, wages, and teamwork in the credit union system. We asked if the credit union stresses development:

I think absolutely. I don't know about other credit unions particularly, but this credit union is very, very big on furthering your education and improving your knowledge. They give us every opportunity here, and they're very big on promoting from within if they can. So yeah, they've given me every opportunity to advance.

This same employee also commented upon more flexibility in hours and positions compared to what she experienced at the bank.³⁷

How are the wages? "They're getting better. At the time that I applied here I actually took a wage cut from the bank that I was working [at], plus I took a reduction in hours," an employee told us.

But faced with the cost of driving to and from Winnipeg and shorter day-care hours as a result of not having to travel, and the fact that I wanted out of the bank so badly, it all was worth it. I quickly made up the difference and then some, probably based on a little bit of my experience and the fact that I was so happy for not being at the bank.³⁸

Teamwork? Managers with experience in both worlds told us that teamwork is a common word, but it takes on a different significance in the credit union, where competition between staff members is played down, and co-operation between different units or functions to serve the member is encouraged. Sunova uses its own “balanced score-card” approach to performance reviews and bonuses, incorporating multiple targets and shared successes:

In the banking world you had a dollar target only. You may have been required to bring in \$2 million worth of new money or solid referrals within a year. Here it's based on your ... performance as a whole. So not just in the new dollars that you bring in, but the new dollars that you keep, the new accounts that you open, and the members that you bring in. It's more of an overall relationship that you're building as opposed to a number.... I think that the credit unions give their employees better tools to achieve those targets than the banks. The banks have a real sink-or-swim philosophy, and you're either doing it or you're not, and if you're not, then they don't want you there. Here, they're willing to invest the time and the money to train you to achieve those targets.... Here our targets are based on team performance as well. I really didn't have a good month this month but we've made every effort to make sure that one of us in the branch is at the top of the charts for the month. So even though it wasn't me, I'm glad it was “Jane,” who sits next to me.³⁹

We did not look for or expect the detailed comparisons we heard between banks and credit unions, but they point to real differences between the two environments that are perceived by those involved

but little appreciated by outsiders. At the same time, several important observations and qualifications are in order.

First, our study documented a clear difference between the bank environment and the credit union environment, but it did not document why this difference exists. It is not necessarily an automatic function of the co-operative form of ownership, though that likely plays a role. To some extent, it is simply a product of a smaller-scale and more community-level organization.

One staff member told us, “When I worked for the financial institution, I knew we had a CEO. I think I even knew what his name was once. But where was he?” She used to look at the bank’s annual reports and see no connection to her own work or accomplishments. But “in our credit union, our CEO can walk past my desk and poke his head in and say, ‘Hi!’” and call her by name. When she reads the annual reports, she knows “what they mean, where we’re going, and what part I had to do with that. I can actually see that I do make a difference. That makes it exciting.”⁴⁰ Here, small scale and proximity to peak decision makers are part of the credit union difference.

Another staff member commented on the difference caused by community involvement and local hiring. “I don’t know about the actual financial services because they’re the same no matter what institution you go to,” this staff member said. “It comes down to the people, absolutely. Generally, the credit union wants to try to hire from the local community. Management is encouraged to live in the community as much as possible, or live close by. We are encouraged to participate in local events and charities, that type of thing. We are the community and we are part of the community.”⁴¹ This too goes with being smaller than a national or transnational corporation. Of course, member ownership, usually on a local basis, is part of the definition of a co-operative, so these characteristics are also linked to the co-operative form.

Second, the fact that Sunova provides a different environment does not mean that all credit unions do. This case study shows that such differences are possible, not that they are inevitable.

Last, not all employees are the same, and some undoubtedly prefer the bank environment; in small ways we heard some evidence of this. The above testimonials by experienced employees can also be read to indicate what kind of people would be more satisfied in this type of credit union, and what kind of people might actually prefer to work for a large bank. At least for employees who wish to work in a more people- or community-oriented way, and be based in a local place, the conversion into a credit union offers the prospect of higher job satisfaction, more autonomy, and more diverse career development. As the large banks have introduced new personnel and management policies in the last decade or so, this credit union has found ways to remain community and people oriented within its regional branch systems.

Observations and Recommendations

The preceding detailed analysis has outlined a variety of opportunities, issues, and concerns in the process of converting bank branches to credit union ownership. Some of the themes touched upon include the following:

- Conversion offers a prospect, at least in some cases, for community revitalization.
- The credit union form is more community oriented than a large bank. Its introduction can lead to improvements in local access, member service, and employee satisfaction, particularly as the branches that banks want to sell are in communities the banks are not very interested in serving.
- The credit union has to demonstrate professionalism and competence in banking to keep former bank customers. Over time, new members and new staff have to be informed and educated. Democratic participation may be hard to kick start.
- There are ways in which the takeover of a branch can be perceived negatively. Working with local residents, ensuring good service, training staff, and trying to generate positive “word of mouth” advertising may help.

- It is not only the branch and its community that are changed in the conversion process; the credit union redefines itself when it becomes larger and potentially more complex. In the example recounted here, conversion was not just “adding on” but was part of a dynamic process in an ambitious and successful organization.
- Growth into a regional network does not have to mean loss of community connection. As one staff member who lived through the transition from bank to credit union said, “Although this branch is part of a bigger organization, it is member oriented and community oriented. We do work cooperatively with other branches, but we are a unit unto ourselves, definitely.”⁴² Regional multibranch credit unions can be perceived as local in character and responsive to community needs if the management approach, staff, and local leaders connect the individual branch to its own community.

Endnotes

1. See B. Fairbairn, *Building a Dream: The Co-operative Retailing System in Western Canada, 1928–1988* (Saskatoon: Western Producer Prairie Books, 1989) on the “associated stores” program of the 1940s, one of the ways in which the consumer co-op distribution system was built up.
2. Examples include plywood manufacturing co-operatives in the Pacific Northwest and Algoma Steel.
3. When the research for this chapter was initially undertaken, the name of the organization was South Interlake Credit Union. Since the research was completed, the credit union changed its name from South Interlake to Sunova. All instances of “South Interlake” in this chapter have been changed to “Sunova”; the name appears in square brackets in direct quotations. References to the website in the endnotes have been changed as well.

4. The theoretical framework we used for analyzing this credit union comes from Marie-Claire Malo, Benoît Lévesque, Geneviève Huot, and Omer Chouinard, "Coopératives financières et cohésion sociale: Quelle interface dans le nouveau territoire 'local' à l'ère de la mondialisation?" (Ottawa: Projet de recherche entreprise avec la collaboration de Secrétariat aux coopératives et Ministère du Patrimoine Canadien, 2001). They analyze "new" or reinvented financial co-operatives in terms of their relationships to territoriality, accessibility of services, employability or job creation, connectivity or local networking, and democraticity or participation.
5. Source: Credit Union Central of Manitoba, "Manitoba's Credit Unions: Good for Manitobans," 2005, p. 6, retrieved 13 June 2006 from http://www.creditunion.mb.ca/cu_news/tru-mem.pdf
6. Retrieved 16 June 2006 from <http://www.sunovacu.ca/> (and the same for the following).
7. Transcript 25. The confidential, semi-structured interviews on which this case is based asked participants about their own jobs, roles, and experience with the credit union, and their knowledge and perception of its connection to its members and communities. Interviews ranged from fifteen to thirty minutes for front-line staff to one to two hours for directors and managers, to two to three hours for focus groups. All were conducted under ethics procedures involving informed consent, recording, preparation of verbatim transcripts, and correction and approval of transcripts by the participants. Most participants chose to remain anonymous and for this reason their comments are referenced only by a non-sequential transcript identification number.
8. Transcript 13.
9. Transcript 30.
10. Dorothy Altstadt, Seven Sisters Falls, comments to a contest by Credit Union Central of Manitoba, posted 13 June 2006 at http://www.creditunion.mb.ca/join_cu/memb_say.htm
11. Transcript 30.

12. Transcript 18.
13. Transcript 16.
14. Ibid.
15. Retrieved 16 June 2006 from <http://www.sunovacu.ca/>
16. Transcript 21.
17. Transcript 13.
18. Transcript 6.
19. Transcript 31.
20. Ibid.
21. Transcript 16.
22. Interview by the author, 21 September 2005.
23. Transcript 18.
24. Ibid.
25. Ibid.
26. Transcript 34.
27. Transcript 8.
28. Transcript 45 (and the same for the following).
29. Transcript 13.
30. Transcript 12 (and the same for the following).
31. Transcript 15.
32. Ibid.
33. Transcript 12.
34. Transcript 15.
35. Transcript 31.
36. Transcript 42.

37. Ibid.

38. Ibid.

39. Ibid.

40. Transcript 15.

41. Transcript 12.

42. Ibid.

An Unexpectedly Quick Conversion

Virginia Poultry Growers Cooperative

JAMES J. WADSWORTH AND JOHN W. BROCKHOUSE, JR.

THE VIRGINIA POULTRY GROWERS COOPERATIVE (VPGC) consists of 155 turkey producers located in Virginia's Shenandoah Valley. The co-operative owns and operates a turkey processing plant in Hinton and a feed mill in Broadway, Virginia. It was founded by a group of about 130 turkey producers who responded to the closure of a privately owned turkey integrator with a processing plant. They banded together to form a co-operative that, in turn, purchased the assets of the private company and established its own producer contracting and marketing system.

The co-operative was incorporated on 26 May 2004. It is governed by a nine-member board of directors, which includes three non-member directors, allowed under Virginia state statute. The leadership of the present co-operative president, as head of the steering committee, was instrumental throughout the development of the co-operative and the subsequent asset and systems purchase.

VPGC's plant has the capacity to process 8 million turkeys annually, operates year round, and specializes in boneless turkey meats and

bone-in turkey parts. The co-operative has added members since its formation, has surpassed initial sales projections, and is planning an operational expansion involving a purchase of eighty-four acres of land to build a feed-storage facility and eventually a new feed mill.

Background

This case is unique, a mutualization that came eighteen years after a demutualization involving essentially the same processing operations. In 1988, Rockingham Poultry Marketing Cooperative, Inc., formed before 1945, consolidated with two other companies (Wampler Foods, Inc., and Horace W. Longacre, Inc.) to become WLR Foods, Inc., a non-co-operative holding company headquartered in Broadway, Virginia. WLR Foods continued to grow by merging with two other private companies (Round Hill Foods, Inc., and Cuddy Farms, Inc.) in the early to mid-1990s. A subsequent private transfer of assets was completed in 2000, when Pilgrim's Pride Corporation, a family-run business founded in 1946, purchased WLR Foods. Now a full reversal has occurred, with the mutualization of the respective Pilgrim's Pride assets and integrated operations into VPGC.

Reasons for the Conversion

Pilgrim's Pride, a large poultry company in the United States, announced in May 2004 that its processing plant in Hinton, Virginia, would be closed as of 1 September that same year. Closure would have meant the termination of contracts with many of the region's turkey producers and would have affected nine hundred plant jobs. The financial impact on the local economy was estimated to be about \$200 million.

Pilgrim's Pride was changing its marketing strategy and indicated that its decision to close the plant was brought on by increased risks in the turkey industry and a desire to focus on its other business units. The company determined that its marketing strategies no longer

included the products from the processing plant. The concern over increased risks likely pertained to the outbreaks of avian influenza in early 2004 in the valley and the adjacent states of Delaware, Maryland, New Jersey, and Pennsylvania, as well as in Texas, which had hit the industry hard.

Given Pilgrim's Pride's decision, the affected producers were faced with losing their contracts and possibly their livelihoods if the contracts were not picked up by another company. Instead of waiting to see what would happen, the growers decided to be proactive by studying the potential of co-operating to buy the processing plant and its integrated equipment from Pilgrim's Pride and thus control the integrated system¹ as well as develop markets for the final products. This would allow the growers to continue producing turkeys and also reap the benefits of the value-added processing.

The potential loss of numerous jobs, farms, and a significant amount of related revenue in the region attracted the attention of local, state, and federal government officials, who offered technical and financial assistance.

The conversion was completed quickly because of the efforts of the board president and several key producers who had the loyal backing of numerous turkey growers. Many other significant players were also involved. A co-operative development centre, described below, conducted feasibility and financial analysis studies in conjunction with a local certified public accounting firm, while lawyers provided legal guidance and prepared documents. The Rural Business-Cooperative Service of the United States Department of Agriculture (USDA) provided financial oversight through the involvement of a co-operative development specialist. State officials and government departments from both West Virginia and Virginia provided oversight and worked at securing respective state grant funding for the project, as did local officials from Rockingham County. Financial officials and officers from commercial banks and the Farm Credit System, including CoBank,² provided feedback and information on financing programs and packages. Even Pilgrim's Pride management seemed, for the most

part, to want to facilitate the conversion by co-operating and working with the producer leadership.

The Conversion Process

The process of converting the privately owned Pilgrim's Pride plant into a co-operatively owned venture took only 181 days, from late May to late November 2004. This short time frame was unprecedented, given the high cost and large scale of the assets and the number of producers involved. The producers not only formed a new co-operative but completed the significant facilities purchase and restarted a multi-million dollar plant, all within six months. Officials designed new contracting systems for producers and marketing plans proceeded quickly.

The process began in May 2004, when the turkey growers agreed to form a co-operative and to study the feasibility of purchasing the plant in Hinton. Just a few days later, on 26 May, the growers filed articles of incorporation in Virginia to form the Virginia Poultry Growers Cooperative.

A steering committee of three members set to work and within two weeks the co-operative raised \$994,000 from potential members to pay for the feasibility study and start-up capital. The amount of capital ultimately raised from members was about \$2.6 million. Individual capital investment was based on a formula of thirty cents per square foot of turkey housing, thus implementing equitable financing requirements based on final patronage benefits.

The equity drive meetings were extremely well attended, with most of the potential members (more than one hundred) of the co-operative taking part and showing enthusiastic support for the newly formed co-operative's leadership.

To determine feasibility, VPGC enlisted the services of the Southern States Co-operative Foundation³ and a local certified public accounting firm. Legal representation was significantly involved and a co-operative development specialist from the USDA, along with state and local government officials, provided project guidance.

In July, the co-operative entered a non-binding letter of intent with Pilgrim's Pride to purchase the processing plant, the feed mill, and the inventory of supplies and birds on or before 31 August 2004. To expedite the conversion, VPGC filed with the United States Internal Revenue Service (IRS) for recognition as a tax-exempt co-operative under section 521 of the US Internal Revenue Code. This allowed the co-operative to have both Virginia and West Virginia members without undergoing an expensive and time-consuming US Securities Exchange Commission registration process. The IRS approved the application.

During this transition period, the new co-operative confronted some serious issues. For instance, Pilgrim's Pride stopped placing poults (young turkeys) with growers, so the co-operative purchased eggs in order to supply the poults itself. Pilgrim's Pride also refused to sell its hatchery operation to the co-operative, which caused a problem since 20 percent of the growers were grower-breeders. These producers had to become grow-out producers instead. VPGC subsequently purchased its poults for growers from a private hatchery.

The steering committee set up a grower committee to develop the co-operative's grower contracts with members, assuming it would build cohesiveness and trust between leadership and members if they involved the members directly in the development of the contracts.

One of the major risks in projects like this is securing a market for the final processed products. VPGC developed an agreement with a national premium deli-meat processing company, which agreed to invest in the processing plant when the agreement was finalized. Making a significant financial investment, the partner signed a contract to purchase 60 percent of VPGC's breast meat within a specified price range. This partner now holds a seat on the co-operative's board of directors.

Also in July, the steering committee, consultants, and specialists met with CoBank and Farm Credit System lenders to work at securing necessary financing. At the same time, the co-op's leadership was communicating with political leaders in the region, as well as contin-

uing the feasibility assessment with the Southern States Co-operative Foundation and the local accounting firm by evaluating financial scenarios depending on various assumptions. They also discussed the possibility of securing a loan guarantee from a USDA program.

The feasibility analysis, conducted using conservative assumptions and historical data, showed that VPGC was viable, and the steering committee, potential lenders, consultants, and USDA used the results to study various financing options in more detail.

During August, the co-op continued discussions and negotiations with Pilgrim's Pride, and on 15 September 2004, signed the purchase agreement to buy the selected assets. The co-operative then proceeded to hire management and staff during the latter half of September and into October, and announced that it planned to begin processing operations after Thanksgiving. The VPGC board of directors made a commitment to hire high quality, professional management. Early on in the process, the board was able to identify a well-qualified manager for the business who was experienced in the processing industry. It also found skilled marketers and food-safety staff who would be able to train incoming processing staff and monitor and test product quality.

Discussions and negotiations continued with financial institutions and the USDA. Farm Credit, through one of its Virginia-based offices, provided VPGC with a \$5 million bridge loan, and CoBank ultimately agreed to supply a \$12 million line of credit. The USDA, under its Rural Economic Development Loan and Grant program, offered a grant of \$8 million to an electric co-op in the area (Shenandoah Valley Electric Cooperative), which in turn loaned it to VPGC. A USDA Business and Industry loan guarantee was also discussed but ultimately not used.

To complete the purchase transaction, the co-operative ended up with a package of financial resources that included producer capital, commercial financing from Farm Credit and CoBank, funding from USDA Rural Development, and grants from both Virginia (\$5,000 directly to the co-op) and West Virginia (\$250,000 to turkey growers to invest in the venture) state governments. Rockingham County in Virginia provided an additional \$100,000 grant.

With financing secured and staff hired, VPGC began processing members' turkeys at the plant on 28 November 2004 as planned. Along the way there were many roadblocks, but due to the persistence of the producer leadership, a loyal membership, and with the help of consultants, state and federal government agencies, legal council, financing entities, local businesses, political allies, and others, the producers realized their goal.

Impact of the Conversion

The threat of a potentially devastating plant shutdown by a private company has resulted in the creation of a co-operatively owned, value-added business venture of turkey growers in the Shenandoah Valley. Producers have been able to continue growing turkeys and now have the opportunity for increased financial benefits. An estimated thirteen hundred jobs related to the poultry industry in Virginia and West Virginia have been saved, and other associated areas of the local economy were spared a possibly devastating hit.

A month after the co-operative plant was up and running, VPGC's board president reported that sales were 10 percent higher than projections, so more workers were required. Beyond positive operating results, the local communities were responding in kind, with many indicating appreciation and applauding the co-operative's efforts. The farmer-owned, locally controlled aspect of the company had become highly visible and communities were reacting positively.

VPGC has grown from about 130 to 155 members who live within a ten-county area in Virginia and West Virginia. The co-operative operates a fully integrated turkey production system with assets now including the processing plant, the feed mill, and the equipment to pick up turkeys from members' farms. With its major marketing partner and others, the co-operative has significant, sustainable contracts with customers throughout the eastern US.

Developments fourteen months later show the co-operative continuing to grow and progress. The *Daily News-Record* (13 January 2006)

announced that VPGC was purchasing eighty-four acres north of Harrisonburg, Virginia, to build a grain-storage facility and, in the future, a feed mill.⁴ The planned \$5 million storage facility will help cut costs and make the co-operative more competitive. According to the *Daily News-Record* story, VPGC has plans within five years to build a \$10 million feed mill at the grain-storage facility to replace the present mill in Broadway.

VPGC operations have reached a scale that requires 530 employees to handle its grower members' turkeys. The co-operative processes about 115,000 turkeys a week, selling boneless turkey meats and bone-in turkey parts to more than seventy customers nationwide. It continues to plan for the future, making adjustments and being progressive in order to maintain growth and secure a place in the region's and the nation's turkey industry.

Observations and Recommendations

It is interesting that a significant number of producers were optimistic — from the moment Pilgrim's Pride announced the plant closing — that they could become owners of the plant and the integrated turkey processing system. This was in spite of the fact that a normally optimistic time frame for such an undertaking is twelve to eighteen months. Simply put, getting a critical core of dedicated producers together, developing a plan, forming a co-operative, and then buying major assets for value-added processing usually takes much longer.

Some key factors allowed this conversion and co-operative development process to be successful:

- a sound business idea
- strong leadership from producers and trust among them
- effective communications among all partners
- a clear, unwavering focus on the end goal
- commitment — financial and psychological — from potential members

- co-operation among numerous professionals — private and government
- a professional feasibility study that indicated viability and was convincing to members, lenders, grant and loan providers, etc.
- the availability of financing on favourable terms

The reason this development project succeeded with a launch in such a short time can clearly be attributed to the unwavering dedication and hard work of the co-operative leaders and members, the close co-operation and co-ordination of many producers and professionals, and finally, a fortuitous confluence of favourable factors.

The communications with, and the subsequent interest of the area's political representation, gave the project a high profile and was instrumental in advancing the cause of the conversion.

An important observation is that VPGC began its operations at an auspicious time. Recent turkey meat prices have been high by historical standards, which has contributed to the co-operative's higher-than-projected sales revenue. However, the co-operative would have succeeded even without this advantage, given the "normal" conditions used in the conservative feasibility study.

VPGC stands as a model for producers to show that co-operation in seeking a common goal can work, and work well. It also stands as a fine example for professional development practitioners, private businesses, and government officials, of how to co-ordinate and work together to make a co-operative vision a reality.

Enhanced co-ordination of associated members, professionals, private industry, and government should be at the forefront of projects such as this. Seeking resource people who can work together is a key to successful development. Furthermore, communication channels among the associated partners must be free flowing and strong.

It is crucial to take a hard look at business feasibility, using conservative but realistic assumptions to produce financial analyses to assess

risk, and communicating those risks to potential members as well as lenders.

Ensuring grower input and frequent and clear communication between growers and the leadership make it more likely that growers will understand and buy into the business idea. Furthermore, the significant investment members made during the equity drive at the beginning of the process showed their commitment and loyalty to the concept.

Education about co-operatives is important. Making sure potential members are knowledgeable about what co-operatives are, how they work, and their potential benefits to members helps keep a positive focus on the conversion process as it relates to co-operative development. The steering committee and co-operating advisors took education seriously by providing educational reports and materials about co-operatives to members and openly discussing co-op principles and operations during initial meetings.

It is critical to have dedicated producer leadership. Leaders must understand business principles, be willing to devote time to frequent meetings (the VPGC steering committee met on an as-needed basis, which turned out to be at least once a week during the conversion period), be willing and able to engage outside professionals for assistance, be willing to make tough decisions in a timely fashion, and work well together.

A major conclusion to be drawn from this case is that success is attainable when leaders with a sound idea stand by it, even when the odds seem poor and the obstacles many. While a number of factors ultimately fell into place for this conversion to happen, there were many instances when the project was thought dead, which put a large amount of grower capital at risk. Leadership persistence paid off and the co-operative was able to navigate a difficult course in a short period of time, which resulted in a successful conversion and a viable grower-owned business.

This case demonstrates that the co-operative form of business continues to have merit to producers pursuing efforts to participate more

extensively in the supply chain with value-added products. The co-operative model was chosen and followed by the turkey producers and resulted in a successful conversion. This mutualization contrasts sharply with demutualizations in which producers give up their direct involvement with a supply chain for immediate financial gain. In many instances, producers then find they no longer have a co-operative to provide them with a direct link to the value-added process, which was the original intent of the co-operative in the first place.

Endnotes

1. In an integrated poultry system, the integrator usually provides feed, technical support, and owns the birds, while the growers provide the housing and labour to raise the birds. A grower contract is signed that specifies the integrator versus grower responsibilities. In VPGC's situation, the co-operative is the integrator and the growers own the co-operative.
2. The Farm Credit System is a nationwide network of borrower-owned financial institutions and specialized service organizations. Farm Credit consists of six Farm Credit Banks and one Agricultural Credit Bank (CoBank), which provide funding and affiliated services to more than one hundred locally owned Farm Credit associations and numerous co-operatives in the United States. CoBank, a part of the Farm Credit System, offers a broad range of flexible loan programs and specially tailored financial and leasing services to agribusinesses, rural communications and energy systems, and Farm Credit associations.
3. The Southern States Cooperative Foundation is a 501(c)(3) public, charitable foundation, headquartered in Richmond, Virginia. The foundation provides technical assistance to farmers throughout the southeastern United States to establish value-added agricultural enterprises. It was formed in 1999 and is sponsored by the Southern States Cooperative of Richmond.

4. D. Wright, "Poultry Co-op Plans New Grain Facility," *Daily News-Record*, 13 January 2006, retrieved 25 July 2007 from <http://www.shenandoah-valley.biz/v.php?pg=46&articleID=335>

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For More Information

- CoBank — <http://www.cobank.com>
- Farm Credit System — <http://farmcredit.com>
- Southern States Co-operative Foundation — <http://www.sscfoundation.org>
- Virginia Poultry Growers Cooperative — <http://www.vapoultrygrowers.co>

Section Three

Remutualizations

From Co-operatives to Conventional Businesses and Back Again

The Irish Co-operative Experience

ROBERT BRISCOE, OLIVE MCCARTHY, AND MICHAEL WARD

Background

DAIRY CO-OPERATIVES IN IRELAND TYPICALLY ENGAGE in a variety of activities and are considered multipurpose, that is, engaging in more than a single purpose (such as milk processing). The main co-operative activities in addition to dairy processing and manufacturing are livestock marts, meat processing, and the distribution and manufacture of farm inputs such as animal feed.

At the end of 2003, there were thirty-one dairy co-operatives in Ireland, including co-operatives with holdings in public limited companies (PLCs), with 88,646 members and total sales of €10.49 (CAD\$14.52) billion. Membership and sales varied dramatically from co-operative to co-operative, depending not only on the size of the co-operative but also on farm sizes in the co-operative's geographical area. The number of co-operatives has steadily declined since the 1960s as a result of amalgamations. The number of dairy farmers, especially smaller farmers, has also been in steady decline.

Irish Co-operative Organisation Society

The Irish dairy co-operatives, along with other rural societies such as marts and fishing co-operatives, are members of the Irish Co-operative Organisation Society (ICOS). ICOS, itself a co-operative, represents the interests of its member co-operatives nationally and internationally and provides them with leadership and training.

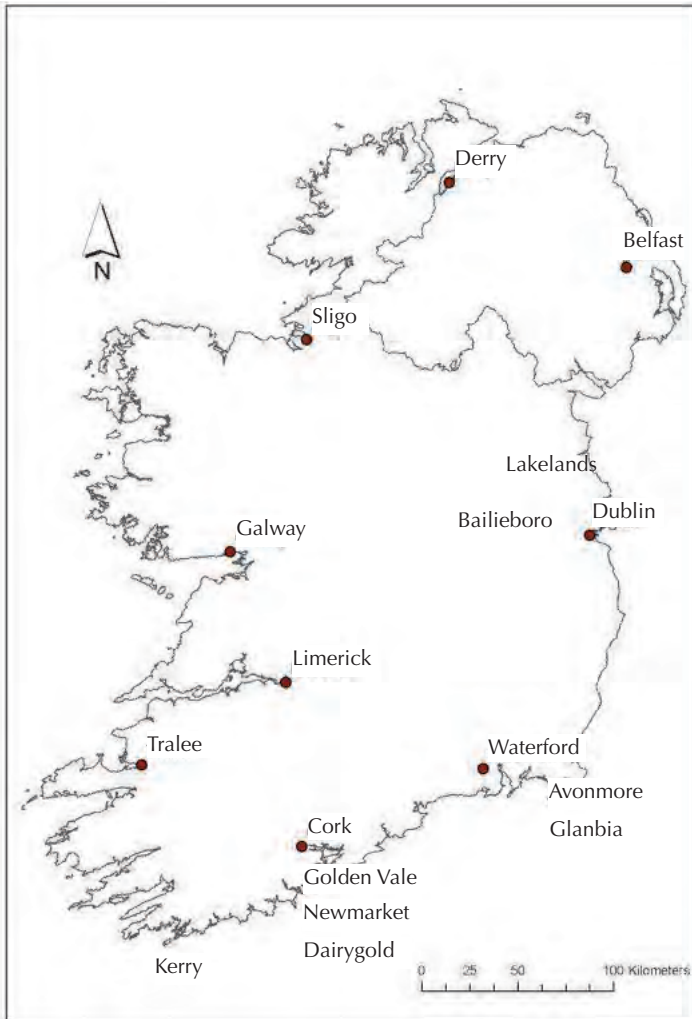
Organization of Membership

Milk suppliers and traders are normally admitted to membership in the co-operative by purchasing a number of ordinary £1 shares (CAD \$1.62) in proportion to their milk supply/trade. They are then entitled to one vote (at shareholders' meetings and elections) regardless of the number of shares they own. Shareholders are organized into branches/areas, which also serve as electoral constituencies. Some co-operatives elect a number of area advisory boards that meet at the area level, a few times per year, to advise on policy, while other co-operatives elect a general committee from their area, which meets centrally with senior management. The board of directors is usually elected from among the advisory/general committees. In co-operatives with a stakeholding in a PLC, the PLC board is normally elected by and from the co-operative boards and includes some senior executives.

The Conversion Process*The Kerry Co-operative Approach*

The first example of a co-operative taking the PLC route in Ireland occurred in June 1986, when Kerry Co-operative Creameries, Ltd., exchanged the bulk of its assets for a majority shareholding in a PLC, allegedly as the only means of raising funds to assist in acquisitions. At that time, Kerry Co-operative had about six thousand shareholders.

The co-operative began the conversion process by exchanging the bulk of its assets for 90 million B ordinary shares in its newly created PLC, Kerry Group PLC. Shortly afterwards, the PLC launched a series

Figure 1: Map of Ireland

of stock exchange placings amounting to a total of 60 million A ordinary shares. Both A and B shares had voting rights of one vote per share, but only the A shares were tradable on the stock market. This meant, at that time, that the co-operative controlled 60 percent of the PLC. In order to ensure the co-operative continued to retain control of

the PLC, the authorized share limits on both types of shares were set at levels that would ensure the co-operative's holdings could not drop below a minimum level of 51 percent.¹ However, the current situation is that Kerry Co-operative Creameries is the main shareholder of the PLC but with holdings of only 30.9 percent of total shares.

What has Kerry done with the additional funds raised by its PLC conversion? In 2004, the Kerry Group spent €665 (CAD\$872) million on eight acquisitions. Kerry has recently set up a bio-science division, thus extending the group's food ingredients platform to bio-ingredient and pharma-ingredient applications. This opens up a new range of customers for Kerry in the pharmaceutical industry. The company has also launched a fragrance operation and markets fragrances for use in home environment, personal care, and household products. Back at its Listowel headquarters, Kerry has succeeded in getting 2.5 acres of recently acquired land rezoned for industrial use. Over the last ten years, the company has invested an average of €4.5 (CAD\$6.23) million per year on the continuing development of this site.² Two major co-operatives, Avonmore Co-operative and Waterford Co-op, were quick to follow the Kerry example.

The Avonmore group was launched in 1967 as a federation of thirty-six small co-operative societies. The Avonmore Creameries Federation was set up to establish a milk processing plant in County Kilkenny as a joint venture with Unigate, a British multinational. In 1973, the bulk of the co-operatives merged into a single society — Avonmore Co-operative Society, Ltd. — and in 1978, the new co-operative bought the Unigate share of the Kilkenny plant.

In 1964, the Waterford Co-operative Society began life as a merger of five co-operatives. Over the years, many more co-ops merged with Waterford. Its first major project was setting up a cheddar cheese plant in 1965, and in 1974, it acquired the valuable Yoplait yogurt franchise. In March 1988, Avonmore Co-operative, with thirteen thousand shareholders, set up a PLC similar to the Kerry model; Waterford Co-operative, with about fifty-five hundred shareholders, followed suit in August 1988.

In 1997, Waterford PLC failed to give a timely profit warning to financial advisors, suggesting possibly a lack of managerial experience in dealing with the stock exchange. This error led to a substantial slump in Waterford PLC's share price. Perhaps partly as a result of this shock and partly to create a larger, more cost-effective and diversified group, Avonmore and Waterford co-operatives and PLCs decided to merge to form Glanbia Co-operative Society and Glanbia PLC.

This 1997 merger was only accepted by co-op members when a commitment was made to pay a set bonus per gallon of milk above the national milk price audit average for the next three years. Selling another portion of the co-operative's PLC shares provided an additional financial incentive for farmers to support the merger.

The merger was followed by rationalizing the activities of the constituent businesses. One consequence of this was the transfer to County Kilkenny of most of the production activities at Waterford's headquarters and plant in Dungarvan, where Waterford Co-op had been a major employer.

According to its website, Glanbia PLC³ is a leading dairy processor and food ingredients group, with an evolving nutritional focus. Glanbia is based in Ireland but also has operations in the United States, the United Kingdom, Germany, and Nigeria. The company employs approximately four thousand people and has an annual turnover of €1.8 (CAD\$2.49) billion.

Group growth strategy is focussed around three core divisions, all with a nutritional emphasis — consumer foods, food ingredients, and nutritionals. With its strong market positions, leading brands in core operations, and a growing innovation/nutrition agenda, Glanbia has a position of leadership in these markets. According to its website, examples of this leadership include the following:

- in Ireland, Glanbia is the number-one producer of butter and cheese and has the leading brand for liquid milk and cream
- in the United States, Glanbia is the number-one producer of barrel cheeses and whey protein isolate, and the fourth largest producer of American cheddar cheeses

- in Europe, Glanbia is the largest supplier of pizza cheeses and customized nutrient premixes

These strong market positions have been achieved largely by acquisitions financed by the funds raised as a result of conversion. Glanbia PLC has completed a strategic restructuring of its food operations and has set aside €6 (CAD\$7.9) million to rationalize its agribusiness division, including the closure of seven stores. However, picking the right business to acquire has not always been easy. In 2003, restructuring resulted in an exceptional charge of €92 (CAD\$120.7) million, transforming a pre-tax profit of €77.1 (CAD\$101) million into a pre-tax loss of €14.9 (CAD\$19.5) million. Glanbia's restructuring resulted in a shift from the United Kingdom to the United States, with most of its UK operations being disposed of. These had been purchased during the nineties (some by Avonmore PLC and Waterford PLC before their merger to create Glanbia in 1997). In addition to cheese, these operations included liquid milk, food service, cooked meats, and fresh pork businesses. Glanbia is now focussed on growing businesses in cheese-based nutritional ingredients and consumer foods in the United States. Increasingly, the emphasis is on health-based functionality. This is being supported by a new €15 (CAD\$19.7) million research and development innovation centre in Kilkenny, which employs around thirty university graduates.⁴

Unlike Kerry Co-operative, Glanbia Co-op has maintained majority control of its PLC. On its website it refers to Glanbia PLC as a subsidiary of the co-operative, which owns 54.8 percent of the PLC's share capital.

The Kerry Group merely refers to Kerry Co-operative as the major shareholder in the PLC. However, even though Kerry Co-op holds a minority of the shares in the Kerry Group PLC, the co-op still provides most of the directors in the Kerry Group. Similarly, the majority of Glanbia PLC's board of directors also serves as directors of the co-operative, elected from and by the co-op's members.

The society nominates from its board of directors, which is elected on a three-year basis, fourteen non-executive directors for appoint-

ment to the board of Glanbia PLC. The remaining directors comprise three executive directors and four additional non-executive directors. All directors are required to submit themselves for re-appointment at least every three years.⁵

The Golden Vale Approach

Golden Vale chose a confusing approach to conversion, quite different from the strategy used by Kerry and copied by Waterford and Avonmore. In the summer of 1989, Golden Vale Co-operative increased its shareholding from 1.6 million shares to about 127 million. In August 1989, rule changes were voted in that effectively differentiated between Golden Vale Co-operative Creameries, Ltd. (the PLC), later named Golden Vale Creameries Ltd., and Golden Vale Food Products, Ltd. (the co-operative). Subsequently, there were two placings of PLC shares that increased the total amount of PLC shares to 163.3 million. Each share in the PLC carried one vote, and it was intended that all 163.3 million shares be tradable on the stock exchange.⁶

In effect, the co-operative had become a wholly owned subsidiary of the PLC, with its responsibilities limited to the collection of milk. The co-op members were each given one voting share in the co-operative, which gave them a say in the supply and assembly of milk and the price paid for it. Initially, about one-third of the PLC's shares were held individually by members/users of Golden Vale Food Products Co-op, and for the first ten years after conversion, the chair of the co-op always served as chair of the PLC and the co-op elected a number of farmers to the PLC board. However, in 1999, much to the annoyance of farmers' representatives, the PLC board decided that those elected by the co-op could no longer sit on the PLC board.⁷

Reasons for the Conversion

Several factors facilitated conversion. First, a high proportion of co-op members were no longer using the services of the co-operative. Many

had retired from farming or were city dwellers who had inherited their shares. Members with no vested interest in maintaining the co-operative's traditional services would be more likely to vote for a PLC strategy that promised substantial cash windfalls. Second, a large proportion of users were non-members and were therefore not qualified to participate in the decision of whether or not to convert the co-operative (see Non-User Members and Non-Member Users, below). Third, the four co-operatives that converted were large-scale businesses that had grown to their current size as a result of the merger of many smaller co-ops. This had tended to break the co-operatives' close relationship and identification with specific communities.

There were also several reasons given for conversion: the perceived need to attract substantial investment capital to finance operations on a global scale; to provide greater incentives for management and thereby alleviate the high transaction costs predicted by agency theory; to enable farmer-members to realize some of the capital value of their shareholdings; and to distribute profits more equitably. Because the co-operative was not distributing profits in proportion to use, there was little if any incentive for non-member users to join these organizations and every incentive for shareholders to support a strategy that would bring them cash refunds. The very possibility of conversion would also be enough to encourage non-users to hold on to their shares. (For more on bonus shares, see *Treating Member Ownership with Respect*, below.)

*Non-User Members and Non-Member Users*⁸

Historically, there has been a tendency in the Irish co-operative movement for co-operatives to allow farmers to use the co-op's services without becoming members. This defective co-operative–farmer relationship has survived into the twenty-first century.

Typically, Irish co-operatives and co-ops with a stakeholding in a PLC do not require users to be member shareholders in the co-operative, nor do they insist that member shareholders who are no longer

using the co-operative's services redeem their shares, though the option of share redemption is available.

In a 1989 survey of fifteen Irish dairy co-operatives with a total of 71,597 shareholders, nearly 48 percent (33,573) were dry shareholders and 13 percent (9,129) were dead or untraceable. The same survey also found that 7,557 milk suppliers, 21 percent of the 35,558 total, were not shareholders.⁹

Despite efforts during the 1990s at the individual co-operative level and with the leadership and support of the Irish Co-operative Organisation Society (ICOS), the problem of inactive shareholders and non-shareholder users continues to be serious, so much so that ICOS felt obliged to issue a best-practice share policy document in March 1999, ten years after the publication of its first policy position on membership and shareholding. This document draws the following conclusion: "For many co-operatives the current shareholding structure is imbalanced because there is a high proportion of inactive shareholders. Inactive shareholders are shareholders who do not trade with the co-operative."¹⁰

Possible reasons for non-membership include the following:

- shareholding membership in Irish dairy co-operatives is not compulsory for users, so farmers can get the benefits of the services of the co-op without having to invest their share of the society's equity capital
- most profits are retained as unallocated capital in Irish dairy co-operatives, so there is relatively little growth in the value of individual share capital over time
- doubts exist about the ability of farmers' representatives to effectively influence the affairs of the co-operative and/or the PLC in the farmers' interest
- there is inadequate marketing of membership by management and representatives who do not consider the encouragement of shareholding to be part of their function

- non-members are more likely to be small suppliers who perhaps see themselves as having less to gain from membership in the co-operative; Ward and Briscoe,¹¹ for example, found that 66.1 percent of non-members compared with 33.6 percent of members supplied 30,000 gallons or less of milk per annum

Equity redemption is not usually required when a member ceases to use the society's services. Non-user members are not motivated to take the initiative and redeem their shares because the shareholding is relatively small. And shareholding has remained small because of the failure of the co-operatives to allocate profits to individual shareholders/users. Many retired farmers like to remain in association with the co-operative, and there is always the outside possibility that the value of shareholding could be multiplied by new conversion activities.

The Impact of the Conversions

The dawn of a new millennium saw some milk supplier dissatisfaction with PLC involvement, particularly in the business of primary milk processing. This was fuelled by the desire of some PLCs, such as Golden Vale, to apply the same return on investment targets to primary milk processing as in secondary added-value food sectors. This was not welcomed by the farmer milk suppliers. There was also the added aggravation of farmers' representatives being forced off the PLC board (see Non-User Members and Non-Member Users, above). In response to farmer-members' concerns, Golden Vale gave serious consideration to remutualizing primary milk processing, but eventually decided to sell its entire business to the neighbouring Kerry Group PLC. The Kerry and Golden Vale South milk pools were merged, while Kerry sold off the Golden Vale North milk pool (formerly Bailieboro and Westmeath Co-operatives) to Lakeland Dairies Co-operative.

Bailieboro Co-operative had been taken over by Food Industries, a conventional company, and had then been acquired by Golden Vale PLC, which was subsequently taken over by the Kerry Group. The sale

of this property to Lakeland Co-operative thus returned it to co-operative control after the circuitous journey from co-operative to a conventional company, to a division of a co-op's PLC, and then back again to a co-operative.

In 2003, farmer discontent with the PLC structure also erupted in Glanbia. Their fresh milk producers' group, accounting for approximately 30 percent of the Glanbia milk pool, proposed a remutualization of Glanbia PLC with a buyback by Glanbia Co-operative. The remutualization proposal did not enjoy the support of Glanbia Foods PLC management and was not implemented. Perhaps the real significance of these events is in the fact that remutualization was being discussed at all. It raises questions about the suitability of the PLC structure, at least in the business of primary milk processing.

The conversions outlined above have had mixed fortunes. Golden Vale and Glanbia had some problems serving two masters — farmer-members versus stock-market investors — and Glanbia has had problems with some of its international investments but appears to be learning fast. Kerry, on the other hand, has prospered. It has used PLC finances to make substantial and lucrative acquisitions, establishing itself as a successful global business and sharing substantial windfalls with its co-operative members. However, the business activities of Kerry Co-operative's members represent a tiny and declining proportion of the Kerry Group PLC's business activities, whereas the interests of stock exchange investors are growing rapidly. Arguably, this may have serious implications for the future well-being of Kerry's farmers.

In 2004, the chief executives of both Dairygold (Ireland's largest dairy co-operative) and Lakeland Dairies (which has grown through acquisitions to be the second largest) independently committed their societies to maintaining 100 percent co-operative control as it is, in their opinion, the most advantageous structure for the dairy business. For a while, it looked as if the centenary of the birth of Irish agricultural and dairy co-operatives was being celebrated with renewed appreciation for co-operative values. Already, however, Dairygold appears to be moving towards a variation of the PLC strategy, retaining the co-op

structure for its core milk processing and agribusiness divisions while transferring its other three divisions — retailing, consumer foods, and property — to a PLC.

Observations and Recommendations

The Membership Problem

Because of the prevalence of non-user members and non-member users in Irish dairy co-operatives, control does not rest fully with the active farmers who use the services of the co-ops. One way of alleviating this problem would be to allocate non-voting stock to retired members in return for their voting shares. Although it is now recommended by ICOS, allocating non-voting stock to retired members is not generally practised, and many users are not members in the first place. There is a danger, therefore, that decisions made in meetings and boardrooms will no longer fully reflect farmers' interests and needs. It should be pointed out that the seriousness of this control problem is reduced by the fact that a proportion of inactive farmers are also inactive as shareholders. It should also be noted that some co-operatives have managed to amend their rules to make sure only active shareholders are entitled to vote on any merger proposal or to be elected to the board.

Co-operative better practice in the area of membership would suggest that substantial users of the co-operatives should be required to become shareholders, and shareholders should be required to cash in their shares when they retire from active use of the co-op's services. To reinforce these policies, profit should be distributed in such a way as to reward farmers for using the services of the co-operative. The usual practice would be to distribute profits to shareholders in proportion to their use of the co-operative's services. These distributions should be done in the form of bonus shares, thus allowing the retention of profits within the co-operative as a revolving fund and building members' equity. In summary, it is the users of a co-operative who are supposed to own, control, and enjoy the benefits of the business. This can only happen when users alone are the active voting members.

In Ireland, in recent times, ICOS has made sure co-operative better practice is well understood, at least among co-operative leadership. Board members are generally aware of the practical benefits of active shareholding and understand the importance of farmer commitment and farmer control if farmer needs are to be satisfied.

Co-operative Share Valuation

Shares in Irish co-operatives have generally been issued at £1 (€1.27 / CAD\$1.7) par value. Traditionally, a very low percentage — less than 10 percent — of co-operative equity (the net worth of the co-operative) is allocated, which means that around 90 percent of member equity is not allocated to individual members. Failure to fully operate a co-operative share market (allocating bonus shares in proportion to use and equity redemption) has resulted in a widely diverging £1 explicit value and a multiple of £1 implicit values for each share. A member's shareholding does not reflect his or her stake in the co-operative's substantial unallocated reserves. Farmers perceived co-op shares as almost worthless pieces of paper until the takeover and PLC activities of the mid-eighties brought attention to the real value of their shareholding. Indeed, in the mid-eighties, many Irish co-operative managers, perhaps somewhat unfamiliar with co-op better practice, believed the only way to give real value to co-operative shares was to restructure in whole or in part as a PLC.

Jacobson and O'Leary have also pointed out that failure to allocate most of the reserves to individual shareholder accounts can lead to a lack of efficiency in co-operative business. In the words of the USDA's Co-operative Service,

There are at least two pitfalls associated with unallocated reserves. The management of the co-operative might view the reserves as interest free working capital.... Then the true cost of operating the co-operative and the true profitability are distorted. The second pitfall is that a respectable patronage refund, while losses are absorbed by unallocated reserves, may misinform members about the true state of the co-operative's performance.¹²

Jacobson and O'Leary recommended that a minimum of 75 percent of annual profits be allocated (through the bonus share procedure) to individual shareholder-users in proportion to their use of the co-operative. While there has been improvement in allocating profits in Irish co-operatives, this target has not become the norm and co-operative share valuation problems continue to exist.

As stated in the March 1999 ICOS document on share policy, "Most co-operatives have substantial accumulated reserves that are largely unallocated."¹³ They have failed to deal adequately with the historic problem of unallocated reserves by a once-off bonus share issue in proportion to existing shares.

For co-operatives that have a majority (Glanbia) or a minority (Kerry) stake in a PLC, the share valuation problem at the co-op level continues to be a concern. They have addressed share valuation problems only with their PLC shares.

Co-operatives with ownership stakes in PLCs might solve their share valuation and unallocated reserves problems by allowing the PLC to gradually buy out the co-operative over a period of time. By the late 1990s, both Glanbia and Kerry had moved in this direction.

Another option would be to operate the co-operative fully in accordance with co-op principles, by insisting that co-operative shareholdings in the PLC be treated on the basis of equality with all other shareholding, and that PLC dividends be in turn distributed by the co-operative to active users in proportion to use. This would give co-op shareholders, who are also active users, a real sense of ownership and continued identification with the organization, as well as some real control over the PLC. This, in turn, would give practical witness to the promise made, at the time of partial PLC conversion, that co-operative control would be maintained into the future. However, in order to fully address the interests of inactive co-operative shareholders, a once-off share bonus (which could be phased in over time) would need to be made in proportion to existing shares. Solving share valuation prob-

lems would enable co-operatives to financially reward users as entitled and motivate all users to become member shareholders.

Financing Co-operatives for Growth

The typical justification for the PLC strategy has been the necessity to provide the finances required to grow the business. This raises the question of whether or not the co-operative would have been able to raise adequate capital. The ICOS 1999 share policy document asserted that the “willingness of farmers to make capital contributions on an ongoing basis to fund future development of co-operatives has never been tested.”¹⁴ Yet Jacobson and O’Leary pointed out the ironic fact that “the necessity to acquire sufficient finance to fund development has been advanced as one of the main reasons why many Irish agricultural co-operatives developed PLC subsidiaries (Kerry and Glanbia) or restructured themselves into PLCs (Golden Vale and Donegal).”¹⁵ They went on to argue that the development of PLC subsidiaries was not an indictment of the usefulness of the co-operative system as a means of raising capital. “Rather it is an indictment of the failure of the leadership of co-operatives to implement viable equity redemption policies and to adhere to the principles of operating at cost and maintaining current member ownership.”¹⁶ They offer as proof of this assertion the fact that “the same farmers who were unwilling to make further investment in their co-operatives in Ireland in the 1986–1989 period were enthusiastic in purchasing shares in the same organizations when they reorganized as PLCs.”¹⁷

The issue of raising capital can be addressed by following co-op principles and operating a co-operative market for shares. In particular, an active equity redemption policy is absolutely essential in order to give shares an economic value. This is still not practised and/or communicated as strongly as it might be in either traditional co-operatives or co-ops with holdings in PLCs. Failure to fully implement co-operative principles has meant, in the words of Jacobson and O’Leary,

that “the owners of the co-operatives were unwilling to individually invest further in the co-operative because their additional investment would continue to have little meaning to them as individuals.”¹⁸

Treating Member Ownership with Respect

The practice of many co-operatives to rely on retained earnings as the prime method of capitalizing their activities (and their consequent failure to distribute a proportion of the profits according to farmers’ use of the business) meant that a high proportion of owners’ equity was held in unallocated reserves, and members’ share accounts did not grow, in spite of the visible growth of the co-operatives. This meant that an initial share investment, perhaps made by a member’s grandfather, would have been a substantial amount of money when first invested but might now be barely enough to take the family out for dinner. This would be in stark contrast to the way in which the co-operative would have grown and prospered during the same time period.

In a PLC, surplus or profit is always allocated to individual accounts, albeit on the basis of individual shareholding rather than use. One implication of Jacobson and O’Leary’s study is that “if co-operatives were to fully operationalise their share market (through bonus shares and equity redemption) and thereby honour member ownership in the same way that the stock market enforces the honouring of investor ownership, then members might be much more willing to invest in their co-operatives.”¹⁹ Jacobson and O’Leary further argue that “co-operatives can be as successful as PLCs in attracting investment when they treat member ownership with respect.... Co-operatives can move swiftly in correcting this situation by adopting appropriate profit allocation procedures and equity redemption policies.”²⁰

Torgerson²¹ supports their point of view when he argues that well-managed co-operatives are well able to amass adequate capital. As evidence, he points to the fact that farmer-owned co-operatives in the United States have been more successful than conventional businesses at increasing their equity capital. Between 1980 and 1996, the top one

hundred co-operatives have increased their equity capital, as a percentage of total assets, from 29.4 percent to 35.2 percent. Over the same period, the Fortune 100 corporations have seen their equity capital decrease, as a percentage of total assets, from 44.9 percent to 26.2 percent. As additional evidence, Torgerson discusses the remarkable success of New Generation Co-operatives at building new, market-orientated, added-value processing businesses.

It is estimated that between seventy-five and one hundred new co-operatives were organized in the 1990s, with a combined investment of over \$3 billion. This new phenomenon has occurred despite the fact that a number of existing regional co-operatives have operated in the same territory, albeit largely marketing commodities in contrast to value-added products. The new wave co-operative idea has even extended to the livestock industry, often regarded as the last bastion of independent behaviour by farmers.²²

Jacobson and O'Leary sum up the financial capabilities of the co-operative model as follows: "The principles do not need changing. The co-operatives must start believing in their own principles."²³ And David Thirkell of the Plunkett Foundation underlines the capacity of farmers to raise capital: "Farmers who perceive potential benefit will fund their own organisations because farming has capital capacity and ample borrowing power."²⁴

Perhaps the above viewpoints are somewhat oversimplified in that farmers will always have to weigh the relative merits of investing on farm versus beyond the farm. Given the costs of diversification and market development, substantial outside finance will always be required. The trick for both traditional co-operatives and those with holdings in PLCs is always to give an adequate return on that finance, without surrendering total control to the outside investors. A healthy balance between the number of inside user-investors and outside investors would be one possible mechanism. Another would be the attraction of ethical investment funds from those in sympathy with co-operative, mutual, and sustainable ways of working.²⁵

Alternative Structures to Public Limited Companies²⁶

Why is a company the size of Glanbia paying farmers a lower price than smaller co-operatives that never amalgamated with anyone? This interesting question was voiced by an Irish dairy farmer. While many of Ireland's larger co-operatives have taken the PLC approach, many of the smaller co-ops have prospered as co-operatives and, arguably, provide a better service to their farmer-members. The following section explores some of the strategies used by small- and medium-sized co-operatives to operate as successful businesses in the interests of their farmer-members.

How Smaller Co-operatives Take on the Public Limited Companies

Many Irish farmers and co-operatives are far from convinced by the efficiency and economy argument for large-scale milk processing. They point to medium-sized societies such as the Town of Monaghan Co-operative in Ulster or Newmarket in Munster, which regularly outperform the largest co-operatives and PLCs on milk price and service to farmers. In the 21 June 2003 issue of the *Irish Farmers' Journal*, Joe Rea commented on the April 2003 milk price league: "The performance of Newmarket [a medium-sized co-op] is remarkable. With only eight million gallons of owned quota, it is a pace-setter. Newmarket is virtually an all cheese manufacturer, which was a very difficult product to sell last year." And: "Monaghan tops the League.... It has performed very well over the last three months, paying impressive Spring Bonuses."²⁷

The efficiency of small, well-managed co-operatives operating in niche markets also has international parallels. In New Zealand, Tatua Co-op and Westland Co-op, with less than 5 percent of milk supply, outperform the gigantic Fonterra on milk price. Arndt Reil, who completed the cost comparisons study for the 2004 European Dairy Conference in Carmarthen, Wales, said, "Some people talk about increasing scale as the panacea to all ills; here it can be clearly seen that of those farms that reduced costs considerably, they did not do it by

increasing scale but by cutting out the cost of infertility, machinery and buildings and increasing labour productivity.”²⁸ Another conclusion reached at the same conference was that “... reducing costs on farm is one of the main ways a farmer can influence how much money ends up in his pockets.”²⁹

Maintaining a Competitive Environment

Many small dairy co-operatives have deliberately followed a strategy of remaining small and independent, even after ICOS began to urge for amalgamations in the 1960s. These small co-operatives strongly believe this is the best way of serving their member-users into the future, pointing to what they regard as a relatively poor performance by the larger co-operatives and PLCs alike. At the very least, they argue that a mix of dairy ownership and scale is a good goal for the industry to maintain a competitive environment. As evidence, they mention the dairy farmers’ nightmare in the Chilean dairy industry, where a single multinational manufacturer decides the price of milk.

The Management Advantages of Smallness

Co-operative leaders in this sector argue that small to medium-sized operations can enjoy unique competitive advantages. These include better communications with farmers, staff flexibility, hands-on management, and greater motivation and identification. In the words of one manager: “With hands-on management, we can gradually keep equipment and technology up to date, without having to embark on major investment programmes ... [We are] often able to spot bargains or acquire pieces of equipment at rock bottom prices from dairies or bigger co-op branches that are closing down and, if necessary, put [them] into storage.”³⁰ Yet another manager claimed, “As outfits get big, real control is lost... Around here the labour force has been reduced gradually with the advent of new technology by simply not replacing staff. So there is no need for big expensive rationalisation programmes, which destroy morale.”³¹

In a recent interview, the chairman of Newmarket Co-op argued that all co-operatives need to be proactive to encourage their suppliers to stay in milk production by promoting increased financial management skills amongst dairy farmers.³² In other words, greater efficiency at the farm level is a key issue.

Federations and Joint Ventures

There is much admiration in Ireland for a West Cork federal co-operative known as Carbery Creameries, Ltd. Four small to medium-sized co-operatives — Drinagh, Bandon, Lisavaird, and Barryroe — hold respectively 39, 22.6, 20, and 18.4 percent of the shares in this second-level milk processing co-operative. It processes all of the milk (seventy-four million gallons) collected by the individual co-operatives, in their own trucks, which are decked out in the individual livery of each co-operative. Each co-operative is free to decide on the milk price it will pay to its own members. Despite this, or perhaps because of this, they typically pay the top milk price in the country. Eric Donald was quoted in the *Irish Farmers' Journal* as saying, "For the second year in a row, Bandon has emerged to pay the highest price in the country.... The second and third highest milk prices in the country last year were also paid in West Cork by Barryroe and Lisavaird respectively. Wexford creameries disrupted the West Cork four in a row by emerging just ahead of Drinagh Co-op."³³

Carbery is a leading cheese manufacturer (Dubliner Cheese is its best-known brand) with some involvement in food ingredients and alcohol. It operates its own dedicated research and development facility. The individual co-operatives that own Carbery continue to operate independently for the provision of farm stores and services to their members. Indeed, they have separately embarked on diversification programs, depending upon their members' needs and interests. For example, Bandon Co-op has encouraged its farmers to grow onions, which it markets through the Supervalu supermarket chain, while Lisavaird is involved in wind energy generation.

The Irish Dairy Board (IDB) is an example of a second-level federal co-operative at the national level; it is owned by the Irish dairy co-operatives. With subsidiaries in the United Kingdom, Germany, Belgium, France, and the United States, IDB's key objective is to market Ireland's dairy products internationally. It has proved particularly useful for the smaller to medium-sized co-operatives, enabling them to access export markets. Inevitably, it duplicates, to some extent, the marketing activities of the larger co-operatives/PLCs, but it nonetheless enjoys strong support from the big co-operatives as well. With a turnover in 2003 of nearly €2 (CAD\$2.6) billion, IDB has enabled small-scale Irish co-operatives to enjoy the benefits of large-scale operation.

IDB's key competitive advantage is the extremely effective Kerrygold brand, a trusted brand for quality butter in approximately sixty countries. The Kerrygold brand accounts for 47 percent of the IDB's total sales, with a third of Kerrygold butter being sold in Germany.³⁴

Joint Purchasing of Inputs

The larger co-operatives and PLCs, given their scale of operation, have enjoyed terms with wholesalers that were not available to the smaller and medium-sized co-operatives. To address this problem, a number of CEOs of smaller co-operatives met in 1996 to discuss the feasibility of establishing a purchasing agency to buy in bulk for their farm supply stores. They decided to set up the Associated Trading Co-operative (ATC), an association of co-operatives that would co-ordinate the purchase of a wide range of store goods, with the aim of improving the profit margins and competitiveness of its members.

Today, twenty of the smaller and medium-sized co-operatives (including members of the Carbery federation in West Cork) are members of ATC, which has an annual turnover of €30 (CAD\$39.4) million. It is a low-overhead agency, without warehouses, inventory, or delivery trucks, and is managed by a co-ordinator assisted by representatives of the membership. They pool the orders of member co-operatives and identify and negotiate with potential suppliers, visiting them

to ensure quality standards. Members are required to purchase the amounts ordered from the selected sources and goods are delivered direct to the co-operatives by the suppliers. ATC has also developed its own brand name, Co-op Source, and suppliers pack a growing range of products in Co-op Source packaging. The aim is to build an attractive brand that guarantees quality products at reasonable prices.

Remutualization I:

Conversion from Company to Farmers' Co-operative³⁵

In the next two sections, we look at some Irish case studies of the conversion of conventional businesses into co-operatives. The first section looks at examples of agricultural co-ops that have converted traditional businesses into agricultural co-operatives. The next section explores two cases of conventional firms that have been converted into worker co-operatives and focusses on the special problem of financing worker takeovers.

Lakeland Co-operative Society

A number of medium-sized co-operatives have grown substantially as a result of acquisitions. Some of these acquisitions have brought conventional businesses that used to be co-operatives back into the co-op fold. As mentioned above, Lakeland acquired and remutualized Bailieboro, a former co-operative that had been sold into private ownership. Lakeland also acquired conventional businesses and converted them into co-operatives — for example, the Nestlé Omagh whole milk powder plant, which had a forty-million-gallon milk pool. Lakeland's most recent acquisition is L. E. Pritchett Newtownards County Down, which has a sixteen-million-gallon milk pool. To demonstrate its commitment to the concept of co-operative ownership, Lakeland has integrated all the farmer suppliers of these acquired companies into its co-operative structure.

Town of Monaghan Co-operative

Another medium-sized co-operative, the Town of Monaghan Co-operative Society, has pursued a strategy similar to Lakeland's. In 2002, Monaghan acquired the Leckpatrick milk powder plant at Artigarvan, County Tyrone, and now processes milk in Northern Ireland for the first time. At its Artigarvan plant, it also produces a range of hydrolyzed wheat and rice flours with various applications for end users in the bakery, baby food, breakfast cereal, and high-energy food sectors. As in the Lakeland example above, the Town of Monaghan Co-operative has absorbed the farmer-suppliers of its acquired companies into the Town of Monaghan co-op structure.

Remutualization II:**Conversion from Family Firm to Worker Co-operative***How Businesses Get Started*

Ireland has developed its own approaches to solving the problems of financing and launching new worker co-operatives. Colm Hughes, the former manager of Ireland's Co-operative Development Unit, also found ways of encouraging some of the traditional advisers of business start-ups (accountants and bankers in particular) to consider supporting the development of worker co-operatives.

Recent research by Colm Hughes identified some of the key problems confronted by worker co-operatives in Ireland. It demonstrated that the whole support system for developing small businesses tends to be centred on the individual entrepreneur.³⁶ It also showed that the key people who give advice to new business start-ups, people like accountants, bankers and employers' organizations, were, for the most part, either ignorant about or hostile towards the concept of worker co-operatives. There was a general tendency to see the worker co-operative as a weak business structure, which was used only in futile attempts to create and subsidize marginal jobs for the socially excluded.³⁷

New Strategies for Developing Worker Co-operatives

In his capacity as manager of Ireland's Co-operative Development Unit, Hughes's brief was to promote the worker co-operative sector in Ireland. As a consequence of his discoveries about the small business start-up process and its impact on the development of worker co-operatives, he set about developing strategies for altering the process to the advantage of the worker co-operative. His hope was to influence the main actors in the small-business support system and change their attitudes towards the worker co-op as a suitable structure for business development. Given the existing negative attitudes towards the co-operative, this was a tall order.

Instead of promoting the worker co-operative as a structure for empowering the socially excluded, Hughes decided to advance it as a powerful corporate structure for operating highly successful businesses. He did this by identifying a number of significant business problems for which the worker co-operative would appear to be an ideal solution. The strategy would then be to sell the concept of the co-operative as a solution to the key problems experienced by the customers of accountants and bankers and the members of employers' associations.³⁸

The problem situations he identified included the following:

- *Family firms with succession problems:* The worker co-operative would be a vehicle for transferring the business to the employees, thereby providing an exit mechanism for owners of family businesses without suitable heirs.
- *Larger companies with problems retaining and rewarding excellent employees:* The worker co-operative would provide a structure for setting up associate companies, worker co-operatives that would develop services, products, and/or markets related to the parent company, but would be managed, owned, and controlled democratically by a team of workers from the parent company.

Family Firms with Succession Problems

According to a 1997 survey by the Chamber of Commerce of Ireland, 90 percent of all businesses in Ireland are family firms, employing an estimated 50 percent of the country's workforce. An alarming 70 percent of these firms do not make it into a second generation of owners, and only 13 percent survive to the third generation. Moreover, even though 60 percent of the owners were over fifty years old, 70 percent of family firms in Ireland have not made any plans for transferring the business.³⁹

Even more frightening statistics emerged from a 1994 European Union study, which revealed that at least three hundred thousand jobs disappear each year across the European Union as a result of poorly managed business transfers.⁴⁰

The failure to transfer a family firm to the next generation would typically create immense problems for the family (perhaps forcing them to wind up the business and sell off the assets). It would also create problems for employees, who would often lose their jobs after years of service (a source of grief to the family owners as well). When there is no suitable heir, the option of transferring ownership to a co-operative of employees would appear to be an attractive one. The employees know the business inside out and have established relationships with the customers and suppliers.

The survival of the family firm is also likely to be of great importance to the community as a whole and particularly to the other businesses and the professionals who deal with the firm.

Financing the Worker Takeover

One of the most difficult barriers to an employee takeover is the challenge of raising the capital necessary to buy the family business as a going concern. This is one of the oft-quoted management dilemmas of a worker co-operative. How is it possible for a group of ordinary workers to raise the capital necessary to buy or set up a substantial business?

To address this problem, Hughes proposed splitting the business into two parts:

1. Create a holding company, to which would be transferred the main assets of the business, land, buildings, and some of the more costly capital equipment. This company would continue to be owned and controlled by the family.
2. Create a trading company, which would be structured as a worker co-operative, with the workers owning at least 51 percent of the shares and the family owning the remainder.

Each working member (including the family and the worker-shareholders) would also hold one voting share to ensure democratic control of the business. The trading company would own and run the trading part of the business and would lease the assets from the holding company on a long lease, with an option to buy the assets.⁴¹

Advantages for the workers are as follows:

- They now have to raise only sufficient capital to purchase at least 51 percent of the trading company.
- The family remains involved in the firm after the transfer and can provide the business and/or technical skills that may be lacking in the workforce.
- The family will have a vested interest in ensuring the business succeeds and will be motivated to transfer skills and know-how to the worker-shareholders.
- Jobs have been safeguarded and the assumption of increased responsibility by the workers should lead to business growth and the creation of more jobs.

Advantages for the family are as follows:

- There is a satisfactory business transfer. The business they have built up survives under a different ownership structure.
- They are able to withdraw partially from the business, sharing more responsibility with the worker-shareholders. They are

also able to continue to participate in the business to the degree mutually agreeable to family and workers.

- Because they are sharing management responsibilities with the workers, the family members may now have the chance to spend more time specializing in areas such as marketing, with a beneficial impact on the growth of the business.
- The lease provides a continuing flow of income to the family, which is important as many small business owners have inadequate pension provisions.

An added advantage for both is that splitting the business in this way is tax-efficient in Ireland. Because assets were not sold, the family is not liable for capital gains tax, and because the employees have bought their share of the business at current market price, they are not subject to taxes on benefit-in-kind.⁴²

Implementing the Strategies

As a first step in the implementation of these strategies, Hughes directed an intensive publicity campaign at accountants, bankers, and employer associations to make them aware of the usefulness of the co-op model as a vehicle for addressing the above problems. He held numerous meetings with professional associations, carefully targeting accounting firms and banks. He also wrote articles for the Irish business press. The result was many requests from accountants on behalf of their clients, as well as direct approaches from family firms with transfer problems.

In 1996, the first Irish family firm converted to a worker co-operative. It was a small engineering firm that manufactured abattoir equipment. The conversion appears to have been an unqualified success. In the first two years after the transfer, the co-operative extended its premises, leased new equipment, expanded into export markets, increased employment, reduced its costs, and increased gross profit percentage and net profit.

Other businesses that have successfully converted to co-operatives include a family-owned nursing home with twenty employees, a local newspaper, a pewter manufacturer, a fish processor, a furniture manufacturer, a motor repair firm, a coach operator, and Heron Foods, a rapidly growing specialty-foods producer.

Case One: P. Barry, Ltd. and the Family-Firm Transfer Model

Based outside the village of Caragh in County Kildare, P. Barry, Ltd. manufactures abattoir equipment. Originally set up in 1969, this firm became a workers' co-operative in 1996. It was the first family-firm transfer initiated by the Co-operative Development Unit (CDU) of FÁS, the Irish National Training and Employment Authority.⁴³ The co-operative has three members and employs four full-time non-member employees (who declined the opportunity to become members), including the wife of the original owner. It has contracts in Ireland and abroad.

The owners, a married couple, had built up the business, but neither of their two daughters was interested in taking it over. The owners contacted the CDU and outlined their case, and then approached their employees, two of whom decided to run the business as a co-operative.

A business plan was prepared outlining the new structure. As described above, the takeover involved splitting the business into two separate firms: a holding company, which owns the fixed assets, and a trading company. The holding company, owned and controlled by the family, leases the fixed assets to the trading company, which owns and controls the business. The trading company, owned by the three co-operative members, carries on the business activities of the original family firm.⁴⁴ Remaining staff decided not to buy into the co-operative. The trading company was registered as a limited company, with memorandum and articles of association, which incorporate co-operative principles such as democratic control (one member, one vote).

Because the business was now a co-operative, the former owner was able to spend less time on production and more on marketing, for

which he had a considerable flair. The company identified export markets in the United Kingdom and northern Europe, and after the first two years of the co-operative's existence, exports accounted for 30 per cent of its sales. During the years since its founding, the co-operative has extended the premises and leased new machinery. It has also diversified into a number of areas and has patents pending for innovative production processes developed by the members.⁴⁵

Case Two: Heron Quality Foods: From Home Cooking to International Marketing⁴⁶

From humble beginnings, Heron Quality Foods, an Irish worker co-operative, now exports its bakery products to Europe and the Middle East. It was launched in 1997 by a retired couple, John and Elizabeth Dawson, who started it as an informal small business in their home in Kinsale, County Cork. Growing out of Elizabeth's hobby, the business produced a range of high-quality savoury breads and confectionery, which were sold locally.

Elizabeth was in charge of the baking and continued to research and develop new products, while John managed the business. Demand grew rapidly and by 2000 the business employed twenty-six people (fourteen full time and twelve part time). This rapid expansion forced them to relocate twice, eventually to Knockbrown, Bandon, County Cork, where the business remains today.

This was a bigger business than they had expected, and the Dawsons decided in 2000 to retire again. They began to explore exit options for themselves that would ensure the future of the bakery and the jobs of the experienced and loyal workforce.

They approached CDU, which was promoting the idea of adopting the worker co-operative structure as a vehicle for owner-managers who wished to retire or exit from their business.⁴⁷ As in the Barry case above, the business was split into two companies — the assets were held in one company (owned and controlled by the original owners) and leased to the other company, which owned the trading part of the business. This latter company was structured as a worker co-operative,

with the shares and democratic voting rights belonging to both the original owners and the participating employees. The worker co-op would also have an option to buy the assets at some agreed future date.

After discussions at CDU, the Dawsons wrote to all employees, advising them of their current thinking and inviting those interested to get involved. Five staff expressed an interest and a meeting was held with all parties concerned. Following the meeting, the owners and participating employees drew up a detailed strategic plan, examining all aspects of the business. The plan identified organic and gluten-free products as a natural progression and complementary to the existing range of products.

The plan also included a new management structure to reflect the additional responsibilities of employees who purchased shares in the business. It closely examined what the company hoped to achieve over the next three to five years and came up with a list of implications that would have to be dealt with (e.g., taxation, pension planning, patents, training, funding expansion, etc.) in order to achieve the strategic objectives. One by one, a plan was devised to overcome each of the problems, the final hurdle being the amount and cost of funding required to develop the business and begin producing the newly identified area of gluten-free products.

Substantial funding was raised from a number of “social” funders who were willing to assist this co-operative venture to ensure the continuation of a business that provided scarce employment opportunities to small rural communities in the area. There was a fear that if the business were bought by another bakery, the recipes would be taken and manufactured elsewhere, closing the Knockbrown operation.

Within months, Heron Quality Foods Limited became the largest gluten-free producer in Ireland, a position it holds to this day. The Dawsons had always maintained that there was a high potential for gluten-free exports, and with the key employees now running the day-to-day business, they had the time to embark on a marketing and sales mission, first in the United Kingdom and later throughout continental Europe.

The co-op's first major export order came from Sainsbury's in the United Kingdom. Currently, the company exports to the UK, mainland Europe, Scandinavia, and the Middle East, and is continuing to develop and expand its export base with plans to export to the United States. It has developed a website to promote its products and attract a worldwide base of customers. In the meantime, John and Elizabeth are still very much involved in the development of the business and appear to have postponed retirement for a little while longer.

Endnotes

1. See R.E. Jacobson and C. O'Leary, *Dairy Co-op Issues in Ireland: With Special Reference to PLC Activities* (Cork, Ireland: Centre for Co-operative Studies, University College Cork, 1990).
2. R. Briscoe and M. Ward, "Is Small Both Beautiful *and* Competitive? A Case Study of Irish Dairy Co-operatives" (paper presented at the ICA Research Conference, University College Cork, Ireland, 2005).
3. See <http://www.glanbia.com>
4. Briscoe and Ward, "Is Small Both Beautiful *and* Competitive?" 4.
5. See "Corporate Governance" on the Glanbia website (<http://www.glanbia.com>).
6. Jacobson and O'Leary, *Dairy Co-op Issues in Ireland*, 26.
7. "Banks and Golden Vale to Pay Millennium Milk Bonus?" *Irish Farmers' Journal*, 8 May 1999.
8. This and the next two sections are based on M. Ward, "Ireland's Multipurpose Dairy Co-operatives," in *The Co-operatives of Ireland*, ed. R. Briscoe and M. Ward (Cork, Ireland: Centre for Co-operative Studies, University College Cork, 2000).
9. Jacobson and O'Leary, *Dairy Co-op Issues in Ireland*, 28–29.
10. Irish Co-operative Organisation Society (ICOS), *ICOS Report on*

- Share Policy Report* (anonymous report prepared by ICOS staff and distributed to member co-operative societies in 1999).
11. M. Ward and R. Briscoe, "Co-operative Management" (unpublished consultancy report commissioned by Waterford Co-operative Society, 1997).
 12. Correspondence with Randall E. Torgerson and K. Charles Ling of the United States Department of Agriculture Co-operative Services, quoted in Jacobson and O'Leary, *Dairy Co-op Issues in Ireland*, 62.
 13. *ICOS Report on Share Policy*, 3.
 14. *Ibid.*
 15. Jacobson and O'Leary, *Dairy Co-op Issues in Ireland*, 3.
 16. *Ibid.*, 53.
 17. *Ibid.*
 18. *Ibid.*, 100.
 19. *Ibid.*, 101.
 20. *Ibid.*, 125.
 21. R.E. Torgerson, *Co-operative Year Book* (Oxford: Plunkett Foundation, 1999).
 22. *Ibid.*, 35.
 23. Jacobson and O'Leary, *Dairy Co-op Issues in Ireland*, 126.
 24. D. Thirkell, "Ignorance Abounds on the Worth of Farmer Co-ops," *Irish Farmers' Journal*, 7 November 1998.
 25. Much of this section is adapted from M. Ward, "Feeding Ourselves II: Farmers' Co-ops and Food," in *Helping Ourselves: Success Stories in Co-operative Business and Social Enterprise*, ed. R. Briscoe and M. Ward (Cork, Ireland: Oak Tree Press, 2005).
 26. Much of this section is extracted from Briscoe and Ward, *Helping Ourselves*.

27. Joe Rea commenting on the March 2003 milk price league in *Irish Farmers' Journal*, 21 March 2003.
28. Conclusion of Arndt Reil at the 2004 European Dairy Conference in Carmarthen, Wales. Reported in the *Irish Farmers' Journal*, 17 July 2004.
29. A conclusion reached by a discussion group at the 2004 European Dairy Conference in Carmarthen, Wales. Reported in *Irish Farmers' Journal*, 17 July 2004.
30. R. Briscoe and M. Ward, "Is Small Both Beautiful *and* Competitive? A Case Study of Irish Dairy Co-operatives," *Journal of Rural Co-operation* 34, no. 2 (2006): 120.
31. *Ibid.*
32. Joe Rea's comments on the 2004 milk price league. Reported in *Irish Farmers' Journal*, 24 June 2004.
33. E. Donald, "KPMG Milk Price Audit," *Irish Farmers' Journal*, 19 July 2003.
34. "Overview of International Dairy Market Provided by Dr. Cawley," *The Northern Standard*, Monaghan, 8 July 2004.
35. Much this section is adapted from R. Briscoe, B. Carroll, and C. Hughes, "Working for Ourselves," in Briscoe and Ward, *Helping Ourselves*.
36. C. Hughes, "The Evolution of the Worker Co-operative Concept in Ireland" (master's thesis, University College Cork, 2000), 54 et seq.
37. *Ibid.*, 40–63.
38. *Ibid.*, 64–92.
39. Reported in the *Irish Independent*, 27 November 1997, and quoted in Hughes, "The Evolution of the Worker Co-operative Concept in Ireland."
40. *Official Journal of the European Commission*, 94/C 400/01.
41. Hughes, "The Evolution of the Worker Co-operative Concept in

- Ireland,” 74–75. Students of Irish co-operative history might notice a similarity between this approach to resolving the financial dilemmas of a worker co-operative with the approach used in the nineteenth century at the Owenite Ralahine co-operative in County Clare. At Ralahine, the farm business prospered spectacularly when the workers took it over, but the workers lost their stake in the enterprise when the landowner gambled away the whole estate in a game of cards. It is hoped that lawyers today are too vigilant to allow this sort of risk to be tolerated.
42. Hughes, “The Evolution of the Worker Co-operative Concept in Ireland,” 77.
 43. The Co-operative Development Unit (CDU) was originally established in FÁS (the national training and employment state agency) to promote worker co-operatives. Later, its terms of reference were extended to include the design and implementation of other forms of employee involvement where this can contribute to the development of viable enterprises.
 44. See Case Two: Heron Quality Foods: From Home Cooking to International Marketing, below, to see how this works in practice.
 45. Briscoe, Carroll, and Hughes, “Working for Ourselves,” 196–97.
 46. This story of Heron Quality Foods was written by Colm Hughes, who was manager of the Co-operative Development Unit when Heron Foods adopted a worker co-operative structure. It was Colm who devised the innovative financing plan that has enabled a number of family businesses to convert themselves into worker co-operatives. Published in Briscoe and Ward, *Helping Ourselves*, 99–100.
 47. One of Colm Hughes’s many articles on this approach is “Passing on the Family Business,” *Business and Finance*, 4 June 1998.

Thematic Exploration and Looking Forward

JORGE SOUSA, DWAYNE PATTISON, AND ROGER HERMAN

AS NOTED IN THE INTRODUCTORY CHAPTER AND IN further discussion below, the choice of organizational form is typically a product of a variety of factors, including the environment in which the organization will function and the activities in which it will be involved. Examining the context in which organizations exist will help identify the challenges and issues they face and how, or if, this might influence a conversion initiative.

We used the co-operative identity as the basis for our analysis because the conversions examined here are characterized essentially by the adoption or rejection of the principles that make the co-operative unique among business models. As explained in chapter one, co-operative identity is defined by a distinctive set of values and principles, which include, but are not limited to:

- providing services to members as opposed to making profits for shareholders
- emphasizing members as users of the co-operative rather than investors
- limiting the return on investment

- returning dividends to members based on usage, not level of investment
- making decisions democratically — one-member, one-vote
- electing boards from the membership

A demutualization would result in an organization no longer adhering to these principles; a mutualization would result in an organization adopting them.

This chapter synthesizes the major themes emerging from the case studies. Although the cases may appear to be quite disparate, our analysis reveals that they have much in common. Exploring these shared themes in relation to the co-operative identity offers us a deeper understanding of the issues that led to either conversion option. As a framework for the organization and analysis of the observations and to provide further clarity to the discussion, we have divided the themes into internal and external influences. By internal influences we mean issues related specifically to the internal operations of the organization. We have subdivided this section into human and organizational elements. Human elements include matters related to the membership such as member involvement, linkage with the organization, member education, stakeholder benefits, and leadership. Organizational elements include governance issues, organizational efficiency, growth plans, and organizational life cycles. External influences are elements outside the organization that impinge upon it, such as the impact of disruptive changes, access to capital, the role of outside agencies, and changes to legislation. We conclude the chapter with suggestions and recommendations that we hope will serve as a useful guide for groups exploring the conversion option.

Internal Influences — The Human Element

Member Involvement

Member involvement is critical to the success of co-operative organizations. In the demutualization cases examined here, seeing an opportunity to receive a return on their investment, members switched from

seeing themselves as users of the services to investors. This threatened the co-operative identity, which limits returns on investments. Ultimately, conversions are based on the decisions of individual members, or potential members, and may be better understood by looking at the influences surrounding personal preferences.

Demutualizations involve a trade-off for members between the co-operative services they received and the financial gains from the distributed equity. As Wadsworth and Brockhouse commented in the chapter on Virginia Poultry Growers:

This mutualization contrasts sharply with demutualizations in which producers give up their direct involvement with a supply chain for immediate financial gain. In many instances, producers then find they no longer have a co-operative to provide them with a direct link to the value-added process, which was the original intent of the co-operative in the first place (233).

At some point, farmers must decide if these linkages in the process are more valuable than the monetary rewards of demutualization.

Members may have difficulty evaluating their personal preferences as the benefits of the co-operative are not always explicit. In her discussion of Australian credit unions, Johnston observed the challenge of explaining the intangible benefits of mutuality. Whereas reduced fees, dividends, and quality of service are obvious benefits, the advantage of mutualism itself may be less clear. As Johnston notes, "The belief is, too, that if mutuality really mattered to the public, the credit union sector would be 'thriving,' which it is not" (35). Explaining the benefits of intangibles was also a challenge in recruiting individuals to join a co-operative. People involved in the Atkinson Housing Co-op and the Mount Adstock conversion were put to task to explain the benefits of community.

Economic Linkage

When co-operatives are created, members are typically quite similar and the groups they form relatively homogeneous. It is such similarity

that allows a collective to identify and pursue common goals. As Fairbairn explains, it is the “economic linkage” — an interlocking of the organization’s and the members’ interests — between the member and the co-operative that allows the organizational model to work effectively.¹ One of the most evident results of the changes occurring to and around the organizations under study is a shift in the economic linkage between the owners/members/users of the organizations and the organizations themselves. The conversion cases repeatedly illustrate how the organizations neglected to educate members about the value of the organization they owned or about the changing environment in which it operated. Driven by regulatory changes, globalization, and growing competition, the operations of the organizations grew increasingly removed from their members. The disconnection not only weakened economic linkage, but also made it more difficult for elected officials to effectively govern the organizations whose businesses were growing increasingly complex.

It is useful to revisit Fairbairn’s discussion of this concept in order to explore the themes related to changing economic linkage that emerged from the case studies. Fairbairn provides the following list of features of co-operative economic linkage:

- the co-operative’s activities *promote the economic success* or well-being of the member’s household or income
- there is a *close connection* between the success of the co-op and of the member: if one does well, the other shares in the success
- the co-op’s products and services are tailored to *specific member needs*
- member choices and behaviour are tailored to what is needed for the co-op to succeed²

Fairbairn explains that if such characteristics exist, then members are more likely to trust and be loyal to their organization, in terms of using the services but also with regard to investing time and capital in the organization. While the co-operative must act as an effective agent for its members, those members must also perceive or be aware of the organization as an effective agent for them.

The case studies offer a good understanding of how the loss of economic linkage may lead to demutualization. The sections below on growth and legislative changes (284ff and 298ff) discuss examples of members becoming less sure about the benefits of the co-operative. These relate to Fairbairn's third point concerning the relevance of a co-operative's products and services to the needs of members. As suggested in the section on growth, expansion into other areas not directly related to the organization's mission may make it difficult for members to see the connection between their needs and the products and services with which the co-op is involved. Members may thus be more willing to demutualize.

The Lilydale Poultry Co-operative and Saskatchewan Wheat Pool's financial troubles illustrate Fairbairn's second point regarding organizational success. Because the two co-ops were no longer profitable, members may have started to question the value of their membership. Fairbairn's fourth point is best reflected in Briscoe, McCarthy, and Ward's work on the Irish dairies and the influence of non-user members. No longer focussed on the services of the co-operatives, non-users marked a change in member choices and behaviour. As the authors note, this can have a significant impact on decision making and can lead to pressure to demutualize. For Dakota Growers Pasta Company, member behaviour — namely, their production decisions — no longer fit well with what the co-op was established to do, leading members to feel that a different organizational form would be better suited to their new interests.

Economic linkage is closely associated with loyalty and trust. If Fairbairn's four concepts are working effectively, then members are more likely to trust the co-operative to meet their needs and, in turn, will be more inclined to be loyal to their co-op and patronize it. But how do conversions affect loyalty, and does a change in loyalty influence conversions? We have observed that declining member loyalty sometimes preceded demutualization activity. The Wheat Pool's market share, for example, fell throughout the 1980s and 1990s. In some cases, the loyalty the co-operative demanded of its members may have influenced the decision to convert. Members of Dakota Growers, for

instance, no longer found the kind of loyalty expected of co-op members useful for their purposes and looked for more flexibility in how they delivered products to the co-operative.

Once a demutualization occurred, it was then incumbent upon the organization to find new ways of engaging its previous members, now customers. A former Wheat Pool manager remarked, “If you are going to go public and remove the co-operative thing, you better replace this core strength with something else because you are going to lose it when you go public. You are going to lose the membership loyalty for lots of reasons, and if you do not replace it with something else, you are going to be in trouble” (116). In the case of Lilydale, former members were no longer inclined to deliver their products exclusively to the new entity. To encourage producers to continue to deal with it as a corporation, the company set up a loyalty program that rewarded producers for delivering to Lilydale.

Lack of Member Education

Nadeau and Nilsestuen suggest that demutualization decisions may not only reflect a lack of member education regarding the conversion, but also a limited understanding of the business of their co-operative, changes to the environment in which it functions, and for that matter, how their co-operative is different from other organizations, including the one they are considering becoming.³ The lack of member education was highlighted in the case study on the Australian credit unions, in which author Judy Johnston suggests a “high degree of member ignorance” (32) about the impacts of demutualization. Members also lacked information in another critical area; it appears that they were rarely informed about alternatives to demutualization. Some interviewees in the Saskatchewan Wheat Pool case did not feel the board of directors even seriously considered other options. And members of Prudential received information packages after the decision to convert had already been made and then were asked to vote on the proposal. Having only one option to consider, it is not surprising that in most demutualization cases, members voted “overwhelmingly” in favour of

converting. Some stakeholders in mutualizations may not have been much better off. As Sousa observes in the Atkinson Housing conversion, “Residents never really had a chance to assess whether or not there were other ways of obtaining more control without converting to a co-operative,” adding that the community may not, in fact, have been ready to become a co-op (150).

Determining Stakeholder Benefits

Nadeau and Nilsestuen argue that the opportunity for large profits by various stakeholders, including select members, management, consultants, and potential investors is behind the drive for demutualization.⁴ While rewards for various stakeholders are alluded to in several of the case studies, this is an area best approached cautiously. The Australian credit unions and Irish dairy co-operatives case studies indicated that managers and select members had both incentives to pursue conversions and rewards for achieving those goals. Directors and employees had much to gain from the conversion of Sunstate Credit Union in Australia, and Johnston states that the general manager was “particularly privileged” in the demutualization process (31). Dakota Growers Pasta management held a special category of shares, and the potential for their increased value could have been a motivating factor in pursuing a conversion. While Fulton and Lang do not suggest any direct financial incentives for Wheat Pool management, they do identify management’s apparent drive to achieve a grand vision rather than serving members’ interests.

In their analysis of the Irish dairy co-ops, Briscoe, McCarthy, and Ward raise the issue of non-user members and how they stood to gain from demutualization. Non-user members — producers who continued to keep their co-op membership but no longer used the services — were much better off if a conversion took place. Because non-users did not patronize the co-op, they had little, if any, interest in keeping it operating, but had much to gain in terms of equity if the conversion went ahead. Likewise, members of Dakota Growers who were no longer able to produce durum wheat kept their shares in the organiza-

tion and stood to benefit from the increased value of those holdings — in essence a return on investment rather than a benefit from the use of the services provided by the organization. Further, if the co-operative membership was open, as in the Australian credit union system, it created the opportunity for carpetbagging. That is, when people became aware of the possibility of a conversion, they could become a member in anticipation of making a profit when the equity was distributed to members during the demutualization process.

Outside stakeholders such as consultants and lawyers benefitted from conversions as well. The only case study that attached a dollar figure to the cost of demutualization was the Prudential conversion.⁵ In that instance, the figure was a whopping \$588 million (US). A considerable portion of that cost would presumably have been fees paid to consulting firms (e.g., legal, accounting, business development, etc.). It is reasonable to assume that each of the other conversions would have required the services of such consultants and would have come at a significant price, though likely not in the range of that incurred by Prudential. The potential financial gain by external stakeholders is worth considering in understanding who was driving the conversions.

The Role of Change Agents and Organizational Leaders

Change agents play a key role in the formation and evolution of an organization. They may include a leader or several leaders (such as a CEO or a board member), management, consultants, lawyers, government agencies, financial advisors, co-operative development organizations, politicians, and others. Rogers states that when change agents introduce innovation into an organization, they assume it “will have consequences that will be desirable, direct and anticipated.”⁶ A key component is “anticipated,” which suggest that agents will institute change they are familiar with rather than following a direction that is foreign to them. Rogers also points out that change agents are typically trained professionals and hence different from the clients they are trying to influence. These individuals must therefore be effective communicators to win over their clients.

The case studies support Rogers's claims. Change agents tended to be professional, effective communicators, and different from the rest of the group. The type of individuals who emerged as change agents, however, were largely dependent on the type of conversion. Co-operative development officers, for example, were an important part of a mutualization but appeared to have little, if any, involvement in a demutualization.

Change agents also differed in the type of work they performed. Agents who were part of mutualizations had more educative work to do since the co-operative model was not as familiar as a corporation to the average individual. The Sunova Credit Union case study provides an example of the type of education that was required; the concept of member ownership took time to explain to new members. In some instances, such as the conversion of the privately run ski hill to a multi-stakeholder co-op in Mount Adstock, the process had never happened before and required leaders to build trust among those involved. Because the Atkinson Housing Co-operative had been a social housing complex, those spearheading the conversion had to sell the idea to officials in government agencies responsible for housing, who were not convinced that the co-op could operate on its own. Other change agents may even be antagonistic to the co-operative form. Briscoe et al. quote Colm Hughes, who states, "Key people who give advice to new business start-ups, people like accountants, bankers and employers' organizations, were, for the most part, either ignorant about or hostile towards the concept of worker co-operatives" (259).

Regardless of the type of conversion, it is apparent from the case studies that leaders played an essential role in moving the process forward and achieving success. Whether it was a mutualization or a demutualization, people and their ideas, values, and goals mattered. The role of the change agents was similar in that they were the sellers of the idea. They worked to convince others — members, boards of directors, and other organizations — that the change was best for everyone involved. There was a key difference between the two conversions: those leading the demutualization had to explain why the co-operative model was not suitable for future development, while those leading the mutualization had to promote the co-operative advantage.

One or two particular people emerged as leaders in most of the cases involving mutualizations. Sonny Atkinson of the Atkinson Housing Co-operative, Gerard Binet of Mount Adstock, and Dan Wilhelmson of Dakota Carrier Network were all recognized for their commitment to their respective projects and their ability to take a leadership role. Their importance cannot be understated. Davis and Patrie felt that the acquisition of the telecommunications company in the Dakota Carrier case might not have happened without the determination and persistence of Dan Wilhelmson.

Demutualizations often followed a change in leadership; someone was brought in who had a new vision for the business and changed the identity of the co-operative. This was the case for Saskatchewan Wheat Pool: “The senior management — and particularly the CEO — had a well-defined vision for the co-operative that did not necessarily correspond with the needs of either investors or members” (114–15). It was also a motivating factor in Prudential’s conversion. With a background in the corporate banking sector, new CEO Arthur Ryan was the first CEO brought in from outside the organization. Lilydale also had a change in CEO prior to the conversion, although it is not certain if this had a significant impact on the demutualization process.

In some cases considering demutualization, management in general was changing. Managers in the Australian credit unions, for example, were being replaced by individuals with a more professional management style. The new managers generally came from the banking sector and may not have understood or appreciated the co-op principles and thus were less likely to support them.

Internal Influences — Organizational Elements

Governance

Governance is a key issue for co-operatives because of the democratic principles upon which they are built. Weak governance systems, which frequently emerge during a period of rapid growth, are often identified as a feature of organizations pursuing demutualization. Although

this was most evident in the Saskatchewan Wheat Pool case, most of the other studies alluded to it as well. Repeatedly, changes in organizational operations and the contexts in which they functioned became increasingly complex and outside the experience of many elected directors. In the case of the Wheat Pool, which expanded significantly during the 1990s, the company's range of products and services soon extended well beyond the board's expertise, and as Fulton and Lang explain, the Pool's board became progressively more reliant on management for information and for interpretation of that information. Thus, the board's ability to make decisions in the best interest of its members declined, while the influence and power of management increased. Similar assumptions about the balance of power between the board and management can be extrapolated from the cases in which management became "professionalized," such as the Australian credit unions, noted just above, and Prudential, where new CEO Arthur Ryan replaced most top managers and started to revamp the company. Boards of large organizations that found it increasingly difficult to carry out their responsibilities likely began to defer more complex decisions to the professional managers. With the co-operative governance structure weakened and most of the decision-making power in the hands of management, the emphasis shifted from member needs to organizational success. If members felt that their needs were not being met, they may have questioned the value of the co-operative model and found the option to demutualize an attractive alternative.

On the other hand, creating a strong co-operative identity coincided with the development of good governance systems, which often rely on committees to develop trust. The Atkinson Housing Co-op, for example, found that committees encouraged people to participate. Sousa notes that the committees helped increase community consultation, allowed residents to voice concerns, and increased awareness of the role of committees in the community (146). The Virginia Poultry Growers Cooperative created a committee that established contracts with members in order to "build cohesiveness and trust between leadership and members" (227).

Some of the cases revealed that co-operative decision making is not easy. In the Mount Adstock case, Girard and Langlois comment:

The public is not familiar with the operation of this type of organization, and running a solidarity co-operative with several different member categories proved to be a demanding task in terms of management skills and knowledge.... In order to succeed, the promoters had to satisfy different interests, settle disputes, and find compromises without neglecting the needs of one member group in favour of another (197–98).

And as Wadsworth and Brockhouse observe in the Virginia Poultry Growers case, governance is also associated with economic linkage and capitalization: “Ensuring grower input and frequent and clear communication between growers and the leadership make it more likely that growers will understand and buy into the business idea” (232). Further, most members saw mutualization as a way of gaining control in the organizations. Several of the mutualization cases noted that members were not only interested in receiving benefits and services from the co-operative but also in having a “voice.”

Organizational Efficiency

Chaddad observed that demutualization can result in enhanced organizational efficiency.⁷ While it is outside the scope of this exercise to compare pre- and postconversion performance, it is clear that in several instances the demutualized entities experienced significant increases in profitability following conversion. Prudential’s profits increased following demutualizing, despite the fact that its revenue growth was flat during the same period. The increase in profitability suggests that the insurance provider was able to discover efficiencies unavailable to it as a mutual.

However, the presence of mutuals and investor-owned firms in the same sector demonstrates that both organizational structures can, in fact, find efficiencies. As Chaddad and Chaddad note in their analysis

of Prudential, “The coexistence of stock and mutual insurers suggests that each achieved efficiency by trading off the costs and benefits specific to each organizational form” (77). Further evidence is provided in the study of the Irish dairy industry. While some dairy co-operatives were demutualizing, a number of the smaller co-ops were not convinced that demutualization would lead to greater efficiencies and chose to retain their original structure. The Newmarket Dairy Co-op in Ireland regularly outperformed the largest co-operatives and public limited companies, paying higher prices and providing numerous services to its producers-members, which seems to demonstrate that the co-operatives were just as efficient as their corporate counterparts. Further, before its conversion, the Dakota Growers pasta plant reported lower operating costs compared to competitors in the industry and therefore was able to expand the co-operative’s market share. Both Sunova Credit Union and Dakota Carrier Network were able to provide highly satisfactory services to their members — and be profitable — in communities that larger corporations had abandoned. Whether demutualizations could further enhance these efficiencies can only be speculated.

Access to Unallocated Equity and Reserves

Providing former members with access to unallocated equity and reserves is another motivation for pursuing the demutualization option. This is clearly illustrated by the Dakota Growers, Irish dairy co-operatives, and Prudential conversions. Prudential policyholders, in particular, had much to gain, with approximately \$12 billion allocated to members as a result of the demutualization. And members of some of the Irish dairies were able to realize the full value of their shares in the co-op after the conversion. As Briscoe, McCarthy, and Ward observe,

Farmers perceived co-op shares as almost worthless pieces of paper until the takeover and PLC activities of the mid-eighties brought attention to the real value of their shareholding. Indeed, in the

mid-eighties, many Irish co-operative managers, perhaps somewhat unfamiliar with co-op better practice, believed the only way to give real value to co-operative shares was to restructure in whole or in part as a PLC (249).

Chaddad explains that it may be these “limited horizon” co-operative members who choose to pursue demutualization even though current members did not contribute all the surplus or reserve of the organization.⁸ The possibility of a co-op converting and allotting these unallocated funds to its members may also lead to such practices as speculation or carpetbagging, as Johnston describes in her analysis of the Australian credit unions. And the loss of what Fairbairn refers to as economic linkage, discussed above, may also drive members to seek access to the monetary value of the organization, in place of the benefits of using the services it provides.

An aging membership and tied up capital has been an ongoing challenge for many co-operatives and mutuals. The need to remain competitive has created favourable conditions for private-sector professionals to undertake management responsibilities and lead a younger membership towards private-sector principles. Several case studies expressed a concern about organizations neglecting to integrate future members into operations and planning. As a result, when the participation of older members dwindles, younger members are not prepared nor even interested in maintaining the original co-operative identity.

The Conversion Option as Part of a Growth Plan

Growth is one type of organizational response to external threats as it is seen as a way of becoming more competitive. A growth strategy was central to strategic plans in nearly all the demutualization cases and often led to the organizations revisiting their form. Prudential’s international expansion and product diversification provided the growth deemed necessary for the company, but it may also have contributed to a growing disconnect between the policyholders/owners and the business activities in which their organization was involved. Any com-

mon identity between the organization and its owners was likely blurred when services were increasingly targeting users who needed disparate types of products or markets in other countries.

Agricultural co-operatives were likewise focussed on growth, but in these cases, this meant accessing new or additional capital to finance expansion. For the Wheat Pool and the Irish dairy co-operatives, initial steps to convert member equity freed up capital that was then used as leverage to acquire more debt capital. Ultimately, this strategy was a stepping-stone to demutualization. The growth plans of these co-operatives included diversification into new business interests as well as operations outside their home countries. As was the case with Prudential, these pursuits lacked an obvious connection or relevance to the activities or the well-being of the farmer/owners. The other two agricultural cases — Lilydale and Dakota Growers — also cited growth and the need for additional capital, but rather than following the two-stage process undertaken by the Wheat Pool and the Irish dairies, these organizations converted directly to publicly traded corporations, which gave them immediate access to the investment capital of shareholders.

In two of the mutualization cases, a desire to grow coincided with other driving forces, although growth may not have been the main motivation. Both Sunova Credit Union and the various partners involved in Dakota Carrier Network recognized and benefited from the expanded market opportunities made possible by pursuing their conversion initiatives. As banks looked to grow nationally and even internationally, they abandoned the small, less profitable, rural communities, leaving the credit union with opportunities to provide financial services to these centres. Dakota Carrier was also able to fill a void left by the large telecommunication companies, which were not interested in smaller markets. It is unclear whether the growth of these enterprises would have been possible or even pursued if competitors were not leaving the market.

Both the circumstances surrounding the expansion and the motivations behind the growth strategy differed in the two conversion types. While Prudential and the Wheat Pool saw growth as an organi-

zational survival strategy, Sunova and Dakota Carrier emphasized meeting members' needs. As one interviewee in the Dakota Carrier case remarked, "The best thing about it was North Dakota Telephone Co-operative didn't buy it [the exchanges] to take all the money out of here; they bought it to grow the company for future revenues for their members" (185).

As the case studies make clear, the growth imperative can potentially lead an organization to reconsider its internal structure — the cooperative identity seen either as restrictive or beneficial for achieving the organization's particular goals. What is less clear is when these considerations will take place. In the late 1800s, for example, Prudential Financial was experiencing "phenomenal" growth, with their insurance sales expanded into neighbouring states as well as into Canada. In 1915, during this unprecedented growth, it converted into a mutual, having initially been structured as a stock company. As Chaddad and Chaddad explain, officials made the decision to convert because mutual insurance companies were regarded as "special organizations" that kept premium prices low and protected the collective capital of policyholders.⁹ As a mutual, Prudential continued to grow through the 1990s, making the Fortune 500 list as one of the largest companies in the US in 1995. In its first stage of development, why did the company choose the mutual model as the best organizational form? Why did it then decide, after making the Fortune 500 list — proving growth was possible as a mutual — to convert into a corporation? The case studies and the questions they raise suggest that researchers analyzing conversions need to consider the entire social and economic milieu in which these organizations operate. Other themes in this chapter such as the trends at the time of conversion, economic linkage, governance, and organizational life cycles may give us further explanations about the possible motivations behind conversions.

The opportunities for growth offered by mergers and acquisitions shaped the context in which conversions occurred. Efficiencies and other advantages, real or perceived, made possible by mergers and acquisitions were presented as necessary to survive in increasingly concentrated and competitive environments. These strategies often pro-

vided entry points to new areas of business activity either through horizontal diversification or by closer vertical integration. Demutualization seemed to present a more straightforward way to proceed. As most other organizations, particularly in the financial sector, were corporations, co-operatives and mutuals believed converting into a corporation could expedite the merger.

Several of the demutualization cases referred to the fact that organizations engaged in merger strategies risked weakening the linkage between the purposes and activities of the enterprise and those of the member/owners. Johnston notes that mergers were influential in the conversion of credit unions in Australia as they changed “the nature of membership from a tight bond of membership to a loose one” (29). The resulting decrease in benefits to members challenged notions of any common co-operative identity and led to diminished member loyalty and reduced market share, thus compromising the financial stability of the organizations.

Even if a co-op proceeds with mergers and acquisitions without changing its organizational structure, these activities are a potential threat to the co-operative identity, specifically the autonomy and independence of members. Bringing in more organizations means there are more players to influence the decision making of the co-operative. Co-operatives are aware of this influence, including it in the most recent iteration of the seven principles: “If they enter into agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy” (5).

The Sunova Credit Union and Dakota Carrier Network examples involved acquisitions, but these differed once again from the demutualization cases. The acquisitions were not like those that had taken place within the Wheat Pool, which tended to fall outside the co-op’s area of expertise, but were directly related to what the credit union and the network did best. The companies and co-operatives that were part of the network’s acquisitions were closely linked with its primary business of telecommunications; the credit union acquired bank branches.

The acquisitions of the Wheat Pool, on the other hand, increased complexity and moved the co-op out of its comfort zone. According to the authors, “The international investments represented major new activities well outside the company’s expertise.... Not surprisingly, all of these investments led to significant losses for the Pool” (106).

The Life Cycle of Organizations

When organizations are created, the services they provide are designed to address the needs of their members, who presumably are similar enough to allow them to work together and identify common needs. As organizations mature, however, and as the memberships grow increasingly diverse or evolve along varied paths, do the members and their respective needs remain similar enough to warrant further collaboration, and do the services provided by the organizations still reflect the needs of all members? Cook and Burress, using a “life cycle” framework to explore these developments in agricultural co-operatives, propose that not only do members become increasingly heterogeneous regarding characteristics such as the size of their farming operation, the nature of their operation, or their use of new technology, but that they may also grow progressively more divergent in their preferences relating to the allocation of residual claim and residual control rights.¹⁰ This theory suggests that at the end of a life cycle, organizations will either make decisions that will initiate another cycle or move the organization in a different direction. While understanding that the life-cycle stage of an organization is not directly related to its age, it is useful to examine the age–life-cycle relationship to assess the extent to which members’ preferences may have evolved and/or how the organizations have developed.

Several of the demutualizing organizations or sectors can be described as “mature,” having been created several decades earlier and, in many cases, having experienced full or even repeated generational changes among their members. Lilydale, created in 1940, was sixty-five years old at the time of its conversion in 2005. Prudential was a mutual insurer for nearly a century when it demutualized in 2001. And the

various Irish dairies (or their merged descendants) were likewise approaching a century of existence when conversion became popular in that sector. By comparison, Dakota Growers Pasta, formed in 1991, was only eleven years old when it converted its organizational form. In this case, the organization and the business model it employed hinged entirely on the ability of its members to produce durum wheat, but because of a crop disease, the members/owners were no longer able to do so.

Australian credit unions had been around for forty or fifty years when conversion became the trend during the 1990s. At that point, the credit unions had to some extent achieved what they set out to do, namely, to provide competition to banks and to offer services to people not being served by banks. Changes to regulatory requirements and technology, along with rapid consolidation through mergers, resulted in an environment in which organizations originally characterized by tight bonds of association became focussed primarily on the requirements of the regulators. The common identity shared by the members and their credit unions was replaced by a business/customer focus.

Saskatchewan Wheat Pool, formed in 1923, was more than seventy years old when it implemented the equity conversion strategy that initiated the eventual organizational conversion. Initially formed to provide competition in a monopolistic grain-handling and -trading industry, the Wheat Pool was highly successful in capturing and holding a majority of the local market. The organization also provided a collective voice for agricultural producers. However, it had to deal with a variety of looming changes. The industry itself was becoming more industrialized, requiring players like the Wheat Pool to vertically integrate more of their operations and thus become more involved in costly value-added activities. The agricultural industry was also becoming increasingly deregulated, making grain handling alone economically questionable. Finally, because many of the Wheat Pool's members were approaching retirement age, a significant draw on retained member equity was inevitable, making it even more challenging for the Pool to finance the initiatives mentioned above. Changing priorities led the

Wheat Pool to focus on activities that were increasingly divergent from those of their members. This resulted in decreased member loyalty and market share, and arguably a loss of common identity for and with its members.

The case studies illustrate the close relationship between organizational maturity and organizational goals. In almost every example of demutualization, the co-operative had more or less achieved what it had originally set out to do, which marked a key phase in the organization's life cycle. When Prudential was first established, it was the only insurance company to sell policies to middle-class Americans; today, Americans can choose from a plethora of companies and policies. Farmers in Saskatchewan came together to create the Wheat Pool to market their grain more effectively and to receive a better price; farmers had far more options at the time of conversion. Dakota Growers Pasta was instrumental in providing a guaranteed market for members' products and raised member dividends from the value-added processing. And the Australian credit unions had succeeded in making relatively scarce credit available to most of the population.

It may be that organizational success makes it more difficult for co-operatives to continue to offer tangible benefits to members, particularly older members, who may no longer use the services as much as they once did. At this stage, the organization must either start a new cycle — which would require a re-visioning of the organization to meet the evolving needs of its members — morph into some other form, or disband entirely. The importance of the co-operative identity is key to the decision. Does the co-operative model continue to provide an advantage, or is another type of structure more relevant? If members feel that neither of these options is adequate, they may decide to dissolve the organization.

The other end of the organizational life cycle — the mutualizations — reveals enterprises in their earliest stages. Here the needs of members and the role of the co-operative in fulfilling them are discernible to everyone involved. The economic linkages may be more tangible and easier to identify and trust in the co-operative can thus be

quickly established. Turkey producers saw the benefits of a processing plant and the Virginia Poultry Growers Co-operative was able to raise a substantial amount of capital in a short timeframe through member investments.

The contrast between newer and older organizations and the level of trust among members may be best explained by Fairbairn's concept of a "black box" co-operative, which he describes as a "large, complicated, opaque organization" with "many different lines of business."¹¹ This type of organization makes it difficult for members to clearly see the connection between their needs and the market in which the co-operative operates. Fairbairn adds: "[The] co-op must not only promote member well-being; it must also be seen to do so — seen clearly, repeatedly, and over time to be making members better off. This question of how members see their co-operative and its activity is the question of *transparency*."¹² A lack of transparency may thus develop in organizations further along in their life cycles as compared to newer businesses, which are likely not as large or as complicated. This is not to say that large, older organizations cannot create the type of transparency members require; they may simply have to work harder at it. Lack of transparency can affect loyalty, as members may not be as willing to support an organization that they do not understand. And the case studies show clearly that established co-operatives wishing to maintain a co-operative identity must focus on member engagement, transparency, and strong economic linkages.

External Influences

The Impact of Local and Global Disruptive Changes

A theme that appeared in every conversion case was that of organizations adapting to external changes. It is useful to consider some of the ways in which change was occurring in order to understand the circumstances that required a particular organizational response and/or the strategies that organizations pursued.¹³ Chaddad suggests that "waves of demutualization often follow disruptive institutional and market changes,"¹⁴ which is certainly reflected by the demutualization

case studies in this book. Regardless of whether it was in financial services or agriculture, change was occurring at an unprecedented rate. Due to regulatory changes, for example, Australian credit unions were required to forgo their emphasis on member services in favour of a focus on the market and on tighter financial control. This regulatory change was a direct result of turbulent times in the financial industry — notably, the failure of a number of prominent financial service providers. Likewise, the industrialization of agriculture created an environment that forced organizations like Saskatchewan Wheat Pool to explore greater diversification and vertical integration. These strategies were not only less familiar to the organization, but they also separated the activities of the co-op from those of its members as well as proving to be more capital intensive. The advancement of technology was one of the contributing factors in Prudential's conversion; it changed the nature of the business as well as the relationship between the insurer and the policyholder. The changes encountered by the organizations in each demutualization case fueled greater market competition. Increased competition and the organizational response to these new developments undermined the very *raison d'être* of these organizations.

Disruptive events can also lead to mutualizations. The two examples from Quebec — a health-care co-operative and a recreational co-op — were a response to market disruptions and the potential loss of services in two regions. Similarly, poultry producers in the southern US were concerned about losing a local market for their products when a nearby processing plant was set to close. The loss led to the creation of the Virginia Poultry Growers Co-operative.

Several of the cases suggest that conversions of either type are undertaken in response to a looming threat. The conversions of Prudential Insurance and, to a lesser extent, the Sunstate Credit Union in Australia are the only demutualizations that specifically mention the organization acting from a position of strength and using conversion as part of a long-term strategy. Generally speaking, the conversions were reactionary rather than proactive.

Demutualizations were often related to an organization requiring capital either to satisfy an aging membership's demand for retained equity or to grow and diversify, which was deemed critical to the organization's viability in a rapidly changing environment. Such market adaptations change the relationship between members and their co-operative, affecting loyalty, trust, and ultimately the co-operative identity. This is consistent with the observations of Nilsson and Ollila, who observe, "Members may find that some market adaptations imply that the co-operatives no longer operate in their interest, and thus involvement, trust, solidarity and loyalty are fading."¹⁵ In these instances, the organizational need to survive outweighed considerations of the co-operative identity.

While the demutualizations were a reaction to a changing market environment, many of the mutualizations were attempts by individuals to change the environments in which they found themselves. This was certainly true for residents of the Atkinson Housing Co-operative, who believed that co-op housing would offer an effective way to improve the community around them. In other cases, the decisions to form a co-operative were related to the imminent loss of jobs (Virginia Poultry Growers, Mount Adstock), access to health services (Aylmer Health Co-op), or the benefits of tourism to the community (Mount Adstock). It thus appears that the focus of mutualizations is on providing services, at least early on in their development. Further, mutuals with a service-oriented mandate often looked to address a number of social issues at one time. The Aylmer Health Co-op, for example, was not only interested in providing health services but also wanted to develop a sense of belonging among members and to provide a voice to residents when dealing with local authorities. The goals fit well within the co-operative identity framework, which includes community-building values such as equality, equity, solidarity, and caring for others. These groups had a specific need and this, too, speaks to co-operatives, which are established to meet a group's social, economic, and cultural needs.

Access to Capital

All of the demutualization cases identified access to capital as a primary factor in the decision to convert organizational form. For some, demutualization made it easier for the former co-operatives to satisfy their increased demand for capital. It is important to keep in mind, however, that the need for additional capital, and the perceived barriers to its acquisition, are neither tested nor proven.¹⁶

There was uncertainty not only about the perceived need for capital but also about how many alternative strategies to consider before demutualizing. In their studies of the Irish dairy co-operatives, for example, Briscoe, McCarthy, and Ward suggest that alternatives for raising capital were never adequately addressed prior to demutualization. Van Bekkum and Bijman discuss six examples of alternative organizational approaches that could be effective in dealing with capital constraints while maintaining some member control in large agricultural co-operatives.¹⁷

1. Internally tradable shares
2. Externally tradable bonds
3. External corporate investors
4. Public listing with preferential shares
5. Conversion into member-owned LLC
6. Entire or partial public listing

The last two options should be considered demutualizations even though there is still some degree of member control. Some of the organizations in this study did employ one of these capitalization methods before completely demutualizing. Dakota Growers Pasta, for example, as do all New Generation Co-operatives (NGCs), used internally tradable shares to generate capital and was relatively successful at raising large amounts of money during its start-up phase. It should be noted, however, that tradable shares offer a means to raise only initial share capital; subsequent trading of shares among members would not raise additional funds for the organization.

The Irish dairy co-operatives used externally tradable bonds, accepting outside investors as a means to inject capital into the organization while leaving control in the hands of producers. And the Wheat Pool and some of the Irish dairy co-operatives employed the public listing with preferential shares method of raising capital, which brought about a two-stage conversion. Initially, voting rights, and thus control of the co-op, were left in the hands of members, as they were the only ones who received Class A voting shares.

The fact that these organizations tried several capitalization methods but failed to meet their financial demands suggests that demutualization may have been their only viable option. If the need for additional capital was actually justified, or whether the co-ops adequately considered all their options prior to demutualization can only be speculated. The Lilydale case, however, provides further insight into this issue. Prior to demutualization, the poultry co-operative attempted to raise funds through a Members Investment Program, requesting that members contribute equity by participating in a revolving check-off plan and a voluntary investment program. Although the check-off plan raised some funds for the organization, the voluntary investment initiative failed to meet the desired targets. Thus, with no other capitalization methods identified, the co-operative chose to demutualize.

Capitalization is also closely connected to organizational life cycles, discussed above. The ability or inability of a co-operative to raise capital may be dependent upon where it is in its organizational life cycle and whether or not it has the characteristics of a black box organization. Two of the case studies — Lilydale and Virginia Poultry Growers — offer a useful comparison, as they were at significantly different places in their organizational life cycles when they decided to convert. Lilydale, later in its life cycle, was unable to garner much financial support from its members, while Virginia Poultry Growers, at its earliest stage of development, raised nearly a million dollars from its members in less than two weeks, which was used for a feasibility study and start-up capital. In their case study on the latter, Wadsworth and Brockhouse note that “the significant investment members made during the equity drive at the beginning of the process showed their com-

mitment and loyalty to the concept” (232). The amount of investment required to establish a New Generation Co-operative such as the Dakota Growers Pasta Company further supports the idea that members are willing to invest in a co-operative if the benefits are clearly visible. More than twelve hundred durum producers contributed in excess of \$12 million in equity to construct a mill and pasta plant, and those same members contributed nearly \$10 million more for an expansion three years later. Fairbairn states that NGCs naturally have a high level of transparency built into them because they focus on niche markets. The member can easily see the connection between what he or she produces and the niche market. That is, the member understands the market and the important role the co-op plays in connecting the producer to the niche.¹⁸

Transparency and economic linkage are also essential to the capitalization of co-operatives. Members of Lilydale may not have been prepared to invest because they were unable to recognize the need or the benefits of providing this additional capital. In the case of the Irish dairies, Briscoe, McCarthy, and Ward, quoting Jacobson and O’Leary state, “The owners of the co-operatives were unwilling to individually invest further in the co-operative because their additional investment would continue to have little meaning to them as individuals” (252). This follows Fairbairn, who conjectures that capital shortages may be, more than anything, a membership relation problem — i.e., a lack of transparency and economic linkage.¹⁹ Thus, the members’ trust in the organization and their ability to see the benefits of capitalization are key indicators of whether or not demutualization will be pursued in order to raise more capital.

The Role of Outside Agencies

Outside agencies seemed to be more prominent, and more involved, in the mutualization cases than in the demutualizations. Co-operative development organizations and various co-operative enterprises took a great interest in the mutualizations, providing financial support and resources to groups involved in the conversion. The Co-operative

Housing Federation of Toronto played an instrumental role in the development of the Atkinson Co-op, offering financial assistance, board training, and other resources. Caisse Populaire Desjardins, a financial co-operative, and Outaouais-Laurentides Regional Development Co-op worked closely with the Aylmer Health Co-op through most of its early development, assisting with the feasibility study and providing expertise throughout the conversion process. The Virginia Poultry Growers Co-operative acknowledged the assistance of many organizations in its development: a co-op development specialist from the Rural Business Cooperative Service of the US Department of Agriculture; state officials; officials from the state banks; Southern States Cooperative Foundation; and a public accounting firm. The contrast in the number of agencies involved in a mutualization compared to a demutualization can be associated with building identity. Mutualizations involved *creating* an identity, possibly a more intensive process than *changing* an identity, as was the case in the demutualizations.

For organizations undergoing mutualization, “community” was often cited as a key component in the success of the project. The Aylmer, Mount Adstock, Virginia Poultry Growers, and Atkinson cases point to mobilization of the community as essential to moving the process forward. Girard and Langlois comment that the Adstock conversion would not have begun without community support early on in the process. The Atkinson Housing Co-operative, in fact, is an excellent example of community building. Key stakeholders faced the challenge and succeeded in bringing many different ethnic groups together to sustain the project.

Some of the case studies illustrate a reciprocal impact on community — a kind of community empowerment. Girard expressed this clearly in his research on Mount Adstock:

The success of this project and the collective initiative and support of the people contributed to helping the region rise above the sense of futility that followed the closure of the mines and other businesses. Local residents have demonstrated their desire and ability to prevent the closure of more businesses and establishments (196).

Financial institutions were involved in many of the demutualizations due to the concerns of capital constraints and debt financing among the organizations. The banks instructed the Wheat Pool and Lilydale to find new sources of capital, which led to the share offering by the Pool and the implementation of Lilydale's Member Investment Program. And Dakota Growers requested a large investment-banking firm to provide options for their corporate structure.

Outside investors and funders influenced conversions as well. The initial share offerings at the Wheat Pool and some Irish dairies gave outside investors more say in the organizations, and although investors did not have voting shares, they clearly influenced decision making in the co-ops, as noted above in the section on growth. For groups involved in mutualization, access to funding was a key concern and obstacle. Financial co-operatives certainly played a significant role in many of the mutualizations, but nonfinancial institutions offered monetary support as well. Farm Credit provided loans and lines of credit for Virginia Poultry Growers. And the Aylmer Health Co-op sought financial support from the Community Economic Development Technical Assistance Program for a business plan and used funds from the Co-operative Development Initiative to run a number of programs.

Unanticipated Effects of Changes to Legislation

The case studies elucidate the close relationship between government decisions and conversions. In some instances, such as the Australian credit union system, legislative changes were the major impetus for demutualization. Grouped together with all other Authorised Deposit-taking Institutions, the credit unions essentially lost both their standing as distinct financial co-operatives and their tax-exempt status. The amendments made it challenging, if not impossible, for credit unions to market their co-operative difference, as the government did not support such a distinction.

Legislative changes could influence conversion decisions without even being directly related to the co-operative sector. Modifications to

the US Farm Bill opened opportunities for farmers in North Dakota to plant crops besides durum, thereby changing the relationship between the producers and the Dakota Growers Pasta Company, which purchased only durum wheat. Policy changes in Canada altered the relationship between Lilydale and its members. The co-operative had been established prior to the introduction of poultry marketing boards, which are characterized by production quotas and price controls to balance supply and demand. The marketing board ensured relatively stable incomes for producers, who subsequently felt less compelled to invest in processing facilities. In their analysis of Lilydale, Goddard, Hailu, and Glover state,

With the majority of financial returns being generated on the farm with negotiated cost-of-production pricing from national and provincial marketing organizations, the immediate necessity to also own the processing capacity may not seem as urgent to current growers as it did when the co-operative was created (60).

The elimination of the Crow Rate — the rail transportation subsidy — in western Canada factored into the Wheat Pool's long-term strategic plan. Without the rail subsidy, it was feared that the Pool would not be able to compete with larger multinationals, which would force the organization to implement policies that would make it more competitive.

These examples highlight the importance of strong economic linkage between a co-op and its members. Legislative changes made it exceedingly difficult for co-operatives to differentiate themselves — i.e., to maintain their co-operative identity — from other companies in their respective industries. The Australian credit unions lost both tax incentives and federal recognition of their co-operative difference. The Wheat Pool's advantage in serving smaller communities dissipated with the elimination of the transportation subsidy. And the introduction of poultry marketing boards meant that producers no longer saw a strong economic linkage between themselves and the Lilydale co-op. When the co-operative advantage is no longer apparent to the individual member, demutualization becomes a viable option.²⁰

Part of an Ongoing Movement or Trend

Decisions to convert were frequently undertaken in keeping with trends in the industry, or made necessary because the organizations were following trends in business strategies that made conversions more likely. In the Prudential case, many mutual insurers were already pursuing the conversion agenda; Prudential simply followed the same course. In other instances, decisions to pursue particular business objectives — e.g., mergers or diversification — created demands for capital that required alternate financing models that served either as a stepping-stone to, or immediately required, a conversion of organizational form. The theme hints at a loss of identity among the demutualizing organizations. Following trends suggests making assumptions about member needs and expectations based on the behaviour of other organizations rather than clearly aligning strategies and services with the interests of members.

Whereas most, if not all, of the demutualized organizations were assimilating into the broader business community, the mutualization cases could be considered industry leaders. The Quebec examples — the Aylmer Health Co-op and Mount Adstock — were among the first of their kind in the province. It was the first time that a health co-operative had purchased a private practice, and Mount Adstock was one of the first to implement the solidarity co-op structure. Similarly, the Atkinson Housing Co-operative was ground breaking — the first public housing project to convert to a co-operative in Canada. Thus, while following industry trends clearly has a negative impact on the identity of some co-ops and may have induced demutualization, the mutualization cases were about creating a co-operative identity. Whether these mutualizations are trendsetters remains to be seen.

Outcomes of the Conversions

Most of the conversions can be considered a success in some way. The demutualizing organizations achieved what they intended — they raised capital, encouraged investments, and reduced debt. Prudential

improved its profitability and was able to increase its merger activity. Dakota Growers expanded its pasta manufacturing capacity and increased the income of its members. The mutualizations had more diverse goals but attained most of them. The Aylmer Health Co-op was able to bring two additional doctors into the clinic and provide health services to two thousand people. The Dakota Carrier Network reported “millions of dollars of new revenue” and “dramatically upgraded” technology that was equal to any telecommunications company in the world (182). The conversions in the Sunova Credit Union and Mount Adstock were positive developments in communities that were being abandoned by other businesses. Finally, a month after Virginia Poultry Growers was in operation, sales were 10 percent higher than projections and membership had increased from 130 to 155. Fourteen months later, the co-op was building storage facilities and had plans to build a feed mill.

Next Steps: Suggestions and Recommendations

The conversion phenomenon is a topic of ongoing study and policy review. Information gleaned from the case studies here can assist researchers and practitioners to analyze and make recommendations upon the most useful options for individual organizations. We provide below some suggestions for future research as well as key considerations for those wanting to pursue the conversion option. Our intention is not to support one conversion type over another, but rather to highlight issues of which individuals considering either option should be aware.

Ensure That Demutualizations Are Member Driven

The case studies support the views of Nadeau and Nilsestuen, who observed that members rarely initiate demutualizations, although they do make the final decision to approve or reject the proposal.²¹ The change agents who are leading the process thus need to be open with the membership about the reasons for the conversion. Once the mem-

bership has been informed, we suggest that a significant amount of time should elapse prior to a vote, which would give members the opportunity to thoroughly discuss the issues among themselves and with the board and management. This should include a consideration of all available options. Further, establishing a by-law requiring a quorum of a minimum of 75 percent in the case of a demutualization vote would ensure that the conversion has the solid support of the stakeholders. These steps are important in creating the transparency that leads to an informed membership.

Understand That Conversions Are a Trade-off

Although members do not typically initiate conversions, as noted above, they do have the final say on whether to proceed or not. The trade-offs are not always apparent. In the case of a proposed demutualization, for example, members must decide if the economic gains of converting outweigh the current benefits they receive as co-operative members. Members should be aware of three main points in making their decision: the economic linkages between themselves and the co-operative; who is leading the process and why; and the short- and long-term repercussions of the conversion.

Openly Address the Conversion Option

To reduce member uncertainty and to increase transparency, co-operatives should deal with the possibility of demutualization early on in their organizational life cycle. Options for capitalization, growth, and dissolution should be presented to members long before a final vote is held. The membership should also discuss the possible positive and negative impacts of conversion. Organizations may wish to employ an independent firm with no stake in the outcome to draft analyses and reports. It would be equally beneficial to ask a firm that is knowledgeable about the co-operative model to create a report that offered alternative viewpoints.

A sentiment that emerged consistently from the case studies was the perceived lack of an accountable, transparent, conversion process.

The conversions were often reactionary, and in many instances the membership was unaware of fiscal problems or whether there were consequences to converting organizational form. Individuals who went through either conversion process reported feeling confused and, at times, disenfranchised. Some even expressed suspicion of managers and the board of directors. In one case, members accused the individuals promoting the demutualization of benefiting financially from the change.

Any conversion should undertake due diligence; transparency and accountability must underlie all aspects of the process. Officials should consider the feasibility of the business, using conservative but realistic assumptions to produce a financial analysis and assess risk, and clearly communicating those risks to potential members as well as lenders. Greater transparency and accountability may prevent a conversion from occurring, but it can also result in the realization that maintaining the co-operative form is no longer viable. Ultimately, the members should possess all the information necessary to make the best decision for the organization. The results of the vote, as noted above, should reflect more than a simple majority.

Place Greater Emphasis on Member Education

Both types of conversion relate directly to the co-operative identity. A demutualization represents a loss of the identity — the organization no longer differentiates itself from other businesses based on its structure, principles, and values. A mutualization, on the other hand, involves the creation of the co-operative identity. A sound understanding of the co-operative model is thus essential for both types of conversion. Stakeholders from both groups need to recognize the advantages and disadvantages of the co-op model and how it impacts them as individuals and as a group if a conversion proceeds. Considering that undercapitalization was a major driver of the demutualizations studied here, methods of raising capital should be explored as early as possible.

We suggest that an education plan should be drawn up and approved by members and that it should be followed closely from the beginning to the end of the conversion process. The education plan should highlight information about the new organizational form, the objectives of the conversion, and collaboration with similar organizations. The education plan should also address succession planning so that conditions are in place to allow younger, future members to be actively involved in the visioning and direction of the organization.

Emphasize Good Governance Practices

Groups considering mutualization may face the dilemma of setting up a governance system with which many people may be unfamiliar. As the case studies show, it was often a challenge to explain the concept of ownership to members. There was a concern in the Atkinson case that lay people elected to the board did not have the business acumen to control and manage a multimillion dollar property (146). Creating a good governance system early in the development of the organization was an important part of the mutualization cases. As Girard states in the case of the Aylmer Health Co-op, “The composition of the administrative council proved to be a key element in the co-operative’s success” (164). And drawing from a study of Danish farmer co-operatives, Nilsson and Ollila comment, “Farmers attach much importance to the member governance of the co-operative. This factor is crucial for member satisfaction and for the co-operatives’ business success.”²² Good governance will also help ensure positive outcomes in demutualizations. As with a mutualization, a demutualization induces a complete overhaul in governance decision making. In the Prudential case study, Chaddad and Chaddad quote Wortman as follows:

One can see how difficult the process is for mutual insurance company boards and management to move an entire organization from a focus on enhancing capital to protect policyholder obligations to a new goal driven by stockholder motivation to increase return on equity (86–87).

Address Compensation Issues in an Open and Accountable Way

Organizational by-laws should set limits on the amount of compensation paid to CEOs, managers, and board members during a demutualization. Preventing the key change agents from receiving large windfall profits from the conversion will ensure that the initiative to demutualize is member driven. There are also intrinsic moral obligations in demutualization cases. There are two key questions:

- Do current members have the right to the accumulated equity of the co-operative?
- Are current members owners of the accumulated capital or do they have the obligation to protect it for future generations?

Fulton contends that conversions can be seen “at least in part, as a situation in which co-operative members obtain a gain at the expense of either past or future members.”²³ The organizational capital was built up over many years, with founding members contributing a large portion of the initial investment. The organization must consider the best way to compensate these individuals, based not only on their capital contributions but also their time commitment in getting the co-op established.

Further, boards should develop policies and procedures for the valuation of the co-operative and for determining how the equity in the organization will be distributed if a demutualization should take place. Considering that non-users can play a significant role in demutualizations, by-laws should also explain how the co-op intends to deal with them. Will they be given different voting rights? How are they defined?

Suggestions for Further Research

Conversions have gained considerable attention among co-operators and policy-makers over the past ten years. Changes and reforms to legislation regulating co-operatives and mutuals in some countries outside Canada favour the demutualization option. However, there is little independent empirical evidence exploring the impact of such

changes on society and whether there is a broader social benefit. Furthermore, with the exception of Nadeau and Nilsestuen,²⁴ there are few studies that have conducted a sector-by-sector analysis of conversions. Our investigation has been unable to locate a comparable analysis within a Canadian context. An important outcome of this study, therefore, is the recognition of the paucity of research on conversions.

We suggest an ongoing collection of data that explores the circumstances of organizations before, during, and after conversion. This research should include the development of standard measures and study formats in order to compare the conversion phenomenon across sectors. Although the focus of this book has been on the process and factors that have contributed to the decision to undertake a conversion, we recommend that future studies include an economic analysis, including a risk assessment, addressing the issues that have led to the decision to convert as well as the costs associated with pursuing either type of conversion.

Conclusion

The motivation behind this book was to offer greater insight into a topic that has been largely under-researched to date — the dilemma faced by those considering organizational conversion. The authors of the case studies explored many issues, including the reasons for and the impacts of conversion, and their analyses provide a good basis for future dialogue. The diversity of themes that have emerged from the case studies can further our understanding of the co-operative model and also educate us to the fact that conversions are the result of many influences. Given the same factors, members of one co-operative may choose to demutualize, while members of another may wish to maintain their current structure. Whatever the choice, voting members must have the information necessary to make an informed decision. If this criterion is met, the decision to demutualize or mutualize will likely be the right step forward for the organization and its stakeholders.

Table 1: Factors influencing conversion of individual organizations

Themes	Demutualization	Mutualization	Remutualization
Member involvement	Dakota Growers	Virginia Poultry Growers, Sunova	
Economic linkage	Australian CUs, Dakota Growers, Lilydale, Prudential, Sask. Wheat Pool	Sunova	
Member education	Dakota Growers, Prudential, Sask. Wheat Pool	Atkinson, Aylmer Health Co-op, Sunova	
Stakeholder benefits	Australian CUs, Dakota Growers, Prudential, Sask. Wheat Pool	Atkinson	Irish Dairies
Role of change agents and organizational leaders	Australian CUs, Lilydale, Sask. Wheat Pool	Atkinson, Dakota Carrier Network, Mount Adstock, Sunova	Irish Dairies
Governance	Australian CUs, Prudential, Sask. Wheat Pool	Atkinson, Mount Adstock, Virginia Poultry Growers	
Organizational efficiency	Dakota Growers, Prudential	Dakota Carrier Network, Sunova	Irish Dairies
Access to unallocated equity and reserves	Australian CUs, Prudential		Irish Dairies
Part of a growth plan	Australian CUs, Dakota Growers, Lilydale, Prudential, Sask. Wheat Pool	Dakota Carrier Network, Sunova	Irish Dairies
Life cycle	Australian CUs, Dakota Growers, Lilydale, Prudential, Sask. Wheat Pool	Sunova, Virginia Poultry Growers	

Table 1 (con't): Factors influencing conversion of individual organizations

Themes	Demutualization	Mutualization	Remutualization
Disruptive change	Australian CUs, Prudential, Sask. Wheat Pool	Atkinson, Aylmer Health Co-op, Mount Adstock, Virginia Poultry Growers	
Access to capital	Australian CUs, Dakota Growers, Lilydale, Prudential, Sask. Wheat Pool	Virginia Poultry Growers	Irish Dairies
Role of outside agencies	Lilydale, Sask. Wheat Pool	Atkinson, Aylmer Health Co-op, Mount Adstock, Virginia Poultry Growers	
Effects of changes to legislation	Australian CUs, Lilydale, Sask. Wheat Pool		
Part of movement or trend	Prudential	Atkinson, Aylmer Health Co-op, Mount Adstock	

Endnotes

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2. Ibid.
3. E.G. Nadeau and R. Nilsestuen, "Strengthening Co-operative Business Structures: Lessons Learned from Demutualization and Co-operative Conversions" (study commissioned by National Co-operative Business Association), retrieved 10 July 2006 from <http://www.ncba.coop/pubs.cfm>
4. Ibid.
5. The possibility of outsiders profiting from mutualizations was less apparent. The only one that offered an estimate of the cost of the conversion was the Atkinson Housing Co-operative, which put the figure at approximately \$300,000.
6. E. Rogers, *Diffusion of Innovations* (New York: The Free Press, 1995), 31.
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9. Interestingly, the CEO explained that one of the reasons for converting into a publicly traded company in 2001 was to distribute the value of the company to its policyholders.
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13. J. Birchall and L. Hammond Ketilson, "Resilience of the Co-operative Model in Times of Crisis. International Labour Organization," retrieved 22 December 2011 from www.ilo.org/wcmsp5/groups/public/—ed_emp/—emp_ent/documents/publication/wcms_108416.pdf
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15. J. Nilsson and Petri Ollila, "Strategies and Structures in the European Dairy Co-operative Industry," *Journal of Co-operative Studies* 42, no. 2 (August 2009): 14–23.
16. Chaddad, "Waves of Demutualization."
17. O.F. van Bekkum and J. Bijman, "Innovations in Cooperative Ownership: Converted and Hybrid Listed Cooperatives" (paper presented at the 7th International Conference on Management in AgriFood Chains and Networks, Ede, The Netherlands, 31 May – 2 June, 2006).
18. Fairbairn, *Three Strategic Concepts*, 16.
19. *Ibid.*, 27.
20. In some instances, conversions may also lead to changes in legislation. The Pool had already been contemplating becoming a publicly traded company, and it was a change in provincial legislation that allowed this to happen. The Atkinson Housing Co-op conversion created a unique type of social housing that may well interest governments as they look to devolve some of the decision making and management of public housing projects.
21. Nadeau and Nilsestuen, "Strengthening Co-operative Business Structures."
22. Nilsson and Ollila, "Strategies and Structures," 20.
23. M. Fulton, "The Future of Canadian Agricultural Co-operatives: A Property Rights Approach," *American Journal of Agricultural Economics* 77, no. 5 (1995): 1144–52.
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Olive McCarthy is a researcher with the Centre for Co-operative Studies and a lecturer with the Department of Food Business and Development at University College Cork, Ireland. Her main research interests are in credit unions and other credit co-operatives, co-operative structure, co-op management and membership, micro-finance, and financial exclusion/inclusion.

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A CO-OPERATIVE DILEMMA

CONVERTING ORGANIZATIONAL FORM

With insights from both academics and practitioners, this book focusses on an issue of paramount importance to co-operatives, nonprofits and other social economy organizations, development specialists, and policy makers. Twelve case studies from Canada, Australia, Ireland, and the United States explore the factors that lead businesses to consider converting their organizational form and the processes involved in the decision to mutualize, demutualize, or remutualize.

Cases include the credit union system in Australia, Lilydale Poultry Co-operative in western Canada, the Prudential Insurance Company in the US, the Atkinson Housing Co-operative in Toronto, the Coop Santé Aylmer Health Coop in Quebec, and dairy co-operatives in Ireland.

Although current research provides important insights into the reasons behind business conversions, there is a notable absence of inquiry into the underlying issues that motivate and inform the process of altering an organizational form. This book addresses these concerns.



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