



co-operatives
and mutuels
canada



DEMUTUALIZATION

OF CO-OPERATIVES AND MUTUALS

MURRAY FULTON AND
JEAN-PIERRE GIRARD

OCTOBER 2015



CO-OPERATIVE
EQUITY



PRIVATE
SHARES

WHAT IS **DEMUTUALIZATION**?

Demutualization is the conversion of a co-operative, credit union or mutual into an alternative organizational form (usually one owned by investors). Demutualization can occur through the conversion of equity into investment shares, or it can occur via a merger, takeover or buyout involving companies that are not co-operatives or mutuals. Regardless of the form it takes, demutualization involves the transfer to private investors of the capital that has been built up over the years in the co-operative.

DEMUTUALIZATION of Co-operatives and Mutuals

OCTOBER 2015

MURRAY FULTON

Professor, Johnson-Shoyama
Graduate School of Public Policy

Co-operative Retailing System
Chair in Co-operative Governance

Centre for the Study of Co-operatives
University of Saskatchewan

JEAN-PIERRE GIRARD†

Les Productions LPS

Lecturer, École des sciences de la gestion,
Université du Québec à Montréal

**A REPORT PREPARED
FOR CO-OPERATIVES
AND MUTUALS CANADA**

†

The authors would like to thank Travis Reynolds and Enzo Pezzini for their research work. Thanks also to Brett Fairbairn who authored the appendix on Demutualization in Co-operative Thought: Perspectives on Assets in Co-operatives. Finally, the authors would like to thank Denyse Guy, Madeleine Brillant and the members of the CMC Demutualization Task Force for their contacts, case examples, comments and advice. The usual caveats apply.

Executive Summary

Demutualization is the conversion of a co-operative, credit union or mutual into an alternative organizational form (usually one owned by investors). Demutualization can occur through the conversion of equity into investment shares, or it can occur via a merger, takeover or buyout involving companies that usually are not co-operatives or mutuals. Regardless of the form it takes, demutualization typically involves the transfer to private investors of the capital that has been built up over the years in the co-operative.

Demutualization occurs for a variety of interrelated reasons, including:

- Changes in the economic and political environment
- A perceived or real lack of access to capital
- Poor financial performance
- Efforts by managers and others to reposition the co-operative and to benefit personally from this repositioning
- Desire by managers and/or board members to make the co-operative similar to the dominant investor-owned business organizations
- A focus by members on “unlocking investor value”
- A focus by others on “unlocking investor value”
- Loss of member engagement

The demutualization of a co-operative or mutual is a major decision and, although there are exceptions, it is one that cannot typically be reversed. The decision to demutualize may be made with less than full information and/or it may be made by individuals or groups with a very narrow set of interests. As a result, a number of concerns have been raised about demutualization:

- Members may not be fully informed about the consequences of the demutualization, both to themselves and to future members
- All the options (e.g., a merger with another co-operative/mutual or a new source of financing) have not been thoroughly explored
- The demutualization process is dominated by management and/or by a small influential group of members

- Management is enriched more than is warranted
- Members receive a larger share of the sale value than is warranted by their contribution to the assets of the co-operative (e.g., current members receive the benefits created by previous members)
- The loss of a co-operative or mutual in the industry will lead to poorer quality products or service and/or higher prices, affecting both members and non-members
- Demutualization will make co-operatives and mutuals look less attractive to existing and potential members, thus damaging the co-operative “brand”
- Fewer co-operatives and mutuals will weaken the co-operative sector and reduce the ability of the sector to support educational initiatives and to influence government.

Of course, demutualization may make sense in certain circumstances. Organizational restructuring is a key element of a dynamic economy and represents an important way for organizations to reposition themselves and remain operational. As one form of this restructuring, demutualization may, under the right set of circumstances, provide for the continued provision of goods or services, the provision of better quality goods or services at lower costs, the development of a more competitive and dynamic economy, and the protection of investments or assets that might otherwise be in jeopardy. The protection of investments/assets might be important from the members’ perspective (e.g., the desire for equity redemption at retirement in the case of co-operatives), and/or it might be important from the government’s perspective if there is an expectation that it would have to provide compensation if failure should occur (as might be the case in the financial area).

The purpose of this report is to examine the pressures that arise for demutualization and to show that these pressures are linked to what can be called “good governance.” The major conclusion of this report is that demutualization, if it occurs, is not an isolated event. Instead, demutualization occurs when the co-operative is not performing well on numerous fronts such as financial performance, member engagement and, most importantly, governance. In effect, demutualization is a sign of a co-operative that is unhealthy in some way, one that has not paid attention to the key issues necessary for its success.

Finding the correct balance for a healthy co-operative is not easy. And no single strategy will do the job. A good example of this is use of indivisible reserves. The term indivisible reserves captures a collection of ideas – limited return on capital, unallocated or co-operative capital; and a requirement that any surplus derived from the sale of a co-operative/mutual be paid to other co-operatives or charity. While indivisible reserves have some real advantages for reducing

the likelihood of demutualization – they are a permanent source of capital and they eliminate the financial incentive that members might have to sell the co-operative/mutual, they are, by themselves, not sufficient to deter demutualization. As well, the tax implications of indivisible reserves may negatively affect the organization’s bottom line; indivisible reserves may also reduce the incentives for people to start co-operatives (particularly worker co-ops).

IMPLICATIONS FOR CO-OPERATIVES: A CHECKLIST

The analysis in this report identifies five tangible areas that co-operatives and mutuals need to address to decrease the likelihood of demutualization. None of these areas are sufficient on their own – typically a combination of all five areas is required to lower the risk of demutualization. The five areas are:

1. Financial soundness, including strong financial performance, sufficiency of capital, and awareness of changes in economic conditions

Co-operatives and mutuals may consider conversion or demutualization if they are financially insolvent, or lack the capital to remain effective and competitive. Although they should always be concerned with sound management, the need for good business practices and decision-making processes is reinforced when unsound management increases the potential for demutualization. Similarly, paying attention to shortfalls in capital, before it is actually required, can be a good way to guard against future demutualization. Tangible ways to achieve financial soundness include: ensuring that proper risk tolerances are established and honoured; determining, monitoring and acting on key performance indicators (which will vary by co-operative/mutual); and maintaining a healthy balance sheet.

2. Member incentives, including the “unlocking of investor value”

Members may have personal financial incentives to pursue demutualization. These incentives emerge because of how savings have been distributed (e.g., to indivisible reserves, or to allocated or unallocated member equity), the legal rules that govern how reserves and equity can be distributed upon dissolution of the co-operative, the tax regulations that apply to different surplus allocations, and the beliefs that members have about collective and individual property within a co-operative/mutual. Paying attention to demutualization means understanding these incentives, and modifying them if necessary. To keep these issues in the forefront, it is important to routinely ask questions from the perspective of members – i.e., How do members perceive the benefits and costs of the rules and regulations that are in place? As well, co-operatives and mutuals should take the time to determine if indivisible reserves would be beneficial for their organization.

3. Co-operative values and democratic engagement, including members' understanding of their co-operative's value

One way of staving off demutualization is for members to have an accurate sense of their co-operative's value. Part of this value, namely the members' financial benefit, is relatively straightforward to determine. Another part of this value, however, is more difficult. This part involves considering the questions: What would the situation be like if the co-operative no longer existed? Would members get comparable service? Would prices be as good? Would the community be as well off, both now and in the future? Properly addressing the issue of demutualization requires that everyone in the co-operative – members, management, and the board – can answer these questions on a day-to-day basis. Ensuring that members are able to do this requires ongoing democratic engagement efforts by the co-operative. These efforts have to go beyond the holding of annual meetings, the sending out of newsletters, and citing of mission and vision statements. Instead, ways need to be found of demonstrating the purpose and relevance of the co-operative or mutual – Why was it formed and why should it continue?

4. Regulatory structures and best practice requirements

As a result of high-profile corporate scandals (e.g., Enron) and the 2008 financial crisis, governments and oversight groups are introducing regulatory requirements and best practices in an effort to ensure good financial performance and restore investor confidence. While such requirements (e.g., the appointment of outside directors) could be advantageous, they also have the potential to weaken performance, particularly in areas that are important to members. In addition, these requirements may push co-operatives and mutuals to adopt structures that are increasingly similar to those of other businesses, thus making demutualization easier and hence more likely. To counteract this pressure, co-operatives and mutuals need to ensure that they can clearly enunciate the strengths of the co-operative/mutual model and they need to be constantly working with regulators and industry groups to communicate these strengths.

5. Corporate governance structures, including managers' desire for increased compensation or influence, and poor decisions by the board or management

Proper corporate governance structures ensure that decisions are made in the members' best interests while ensuring the continued operation of the co-operative. As co-operatives and mutuals become larger and more complex, members and boards grow increasingly reliant on information from management about their organization's operations and finances. Having more detailed knowledge than everyone else allows management to serve their own interests (and sometimes those of outsiders that are able to influence managers), rather than those of the members. Furthermore, conversions and demutualizations often create significant financial windfalls for senior management, who typically propose demutualization in the first place. Consistently practicing good governance helps ensure the proper distribution of authority and decision-making within the co-operative, ensuring that conversion, if proposed, is beneficial to the co-operative and its members. Good governance means establishing the proper incentives for managers, board members and members, making sure that the ideas and assumptions that underlie investment and operational decisions are properly examined, and ensuring transparency and accountability in the decision-making process so that legitimacy and trust are maintained.

Table of Contents

EXECUTIVE SUMMARY	i	INCENTIVES – CAPITAL AND FINANCE	8
Implications for Co-operatives: A Checklist	iii	Financial Incentives: An Introduction	8
1. Financial soundness, including strong financial performance, sufficiency of capital, and awareness of changes in economic conditions	iii	The Incentive to “Unlocking Investor Value”	10
2. Member incentives, including the “unlocking of investor value”	iii	Norms, Values and Financial Incentives	12
3. Co-operative values and democratic engagement, including members’ understanding of their co-operative’s value	iv	Indivisible Reserves and Incentives	14
4. Regulatory structures and best practice requirements	iv	Canada	15
5. Corporate governance structures, including managers’ desire for increased compensation or influence, and poor decisions by the board or management	v	Québec	16
		United States	16
		Other Countries	17
		The Advantages and Disadvantages of Indivisible Reserves in Avoiding Demutualization	18
		Sale of assets	19
		Other options to control demutualization	20
		INCENTIVES – MEMBER PATRONAGE	22
		INCENTIVES – CORPORATE GOVERNANCE AND AGENCY ISSUES	24
TABLE OF CONTENTS	F	COGNITIVE MAPS	27
INTRODUCTION	1	LEGITIMACY	29
DEMUTUALIZATION AND GOVERNANCE	4	DEMUTUALIZATION AND CO-OPERATIVE PERFORMANCE	30

CHECKLIST FOR FORESTALLING DEMUTUALIZATION	34	Co-operative Capital in Continental European Thought	66
1. Financial soundness, including strong financial performance, sufficiency of capital, and awareness of changes in economic conditions	34	The 1937, 1966, and 1995 ICA Principles	68
2. Member incentives, including the “unlocking of investor value”	34	1937	68
3. Co-operative values and democratic engagement, including members’ understanding of their co-operative’s value	35	1966	69
4. Regulatory structures and best practice requirements	35	1995	71
5. Corporate governance structures, including managers’ desire for increased compensation or influence, and poor decisions by the board or management	36	Conclusion	73
CONCLUSION	37	References	74
REFERENCES	38	APPENDIX D – FEDERAL, PROVINCIAL AND TERRITORIAL LAW DEDICATED TO CO-OPERATIVES: THE DISTRIBUTION OF ASSETS ON DISSOLUTION.....	75
APPENDIX A – CASE STUDIES	43	APPENDIX E – DISINTERESTED TRANSMISSION OF ASSETS IN CASE OF DISSOLUTION: INTERNATIONAL EXAMPLES	79
References	57	APPENDIX F – INDIVISIBLE RESERVES IN THE UNITED STATES: EXAMPLES FROM NEW HAMPSHIRE AND NEW YORK	82
APPENDIX B – CO-OPERATIVE AND MUTUAL TAXONOMY	60	APPENDIX G – THE QUEBEC EXPERIENCE WITH THE INDIVISIBLE RESERVE: HISTORICAL OVERVIEW	84
APPENDIX C – DEMUTUALIZATION IN CO-OPERATIVE THOUGHT: PERSPECTIVES ON ASSETS IN CO-OPERATIVES	62	References	87
Overview	62	APPENDIX H – LIST OF INTERVIEWEES (QUÉBEC, NEW-BRUNSWICK AND ONTARIO: FRANCOPHONE)	88
Co-operative Capital in British Co-operative Thought	63	APPENDIX I – THE LA CAPITALE, SSQ BUSINESS AND AGROPUR MODELS	89

Introduction

Demutualization is the conversion of a co-operative, credit union or mutual into an alternative organizational form (usually one owned by investors).¹ Demutualization can occur through the conversion of equity into investment shares, or it can occur via a merger, takeover or buyout involving companies that usually are not co-operatives or mutuals.² Regardless of the form it takes, demutualization involves the transfer to private investors of the capital that has been built up over the years in the co-operative.

Demutualization occurs for a variety of interrelated reasons, including:³

- Changes in the economic and political environment
- A perceived or real lack of access to capital
- Poor financial performance
- Efforts by managers and others to reposition the co-operative and to benefit personally from this repositioning
- Desire by managers and/or board members to make the co-operative similar to the dominant investor-owned business organizations
- A focus by members on “unlocking investor value”
- A focus by others on “unlocking investor value”
- Loss of member engagement

1 See Chaddad and Cook (2004), Galor (2008) and Battilani and Schröter (2011) for additional definitions of demutualization.

2 A merger involves a mutual decision by two organizations to join together to create a single organization. A takeover involves one organization purchasing another. A buyout typically involves a partial purchase of another organization, with the intent of gaining control. A sponsored demutualization occurs when the shares of the converted co-operative/mutual are issued to a sponsor (McDowell et al. 2008). The sponsor may or may not be a co-operative.

3 See Chaddad and Cook (2004), Hogeland (2006), Galor (2008), Fulton and Hueth (2009), Battilani and Schröter (2011), Desjardins Group (2011) and Kenkel (2014) for a discussion of these various reasons.

The demutualization of a co-operative or mutual is a major decision and, although there are exceptions, it is one that cannot typically be reversed.⁴ The decision to demutualize may be made with less than full information and/or it may be made by individuals or groups with a very narrow set of interests. As a result, a number of concerns have been raised about demutualization:

- Members may not be fully informed about the consequences of the demutualization, both to themselves and to future members
- All the options (e.g., a merger with another co-operative/mutual or a new source of financing) have not been thoroughly explored
- The demutualization process is dominated by management and/or by a small influential group of members
- Management is enriched more than is warranted
- Members receive a larger share of the sale value than is warranted by their contribution to the assets of the co-operative (e.g., current members receive the benefits created by previous members)
- The loss of a co-operative or mutual in the industry leads to poorer quality products or service and/or higher prices, affecting both members and non-members
- Demutualization make co-operatives and mutuals look less attractive to existing and potential members, thus damaging the co-operative “brand”
- Fewer co-operatives and mutuals weaken the co-operative sector and reduce the ability of the sector to support educational initiatives and to influence government.

⁴ Briscoe, McCarthy and Ward (2012) provide an example of an Irish co-operative that demutualized and then converted back to a co-operative.

Of course, demutualization may make sense in certain circumstances. Organizational restructuring is a key element of a dynamic economy and represents an important way for organizations to reposition themselves and remain operational. As one form of this restructuring, demutualization may, under the right set of circumstances, provide for the continued provision of goods or services, the provision of better quality goods or services at lower costs, the development of a more competitive and dynamic economy, and the protection of investments or assets that might otherwise be in jeopardy. The protection of investments/assets might be important from the members' perspective (e.g., the desire for equity redemption at retirement in the case of co-operatives), and/or it might be important from the government's perspective if there is an expectation that it would have to provide compensation if failure should occur (as might be the case in the financial area).

The purpose of this report is to examine the pressures that arise for demutualization and to show that these pressures are linked to what can be called "good governance." The major conclusion of this report is that demutualization, if it occurs, is not an isolated event. Instead, demutualization occurs when the co-operative is not performing well on numerous fronts such as financial performance, member engagement and, most importantly, governance. In effect, demutualization is a sign of a co-operative that is unhealthy in some way, one that has not paid attention to the key issues necessary for its success.

“ Demutualization occurs when the co-operative is not performing well on numerous fronts such as financial performance, member engagement and, most importantly, governance.”

Demutualization and Governance

The starting point for thinking about demutualization and governance is the organization. Organizations – and this includes co-operatives – are so named because they involve the organization of people and tasks for the purpose of accomplishing a set of goals. Authority and power are an integral part of an organization and of organizing; they arise because people and groups use the rules set down in the legal system and in the bylaws, augmented by the influence they are able to exert because of the resources they command, to exert control over particular decisions.

Governance is concerned with the manner in which this power and authority are distributed. As the Institute on Governance indicates, governance “determines who has power, who makes decisions, how other players make their voice heard and how account is rendered” (Institute on Governance 2015). In simple terms, governance is concerned with “who gets to decide what?”

“Who gets to decide what?” is important because, depending on who has power and authority, the decisions that are made will either be beneficial for the organization and all its stakeholder, or they will be beneficial for only a small group. In the case of co-operatives, there are four key groups that have power and authority, albeit in different spheres and to different degrees: members, the board of directors, senior management and employees. Co-operative governance involves a determination of which groups have power and authority to make decisions in each of the many spheres where decisions are required (e.g., everything from the choice of director to strategic planning to hiring practices to service provision). Good co-operative governance occurs when the allocation of authority results in good decisions being made – i.e., decisions that benefit the members and that sustain the organization both organizationally and financially.

For an organization to run efficiently and effectively, the allocation of authority and power have to be done in such a way as to address three general organizational problems. These problems are:

1. The appropriate incentives have to be developed;
2. The appropriate cognitive maps or frames for making decisions about the future have to be developed; and
3. The legitimacy of the authority that is being exercised has to be maintained.⁵

⁵ See Fulton, Pohler and Fairbairn (2015) for a discussion of a governance framework that embodies these three elements and for an application of this framework to specific co-operative cases.

The failure of a governance structure to properly allocate power and authority to address these three problems is a key cause of demutualization. Consider, for example, the case of the Saskatchewan Wheat Pool (SWP). The problems that occurred in the SWP resulted from a failure of the board to effectively oversee the senior management (the incentive problem), hubris and overconfidence on the part of the senior management (a failure to develop the appropriate cognitive map), and a failure of the SWP to maintain the confidence of the members (the legitimacy problem). The result of these problems was a series of bad investments, a rapid build up in debt, a dramatic loss of market share, and severe financial problems. These outcomes led to the termination of the CEO, followed by the conversion of the SWP to an investor-owned firm (IOF).⁶

Governance was also important in the demutualization of savings and loan associations, insurance companies and credit unions in the United States in the 1980s, the 1990s and early 2000s. Demutualization was in part a response to a new market environment, one that managers and members often did not fully understand, thus highlighting the importance of the cognitive model for decision making.⁷ In some cases (e.g., the savings and loans, and insurance cases, primarily), demutualization appears to have benefited all the major stakeholders, suggesting that a new ownership structure created a better set of incentives, which in turn lead to better performance.⁸

However, the new structure and incentives did not always produce better outcomes. Demutualization has been linked to the taking on of greater risk, an outcome that could be disadvantageous for the industry.⁹ Better performance does not always follow from demutualization – demutualized credit unions in the United States have not have higher asset growth rates or lower capital ratios than their counterparts that remained as credit unions.¹⁰ As well, demutualized credit unions have offered lower interest rates for savers and higher interest rates for borrowers than did credit unions that did not demutualize.¹¹ One of the possible reasons for this lack of improved performance is that demutualization was driven by management's

6 See Fulton and Larson (2009a, 2009b) for a discussion of the SWP. Fulton, Pohler and Fairbairn (2015) provide an analysis of the SWP case in terms of the general governance problem.

7 Chaddad and Cook (2004).

8 Chaddad and Cook (2004) and Mayer and Smith (1986)

9 Chaddad and Cook (2004).

10 See Wilcox (2006) and Mayer and Smith (1986).

11 Heinrich and Kashian (2006). The experience in the U.K. with the demutualization of building societies and the financial mutual is similar. According to the All-Party Parliamentary Group that examined the issue, "(t)he balance of the evidence (both verbal and written) received by the Inquiry was that mutuals, both in the building society and life assurance sectors, performed better than their plc rivals in a variety of financial performance indicators. It was also shown that they pass these cost advantages onto consumers in terms of better rates. This was clearly backed up by any study of 'best buy' tables. The Inquiry also found there had been substantial increases in remuneration enjoyed by directors of those institutions that had demutualized in the 1990s, but no corresponding improvement in performance. It should be pointed out, however that the strategic direction chosen by an institution's board, particularly one pursuing corporate growth, may push it towards the plc model. This is especially so in the life sector, where some mutuals have sought extra capital" (All-Party Parliamentary Group 2006, p. 6).

desire for greater remuneration and authority rather than by member benefit.¹² In this case, demutualization is a consequence of management acquiring improper authority and power.

The argument made in this report is that the experience of the SWP, the credit unions, the life insurance mutuals, and the savings and loans associations are not unique. Instead, demutualization can be understood generally as the result of a governance failure – the failure to allocate authority in a way that results in good decisions and strong organizational performance. The key issue for mutual and co-operatives is whether, prior to demutualization, authority within the mutual or co-operative is allocated in a way that produces outcomes that are beneficial to stakeholders and in particular to members so that demutualization is not undertaken.

As was pointed out earlier, demutualization occurs for a number of reasons, including: changes in the economic and political environment; a perceived or real lack of access to capital; poor financial performance; efforts by managers to reposition the co-operative and to benefit personally from this repositioning; desire by managers and/or board members to make the co-operative similar to the dominant business organizations; a focus by members on “unlocking investor value;” and a loss of member engagement.

Each of these factors has at its root one or more of the three problems identified above – providing the correct incentives, developing an appropriate cognitive map, and maintaining legitimacy. For instance, attempts by management to promote demutualization for their own gain rather than the benefit of members results from a failure to provide the proper incentives and to properly curtail the power and authority of management. Similarly, the focus that members have on “unlocking investor value” is a direct consequence of the incentives in place regarding member access to the equity built up in the co-operative.

Significant changes in the political and economic environment can affect the ability of co-operative leaders to develop the appropriate cognitive maps to guide business decisions. Alterations in the cognitive mapping are behind the desire by managers and/or board members to make the co-op similar to the dominant business organizations.

The loss of member engagement can be seen as a result of a diminution of legitimacy, which in turn affects the incentive to patronize the organization. Finally, a lack of access to capital, whether real or perceived, and poor financial performance arise, as in the case of the SWP, because of problems dealing with all three factors.

Seen in this light, the key issue is how to avoid these problems, and hence demutualization. In short, what can co-operatives and mutuals do to ensure that the allocation of authority is such

¹² Chaddad and Cook (2004), Mayer and Smith (1986) and Wilcox (2006) discuss the possibility of managerial self-interest as a driving force behind demutualization.

that the key governance issues are addressed and demutualization does not emerge as a strategy chosen by a co-operative?

Based on the analysis in this report, a checklist is developed of five tangible activities that co-operatives and mutuals can undertake to decrease the likelihood of demutualization. The checklist focuses on the following:

1. Financial soundness, including strong financial performance, sufficiency of capital, and awareness of changes in economic conditions
2. Member incentives, including the “unlocking of investor value”
3. Co-operative values and democratic engagement, including members’ understanding of their co-operative’s value and demographic changes in membership
4. Regulatory structures and best practice requirements
5. Governance structures, including managers’ desire for increased compensation or influence, and poor decisions by the board or management

The next sections of the report examine the three governance factors and illustrate their importance in demutualization. The discussion begins with a focus on incentives in three key areas – financing and capital, member patronage, and co-operative management. The paper then turns to an examination of cognitive maps and legitimacy and the role these play in good governance. The paper then empirically examines the role played by these various factors in demutualization. Based on this examination, the paper concludes with the presentation of the five tangible activities that co-operatives and mutuals can undertake to decrease the likelihood of demutualization.

INCENTIVES – Capital and Finance

The key incentives that have to be addressed in co-operatives are associated with the free rider problem and the agency problem.¹³ Free rider problems exist when there is a tension between what is good for the individual member and what is good for the membership as a whole. This tension can arise as members make decisions whether to contribute capital to the co-operative or to do business with the co-operative.

Agency problems exist between the members and the board, the board and management, and management and employees. Agency problems are concerned with what is typically called corporate governance – such things as getting board members to work for the co-operative rather than the group they represent, getting managers to make decisions in the best interest of the members, and getting employees to work hard and provide high quality service.

The discussion in this section will focus on the free rider problems that members face as a result of the financial structure of co-operatives. The section following will examine the incentives for member patronage, followed by a discussion of corporate governance.

FINANCIAL INCENTIVES: AN INTRODUCTION

Although the financing of co-operatives has become much more complex over the last 20-30 years, the basics of co-operative financing are simple. To provide members with the services they expect, co-operatives must finance the assets that allow these services to be provided. As in any organization, the co-op's assets equal its liabilities plus its equity. Liabilities include accounts payable and debt, while equity consists of the capital provided by investors. To increase assets requires an increase in liabilities and/or equity.

In the traditional co-operative financing model, equity is made up of three components:

1. Initial member investment
2. Retained earnings that are allocated to members but not yet distributed (member equity); and
3. Retained earnings that are not allocated to members (unallocated equity, co-operative capital, or indivisible reserves).

¹³ Sexton and Iskow (1988) and Cook (1995) provide a good overview of the importance of free rider and agency problems in co-operatives.

To this mix co-operatives are now using different forms of shares – typically non-voting – to allow both members and non-members to make equity investments. These shares often offer both members and non-members the ability to see the value of their equity fluctuate with changes in the co-operative’s performance. New debt instruments are also being developed that allow co-operatives to obtain debt financing from their members.¹⁴

The use of retained earnings (whether allocated or unallocated) and the development of new share structures are a response to the free rider problem. Left to make their decision independently, there is a concern that some people would not invest in their co-operative – instead, they would free-ride on the investments made by others. However, if everyone behaved this way, the co-operative would have few assets and would be unable to offer members the services they demand.

To deal with this problem, co-operatives developed the practice of retaining the earnings that were generated and using these earnings to finance additional assets. Since the alternative to retaining the earnings would have been to pay the earnings as a patronage dividend, the retained earnings are often allocated to a member account as individualized equity; when the member leaves the co-operative, he/she is entitled to receive a payout of his/her equity. In addition, some of the earnings are retained as unallocated equity – i.e., it becomes the property of the co-operative and not of the individual members. Co-ops use unallocated equity to protect member equity from decreases in the asset base because of short-term losses and as a permanent source of capital that can be leveraged against debt.¹⁵ Unallocated equity – in the form of an indivisible reserve – may also reduce the incentive for demutualization (see discussion below).

Many co-operatives find that they are unable to raise enough capital to finance the desired growth in assets through the use of retained earnings. To provide an incentive for members and outside investors to provide the capital that is required, co-operatives have developed the new share structures described above. While the use of retained earnings and new share structures serve to address the lack of incentive for members to contribute capital, they also have the potential to create incentives for demutualization. To understand these incentives, it is necessary to examine the concept of “investor value.”

14 See Andrews (2015) for an excellent examination of the various sorts of financing used by co-operatives.

15 See Kenkel (2014) for a discussion of these issues. Kenkel (2014) notes that legal and taxation restrictions on allocating non-member income to members is also a reason for the use of unallocated equity.

THE INCENTIVE TO “UNLOCKING INVESTOR VALUE”

To understand the incentives for demutualization, consider what happens if the co-operative is sold. If this were to happen, the revenue raised from the sale is first used to cover the liabilities of the co-op – as is customary, debt holders have the first claim on the sales revenue and are paid off according to the terms of the loans. If there is revenue left over, the equity holders are then paid.

The amount received by equity holders depends on a number of factors, such as the size of the revenue from the sale relative to the debt and equity, and the nature of the ownership rights to the equity. Consider first the case where the revenue available from the sale is just sufficient to cover the debt and the equity. In addition, assume that there is no unallocated equity – i.e., all retained earnings were allocated to members. In this case, the members would simply receive the face value of their equity – i.e., the value of their initial investment and any patronage returns that had been allocated but not paid out.

If the sales price exceeds the sum of the liabilities and the face value of member equity, then the manner in which this residual is allocated depends on the rules and norms in place. If the co-op adheres to a co-operative norm of a limited return on investment (adherence could be the result of legislative restrictions, bylaw restrictions or restrictions imposed by the membership at the time of sale), then the members would only be entitled to the face value of their equity. In fact, restricting member payments to equal the face value of their equity is equivalent to imposing a limited return on capital. Any remainder after covering this face value would be allocated in some other way; in many jurisdictions, legislative provisions require that this residual be donated to charities or to suitable co-operative activities (e.g., co-op development or education initiatives). These provisions are part of the idea of the indivisible reserve.

If the co-operative does not adhere to the norm of a limited return on capital, then member equity holders could presumably capture all of the difference between the sales price and the sum of liabilities. This difference is defined as “investor value” and has the same meaning as the term “shareholder value” that is used in the corporate finance literature. One way for the members to capture the “investor value” would be for the member equity to be priced so as to capture this residual value. For instance, if the “investor value” from the sale were equal to twice the face value of the equity, then members would receive two times the face value of their shares (recall that it is assumed that member equity makes up all the equity in the co-operative).¹⁶

The value attached to member equity is altered if some of the equity in the co-op is unallocated. The co-op may have unallocated equity because it did business with non-members and/

¹⁶ The allocation of the investor value can differ from co-operative to co-operative depending on what is specified in the by-laws. For instance, a co-operative may specify that the allocation shall take place according to the patronage undertaken over a period of specified time (e.g., five years). In some co-operatives, such as worker co-operatives, the allocation might depend on other factors such as relative pay or seniority.

or because it made a decision sometime in the past to not allocate all of the net returns to the members, but instead to retain a portion of them as unallocated. To make this concrete, assume, for example, that unallocated earnings are equal to member equity, an amount that is not unreasonable for many co-operatives.¹⁷

If, as in the example above, the residual value from the sale (i.e., sales price less liabilities) were equal to twice the face value of the total equity, then the amount received by each member would once again depend on the restrictions in place regarding the distribution of the residual value. If members were constrained to receive a limited return on their investment, then, as above, they would receive only the face value of their shares. If there were no constraints, however, then, in the absence of any restrictions on the distribution of the unallocated capital, each member would receive four times the face value of his or her shares. Even if there were constraints on the disposition of the unallocated equity (suppose it is to be donated to charity), then in the absence of constraints on the disposition of member equity, each member would receive three times the book value of his or her shares.

In situations like this in IOFs, where the sale price of the corporation exceeds the value of liabilities, one of the motivations for a merger or takeover is the desire to “unlock investor value” or, in the corporate finance terminology, “unlock shareholder value.” By selling the corporation to other buyers, the existing shareholders are able to capture the difference between the selling price and the value of the liabilities.

As can be seen from the examples above, the incentive to “unlock investor value” depends on the residual value that could be obtained from the sale of the co-operative, the restrictions in place regarding the rate of return that members can earn on their investment in the co-operative, the amount of capital that is unallocated, and the restrictions on the use of this unallocated equity.

The residual value obtained from the sale of the co-operative depends on the value that the purchasers see in the co-operative’s assets. A good case in point is the demutualization of Calavo, a co-operative in California that marketed avocados on behalf of its members. One of the reasons for the demutualization was that outside investors were willing to pay a high price for the Calavo brand.¹⁸ Since the members were able to capture the resulting difference between this sales price and the liabilities of the co-operative, they had a significant financial incentive to agree to the purchase.

17 Kenkel (2014) provides estimates of the amount of unallocated equity in U.S. agricultural co-operatives. While the percentages vary dramatically by sector, on average 41% of equity is in the form of unallocated equity. Kenkel notes that in most credit unions the unallocated equity makes up 100% of the total equity. Andrews (2015) notes that “Retained earnings and other reserves making up undistributed income account for almost one-fifth of the total liabilities and equity of the nonfinancial co-operatives in the largest 300 co-operatives and mutual” (p. 18).

18 See Hogeland (2006) for details. Similar pressures for other national brands such as Welch’s, Ocean Spray and Diamond Walnut are also discussed.

Of course, a large residual value does not necessarily provide members with a financial incentive to demutualize. The incentives to “unlock investor value” depend on what investors believe the shares will trade for once they are available on the market. This value will be very small – effectively zero – if there are restrictions on the rate of return that members can earn on their equity in the co-operative. If these restrictions are removed, however, the incentive to sell the co-op and capture the residual value depends on the amount of unallocated capital. As the examples above showed, the larger the unallocated capital, the greater the members’ monetary benefit from demutualizing.¹⁹

Finally, significant “investor value” is often linked to higher compensation for management should demutualization be successful. The result is that managers will often have an incentive to promote demutualization precisely when members see an economic advantage to do so. The demutualization of the building societies in the United Kingdom and the demutualization of the life insurance mutuals in Canada in the late 1990s provide examples of how these two incentives come together to create a greater likelihood of demutualization.²⁰

NORMS, VALUES AND FINANCIAL INCENTIVES

The question of whether co-operative members should be able to capture “investor value” ultimately depends on the co-operative philosophy and norms around equity. The treatment/ allocation of equity reflects differences in the perception that members have of their mutual or co-operative. The idea of a limited rate of return is consistent, for instance, with the concept of “paying it forward” – the idea that member investments made today are for the benefit of people in the future, just as the current members are benefiting from investments made by their predecessors.²¹ In a similar vein, a limited return on capital might be appropriate as a way of ensuring intergenerational equity among members. In contrast, treating all equity as the property of current members reflects the idea that the current members are the owners and proper stewards of the capital that has been built up over time.

19 Kenkel (2014) discusses this issue in depth. Using a survey of CEOs and board members from U.S. agricultural co-operatives, he argues that co-ops that adopt a large unallocated reserve run a risk of demutualization.

20 All-Party Parliamentary Group (2006). Rickards (2014).

21 See Fulton and Giannakas (2012) for a model that examines the impact of a norm that, in exchange for the use of capital provided by past generations, the current generation provides capital for the use of future generations.

As Brett Fairbairn notes in the conclusion to his research note (see appendix C),

There is a rich body of thought, accumulated over nearly two centuries by co-operative leaders and writers, addressing questions of capital, assets, and ownership in co-operatives. Reflecting the international breadth and diversity of co-operatives, this body of thought is less about specific, binding rules, and more about ethics, principles, and the basic purposes of co-operatives. Historically few co-operative leaders and writers specifically discussed demutualization, but they did address relevant topics including the importance of nonspeculative returns, indivisible collective property, and what to do with collective assets in the event of the dissolution of a co-operative. A fair reading of this body of thought suggests that many co-operative leaders believed it would be illegitimate for a present generation of members of a co-operative to sell or privatize accumulated assets and to gain speculative or unearned individual benefits from doing so. Co-operative principles or values are binding and must be taken into account in such circumstances, though the interpretation and application is generally up to co-operative members themselves.

This reading of co-operative history and philosophy suggests that demutualization for the purpose of unlocking “investor value” for the benefit of the current membership is not consistent with the co-operative norms and values that have built up over time. These norms, however, are not well specified and are implemented to various degrees in practice.

Consider, for instance, the International Co-operative Alliance “Statement on the Co-operative Identity.” The 1995 wording of the third principle (Member Economic Participation) statement indicates that,

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.²²

While the third principle suggests that members “usually receive limited compensation, if any, on capital subscribed as a condition of membership” (italics added), there is no requirement

22 See ICA (2015a).

that this be done. In addition, the principle only speaks to “capital subscribed as a condition of membership” and not to capital provided as an investment. The principle is also not overly prescriptive on the creation of reserves that are not allocated to individual members, although it does suggest that this is a good practice.²³ The degree to and the manner in which the third principle is implemented in co-operatives around the world are explored in the next section.

INDIVISIBLE RESERVES AND INCENTIVES

Following from the discussion above, requirements that members receive a fixed or limited rate of return on their member equity can be important in limiting the incentive to demutualize. In short, when members have no way of capturing the “investor value,” the incentive to demutualize to capture this value diminishes.

Given this background, the purpose of this section is to review the use of indivisible reserves in co-operatives in Canada and around the world. The term “indivisible reserves” has emerged as the term used to capture a collection of ideas – the notion of a limited return on capital, the notion of a co-operative reserve (i.e., the presence of capital that has not been allocated to members) and the notion that any surplus derived from the sale be paid to other co-operatives or charity. In short, the concept of indivisible reserves is closely connected to the concept of the disinterested transfer or dispersal of assets without profit. In the case of Québec, for instance, the Co-operatives Act specifies that once the creditors have been paid and the member equity has been distributed, “the balance of the assets shall be transferred to a cooperative, a federation, a confederation or the Conseil québécois de la coopération et de la mutualité.”²⁴

The manner in which co-operatives deal with capital and indivisible reserves varies significantly from country to country and region to region. In some countries, the national co-operative movement – both through its own practices and through the legislation it supports – has strongly signaled that “investor value” is not the property of the individual members and that the indivisible reserve is a core principle of the co-operative identity. In other countries, the co-operative sector and the legal framework are silent on the issue of ownership.

23 The ICA (2015b) recently released “Guideline Notes” on the co-operative principles. Notes 3.20 – 3.29 on the 3rd principle discuss indivisible reserves, limited return on capital, and the access that members may have to the co-operative’s reserves. While the principles are not overly prescriptive, the guideline notes are much more forceful in stating that members are to earn a limited return on capital, that a part of the co-operative’s earnings will not become the property of any member (now or in the future), and that indivisible reserves do not belong to any single generation of members, but instead to the co-operative as a whole. It should be noted that the publication of the guidelines represent a recognition by the ICA that the principles will not be altered, but that some guidelines will be provided for how these principles might be interpreted.

24 See Government of Québec (2015).

For instance, as is shown in the appendix E, a review of co-operative legislation in numerous countries around the world indicates that:²⁵

- There is a trend to avoid the implementation of reserves that are not owned by the individual members. If the law obliges the set-up of a reserve, it will also identify a percentage of the surplus that must be channeled to the reserve and an upper limit to the reserve as a percentage of the co-operative's debt or assets.
- The United States indicates that it is possible to share the net assets of the co-operative during the life of the co-operative. This issue is not mentioned in other countries.
- There is a trend in the legislation toward not obliging the disinterested transfer of assets. If there is no legal obligation, the legislation is either silent on the issue or it suggests that the co-ops specify a rule in their by-laws to implement such an outcome. Of course, there are countries and regions where the disinterested transfer of assets is compulsory.
- In countries with a German and Protestant origin (e.g., Germany, United Kingdom, Denmark, United States, Canada) and in the former socialist countries, indivisible reserves are typically not required.
- In countries with Latin roots (e.g., France, Italy, Spain, Costa Rica, Columbia, the province of Québec), indivisible reserves are generally compulsory. In a number of these countries the state provides support to co-operatives through subsidies (Italy) or tax rebates (France).

These conclusions have to be examined carefully, however, since they differ significantly by country, as the following discussion shows.

Canada

In Canada, co-operative legislation differs by province (see appendix E for the details on the legislation governing the distribution of assets on co-op dissolution).

- In three provinces (Québec, Newfoundland and Labrador, Prince Edward Island) there is an obligation in the co-op legislation for indivisible reserves.
- In the legislation that allows divisible reserves, members can choose to devolve assets to charities and co-ops (e.g., Manitoba).

- Even if the general co-operative legislation allows divisible reserve (e.g., British Columbia, Ontario and Canada), non-profit housing co-ops are required to hold indivisible reserves.
- Indivisible reserves are also required for community service co-ops (British Columbia) and for non-profits (Nova Scotia, Manitoba);
- There is a strong consensus among New-Brunswick French and English co-op development organizations to introduce provisions for indivisible reserves in the provincial co-operative act.

Québec

Indivisible reserves have been in place in Québec since 1911 for *caisse Desjardins* and since 1968 for all other kind of co-op (except agri-cooperatives). The exception of agri-cooperatives is due to historical reasons particular to this sector and does not seem to have had a major negative impact on the development of these co-ops over the 20th century.

In 2005, after intensive discussion with co-operative representatives and the Office of Cooperatives (or *Direction du développement des Coopératives (DDC)*), within the Québec Ministry of Industry and Commerce, a new reserve (enhancement reserve) has been legally recognized in the Co-op Act to lighten the rule of the indivisible reserve for workers, producers and shareholding working co-operatives. The enhancement reserve is a way to allow members to have access to a part of the reserve.

It is important to note that indivisible reserves do not block the winding-up of a co-op, but instead represent restrictions on how to transfer the net assets of the co-operative. In this sense, since 2006, the DDC managed a register of the disinterested transfer of assets. Over the period October 2006 to February 2015, a total of \$443,040 has been transferred from one co-operative to another. Twenty-eight co-ops have been wound up and funds have been transferred to 30 co-ops (there are two co-ops that each decided to transfer funds to two co-ops).

United States

Indivisible reserves were compulsory among U.S. co-operatives in many states up until 1951 when a major tax reform was introduced and these requirements were mostly eliminated. Under current tax law, for-profit co-operatives that allocate earnings to a general reserve pay tax on these earnings. As discussed, above, reserves provide a way of protecting member equity from short-term losses and represent a permanent source of capital that can be leveraged against

debt.²⁶ Non-profit co-operatives (e.g., in housing and other service areas) can establish indivisible reserves without paying tax, since as a non-profit, the co-operative does not pay tax.²⁷

Over the past 15-20 years, the United State has experienced the demutualization of several large mutual insurance companies and agricultural cooperatives. In some cases, large unallocated equity reserves have been viewed as an incentive for members to demutualize. However, there have been no documented examples of unallocated reserves causing demutualization.

Other Countries

As was shown in a 1998 study, Costa Rica and Columbia both have obligations to set up a reserve in addition of funds dedicated for co-op education and solidarity.²⁸ Both countries have also implemented indivisible reserves.

In Japan, it is up to the co-operative to implement indivisible reserves in its bylaws. Thus, the law opens the door to the distribution of residual assets among the members.

In Denmark, Finland, Germany and UK there is no state rule regarding indivisible reserves. Instead, the decision is left to the members to implement in the bylaws. In contrast, indivisible reserves are compulsory in France, Italy, Spain, Portugal and Netherlands. In some countries, such as Spain, co-operatives must also implement education and promotion funds.

For more details on the transmission of assets in case of dissolution in these and other countries, see appendix E.

While conceptually it is expected that the presence of indivisible reserves should be linked to fewer cases of demutualization (see the argument above), the evidence on this point is mixed, with different cases indicating both positive and negative consequences:

- The experience of plywood producer co-ops in the northwest United States suggests that the sharing of the reserve without any other obligations may have a negative impact on the sustainability of co-op.
- Sharing the reserve has not had adverse consequences on the development of co-operatives in Denmark where there is an impressive history of co-operative development.

²⁶ See Kenkel (2014) for a full discussion of the reasons for the use of unallocated reserves.

²⁷ Appendix F provides an example of a nonprofit co-operative (New-Hampshire) and a for-profit co-operative (New-York)

²⁸ See Girard, and al. (1998).

- Similarly, sharing the reserve does not seem to have affected the development of agricultural co-operatives in Québec.
- Worker co-operatives in Poland have argued that the lack of indivisible reserves in their co-operative law has opened the door to the conversion of co-operatives into other business models.²⁹

One of the reasons for this differing treatment and outcome of indivisible reserves is that they can offer both advantages and disadvantages. These are explored in the next section.

THE ADVANTAGES AND DISADVANTAGES OF INDIVISIBLE RESERVES IN AVOIDING DEMUTUALIZATION

Indivisible reserves have often been put forward as a way to reduce the incentives for co-operatives and mutuals to demutualize. In addition to being a permanent source of capital, which in turn can strengthen the financial position of the mutual or co-operative, indivisible reserves represent a way of reducing the pressure for demutualization – if members are unable to capture the “investor value,” their incentive to convert the co-operative to an IOF is greatly diminished.

Indivisible reserves also have disadvantages. Since they are not distributed to members, they can act to reduce the patronage payment received by members, thus reducing the member incentive to patronize the co-operative. And the creation of indivisible reserves may, via tax regulations, have negative impacts on a co-operative’s bottom line.

Indivisible reserves could also discourage people from starting a co-operative. During the 1990s, many small worker co-ops in Québec kept the reserve close to zero for the simple reason that members did not want to put all their energy into the co-operative without seeing a payoff.

To further examine the advantages and disadvantages that indivisible reserves provide in discouraging demutualization, interviews were conducted with people that had either been involved with co-operatives or mutuals for many years or had participated in their regulation. Most of the people interviewed were from Québec, since, with the exception of the agricultural co-operatives, indivisible reserves have been in place there for many decades. Interviews were also conducted with people involved in French speaking co-ops in Ontario, New Brunswick and at the federal level.³⁰

²⁹ Reported by Isabel Faubert-Mailloux of Réseau de la coopération du travail. The comments were made during a seminar on workers co-operatives that took place at the 2014 International Summit of Co-operatives.

³⁰ The interviews were conducted in February and March 2015. The interviewees were asked to provide their personal views. Unless it is indicated, the views expressed are those of the interviewee and do not necessarily represent the official view of their organization. Formal approval was obtained from most of the respondents to record the interviews, although in a few cases the exchange was too short to produce a record. The list of those interviewed is found in appendix H.

All the interviewees recognized the importance of indivisible reserves for the sustainability of the co-operative. However, this recognition often involved some nuance. The main items that emerged from the interviews were:

- **The Québec Co-operative Act (including the indivisible reserve) is one of the four pillars of the Québec co-op development strategy that was released in 2003 by the Québec Government**
- **The indivisible reserve has three important strengths:**
 1. It demonstrates the notion of collective capital inalienability
 2. It defines a framework for strategic planning by preserving co-operative control over the assets generated by the work of members across many generations.
 3. The indivisible reserve is closely connected with the principle of co-operation among co-operatives because it provides a guarantee that the assets that derive from co-operative activity will remain in the sector so as to build a human economy.
- **Given that there is a wide consensus about the contribution of the indivisible reserve to reinforcing the co-operative identity, people involved in co-operative development argue it could make sense to think about two options to modify the indivisible reserve requirement in the case of worker co-operatives and certain other co-operatives in order to attract more members:**
 1. Make the enhancement reserve (a mechanism that allows members in worker, producer and shareholder co-operatives to access part of the reserve) more attractive.³¹
 2. Open the door to a first generation of co-op members free of the indivisible reserve obligation.

Sale of assets

Interviewees recognized that indivisible reserves cannot save a co-operative from the situation where reserves are gradually depleted because earnings are not large enough to cover expenses. In this case, the cause of demutualization, if this is where the process ends, is the failure to control costs and/or to develop markets sufficiently to sustain the organization financially. What is needed to address this situation is a good monitoring system that can help management and the board avoid such a situation.

31

See the Québec Co-operative Act (sections 149.1 – 149.2 and 149.3) for more details on the enhancement reserve.

An example of such a monitoring system is found in La coop fédérée (LCF). When a co-operative decides to join LCF they must signed a contract giving LCF the right to intervene in case of business problems (financial, marketing, governance, etc.). Since 1990, no agricultural co-operatives have been wound up. While two agricultural co-operatives decided to leave LCF, they are still in operation today.

Another example provided in the interviews was from the Québec housing co-operatives. Québec has a network of more than 1,200 housing co-op that offer 25,000 apartments. This network has been developed since the 1960s through different government programs (both provincial and federal). For at least 25 years, the co-operatives have avoided selling the housing assets to the members. During the last few years, however, a few housing co-operatives have sold their housing assets; moreover, these sales have been at a price significantly below the market value of the assets. The result is a reduction in the number of affordable apartments and a privatization of housing assets that were built up using public funds. The Québec co-op housing confederation (CQCH), the Québec Justice Ministry and the co-operative department (DDC) have taken a person to court in Québec City over such an incident. A December 2014 judgment of the Québec Court recognized the illegality of the sale – one of the reasons was that the sale did not respect the indivisible reserve.³² It is expected that this sentence will be communicated sometime in 2015.

One consequence of this case is an amendment to the Québec Co-operative Act with more emphasis on the notion of indivisible reserve. The CQCH have also introduced measures to avoid similar cases in the future; these measures include the development of a communication plan, the production of pamphlets, and special action with notaries through collaboration with their professional association. The key word is prevention – i.e., the need to educate the board of directors of housing co-operatives about the notion of disinterested transfer of assets and implementing a monitoring system to detect problematic cases.

Other options to control demutualization

Even if indivisible reserves were believed to have been beneficial in staving off demutualization, many of the people interviewed pointed out other dimensions that are required to deal with the issue of demutualization.

- **Members of a board of directors of a cooperative or mutual are required to complete a training program and answer a grid with qualification criteria;**
- **The importance of co-op education and the promotion of co-op value-added to reinforce the link with the co-op identity. It should focus on three dimensions: how the co-op helps to better control the activity, a model base on equality, and local roots.**

32

Cour du Québec, no 200-61-152689-129, 19 décembre 2014, Directeur des poursuites criminelles et pénales vs Vicky Lépine.

One of the interviewees pointed out that co-operatives must receive recognition from the government as a different model from investor-owned organizations. This co-operative difference must be recognized in terms of fiscal incentive and budget measures. For instance, it was suggested that, vis-à-vis other forms of organization, taxation should be different for co-operatives that agree to hold indivisible reserves.

Finally, the development strategy used by co-operatives and mutuals should be designed to ensure that members retain control of their organization and, in this way, avoid possible demutualization. Here are examples of the strategy used by a co-operative, Agropur, and two mutuals, La Capitale and SSQ.³³

- Agropur has grown to become one of the major dairy producer co-operatives in Canada, in large part by buying other enterprises and by merging with other co-operatives. The co-operative has developed an innovative capitalization strategy that encourages members to invest as much as possible in the co-operative share. At the same time, the co-operative supports training programs focusing on co-operative values, the history of the co-operative and its business strategy. Agropur has also developed an extensive democratic framework to share information on the business and to listen to the members' needs and questions.
- La Capitale was set up in the 1940s as a mutual for Québec's civil servants. Over the decades it has developed new products and created new subsidiaries so that today it is a multi-layer enterprise. To maintain its connection to its 250,000 members, control has been maintained under the management mutual (La Capitale, mutuelle de gestion).
- SSQ was set up as a health co-operative in the 1940s, and was transformed into a mutual selling group insurance in the 1960s. To deal with its financial needs in the early 1990s, SSQ welcomed development capital from the Fonds de solidarité/FTQ. Although the Fonds de solidarité/FTQ controls 70% of the business property, they have agreed to have a majority of the board belong to the management mutual (SSQ, mutuelle de gestion) that belongs to 1,290,473 members.

INCENTIVES –

Member Patronage

Co-operatives are an important part of the economy in countries around the world. Yet, they are only one part – they operate alongside organizational counterparts such as: government departments, agencies and corporations; non-governmental organizations (NGOs); non-profit organizations; social enterprises,³⁴ and, perhaps most importantly, the much more numerous IOFs (and in some cases much larger). Moreover, co-operatives tend to be concentrated in specific activities and in specific sectors (e.g., agriculture, financial services, retail).

The result of being imbedded in a market economy is that co-operatives need to constantly be concerned with how they are performing relative to other organizations. If other organizations are providing better value or better service, or are better at meeting needs, then co-operatives will find it increasingly difficult to operate successfully. Providing the correct incentives for members to continue to patronize the co-operative is thus critical to co-operative performance; those co-operatives that are able to develop governance structures and decision-making processes that properly address these incentives are less likely to face pressures to demutualize.

The dynamics of these incentives are complex and change over time. Although there are exceptions, co-operatives are typically formed as a reaction to the limitations of other organizational forms.³⁵ For instance, co-operatives and mutuals often developed in sectors where there was a sense that the market was not working effectively. These “market failures,” as they are described, included the presence of monopolistic or oligopolistic firms, lack of provision of goods and services to particular groups, and the supply of poor quality or highly priced goods. As Brett Fairbairn puts it, “co-operatives arise when worlds collide — when the market ignores needs; when value systems of communities and of the market are in conflict” (Fairbairn, 2006, p. 11).

As co-operatives mature and the industry in which they operate changes, the membership body is altered and the *raison d’être* for co-operatives can disappear.³⁶ For instance, if the co-operative was successful in improving product provision, quality or pricing, members may come to believe that the co-operative is no longer necessary. Yet it may be in precisely such situations that the removal of a co-operative has an impact – if the underlying oligopolistic

34 One form of social enterprise is the B Corporation, a corporation certified to meet comprehensive and transparent standards related to social and environmental performance.

35 Powell and Steinberg (2006).

36 A number of authors have put forward life-cycle models of the co-operative. See, for instance, LeVay (1983), Ben-Ner (1988) and Cook (1995).

structure is still present, then the provision, pricing and quality problems can re-emerge. Moreover, communication of this potential impact is difficult, since it can only be observed once demutualization has occurred.

The type of people involved in the co-operative may also change over time. For instance, the original members of a co-operative may have a strong ethic of co-operation – indeed, it could be this ethic that allowed the collective action of the members to be mobilized to deal with market failures. Over time, however, members may join that do not have such a strong commitment to the co-operative. As this occurs, the co-operative may have to rely more on financial rewards to ensure the continued patronage of the members. If the use of financial rewards leads to a further weakening of the co-operation ethic, then a downward spiral can emerge in which the further use of financial rewards is required. The problem with the use of financial rewards and the presence of members that respond primarily to financial rewards is that the benefit of the co-operative is seen more and more in strictly financial terms. As a result, a co-operative becomes increasingly vulnerable to demutualization pressures, particularly if the co-op can be sold at a price substantially above the face value of its shares (see earlier discussion).³⁷

Co-operative membership may evolve in other ways as well. While the membership is never homogeneous at the time the co-op is formed, it is likely that over time the membership becomes more diverse. For instance, farmers specialize in different production activities and engage in varying degrees of off-farm employment, while consumers demand different levels or types of services depending on their age, income, and socio-economic status. As membership diversity increase, it becomes more difficult for a co-op to meet the needs of all the members and the efficiency of the co-operative structure decreases as compromises are made in an effort to satisfy all the members. Costs may also increase as more time and resources are required to address the conflicts that greater diversity brings. If these impacts are large enough, co-operatives can face pressures to demutualize.³⁸

Finally, as co-operatives develop and expand, their need for capital grows, particularly if the industry is highly capital intensive (as is the case in the financial, retail and agricultural sectors, to name a few). Failure to obtain the required capital can result in a co-operative becoming non-competitive, either because of the inability to lower operating costs or because of the inability to invest in the new technology required to deliver high quality goods and services. Thus, member patronage incentives are closely linked to financial incentives.

37 Ben-Ner (2013) discusses the various forms of preferences that exist in populations and how these preferences range between those that are truly selfish to those that are fully dedicated. As he discusses, a changing mix of individuals changes the efficiency and effectiveness of the organization. Fehr and Falk (2002) provide evidence that a reliance on financial incentives can weaken intrinsic incentives. See also Francois (2000) and Frey and Jegen (2001).

38 See Hart and Moore (1996) for a discussion of this issue. Member homogeneity is an important element in Hansmann's explanation for the emergence of co-operatives (Hansmann 1996).

INCENTIVES –

Corporate Governance and Agency Issues

Over the last decade or two, corporate governance – i.e., the relationship between the board of directors and the senior management – has emerged as the defining issue of why organizations perform well or poorly.³⁹ Based on the belief that problems at Enron, WorldCom and other corporations could have been avoided if good corporate governance practices were followed, the U.S. government enacted the Sarbanes-Oxley legislation and required corporations to increase accountability, add new auditing requirements and tackle conflicts of interest (Sarbanes-Oxley 2002). Similar legislation has been passed in most of the major countries in the world. The financial sector has also focused on corporate governance through the Basel Committee on Banking Supervision.

At the heart of the corporate governance problem is the need to ensure that the CEO operates in the best interest of the organization that he/she has been hired to manage and oversee. Indeed, finding the correct incentives to ensure that the CEO operates in the organization's interest and not her/his own interest is the key focus of most of the corporate governance literature.⁴⁰

As a result of Sarbanes-Oxley and high-profile governance problems among prominent co-ops, concerns over corporate governance have spread to the co-operative sector. For example, as was outlined above, weak managerial oversight by the board of directors has been identified as an important factor in the demise of the Saskatchewan Wheat Pool, while a complex and non-transparent governance structure is argued to have played a key role in the troubles that have befallen the UK's Co-operative Group.⁴¹ Researchers have also begun examining the link between governance features and co-operative performance.⁴² In all cases, the question is the same, "Are the correct incentives in place to get the CEO to perform in a way that promotes good governance?" – i.e., to provide services that benefit the members and that can sustain the organization both organizationally and financially over time.

³⁹ Bevir (2012).

⁴⁰ See Schleifer and Vishny (1997) for one of the most explicit statements of this view; see also Gourevitch and Shinn (2005).

⁴¹ Fulton and Larson (2009a) discuss the Saskatchewan Wheat Pool, while Birchall (2014) and Myners (2014) discuss the Co-operative Group.

⁴² Spear (2004), Cornforth (2004), and Birchall (2013) have investigated the role of co-operative governance generally, while studies by Burgess (2013), Bijman, et al. (2013) and Franken and Cook (2013) have examined the empirical link between governance and performance.

The governance of co-operatives is challenging, in large part due to the complicated relationships that exist between the members, the elected board of directors and the senior management. Since co-operatives typically do not wish to maximize profits, they cannot use profit sharing as a way of rewarding managers in a way that aligns the manager's objectives with those of the organization. Instead, they often rely on attracting CEOs that share the mission of the co-operative, and they generally use monitoring of the manager by the board and membership as a way of ensuring proper behaviour. In part because of political reasons (members are sometimes unwilling to pay CEO salaries that are many multiples of what they earn personally) and in part because the acceptance of a lower salary may signal greater alignment with the co-operative's mission, the remuneration paid to co-op CEOs is typically lower than that of their investor-owned counterparts.⁴³

The corporate governance problem is further complicated as a result of the volunteer nature of the boards of directors. As a number of high-profile cases illustrate, co-operative boards appear to be susceptible to being captured by powerful, over-optimistic managers who make excessive investments.⁴⁴

Co-operative managers are often trying to achieve multiple objectives and balancing off competing interests; this not only makes co-op management more difficult, it also makes it more difficult to provide the correct incentives and to gauge performance. Difficulties in launching mergers and takeovers of co-operatives may also weaken the external control exerted on the manager.⁴⁵

These corporate governance problems appear to play an important role in demutualization. For some managers, demutualization is a way of breaking out of the governance model and remuneration schemes used in a co-operative or mutual and replacing them with alternatives that result in greater pay and less day-to-day monitoring. For instance, a U.K. study found that over the period 1993–2000, CEO remuneration in building societies and life assurance mutuals that demutualized increased by 228% more than did CEO remuneration in those that did not demutualize. This study also found that this rise was not associated with an increase in performance, suggesting that the rise in compensation was solely the result of a change in ownership.⁴⁶

Given the possibility of larger salaries, it is not surprising that managers and or outside consultants are often the ones promoting demutualization.⁴⁷ Indeed, as was pointed out earlier, the financial benefit to managers is often the greatest at the exactly the same time that the members see

43 Hueth and Marcoul (2009, 2015).

44 Fulton and Larson (2009a), Birchall (2014) and Myners (2014).

45 See Spear (2004) for a general overview of this issue.

46 Welch (2006).

47 Nadeau and Nilsstuen (2004). Chaddad and Cook (2004).

a financial benefit from demutualizing. The concern in such situations revolves around whether members have sufficient information regarding the sale of the co-operative or mutual to make an informed decision, or whether managers are able to exert undue influence on members because of the power and authority that the managers possess.

Corporate governance in co-operatives is also receiving attention because the regulatory requirements introduced in Sarbanes-Oxley and its counterparts are being applied to co-operatives. For instance, in Canada, all federally regulated financial cooperatives are required to notify the Office of the Superintendent of Financial Institutions (OSFI) when they make changes to the board of directors. OSFI also has the right to disqualify or remove directors. It is expected that similar requirements may be implemented at the provincial level.

Such regulatory requirements could have important impacts on co-operatives and mutuals. For instance, to comply with the OFSI regulations, credit unions might be required to appoint outside directors if suitable directors within the membership cannot be found or do not wish to run for office. Under the right circumstances, the appointment of outside directors can be advantageous. However, problems can emerge if outside directors have more of a focus on, say, maximizing profits rather than on simply making sufficient profits to meet members' needs.

Similarly, the presence of outside directors can lead to poorer co-operative performance if, as a result of being from the outside, they are less able to monitor the day-to-day outcomes that members are able to observe and have less interest in these outcomes. Simply put, co-operative governance is unique and changes to the model have to be made very carefully to ensure that the strengths of the model – namely the attention paid to a wider set of goals than simply maximum profitability – are not undone as a result of a desire by government to bring all organizations – be they IOFs, co-operatives or nonprofits – under the same regulatory framework.⁴⁸

The idea that the goals, objectives and mindset of the directors can play an important role in co-operative performance suggests the need to focus more attention on the cognitive maps that drive people's decisions.

48 See Fulton (2014). For the argument regarding nonprofits, see Reiser (2004) and Mulligan (2007).

Cognitive Maps

Organizations, whether they are co-operatives or investor-owned firms, are limited in the information and knowledge that they can process. As a result, they need to find ways of sorting, filtering and interpreting the vast amount of information to which they have access. In addition, organizations need to develop ways of understanding how the future might unfold.

To address these two challenges, organizations have become “interpretative systems.”⁴⁹ Either implicitly or explicitly, organizations develop rules and procedures that effectively assign some information more weight than other information. Moreover, the information that is gathered has to be organized into patterns, patterns that can then be used as the basis for making decisions about the future – e.g., what will happen to costs? What will a competitor do? What services will the members be looking for?

The patterns that are developed to aid in the interpretation of information and in the making of decisions can be thought of as cognitive maps or cognitive frames. Given the importance of these frames – they drive everything from investment decisions to HR strategies to government lobbying – the determination of the frames is highly contested.⁵⁰

The frames or maps that are at work in co-operatives can take many forms. Some of the maps are based on the purchasing patterns of the members and can be used to develop marketing plans. Other maps are concerned with the functioning of the economy within which the co-operative operates. Still other maps are concerned with the manner in which activities should be “best” undertaken.

In this vein, co-operative values and principles are part of the map, as is member commitment. For instance, a belief that a co-operative has a different purpose than an IOF arises because members attach importance to a different set of criteria and outcomes. This differential importance then affects how they interact with the co-operative. For instance, members are likely to be more committed to their co-operative if it can demonstrate that it is meeting these other criteria.

The nature of these maps or frames is important for demutualization. For instance, in the case of the Saskatchewan Wheat Pool, a mental map that viewed the members as being intensely loyal to the SWP and the SWP as the dominant company in the industry served as the basis for large investments by the co-op in grain handling facilities. When this mental map turned out to be wrong and market share tumbled, the result was large losses that eventually led to the demutualization of the co-op.⁵¹

49 Daft and Weik (1984), Loasby (2001).

50 Kaplan (2008).

51 Fulton and Larson (2009a).

At a different level, CEOs and board members operate with institutional logics in place that determine how they value certain activities.⁵² For instance, the presence of a financial logic would result in the closure of a non-profitable branch being viewed as a way of generating greater economic efficiency, while the presence of a community logic would involve the closure being viewed as a loss of employment and services.

The presence of different institutional logics is important for the understanding of demutualization. Numerous studies have argued that one of the key causes of demutualization is the belief among managers, board members and outside consultants that the co-operative structure is not efficient and that allowing outside investors to own the business will produce better results. The argument here is consistent with the idea that co-operatives and mutuals are pulled towards the investor model because of isomorphic pressures.⁵³

The presence of waves of demutualization that follow fundamental changes in the “rules of the game” generated by major institutional, regulatory or market changes can also be understood using the concept of cognitive maps.⁵⁴ In the presence of major changes in the “rules of the game,” some co-ops have managers that see opportunities that open up, and push for demutualization to take advantage of these opportunities. Other co-ops are caught with outdated cognitive maps and struggle to find a way to compete effectively. In other cases, managers simply follow the lead of others and rely on a dominant logic supplied by groups with different values and objectives than those present in the co-operatives and mutuals sector. Whatever the reason, the result is a wave of demutualization as managers maneuver to try and survive in an industry they no longer fully understand.

52 Friedland and Alford (1991).

53 Hogeland (2006), Galor (2008), Spear (2004).

54 Chaddad and Cook (2004).

Legitimacy

Authority and power are key aspects of organizations; for these to be effective, those in positions of authority have to have legitimacy. Interestingly, legitimacy does not derive from the use of authority – instead, authority derives from legitimacy. As Chester Barnard pointed out, “the decision as to whether an order has authority or not lies with the persons to whom it is addressed and does not reside in ‘persons of authority’ or those who issue these orders” (Barnard 1938, p. 163).

In other words, people are willing to go along with what others propose and decide if they believe that those making the decisions can be trusted, more or less, to make good decisions. Trust and legitimacy can be generated and earned in a number of ways. Competitive contestation of board elections is argued to be an important factor in creating board legitimacy.⁵⁵ Making good decisions is critical – returning to the case of the Saskatchewan Wheat Pool, the legitimacy of the management and board to run the organization was deeply damaged when members saw that the SWP’s investment decisions did not appear to be based on solid economic grounds but were instead based on a desire to thwart their competitors at any cost.⁵⁶

Responsibility and accountability are important factors in creating legitimacy. As accountability starts to fall apart, members can lose trust in the organization and legitimacy can begin to wane. Interestingly, the lack of accountability may emerge because members failed to take the responsibility of asking for and requiring appropriate accountability. Moreover, since legitimacy is often not an issue for most organizations, it can easily be ignored – indeed, this may be why members fail to ask for accountability. The result is a complex system that can be difficult to manage.

Regardless of the reason, co-ops and mutuals that lose their members’ trust and commitment likely have a difficult time remaining as co-ops or mutuals. Whether because of institutional logics or better perceived performance, IOFs represent a viable alternative for co-op/mutual members worried about the services being provided and the capital that they have invested. Thus, while legitimacy and trust is not a critical factor when it is present, when it disappears it often becomes a driving force for some type of organizational change, including demutualization.

55 Spear (2004).

56 Fulton and Larson (2009a).

Demutualization and Co-operative Performance

While co-operatives that are able to successfully establish their operations face a number of advantages (e.g., strong member identity, a focus on the long term rather than the short term, and strong monitoring by members), they also face a number of problems. Chief among these are problems of raising capital and of ensuring good governance and management.⁵⁷ As well, over time, co-operatives can experience problems related to the loss of identity and purpose.

These problems are linked to the underlying dynamic facing co-operatives and are critical to understanding demutualization. The features that made co-operatives successful as a way of addressing the problems created by IOFs (as a result of their narrow focus on profitability) also created vulnerabilities. Co-operatives are often formed in sectors that have relatively high capital requirements – one of the reasons is that high capital requirements result in oligopolistic market structures and hence poor IOF performance. And although the incentive structure in co-operatives means that they are able to address these market failures, it also means that co-operatives often have trouble generating the capital they need to undertake their activities and remain competitive.

In addition, as an alternative to the dominant organizational form – i.e., the IOF – the co-operative often finds itself having to fight very well-established norms of behavior, particularly among management, that stress profitability, increases in share price and market growth. The difficulty of operating with a different organizational logic is typically manifested as a governance problem, and specifically the inability to properly monitor the actions of management.

As previous research has shown, there is a strong interaction among these factors. Fulton and Hueth (2009) show that, among co-operatives that failed or were restructured, those that experienced poor financial performance inevitably were identified as having significant governance problems. Governance weaknesses also increase the incentive and the ability of managers to put forward the case for demutualization; this linkage is worrisome because managers often stand to gain significantly both monetarily and status-wise from demutualization.

⁵⁷ For a discussion of the capital models used by co-operatives, see the recent report by Andrews (2015). On governance and management, see Spear (2004) and Birchall (2013).

These connections were noted by the Desjardins Group in the position paper it submitted to the Department of Finance Canada regarding the “Consultation on a Demutualization Framework for Federal Property and Casualty Insurance Companies.” Specifically, the Group argued that the demutualization process arises from four factors (p. 2):

1. A precarious financial situation
2. Poor planning in the administration of the capital that is necessary to the growth and survivability of the mutual company or cooperative
3. Disengagement by the members
4. Pressure from management or external advisors who are seeking significant financial benefits from the demutualization

Table 1 and figures 1 and 2 provide additional information on the linkage between these factors. Table 1 presents a summary of the experience of 25 co-operatives or mutuals that have demutualized over the past 20 years. Details on each of these cases are presented in the appendix A. For each case, a determination was made regarding the key factors that were at play in the demutualization. These four factors were: financial soundness, governance structure, member incentives, and co-operative values/democratic engagement. Note that more than one factor may be present in each case.

Figures 1 and 2 illustrate the connections between factors, and how often they contribute to demutualization/conversion. Figure 1 shows that financial soundness and governance structure issues are most often present in demutualizations. Indeed, financial soundness appears most often as a contributing factor, suggesting it may be the key feature to examine in determining the likelihood of demutualization.

A closer look at the data, however, suggests a slightly different story. Figure 2 shows how different combinations of factors appear as contributing factors in demutualization. The connection between financial performance and governance structure is the strongest, with 16 of the 25 cases exhibiting both of these factors (other factors, of course, could also be present). Governance structure was also often present when member incentives and co-operative values were present, suggesting the importance of governance structure on other aspects of co-operative performance.

In addition to being important in their own right, these other performance factors are linked to financial soundness, suggesting that financial soundness is not determined by just one factor. Indeed, one of the pictures that emerges from figure 2 is that problems in governance spread to all aspects of the co-operative, which in turn affect financial performance. In addition, there is a strong likelihood that the causation is not one way, with problems of financial performance, member incentives and member engagement affecting governance.

TABLE 1: Demutualized or converted co-operatives and mutuals

	NAME	SECTOR	DATE	COUNTRY	FINANCIAL SOUNDNESS	GOVERNANCE STRUCTURES	MEMBER INCENTIVES	CO-OP VALUES/ DEMOCRATIC ENGAGEMENT
1.	Bridlewood	CC	2012	CA		•	•	•
2.	Peace Country	CC	2012	CA	•			
3.	Peace Grove	CC	2011	CA				•
4.	Canada Life	FC	1999	CA	•	•	•	
5.	FCStone	FC	2005	US	•		•	
6.	Manulife	FC	1999	CA		•	•	•
7.	Mutual Life	FC	1999	CA	•	•	•	•
8.	Prudential	FC	2001	US	•	•		
9.	Sun Life	FC	1999	CA	•	•	•	
10.	Sunstate	FC	1997	AU		•		
11.	Trygg-Hansa	FC	1988	SE	•	•	•	
12.	Agricore	PC	2001 ⁵⁸	CA	•	•		
13.	Agrifoods	PC	2001 ⁵⁹	CA	•	•		
14.	Agricore United	PC	2007 ⁶⁰	CA	•	•		•
15.	Alta. WP	PC	1998 ⁶¹	CA	•	•		•
16.	Dakota Growers	PC	2002	US	•		•	
17.	DWG	PC	2005	US	•	•	•	•
18.	Lilydale	PC	2005	CA	•	•		•
19.	Man. PE	PC	1998 ⁶²	CA	•	•		•
20.	Scotsburn	PC	2014	CA	•		•	
21.	Swedish Meats	PC	2007	SE	•	•		•
22.	Sask Wheat Pool	PC	2005	CA	•	•		•
23.	UGG	PC	2001 ⁶³	CA	•	•		•
24.	CRS	WC	1996	CA	•			
25.	PSC	WC	1998	CA		•	•	•

SECTOR (see appendix B for details):

CC: Consumer co-operatives

FC: Financial co-operatives

PC: Producer co-operatives

WC: Worker co-operatives

COUNTRY:

AU: Australia

CA: Canada

SE: Sweden

US: United States

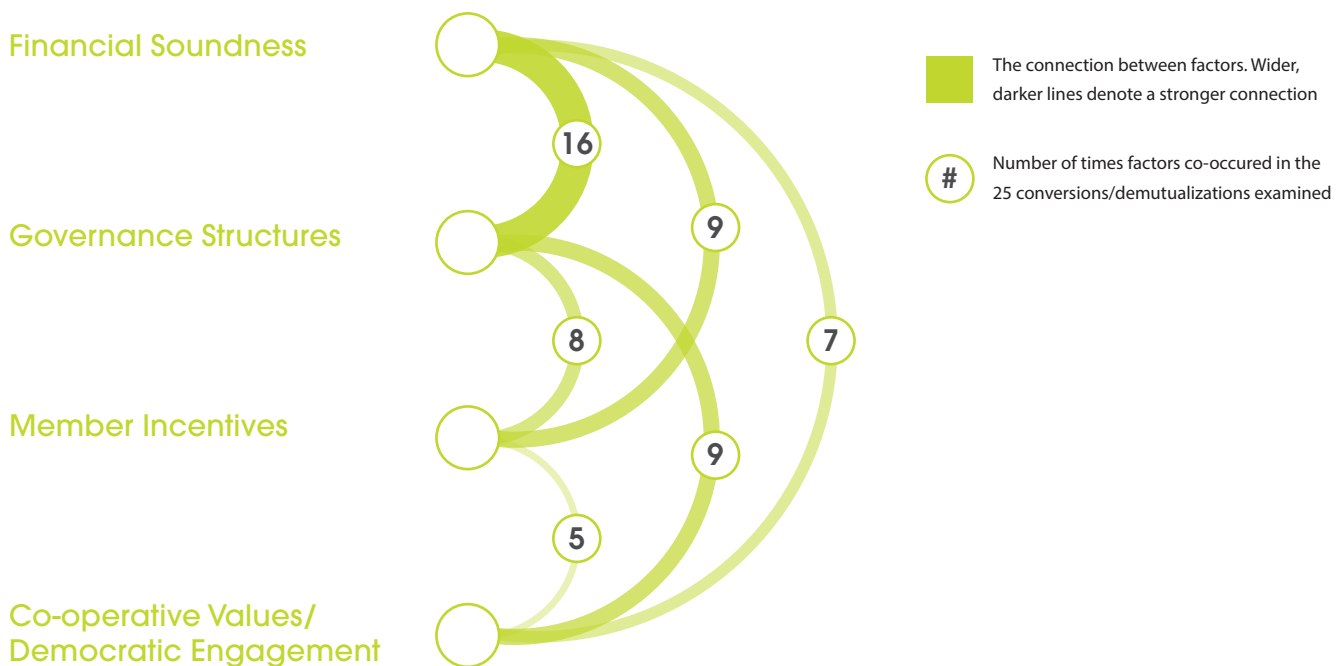
The bullets in the table indicate which of the four factors were at work in each of the demutualization cases.

Thus, for instance, the demutualization of Bridlewood was influenced by the governance structure, member incentives and co-op values/democratic engagement.

FIGURE 1: Factor Occurrences – Connections between the factors that contributed to demutualization or conversion. In 60 per cent of the cases, co-operatives had problems with both their financial soundness and governance structures.



FIGURE 2: Connections Between Factors – The number of times each factor was present in the 25 cases of conversion or demutualization



58 Taken over by UGG to form Agricores United.
 59 Sale of its fluid milk and cheese operations to Saputo, however Agrifoods still exists as a federal co-op handling raw milk transportation and logistics
 60 Taken over by SWP (now private), the combined companies rebranded as Viterra
 61 Briscoe, McCarthy and Ward (2012) provide an example of an Irish co-operative that demutualized and then converted back to a co-operative.
 62 Merger between AWP MPE, forming Agricores
 63 Taken over of Agricores by UGG to form Agricores International

Checklist for Forestalling Demutualization

Based on the above discussion and analysis, a checklist is developed of five tangible activities that co-operatives and mutuals can undertake to decrease the likelihood of demutualization. The checklist focuses on the following:

1. Financial soundness, including strong financial performance, sufficiency of capital, and awareness of changes in economic conditions

Co-operatives and mutuals may consider conversion or demutualization if they are financially insolvent, or lack the capital to remain effective and competitive. Although they should always be concerned with sound management, the need for good business practices and decision-making processes is reinforced when unsound management increases the potential for demutualization. Similarly, paying attention to shortfalls in capital, before it is actually required, can be a good way to guard against future demutualization. Tangible ways to achieve financial soundness include: ensuring that proper risk tolerances are established and honoured; determining, monitoring and acting on key performance indicators (which will vary by co-operative/mutual); and maintaining a healthy balance sheet.

2. Member incentives, including the “unlocking of investor value”

Members may have personal financial incentives to pursue demutualization. These incentives emerge because of how savings have been distributed (e.g., to indivisible reserves, or to allocated or unallocated member equity), the legal rules that govern how reserves and equity can be distributed upon dissolution of the co-operative, the tax regulations that apply to different surplus allocations, and the beliefs that members have about collective and individual property within a co-operative/mutual. Paying attention to demutualization means understanding these incentives, and modifying them if necessary. To keep these issues in the forefront, it is important to routinely ask questions from the perspective of members – i.e., How do members perceive the benefits and costs of the rules and regulations that are in place? As well, co-operatives and mutuals should take the time to determine if indivisible reserves would be beneficial for their organization.

3. Co-operative values and democratic engagement, including members' understanding of their co-operative's value

One way of staving off demutualization is for members to have an accurate sense of their co-operative's value. Part of this value, namely the members' financial benefit, is relatively straightforward to determine. Another part of this value, however, is more difficult. This part involves considering the questions: What would the situation be like if the co-operative or mutual no longer existed? Would members get comparable service? Would prices be as good? Would the community be as well off, both now and in the future? Properly addressing the issue of demutualization requires that everyone in the co-operative – members, management, and the board – be able to answer these questions on a day-to-day basis. Ensuring that members are able to do this requires ongoing democratic engagement efforts by the co-operative. These efforts have to go beyond the holding of annual meetings, the sending out of newsletters, and citing of mission and vision statements. Instead, ways need to be found of demonstrating the purpose and relevance of the co-operative or mutual – Why was it formed and why should it continue?

4. Regulatory structures and best practice requirements

As a result of high-profile corporate scandals (e.g., Enron) and the 2008 financial crisis, governments and oversight groups are introducing regulatory requirements and best practices in an effort to ensure good financial performance and restore investor confidence. While such requirements (e.g., the appointment of outside directors) could be advantageous, they also have the potential to weaken performance, particularly in areas that are important to members. In addition, these requirements may push co-operatives and mutuals to adopt structures that are increasingly similar to those of other businesses, thus making demutualization easier and hence more likely. To counteract this pressure, co-operatives and mutuals need to ensure that they can clearly enunciate the strengths of the co-operative/mutual model and they need to be constantly working with regulators and industry groups to communicate these strengths.

5. Corporate governance structures, including managers' desire for increased compensation or influence, and poor decisions by the board or management

Proper corporate governance structures ensure that decisions are made in the members' best interests while ensuring the continued operation of the co-operative. As co-operatives and mutuals become larger and more complex, members and boards grow increasingly reliant on information from management about their organization's operations and finances. Having more detailed knowledge than everyone else allows management to serve their own interests (and sometimes those of outsiders that are able to influence managers), rather than those of the members. Furthermore, conversions and demutualizations often create significant financial windfalls for senior management, who typically propose demutualization in the first place. Consistently practicing good governance helps ensure the proper distribution of authority and decision-making within the co-operative, ensuring that conversion, if proposed, is beneficial to the co-operative and its members. Good governance means establishing the proper incentives for managers, board members and members, making sure that the ideas and assumptions that underlie investment and operational decisions are properly examined, and ensuring transparency and accountability in the decision-making process so that legitimacy and trust are maintained.

These five guidelines embody the three elements of good governance that were outlined at the start of the paper. The incentive element forms the core of the second and fifth guidelines, the cognitive element is critical to the first, third and the fourth guidelines, while the legitimacy element forms the root of the third guideline. Framing these elements in terms of guidelines serves as a way of focusing attention on concrete actions that co-operatives can take to reduce the likelihood of demutualization.

Conclusion

After a wave of demutualizations in the financial and insurance sector in the 1980s and then again in the 1990s, and a set of co-operative conversions in the agricultural sector in the late 1990s and early 2000s, sufficient evidence has been accumulated to determine the key elements at work in these organizational changes. The purpose of this report is to examine the pressures that arise for demutualization and to show that these pressures are linked to what can be called “good governance.” The major conclusion of this report is that demutualization, if it occurs, is not an isolated event. Instead, demutualization occurs when the co-operative is not performing well on other fronts such as financial performance, member engagement and, most importantly, governance. In effect, demutualization is a sign of an unhealthy co-operative, one that has not paid attention to the key issues necessary for its success.

While our understanding of the forces behind demutualization is relatively good, some questions nevertheless remain. While the use of indivisible reserves has often been put forward as a way of reducing the incentives for demutualization, the evidence gathered for this report was inclusive regarding the causal connection. More research is needed to establish the link, if any, between the use of indivisible reserves and demutualization – e.g., is it possible to find a connection between the desire to merge or liquidate a co-operative and the members’ access to reserves. Similarly, while a checklist was developed of five key activities that lead to stronger co-operative and mutual performance, more work is needed to explore ways in which co-operatives and mutuals could evaluate how well they are performing in each of the activity areas (for example, by using a scoring system).

In conclusion, there is no silver bullet to ward off demutualization. Instead, members, boards, managers and employees have to engage in a set of activities that together support the continued operation of their co-operative or mutual as a co-operative or mutual. These activities include maintaining strong financial performance, ensuring that current members are not able to benefit inappropriately from the investments made by previous members, engaging members in a democratic fashion so that they develop a clear sense of the many benefits – both financial and non-financial – that co-operatives provide, carefully monitoring regulatory structures and best practice requirements to ensure that they do not weaken performance, and practicing sound co-operative governance so that the goals and values of the membership are reflected in the decisions that are made.

References

- All-Party Parliamentary Group. 2006. *Windfalls or Shortfalls? The true cost of Demutualisation*. London: The All-Party Parliamentary Group for Building Societies & Financial Mutuals.
- Andrews, A. Michael. 2015. *Survey of Co-operative Capital*. International Co-operative Alliance. Available at http://ica.coop/sites/default/files/352_ICA_Coop_Capital.pdf.
- Barnard, Chester, 1938. *The Functions of the Executive*. Cambridge, MA: Harvard University Press.
- Battilani, P. and H.G. Schröter. 2011. Demutualization and its Problems. Quaderni – Working Paper DSE No. 762. Department of Economics, Alma Mater Studiorum – Università di Bologna.
- Ben-Ner, A. 1988. *The life cycle of worker-owned firms in market economies: A theoretical analysis*. Journal of Economic Behavior and Organization 10(3): 287-313.
- Ben-ner, Avner. 2013. "Preferences and Organization Structure: Toward Behavioral Economics Micro-Foundations of Organizational Analysis." The Journal of Socio-Economics 46 (October): 87-96.
- Bevir, M. 2012. *Governance: A Very Short Introduction*. Oxford, United Kingdom: Oxford University Press.
- Bijman, J., G. Hendrikse, and A. van Oijen. 2013. "Accommodating Two Worlds in One Organisation: Changing Board Models in Agricultural Cooperatives." Managerial and Decision Economics 34:204-217.
- Birchall, J. 2013. *The Governance of Large Co-operative Businesses: A research study for Co-operatives*. UK. Manchester: Co-operatives UK.
- Birchall, J. 2014. "Innovation in the governance of large co-operative businesses: The alarming case of UK Co-operative Group." International Journal of Co-operative Management 7:22-28.
- Bond, J.K. 2009. "Cooperative Financial Performance and Board of Director Characteristics: A Quantitative Investigation." Journal of Cooperatives 22:22-44.
- Briscoe, R. O. McCarthy and M. Ward. 2012. "From Co-operatives to Conventional Businesses and Back Again: The Irish Co-operative Experience." In J. Sousa and R. Herman (Eds.). *A Co-operative Dilemma: Converting Organizational Form*. Saskatoon Canada: Centre for the Study of Co-operatives.

- Chaddad, Fabio R., and Michael L. Cook. 2004. "The Economics of Organization Structure Changes: A US Perspective on Demutualization." *Annals of Public and Cooperative Economics* 75 (4): 575–94.
- Cook, M.L., and M.J. Burgess. 2013. "The Impact of CEO Tenure on Cooperative Governance." *Managerial and Decision Economics* 34:218–229.
- Cook, Michael L. 1995. "The Future of U.S. Agricultural Cooperatives: a Neo-Institutional Approach." *American Journal of Agricultural Economics* 77(5): 1153–59.
- Cornforth, C. J. 2004. "The governance of co-operatives and mutual associations: a paradox perspective." *Annals of Public and Co-operative Economics* 75: 11-32.
- Daft, Richard L., and Karl E. Weick. 1984. "Toward a Model of Organizations as Interpretation Systems." *Academy of Management Review* 9 (2): 284–95.
- Desjardins Group. 2011. Position Paper by Desjardins Group. Submission to the Department of Finance Canada on the document "Consultation on a Demutualization Framework for Federal Property and Casualty Insurance Companies." Available at http://www.desjardins.com/en/a_propos/profil/difference/memoires/memoire-consultations-demutualisation.pdf.
- Fairbairn, B. 2006. *Co-operative Heritage – Where We've Come From: Reflections on Co-operative History on the Occasion of Saskatchewan's Hundredth Anniversary*. Centre for the Study of Co-operatives, University of Saskatchewan. Available at <http://usaskstudies.coop/documents/books,-booklets,-proceedings/Co-op%20Heritage.pdf>.
- Fehr, Ernst, and Armin Falk. 2002. "Psychological Foundations of Incentives." *European Economic Review* 46 (March): 687–724–724.
- Francois, Patrick. 2000. "Public service motivation' as an argument for government provision." *Journal of Public Economics* 78: 275-299.
- Franken, J.R., and M.L. Cook. 2013. "Impact of Board Structure and Process on Cooperative Performance." Selected paper presented at the Agricultural and Applied Economics Association and Canadian Agricultural Economics Society 2013 Joint Annual Meeting, Washington, DC, August 4-6 .
- Friedland, R., and R. R. Alford. 1991. *Bringing society back in: Symbols, practices and institutional contradictions*. (1991): 232-263.
- Frey, Bruno S. and Reto Jergen. 2001. "Motivation crowding theories." *Journal of Economic Surveys* 15 (5): 589-611.
- Fulton, M.E. 2014. *Outside Directors*. Cooperative Economy Blog Post. Accessed May 16, 2015 at <http://cooperativeeconomy.net/outside-directors>.

- Fulton, M.E., and Kathy Larson. 2009b. "Overconfidence and Hubris: the Demise of Agricultural Co-operatives in Western Canada." *Journal of Rural Cooperation* 37 (2): 166–200.
- Fulton, M.E., and K. Giannakas. 2012. *The value of a norm: open membership and the horizon problem in cooperatives*. *Journal of Rural Cooperation, Special Issue: Cooperative Values in Internationalized Operations*, 40(2), 145-161.
- Fulton, M.E., and B. Hueth. 2009. "Cooperative Conversions, Failures and Restructurings: An Overview." *Journal of Cooperatives* 23:i-xi.
- Fulton, M.E., and K. Larson. 2009a. "The Restructuring of the Saskatchewan Wheat Pool: Overconfidence and Agency." *Journal of Cooperatives* 23:1–19.
- Fulton, M.E., D. Pohler, and B. Fairbairn. 2015. "The Political Economy of Good Co-operative Governance." ICA Research Conference 2015 Selected Paper. Paris.
- Gunn, C.E. 1980. "Plywood co-operatives of the pacific Northwest : Lessons for workers' self-management in the United States", *Economic Analysis and Workers' Management* XIV(3): 393-416.
- Galor, Zvi. 2008. *Demutualization of Cooperatives: Reasons and Perspectives*. <http://www.coopgalor.com/doc/DemutualizationCooperatives21.5.08.pdf>
- Girard, J-P, F. Coggins, M. Clément and M. Cournoyer 1998. "La réserve impartageable: origine, évolution, situation actuelle." Montréal et Québec, Chaire de coopération Guy-Bernier (UQAM), Cahier de recherche 96, Direction des coopératives, Ministère de l'Industrie, du Commerce, de la Science et de la Technologie, Gouvernement du Québec, 48 p.
- Gourevitch, P.A., and J. Shinn. 2005. *Political power and corporate control: The new global politics of corporate governance*. Princeton: Princeton University Press.
- Government of Québec. 2015. *Co-operatives Act*. http://www2.publicationsduQuébec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2andfile=/C_67_2/C67_2_A.html
- Hansmann, H. 1996. *The Ownership of Enterprise*. Cambridge: The Belknap Press of Harvard University Press.
- Hanson, M.J. 2015. *Law of Cooperatives: The Changing Boardroom for Cooperatives*. Legal Note. Stoel Rives LLP. http://www.agmrc.org/media/cms/The_Changing_Boardroom_E8033ED46E291.pdf.
- Hart, Oliver, and John Moore. 1996. "The Governance of Exchanges: Members' Cooperatives Versus Outside Ownership." *Oxford Review of Economic Policy* 12(4): 17.

- Heinrich, J. and R. Kashian. 2006. "Credit Union to Mutual Conversion: Do Rates Diverge?" Working Paper. University of Wisconsin-Whitewater.
- Hogeland, A. J. 2006. "Co-op Conversions Extent of Commitment to Co-op Values Key Factor in Decisions to Convert" *Rural Cooperatives* May/June: 17-20.
- Hueth, B., and P. Marcoul. 2009. "Incentive pay for CEOs in cooperative firms." *American Journal of Agricultural Economics* 91 (5):1218–1223
- Hueth, B., and P. Marcoul. 2015. "Agents Monitoring Their Manager: a Hard-Times Theory of Producer Cooperation." *Journal of Economics and Management Strategy* 24(1): 92–109.
- ICA. 2015a. *Co-operative identity, values and principles*. International Co-operative Alliance. <http://ica.coop/en/whats-co-op/co-operative-identity-values-principles>.
- ICA. 2015b. *Guidance Notes*. International Co-operative Alliance. <http://ica.coop/en/blueprint-themes/identity/guidancenotes>
- Institute on Governance. 2015. *Defining Governance*. <http://iog.ca/defining-governance/> as accessed April 9, 2015.
- Kaplan, Sarah. 2008. "Framing Contests: Strategy Making Under Uncertainty." *Organization Science* 19 (5): 729–52.
- Kenkel, P. 2014. "The Impact of Unallocated Equity on Agricultural Cooperatives." Invited Paper Prepared for Farm Credit Council Coordinating Committee.
- LeVay, Clare. 1983. "Agricultural Co-operative Theory: A Review." *Journal of Agricultural Economics* 34(1): 1–44.
- Loasby, Brian J. 2001. "Organisations as interpretative systems." *Revue d'économie industrielle* 97 (4): 17-34.
- McDowell, R., K. Christensen and W. Baraniak. 2008. *Sponsored Demutualization Comes to Canada*. Financial Institutions and Services Bulletin. Fasken Martineau DuMoulin LLP. Accessed June 9, 2015 at http://www.fasken.com/files/Publication/0f389377-ae4e-4ba6-a335-444cfc4f7144/Presentation/PublicationAttachment/91eba8f3-1547-4559-9036-11cb8cba1bde/Bulletin-FIS_Sponsored_Demutualization_Comes_to_Canada.pdf.
- Mayers, D., and C.W. Smith. 1986. "Ownership structure and control: The mutualization of stock life insurance companies." *Journal of Financial Economics* 16(1): 73-98.
- Mulligan, L.N. 2007. "What's Good for the Goose Is Not Good for the Gander: Sarbanes-Oxley-Style Nonprofit Reforms." *Michigan Law Review* 103 (8): 1981–2009.

- Nadeau, E.G. and R. Nilsestuen. 2004. "Strengthening Cooperative Business Structures: Lessons Learned from Demutualization and Cooperative Conversions" *Cooperative Business Journal*
- Novkovic, Sonja. 2006 "Co-operative business: the role of co-operative principles and values." *Journal of Co-operative Studies* 39(1): 5-15.
- Powell, Walter W, and Richard Steinberg, eds. 2006. *The Nonprofit Sector: A Research Handbook*. 2nd ed. New Haven: Yale University Press.
- Reiser, D.B. 2004. "Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability." *U.C. Davis Law Review* 38: 205–80.
- Rickards, A. 2014. (No.258) *Insurance company demutualization in Canada*. Accessed May 18, 2015 at <http://www.rickardsread.com/2014/02/no258-insurance-company-demutualization.html>
- Sarbanes-Oxley. 2002. *A Guide To The Sarbanes-Oxley Act*. <http://www.soxlaw.com/>.
- Schleifer, Andrei, and Robert W Vishny. 1997. "A Survey of Corporate Governance." *The Journal of Finance* 52 (2): 737–83.
- Sexton, Richard J, and Julie Iskow. 1988. "Factors Critical to the Success or Failure of Emerging Agricultural Cooperatives." Department of Agricultural and Resource Economics, University of California, Davis. Giannini Foundation Information Series No. 88-3, June.
- Sousa, J., and R. Herman (Eds.). 2012. *A Co-operative Dilemma: Converting Organizational Form*. Saskatoon Canada: Centre for the Study of Co-operatives.
- Spear, R. 2004. "Governance in Democratic Member-Based Organisations." *Annals of Public and Cooperative Economics* 75:33–59.
- Welch, I. 2006. *Windfalls or Shortfalls? The true cost of Demutualisation*. Short Inquiry, London: The All-Party Parliamentary Group for Building Societies and Financial Mutuals.
- Wilcox, J.A. 2006. *Credit Union Conversions to Banks: Facts, Incentives, Issues and Reforms*. Madison Wisconsin: Filene Research Institute.

APPENDIX A – Case Studies

In alphabetical order

Agricore United:

Alberta Wheat Pool, Manitoba Pool Elevators, United Grain Growers, Agricore, Agricore United

Type: Producer co-operative

Country: Canada

Date of demutualization: 2007

Reasons for demutualization: FS, GS, CV

Throughout the early 1990s, the Alberta Wheat Pool (AWP) and Manitoba Pool Elevators (MPE) replaced aging grain elevators with new inland terminals (Earl, 2009). Resulting from managerial overconfidence and board inexperience (Fulton and Larson, 2009), the process, funded primarily through debt, nearly bankrupted the co-operatives. AWP and MPE merged in 1998 to form Agricore Limited. Agricore fared little better and, in 2001, merged with United Grain Growers (UGG) to create Agricore United (AU).¹

To access much needed capital, AU issued public shares, becoming a hybrid organization comprised of investors and members. Over time, the board came to see their primary responsibility as maximizing investor returns instead of protecting member rights (Earl, 2009). In November 2006, the Saskatchewan Wheat Pool (SWP), now an investor-owned firm, launched a hostile takeover. Although they rejected SWP's initial bid as too low, as subsequent offers increased in value, AU's board felt increasing pressure to endorse the takeover. In May 2007, the board recommended acceptance of SWP's offer of \$20.50 per common share, and \$25 for each Agricore preferred share.²

¹ Earl (2009).

² CBC News (2007).

Although opposed by those board members who were themselves farmers (Earl, 2009), the takeover was complete by May 29, 2007, for a final value of \$1.8 billion, including cash and assumed debt (Iexpert, 2007). In the end, the demutualization of Agricore United resulted from several factors including: conflict between senior management and farmer members of the AU board, an emphasis of investor rights over those of farmers, and decreased empathy amongst younger farmers for the co-operative philosophy.³

Agrifoods International Co-operative Ltd.

Type: Producer co-operative

Country: Canada

Date of demutualization: 2001

Reasons for demutualization: FS, GS

With the merger of Dairy Producers Cooperative Ltd. and Dairyworld Foods in 1996, the newly formed Agrifoods International Co-operative Ltd. became the largest dairy co-operative in Canada. Sales reached \$1.13 billion.⁴ However, by 2001 the co-operative was forced to sell the majority of its assets to the Montreal based, investor-owned firm Saputo (Agrifoods retained its raw milk trucking operations). The sale was necessitated, in part, because the co-op had incurred significant debt to finance several mergers and acquisitions in the 1990. Market factors also played a role, as competition in the retail sector increased.⁵

Managerial overconfidence and ineffective governance structures also spurred the sale. According to Fulton and Larson, Agrifoods' pattern of acquisitions and incurred debt "point to a board and management that would appear to have been highly overconfident."⁶ Senior management also kept the board and member delegates ignorant of Agrifoods' growing debt. This lack of transparency is alleged to have contributed to the decision to sell Saputo. According to a delegate, "No-one knew what was going on. Delegates were not kept up to date; there was no transparency ... Basically, (senior management) destroyed the co-op and Saputo stole it for 50 cents on the dollar."⁷

³ Earl (2009); Fulton and Larson (2009).

⁴ Holm (2011).

⁵ Fulton and Larson (2009).

⁶ Fulton and Larson (2009), p. 192.

⁷ Holm (2011), p. 15.

Bridlewood Co-operative Inc.

Type: Consumer co-operative

Country: Canada

Date of demutualization: 2012

Reasons for demutualization: GS, MI, CV

Four times between 1996 and 2012, several dozen members of the Ontario housing co-operative Bridlewood tried to convert the organization's assets into private property,⁸ in order to purchase the homes at upwards of 50% below market values.⁹ The final attempt placed the co-op in receivership after the board stopped paying its \$39,000 monthly mortgage in 2010. It was believed this would trigger a mass sale of the houses as the lender sought to recover what was owed.¹⁰

Instead the Ontario Superior Court prohibited members from purchasing the homes at depressed prices. Subsequent rulings stripped Bridlewood of its assets, awarding the homes to a non-profit subsidiary of the Cooperative Housing Federation of Canada.¹¹ According to Dale Reagan, Managing Director of CHF Canada's Ontario region, "This landmark decision means that 131 units of affordable housing have been preserved and we have avoided the very damaging precedent that would have been set if members had been able to enrich themselves with the public investment in non-profit housing."¹² Ironically, Bridlewood Cooperative's demutualization was done to preserve its cooperative values.

8 Thompson (2014).

9 Battagello (2012).

10 CHF Canada (2012).

11 CHF Canada (2012), Thompson (2014).

12 CHF Canada (2012).

Canadian Life Insurance Mutuals

Canada Life Insurance Co., Manufacturers Life Insurance Co. (Manulife), The Mutual Life Assurance Co. (Clarica Life Insurance Co.), Sun Life Assurance Co.

Type: Financial co-operative

Country: Canada

Date of demutualization: 1999

Reasons for demutualization: FS, GS, MI

Anticipating legislative changes, Canada's largest insurance mutuals (Canada Life, Manulife, Mutual Life, and Sun Life) announced their intentions to demutualize in 1998.¹³ The following year, all four converted from policyholder-owned co-operatives to investor-owned firms. Although a need to raise capital was comm only cited as the reason for demutualization,¹⁴ none of the four were experiencing a shortfall. In fact, all were well-capitalized with strong capital positions.¹⁵ Such levels were insufficient, however, to meet expansionary desires for big mergers and acquisitions that had become prevalent within the industry.¹⁶

Aside from regulatory changes allowing conversion and a "need" for capital, industry insider Alastair Rickard credits the rash of demutualizations to managerial desires for increased compensation.¹⁷ Although stock options are not available to mutual company executives until a year after conversion, the temptation of financial gain cannot be ignored.¹⁸ According to Claude Gingras, Mutual Life vice-president and general-counsel until 1995, senior management were the primary beneficiaries of conversion, receiving "very generous free allocations of share options" two years after demutualization.¹⁹

Furthermore, Gingras states that management would be incapable "of producing any substantial evidence of policyholders requesting demutualization."²⁰ This contradicts Donald Stewart, then chairman and CEO of Sun Life, who said going public would "provide substantial benefits for the Company (sic) and policyholders as a whole."²¹

¹³ Department of Finance Canada (1998).

¹⁴ Rickard (2014).

¹⁵ Pargeans and Adams (1999).

¹⁶ Martin (1999).

¹⁷ Rickard (2014).

¹⁸ Martin (1999).

¹⁹ Rickard (2014).

²⁰ Rickard (2014).

²¹ Sun Life Assurance Company of Canada (1999).

Collective Resource and Services (CRS) Workers' Co-operative

Type: Worker co-operative

Country: Canada

Date of demutualization: 1996

Reasons for demutualization: FS

The Collective Resource and Services (CRS) Workers' Co-operative Provide was an organic foods wholesaler and distributor, established in 1972 as resource group. By 1993, the organization had over fifty members and annual sales of almost \$10 million, driven by its two business collectives: Horizon Distributors, an organic food wholesaler; and the Uprising Breads Bakery, which specialized in organic bread and other bakery products.²²

According to former general manager, Marty Frost, prior to its demutualization, CRS suffered from a shortage of capital. Outside investment was prohibited, and members were already heavily invested – from \$4,000 to \$32,000 each. There was also a strong impetus to refinance due to a “healthy rate of expansion,” and the co-operative’s financial lender, BC Credit Union, demanding an infusion of outside capital.²³ In 1996, the co-operative converted to an investor-owned firm.

Dakota Growers Pasta Company

Type: Producer co-operative

Country: United States

Date of demutualization: 2002

Reasons for demutualization: FS, MI

The Dakota Growers Pasta Company (DGPC) was formed in 1991 (Boland, 2012). Its members were durum wheat producers in Minnesota, Montana, and North Dakota. Before conversion, the co-operative had 1,155 members, each obligated to deliver a set amount of durum wheat. Changes in governmental regulations, and harvest shortfalls due to disease and poor weather prompted farmers to plant crops other than durum. Many producer-members were unable to meet their annual quotas. This jeopardized DGPC’s co-operative status as member patronage declined.

²² Gao (1993).

²³ Frost (2015).

In 2002 the co-operative converted to an investor-owned firm. This freed members from their obligation to deliver durum. It also provided DGPC with access to capital markets beyond member-owners, and improved liquidity because non-producers could become equity holders. Co-op members were well informed about the conversion. They realized additional capital was necessary for future growth. The relative success of DGPC's conversion is partially attributed to the open discussion between the board and members concerning the conversion, and to members' continued ability to deliver wheat to the company.²⁴

Diamond Walnut Growers

Type: Producer co-operative

Country: United States

Date of demutualization: 2005

Reasons for demutualization: FS, MI

The Diamond Walnut Growers (DWG) walnut-marketing co-operative evolved from the California Walnut Marketing Association in 1956. Almost half a century later, the co-operative converted to a publically traded firm in 2005. Several factors contributed to the demutualization. In 2002, DWG entered the snack food market, and incurred significant expenses from advertising, and slotting fees (Hardesty, 2009). Capital was needed to cover costs. Furthermore, due to member resistance, DWG had stopped retaining 3.5% of members' annual proceeds. Also, inasmuch as the cooperative was required to annually distribute its net proceeds, members preferred maximum cash distributions instead of investing for future growth.²⁵

The shift to an investor-owned firm was encouraged by CEO Michael Mendes, who had been moving DWG away from its traditional cooperative structure since taking the helm in 1998. Additionally, Mendes and other senior management stood to receive \$14 million in stock options and grants with the conversion. Co-op members approaching retirement also had financial incentive to support demutualization. They could capitalize on investments made building DWG's branded program and snack product lines.²⁶

²⁴ Boland (2012).

²⁵ Hardesty (2009).

²⁶ Hardesty (2009).

Besides, all members, not just the ones retiring, had become less involved with DWG's governance, interacting only minimally with the board. This lack of engagement, combined with insufficient knowledge further contributed to the co-op's conversion. Members did not have the expertise to properly assess the conversion, nor were they given substantial time to consider the process (Hardesty, 2009). In all, managerial desires for increased remuneration, the absence of mechanisms to encourage long-term investment, and an uninformed and disengaged membership influenced DWG's demutualization.

FCStone Group

Type: Financial co-operative

Country: United States

Date of demutualization: 2005

Reasons for demutualization: FS, MI

FCStone Group Inc. is a publically held corporation specializing in commodity risk management. It converted from a co-operative to a privately held firm in 2005, becoming publicly traded in 2007. The co-operative converted to provide members with sizable financial benefits, and to service non-member customers. It also sought to access new capital and improve liquidity. The conversion was strongly supported – 96% of members voted in favour. Since then, FCStone has been able to provide the same, if not improved benefit to its members-cum-shareholders. Those promised financial benefits were realized, yet members still have the same access to FCStone's risk management services, only now as customers.²⁷

Lilydale Poultry Co-operative

Type: Producer co-operative

Country: Canada

Date of demutualization: 2005

Reasons for demutualization: FS, GS, CV

Created in 1940, the Lilydale co-operative became one of the biggest poultry producers in Canada.²⁸ Faced with large financial losses, \$65 million in long-term debt, and member dissatisfaction, the co-operative voted to convert to an investor-owned firm in 2005. Over the previous two decades, the co-operative had engaged in substantial growth, primarily financed with debt, and had incurred significant losses. The largest was \$16.3 million in 2003. In response, lenders requested increased equity contributions from members to relieve the co-op's debt. Lilydale instituted a Member Investment Program, which failed.²⁹ Altogether, Lilydale's conversion from a co-operative to an investor-owned firm occurred because it borrowed too heavily, and was unable to find alternative solutions to its debt problem.

Rural Electrification Associations (REA): Peace Country REA and Peace Grove-Worsely REA

Type: Consumer co-operative

Country: Canada

Date of demutualization: 2011

Reasons for demutualization: FS, CV

When the province's utility provider could not afford to bring electricity to farming communities,³⁰ the Alberta government established a rural electrification program in 1947. Within a decade, over 90% of the province's farms had power. By the end of the 1950s, most farmers were members of a rural electrification association (REA). Currently, most REAs are electricity distribution co-operatives, using pooled resources to acquire sections of the distribution grid. Some, however, have the capacity to generate their own power or purchase low-cost, bulk electricity for their members.³¹

28 Hailu and Goddard (2009).

29 Goddard, Hailu, and Glover (2012).

30 Plummer (2011).

31 Duguid (2013).

At their peak in the 1960s, 380 REAs served about 7% of Alberta’s electricity consumers. By the early 2000s, that number had dropped to 50 associations serving only 1% of consumers.³² A number of factors have led to this decline. Increased competition from the investor-owned utilities ATCO and Fortis, industry deregulation, restrictive governmental policies, onerous safety regulations, and high maintenance and operating costs have all been cited (Dika, 2012; Musselman, 2010; Toma and Bouma Management Consultants, 2013).

For example, Nick Hudak, president of the Peace Grove-Worsely REA, states that the sale of the co-operative to ATCO in 2011 was necessary “given the sheer amounts of rules and regulations required.”³³ In addition, Peace Grove-Worsely faced a problem common to many rural co-ops, an aging membership. Most of its board were in their 70s, and “young people (were) not stepping up to the plate.”³⁴

Pacific Share Collective (PSC) Workers’ Co-operative

Type: Worker co-operative

Country: Canada

Date of demutualization: 1998

Reasons for demutualization: GS, MI, CV

With the demutualization of the Collective Resource and Services co-op in 1996, members of the Pacific Share Collective (PSC) Workers’ Co-operative were confronted with a organization that had gone from being a friendly “rival” to a new, highly capitalized, and well-organized competitor.³⁵ Foreseeing a struggle holding market share, PSC members elected to join the investor-owned firm. This allowed them to retain their jobs while realizing large capital gains on their membership. The demutualization of PSC was a case of, “if you can’t beat them, join them.”

32 Musselman (2010).

33 Dika (2012).

34 Plummer (2011).

35 Frost (2015).

Prudential Insurance Company

Type: Financial co-operative

Country: United States

Date of demutualization: 2001

Reasons for demutualization: FS, GS

Prudential Insurance originated in 1873 as the Widows and Orphans Friendly Society.³⁶ Friendly societies were small, voluntary mutual organizations that provided insurance to the poor. In 1877, the society changed its name to Prudential Insurance Co. of America, becoming a mutual insurer in 1915, after the majority of shareholders sold their stock back to the company. By the early 1990s, Prudential's consolidated assets exceeded \$100 billion, earning it a position on the "Fortune 500" in 1995. Six years later, however, the mutual converted to an investor-owned firm. At the time, it was the largest insurance initial public offering, valued at \$4 billion.

Prudential's demutualization was spurred by several industry-wide disruptions: changing consumer behaviour and shifting preferences toward low-margin, long-term savings products; the rise of online distribution channels; blurring boundaries between banking and insurance services; and increased merger and acquisition activity amongst insurance companies.³⁷ Prudential's CEO, Arthur Ryan, also promoted an aggressive growth strategy that would have been unsustainable for a mutual. The conversion provided Prudential with the financial flexibility needed to grow and buy other companies. It was also provided policyholders with a \$12 billion windfall.

³⁶ Chaddad and Chaddad (2012).

³⁷ Chaddad and Chaddad (2012).

Saskatchewan Wheat Pool

Type: Producer co-operative

Country: Canada

Date of demutualization: 2005

Reasons for demutualization: FS, GS, CV

The Saskatchewan Wheat Pool (SWP) was originally incorporated as the Saskatchewan Co-operative Wheat Producers Ltd. in 1923. From the early 1970s until 1992, the SWP handled 60% of Saskatchewan's grain – its net earnings as high as \$72.7 million in 1981. However, from 1993 onward the SWP's fortunes began to erode. Its market share fell to 22% by 2004, and the co-operative suffered multi-million dollar losses from 1999 to 2003. In 2005, the SWP fully converted to a investor-owned firm.³⁸

Prior to demutualization, the SWP underwent a share conversion in 1996, becoming a publicly traded co-operative. This shifted decision-making power from the board to senior management. As business became more complicated, board members were increasingly reliant on management to tell them what to do. The board also fell under the sway of Don Loewen, the SWP's ambitious CEO from 1993, until his dismissal in 1999. Under Loewen, the SWP made a number of poor decisions that resulted in significant losses, including unsuccessful investments in Poland and Mexico, and Project Horizon – a failed attempt to drive competition out of the market.³⁹

Although a lack of oversight by the board, and overconfidence by management contributed to the SWP's demutualization, its declining market share also played a role, as members lost confidence in the co-op's value. And as member commitment dwindled, so did member ownership. After its conversion to a public co-operative, members held 54% of the SWP's equity. By 1999, the number had dropped to 30%.⁴⁰ The board's inability to restrain senior management, and management's subsequently poor decision-making served to weaken members' trust, and bring about the SWP's eventual demutualization.

38 Lang (2006); Fulton and Larson (2012).

39 Fulton and Larson (2012).

40 Fulton and Larson (2012).

Scotsburn Co-operative Services Ltd.

Type: Producer co-operative

Country: Canada

Date of demutualization: 2014

Reasons for demutualization: FS, MI

Scotsburn Co-operative Services Ltd. was founded in Nova Scotia in 1900. Originally a dairy co-operative, Scotsburn expanded into ice cream, frozen yoghurt, cottage cheese, spring water and other products.⁴¹ In 2014, the co-op sold its fluid milk division to Saputo Inc., citing increased competition and decreased profitability (CBC Newfoundland and Labrador, 2014). Commenting on the sale, Scotsburn president and CEO Doug Ettinger stated, "Where it has become more difficult for regional players to remain competitive in Atlantic Canada, this transaction will accelerate Scotsburn's growth strategy on ice cream. ... This is good news for Scotsburn shareholders as this direction will result in strong returns for our co-operative members here in Atlantic Canada."⁴²

Swedish Meats

Type: Worker co-operative

Country: Sweden

Date of demutualization: 2007

Reasons for demutualization: FS, GS, CV

Swedish Meats came about in 1999, when all but one Swedish co-operative slaughterhouse merged. Less than a decade later, members decided to sell its operations to the Finnish firm HK Ruokatalo in 2007. Although Swedish Meats still exists, it does so only as a minority shareholder of HK Scan, formerly HK Ruokatalo.⁴³

Soon after its inception, Swedish Meats fell behind investor-owned slaughterhouses, unable to offer farmers competitive prices for their pigs. This led to dissatisfaction amongst members, who began to trade with other firms. Instead of being disloyal, such defections were considered good business. Furthermore, members were more concerned with short-term economic gain, than with the co-operative's survival. As a result, any profits Swedish Meats made were returned

⁴¹ MacGillivray and Ish (1992).

⁴² The Telegram (2014).

⁴³ Lind (2011).

as patronage refunds rather than invested in the co-operative.⁴⁴ Although Swedish Meat's underperformance and lack of long-term viability contributed to its demutualization, so too did its directors' ineptitude.

Although charismatic, Swedish Meats' directors lacked the skill and determination to make uncomfortable, but necessary, decisions. Nor did they understand such strategically important issues as product development, or the co-op's markets, which had shifted by 2007.⁴⁵ The market failures that necessitated Swedish Meats no longer existed. Farmers were no longer subject to private actors offering low prices. Increased market power, cheaper transportation, internet-based spot pricing, and higher prices from investor-owned slaughterhouses reduced the need for Swedish Meats. Given its ineffectiveness nearly from the start, Swedish Meats' demutualization seems almost inevitable.

Sunstate Credit Union

Type: Financial co-operative

Country: Australia

Date of demutualization: 1997

Reasons for demutualization: FS, GS

In 1997, Australian credit unions lost their tax-exempt status. This reduced their competitive advantage over other financial institutions. Further regulatory changes in 1999 placed the credit unions under the same legislative regime as banks. Credit unions lost their co-operative status (Johnston, 2012). Growing regulatory obligations also pulled their attention away from commitments to members. By 2006, the number of credit unions had dropped from 310 in 1994 to 151.⁴⁶

Although the number of credit unions declined, their assets increased as small and medium-sized credit unions merged. Total assets reached AUD\$33.1 billion in June 2005.⁴⁷ However, as members lost their credit unions to mergers, their connection to co-operative principals or other credit unions weakened. Declining member loyalty, increased regulatory requirements, and difficulty in raising capital all contributed to a desire to demutualize.

The first credit union to demutualize was Sunstate Credit Union, which did so in 1997. Its conversion was prompted primarily by managerial greed, however, not decreased loyalty or increased

⁴⁴ Lind (2011).

⁴⁵ Lind (2011).

⁴⁶ Johnston (2012).

⁴⁷ Johnston (2012).

regulation.⁴⁸ Although 86% of Sunstate's members received nothing through demutualization, its directors and management profited significantly.⁴⁹ Of the 4 million shares available during conversion, 200,000 were reserved for directors, and another 200,000 for employees. By some calculations, directors were eligible for benefits 300 times greater than those available to normal members. The credit union's former CEO received 25 thousand shares alone. Instead of acting to preserve its mutualist character, Sunstate's management hastened its demise.⁵⁰

Trygg-Hansa

Type: Financial co-operative

Country: Sweden

Date of demutualization: 1988

Reasons for demutualization: FS, GS, MI

The Swedish insurance firm Trygg-Hansa demutualized in 1988, after having been in existence for nearly a century.⁵¹ During the 1980s, the Swedish market experienced a "financial frenzy" as governmental regulations that had limited the number insurance companies were abolished, and capital markets were deregulated. At the same time, the borders between banking and insurance began to blur. Along with this frenzy, emerged the fear that foreign banks and insurers would enter the market, hurting Swedish companies unless they could grow large enough to withstand the increased competition. Calls for Trygg-Hansa's demutualization played upon this fear.

In documents outlining the mutual's conversion, three reasons were offered: the need for increased to capital to allow for future endeavours; a desire to expand the company through acquisitions; and the belief that conversion to a investor-owned firm would increase transparency, making the company more profitable and efficient.⁵² This did not happen. By 1998 the company had been broken up and sold off, having suffered through Sweden's banking crisis, a failed partnership with Swedish insurance giant SPP, and the sinking of the ferry Estonia, which Trygg-Hansa had insured.

48 Johnston (2012).

49 Mathews (2000).

50 Mathews (2000).

51 Grip Gunvall (n.d.)

52 Grip Gunvall (n.d.)

REFERENCES

- Barton, D. G. (2009). *FCStone conversion to a public corporation*. In Cooperative conversions, failures and restructurings: Case studies and lessons from US and Canadian agriculture (pp. 189–207). Knowledge Impact in Society and the Centre for the Study of Co-operatives, University of Saskatchewan.
- Battagello, D. (2012, October 21). *Essex co-op housing development saved by court decision*. Windsorstar.com. Windsor. Retrieved March 12, 2015, from <http://blogs.windsorstar.com/news/73280>
- Boland, M. (2012). *When you need to expand: Dakota Growers Pasta Company*. In J. Sousa & R. Herman, A Co-Operative Dilemma: Converting Organizational Form (pp. 40–52). Saskatoon: Centre for the Study of Co-operatives.
- CBC Newfoundland and Labrador. (2014, January 17). *Facebook.com*. Retrieved May 11, 2015, from <https://www.facebook.com/cbcnl/posts/10152189284997174>
- CBC News. (2007, May 9). *Sask. Wheat Pool, Agricore agree on new takeover deal*. Cbc.ca. Retrieved May 6, 2015, from <http://www.cbc.ca/news/business/sask-wheat-pool-agricore-agree-on-new-takeover-deal-1.667654>
- Chaddad, Fabio R, & Chaddad, F. R. (2012). *Coming full circle: Prudential Insurance Company*. In J. Sousa & R. Herman, A Co-Operative Dilemma: Converting Organizational Form. Saskatoon: Centre for the Study of Co-operatives.
- CHF Canada. (2012, October 19). *Ontario court approves plan to save 131 units of affordable housing in Windsor area*. Windsor: The Co-operative Housing Federation of Canada.
- Department of Finance Canada. (1998). *Demutualization Regime for Canadian Life Insurance Companies* (pp. 1–40). Ottawa: Department of Finance Canada.
- Dika, R. (2012, November 9). *Rural electrification associations face buyouts from big operators*. Albertafarmexpress.ca. Retrieved March 5, 2015, from <http://www.albertafarmexpress.ca/2012/11/09/rural-electrification-associations-face-buyouts-from-big-operators%E2%80%A9/>
- Duguid, F. (2013). *Recognizing How REAs Help Rural Alberta: Report 1* (No. 1) (pp. 1–47). Toma & Bouma Management Consultants.
- Earl, P. D. (2009). *Lessons for cooperatives in transition: The case of Western Canada's United Grain Growers and Agricore United*. In Cooperative conversions, failures and restructurings: Case studies and lessons from US and Canadian agriculture (pp. 19–38). Knowledge Impact in Society and the Centre for the Study of Co-operatives, University of Saskatchewan.
- Frost, M. (2015). *Demutualization data on three worker co-ops*. Personal Communication.

- Fulton, M. E., & Larson, K. A. (2009). *Overconfidence and hubris: The demise of agricultural co-operatives in Western Canada*. *Journal of Rural Cooperation*, 37(2), 166.
- Fulton, M. E., & Larson, K. A. (2012). *Failing members and investors: Saskatchewan Wheat Pool*. In J. Sousa & R. Herman, *A Co-Operative Dilemma: Converting Organizational Form* (pp. 94–124). Saskatoon: Centre for the Study of Co-operatives.
- Gao, H. (1993, July). *CRS Workers' Cooperative: A Case Study in Cooperative Evolution and Survival*. Simon Fraser University, Vancouver.
- Goddard, E., Hailu, G., & Glover, F. (2012). *Striking a balance: Lilydale Poultry Co-operative*. In J. Sousa & R. Herman, *A Co-Operative Dilemma: Converting Organizational Form* (pp. 53–72). Saskatoon: Centre for the Study of Co-operatives.
- Grip Gunvall, F. (n.d.). Trygg-Hansa.
- Hailu, G., & Goddard, E. (2009). *Sustainable growth and capital constraints: The demutualization of Lilydale Co-operative Ltd*. In *Cooperative conversions, failures and restructurings: Case studies and lessons from US and Canadian agriculture* (pp. 117–130). Knowledge Impact in Society and the Centre for the Study of Co-operatives, University of Saskatchewan.
- Hardesty, S. D. (2009). *The conversion of Diamond Walnut Growers*. In *Cooperative conversions, failures and restructurings: Case studies and lessons from US and Canadian agriculture* (pp. 39–51). Knowledge Impact in Society and the Centre for the Study of Co-operatives, University of Saskatchewan.
- Holm, W. (2011, May/June). *The Dairyland story*. *Western Dairy Farmer*, 14–15.
- Johnston, J. (2012). *Credit co-operative to credit corporate: Australian credit unions*. In J. Sousa & R. Herman, *A Co-Operative Dilemma: Converting Organizational Form* (pp. 25–39). Saskatoon: Centre for the Study of Co-operatives.
- Lang, K. (2006). *Saskatchewan Wheat Pool*. Uregina.ca. Retrieved May 7, 2015, from http://esask.uregina.ca/entry/saskatchewan_wheat_pool.html
- Lexpert. (2007, May). *Saskatchewan Wheat Pool Acquires Agricore United*. Lexpert.ca. Retrieved May 6, 2015, from <http://www.lexpert.ca/article/saskatchewan-wheat-pool-acquires-agricore-united/?p=|273&sitecode=DIR>
- Lind, L. W. (2011). *The demutualization of a cooperative-Swedish Meats*. Presented at the EAEE (European Association of Agricultural Economists) Congress.
- MacGillivray, A., & Ish, D. (1992). *Co-operatives in Principle and Practice* (No. 92-01) (pp. 1–154). Centre for the Study of Co-operatives.

- Martin, T. (1999, October 1). *The big payout: demutualization is one gift horse you should look at very carefully*. Report on Business Magazine, 16(4), 145–148.
- Mathews, R. (2000). *Looting the Mutuals: The Ethics and Economics of Demutualisation*. Australia.Coop. Retrieved March 12, 2015, from http://www.australia.coop/rm_lm_2000.htm
- Musselman, C. M. (2010, September). *Challenges Facing Cooperatives Balancing Corporate Vision With Membership Commitment: A Case Study of the Battle River R.E.A.* Cape Breton University.
- Pargeans, W. N., & Adams, R. L. (1999). *A Nation on the Brink Of Demutualization*. Best's Review / Life-Health Insurance Edition, 100(6), 64.
- Plummer, E. (2011, March 4). *REA sells electricity distribution system to Atco for \$13.1M*. Peacecountrysun.com. Retrieved March 5, 2015, from <http://www.peacecountrysun.com/2011/03/24/rea-sells-electricity-distribution-system-to-atco-for-131m>
- Rickard, A. (2014, February 9). "Some reflections on 'what if?' history & an insurance business odyssey." Rickardsread.com. Retrieved March 20, 2015, from <http://www.rickardsread.com/2014/02/no257-some-reflections-on-what-if.html>
- Sun Life Assurance Company of Canada. (1999, September 28). *Sun Life of Canada Board finalizes demutualization plan, policyholders to vote on December 15*. Sunlife.ca. Retrieved March 23, 2015, from http://www.sunlife.ca/Canada/sunlifeCA/About+us/Newsroom/News+releases/Archives/1999/Sun+Life+of+Canada+Board+finalizes+demutualization+plan+policyholders+to+vote+on+December+15?vgnLocale=en_CA
- The Telegram. (2014, January 17). *Scotsburn sells fluid milk distribution network*. Thetelegram.com. New Glasgow. Retrieved May 11, 2015, from <http://www.thetelegram.com/News/Local/2014-01-17/article-3580928/Scotsburn-sells-fluid-milk-distribution-network/1>
- Thompson, D. J. (2014). *Ontario Government and CHF Canada Stop the Stealing of a Cooperative* (pp. 1–4–5). National Association of Housing Cooperatives.
- Toma & Bouma Management Consultants. (2013). *Alberta REA Strategic Review- Rural Economic Impacts* (pp. 1–34). Toma & Bouma Management Consultants.

APPENDIX B –

Co-operative and Mutual Taxonomy

Based upon the taxonomy used by the Co-operatives and Mutuals Canada (see <http://canada.coop/en/co-operatives-and-mutuals/co-op-types>), the demutualized, or converted co-operatives highlighted in these case studies are classified as:

1. **Consumer co-operatives:**

Co-operatives whose members are their customers.

Most of these organizations are retail stores.

Specific examples: Mountain Equipment Co-op (MEC), United Farmers of Alberta (UFA), the retail co-ops that are part of Federated Co-operatives Limited

General examples: Housing co-ops, car share co-ops, funeral co-op, etc.

2. **Financial co-operatives:**

Co-operatives whose members are their customers, different from consumer co-operatives in that they provide financial services such as banking and insurance.

Specific examples: Vancouver City Savings Credit Union (Vancity), Affinity Credit Union, Desjardins Group, The Co-operators Group Limited (CGL)

General examples: Credit unions, caisses populaires, insurance and trust co-operatives, etc.

3. **Producer co-operatives:**

Co-operatives whose members come together to process, or market their products.

Specific examples: Gay Lea Foods, Agropur, La Coop fédérée, Northumberland Dairy

General examples: Agriculture co-ops, equipment co-ops, advisory services, etc.

4. **Worker co-operatives:**

Co-operatives whose members own and control the business for which they work.

Specific examples: La Siembra, Just Us! Coffee Roasters, Vancouver Renewable Energy, etc.

General examples: Printing and publishing co-ops, forestry co-ops, production and manufacturing co-ops, etc.

5. **Multi-stakeholder co-operatives:**

Co-operatives with a diverse membership sharing a common interest in the organization.

Specific examples: Common Ground Co-operative, the West End Food Co-op, the Aylmer Health Co-op

General examples: homecare services, health services, community services, etc.

APPENDIX C –

Demutualization in Co-operative Thought:

PERSPECTIVES ON ASSETS IN CO-OPERATIVES

Brett Fairbairn

Fellow in Co-operative History and Governance

Centre for the Study of Co-operatives

University of Saskatchewan

OVERVIEW

Since the earliest emergence of co-operatives, leading thinkers in and associated with co-operatives have considered the nature of capital and assets in co-operatives. While historically there were few explicit discussions of demutualization (sale or conversion of a co-operative to a private-ownership form), there have been periodic discussions about three related topics. First, discussions of the nature of capital in co-operatives, from the beginning to the present day, have emphasized that members and shareholders in co-operatives should never seek or receive speculative returns on their investments; ownership of shares in a co-op should never bring a return greater than a limited return equivalent to interest. Second, many co-operative thinkers stressed how important it is for co-operatives to build indivisible, collective funds rather than to distribute all surpluses to members; division of savings is not required and collective use of funds is a desirable business practice. If division of accumulated surplus occurs, care should be taken that no member benefits at the expense of any other; they should only get out what they earned themselves. Third, periodically co-operative leaders have addressed the topic of what should happen to net assets of a co-operative in the event of dissolution. This third topic is of particular interest, since the sale or complete transformation of a co-operative is equivalent to dissolving the hitherto-existing organization. In this case, there has been a persistent view, at least in many countries and for many co-operatives, that assets should not be divided among current members on dissolution.

Overall, co-operative thought and principles do not strictly prohibit dividing co-operative assets among members in a demutualization; but they do identify the issue and raise ethical considerations. The current version of co-operative principles suggests that co-operatives are responsible for putting the values of the co-operative movement into practice. It would be fair to say that there is a roughly 200-year continuous and evolving body of co-operative thought suggesting that, beyond legal requirements, there are ethical and principled considerations that must be taken into account by co-operatives where capital is concerned.

CO-OPERATIVE CAPITAL IN BRITISH CO-OPERATIVE THOUGHT

British co-operative thought is of particular interest in the history of co-operatives because of the disproportionate influence of British co-operatives, especially the Rochdale Society of Equitable Pioneers, in the world co-operative movement.

Prior to the creation in 1844 of the famous Rochdale co-operative, early British co-operative leaders held firmly to the idea that property in co-operatives is always and only collective in character, and should never be allocated or distributed to members. The Third Co-operative Congress held in London in 1832 resolved, “it is the unanimous decision of the delegates here assembled that the capital accumulated by such associations (i.e. co-operatives) should be rendered indivisible” – and that organizations not adhering to this principle would not be recognized as co-operatives.¹ Capital was to be raised from individual members through weekly subscriptions, but once raised, the capital was to be used only for the good of all; in the early co-operative movement, this was intended to be to create co-operative workshops and landed communities for the employment of members.

These early ideas reflected a fundamental suspicion by co-operators about the roles of profit and capital, which they saw as linked concepts. They viewed profit as unearned income; one of their main critiques of existing businesses was that owners of capital claimed all the surplus. A main purpose of forming co-operatives was to ensure that surpluses were distributed to those whose actions created them through production or consumption.

As 19th-century writer George Jacob Holyoake saw it, three features characterized co-operatives: honesty, “equitable distribution of profits among all concerned in creating them, whether by purchases, service in distribution, or by labour”, and education.² “In England,” he emphasized, “we do not apply the term co-operative to business in reference to the source of profit, but to the distribution of the profit” – in other words, what makes a co-op a co-op is not how it earns

1 Appendix III: Model Rules for Co-operative Societies in 1832, from the Report of the Third Co-operative Congress, held in London, April 23rd to 30th, 1832. In Bonner 1961, p. 507.

2 Holyoake 1879, p. 78.

money, but what it does with it after it earns it.³ And the important point was that surpluses not be distributed simply to those who owned capital.

Hall and Watkins – in the early to mid-20th century the leading authorities on co-operative principles and practices – summarized the legacy of this tradition as follows: “the reason why co-operators refuse the lender of capital anything more than bare interest is that they are endeavouring to find an equitable method of sharing the benefits derived from this business amongst all those who contribute to its success.”⁴ Equitability is the underlying concept. Co-ops wanted no person to receive a return that was not attributable to their own active contribution to the business. Every person was to get out of a co-op only and exactly what they earned or contributed.

The 1844 statutes of the Rochdale Pioneers set British co-operatives on a new course by settling on the idea of individual share capital. As Cole put it one hundred years later:

*The Pioneers, by making the payment of fixed interest on paid-up capital definitely a first charge on the trading surplus, gave those who joined the Society a solid reason for leaving their savings on deposit with it. They were, however, evidently fearful that this practice of paying interest on capital might, unless there were careful safeguards, lead them astray into the evil practices of capitalism; and they were accordingly at pains to limit the amount of capital which any member could hold. They set out with the notion that they were likely to need a certain minimum amount of capital, and thereafter a certain maximum amount per member...*⁵

Rochdale’s compromise was that members would have shares and capital would have a role, but these were to be kept in their place. After remunerating share capital at only a fixed 3.5% rate, the statutes provided that “the remaining profits shall be paid to each member in proportion to the amount of money expended at the store.”⁶ The co-operative was not intended to accumulate capital (except by having more members and shares); any surplus earnings were to be paid out.

Even in this bare-bones system, a co-op might retain some surpluses or reserves, and the 1844 statutes did not foresee how such excess capital might be dealt with in the event of dissolution. In itself this is not surprising, as the original statutes were not specific about or did not foresee a number of key co-operative ideas (including one member, one vote). The Pioneers did, however, deal with the dissolution issue when they revised their statutes in 1854, which

³ *Ibid.*, p. 85.

⁴ Hall and Watkins 1937, p. 355.

⁵ Cole 1944, p. 65.

⁶ Appendix V, Extracts from the Laws and Objects of the Rochdale Society of Equitable Pioneers. 1844, in Bonner 1961, pp. 511-12.

interestingly was at the same time they developed the idea that the co-op would have an educational fund. The new 1844 article stated that, in the case of dissolution, gross assets would be used to repay debts and shares after which the remainder (the net assets) “shall be applied by the trustees for the time being of the society to such charitable or public purposes as they think fit.”⁷ The net assets were ultimately charitable or communal in nature. In this way Rochdale continued earlier ideas of indivisible capital in co-operatives associated with the public good; the innovation was that this indivisible capital would only be part of the whole, not all of it.

Nevertheless, it would be fair to say that Rochdale started the British movement on a track of paying attention to the distribution of dividends, and not to think about the growth or accumulation of permanent capital. “There was at certain periods in the history of the (Rochdale) Society a tendency among the members to regard as an embarrassment the rapid growth of the capital placed in its hands. When the available capital came to exceed what could be profitably employed in the Society’s own business, the committee did not quite know what to do with it.”⁸

Rochdale’s success inaugurated two generations of amazing growth and spread of retail co-operation in Britain. Improved working-class incomes and the winning formula of Rochdale principles and practices (central among these individual share ownership, patronage refunds on purchases, democratic voting, and education) to produce the world’s biggest and leading co-operative movement. Along the way, it is fair to say that the thinking and practice of the British movement became more narrowly and superficially focused on the “dividend” (patronage refund), and earlier ideas (including indivisible capital funds) were relatively neglected.

Nevertheless, the original critiques of capital and profits, and desire for equity, were embedded in the routinized practices of the late 19th-century British co-ops. Capital continued to be limited, and paid a fixed return; earnings continued to be distributed in proportion to purchases. Co-ops did grow in capitalization, but this was due to growth in numbers of members and reinvestment of refunds in new shares. **Although the vast majority of capital was held by individual shareholders,**⁹ the growth was in proportion to people’s numbers and patronage. Each member-shareholder accumulated shares in proportion to their own purchases; thus the principle of equity (members rewarded only according to their contribution) was preserved. Where reserve funds were built up, these were collective and indivisible during the life of the co-operative.¹⁰

7 Lambert 1962, p. 81.

8 Cole 1944, p. 93.

9 Total funds of retail societies in 1935 were £198m, of which £135m was share capital, £34m was loan capital (also from members; share value per person was regulated by law but additional loans were not); and only £13m was disclosed reserves. Carr-Saunders et al. 1942, p. 129.

10 See Hall and Watkins, pp. 268ff on the operation of co-operatives under the Industrial and Provident Societies Acts; pp. 395ff on reserve funds and dividends.

These practices did not address what to do with collective assets in the case of dissolution. British legislation provided that on dissolution of a co-op, the members would decide how its property would be distributed; it appears they were free to allocate collective reserves built up over many years to the current members at time of dissolution. Legislation did not constrain them; only co-operative principles would have done. But British writings about co-operatives, and sample bylaws, in this period do not appear to address the issue. There are likely at least three reasons for this. First, the movement had been growing rapidly, so it may have seemed unnecessary to worry about dissolutions. Second, co-operative retailing is a service function that (it appears) will always be needed – there will never cease to be a need for purchases of food and daily necessities, so leaders may never have contemplated a co-operative ceasing to be needed or winding up while still in the black. Third, consumer co-operatives are characterized by a large number of members with relatively little stake each; the unallocated assets on dissolution might be assumed to be small compared to the number of members, and so no topic of great concern. For whatever reason, despite the longtime teaching of the movement and the example of the Rochdale Pioneers, the concept of permanently indivisible property was not explicit in the British tradition by the 20th century.

CO-OPERATIVE CAPITAL IN CONTINENTAL EUROPEAN THOUGHT

Alongside British co-operatives and co-operative thinkers, those in France and Germany were also influential in the global co-operative movement. The starting points were similar to Britain, but on the continent the idea of permanently indivisible co-op capital, linked to a public or common-good mission, remained much more explicit well into the 20th century.

This perspective began with the idea – as we have seen, a founding idea of the co-operative movement – that use of capital for collective and community benefit was higher in purpose and more in keeping with co-operative principles than allocating it for individual benefit. Well-known French co-operative leader and publicist Charles Gide wrote in 1930, “the surplus is increasingly tending to be used for community rather than individual purposes.’ ... I have always thought that from the standpoint of co-operative principle this use of the surplus is thoroughly sound.”¹¹ Given this perspective, many thinkers considered it a foundational co-operative principle that assets accumulated for public purposes should never be parceled out among individual co-operative members. Lambert 1962, who considered that “accumulation and distribution of the surplus and treatment of the net assets” was the second key principle of co-operatives (following only democracy), provides a useful review.¹²

11 Lambert 1962, p. 77.

12 *Ibid.*, pp. 74ff.

As in Britain, early co-op leaders were thinking mainly about workers' production co-operatives, and in this context placed front and centre the idea of indivisible common capital. Lambert describes how Buchez, writing in 1831, "was opposed to any extra assets – corresponding to the reserves – being shared out among the members. There would be a temptation for the members to increase the registered capital by any and every means, in the main by overcharging the customers, and then to wind up the society and share out its assets."¹³ As in Britain the desire was to create a form of business that would hinder such self-interested behavior, a characteristic Lambert refers to as the "disinterested outlook of the co-operative movement": co-ops stand for more than the short-term and narrow self-interest of current members, and this public-spirited outlook is expressed in their views of capital and profit.

Lambert cites several influential 20th-century writers who kept these perspectives alive with particular emphasis¹⁴:

- Ernest Poisson: "Special importance attaches, *in the event of the dissolution of a co-operative, to the transfer of its assets to a disinterested organisation.*" To him, this along with democracy and the dividend was one of the three most important co-op principles.
- Georges Fauquet: "It is easy to prove that, when a society is wound up, the distribution of the reserves that have hitherto belonged to the members as a whole is at variance with the vital principles of co-operation."
- André Hirschfeld: "When a co-operative society is dissolved, the surplus assets, after repayment of the shares, must be transferred to other co-operatives or to bodies serving the community and in no circumstances may the refunded value of the shares exceed their face value."

Based on these authoritative thinkers, Lambert concludes that "Altruism is thus essential to Co-operation ... members only seek to further their own interest in so far as they consider it consistent with the general interest, i.e. that of the vast majority of the citizens."

Lambert's review is no doubt a little selective, and weighted towards French writers. Hermann Schulze-Delitzsch and his successors in Germany provide an example of a co-operative tradition that emphasized individual share-ownership and the autonomy of groups of co-operators to control their businesses for their own personal benefit. However, Schulze-Delitzsch's contemporary Friedrich Wilhelm Raiffeisen provides an example more in keeping with the French tradition. Raiffeisen argued that "communal ownership is of incalculable significance" and passionately

13 *Ibid.*, p. 81.

14 *Ibid.*, p. 82.

argued for credit unions to build up strictly indivisible capital and to use it for the benefit of the whole community, not only the current members.¹⁵

THE 1937, 1966, AND 1995 ICA PRINCIPLES

The views of thinkers described and analysed above were influential in the guidelines created by the International Co-operative Alliance (ICA) – the world apex body for co-operatives – and communicated to co-operative movements throughout the world in the 20th century. Effectively the ICA’s statements represent an amalgam or synthesis of these and other bodies of co-operative thought, and contain reflections of the original views of the earliest leaders of co-operatives. What do the ICA’s statements say about the nature of capital in co-operatives and its treatment, including distribution (if any) to members when the lifetime of a co-operative is over, or at any other time?

1937

One of the ICA’s first large-scale attempts to restate and generalize “Rochdale” co-operative principles occurred in 1937, when co-operative leaders and representatives from many countries deliberated on the Rochdale tradition and on what was essential to co-operatives. At that time, the ICA settled on 4 essential features that defined co-operatives and would qualify them for membership in the ICA: open membership; democratic control; “distribution of the surplus to the members in proportion to their transactions”; and limited interest on capital.¹⁶ By and large this list, and especially the prominence given to patronage refunds, reflects the continuing dominance at that time by the British movement. But along the way a number of ideas and practices were discussed by the ICA and its members.

One of the points of debate was “the question of the proper method of the disposal of the Collective Assets of a Co-operative Society.”¹⁷ Questionnaires showed that “in a considerable number of countries the Principle of the Indivisibility of Reserve Funds and Collective Assets was observed and, in several of them, had the force of law.” However, “in other countries, notably in Great Britain, the fund which remains over on the liquidation of a society, after all its obligations have been met, is regarded as the property of the shareholding members of the society at the time of the liquidation, or dissolution, and is divided amongst them in proportion to their shares.” The view of the British movement on this point was challenged during the 1930s discussions of co-op principles by leaders who contended “that shares in a co-operative society have no

¹⁵ Raiffeisen 1951, p. 116 and ff.

¹⁶ International Co-operative Alliance (ICA), 1937, reprinted 1964.
The 1937 report is discussed in Watkins, 1986, p. 7, and Bonner 1961, pp. 295ff.

¹⁷ ICA 1937, and the same for the following.

claim upon any part of those surpluses beyond the limited amount of interest that may be accorded by the rules.” These participants argued that collective assets derive “largely from the operations of the past members of the society on which the members remaining at the time of the liquidation have no legitimate claim.”

The British movement’s position was based in co-operative practice, which as we have seen did not pay a lot of attention to dissolution of co-ops, and generally adopted a laissez-faire attitude towards what members in individual co-ops might do. Those who disagreed with the British position expressed views that are recognizably based in 19th- and 20th-century discussions of co-op principles. The concern that shares not entitle owners to anything beyond the nominal value of the shares reflects historic ideas of limited privileges for capital. The idea that present members should not benefit from assets built by past members reflects the historic ideas associated with the value of equity, that no member should benefit from something they did not themselves create and earn.

The commission took no strong view on the subject of indivisible reserves. They did make the observation that a third view was that restriction on disposal of assets was perhaps unnecessary “in those countries where, as in great Britain, Co-operative Societies are established without definite term to their existence, and, in fact, only liquidate or dissolve by reason of their inability to meet their obligations to their creditors when it is clear no collective assets remain for disposal.” In other words, perhaps disposition of assets did not need to be regulated because the issue would never arise in real life. The report on co-operative principles included a committee recommendation that all co-ops consider putting into practice and into law that remaining assets of a co-operative society be passed to other co-operative organizations, “to be used for purposes of financing new co-operative enterprises; assisting societies in difficulties; or to works of social welfare, education or public utility.”

1966

When the ICA again reviewed co-operative principles in the mid-1960s, international consultation and discussion yielded a new list of six principles put together by a special ICA commission.¹⁸ Although the principles say co-operatives “should” do one thing another, they were presented to the 1966 congress as universal and inseparable principles that “all possess equal authority,” “form a system and are inseparable ... and should be observed in their entirety by all co-operatives.”¹⁹

18 International Co-operative Alliance 1966. The 6 principles were: open and voluntary membership; democratic control; limited interest on shares; return of surplus to members; co-operative education.

19 *Ibid.*, pp. 160 and 181. See Fairbairn 1994.

The third principle specified that return on shares, if any, should be limited. In explaining this principle the commission reiterated the Rochdale Pioneers' view that capital in a co-operative is special, and that co-operatives were about "labour working with capital, not labour working for capital of its possessor." Co-operators therefore reject "the claim of the owners to any part of whatever surplus remained after the other factors of production had been remunerated at market rates."²⁰

Following the third principle, the commission went on to discuss the next question, "disposal of surplus," under which heading they observed "there are two sets of considerations which, if (co-operatives) hope to prosper, they dare not neglect. On the one hand, there are considerations of business prudence; on the other considerations of equity."²¹ The commission spent a lengthy section of its report discussing how equity related to division of surpluses. Essentially the commission relativized the practice of patronage refunds (conveying that such a practice is certainly allowable, but not required) and emphasizing that surpluses can also be used for collective benefits, with equity being the important consideration. The commission observed in passing that "in deciding in what forms and in what proportions or amounts the surplus or savings shall be allocated or divided, the members as a body have, and ought to have, absolute discretion."²²

The discussion at the 1966 Congress reinforced the importance of equity and multiple uses of surpluses. Lambert stressed in the plenary discussion that surpluses and reserves were to be used for the benefit of the members, not necessarily to be distributed to them, "and again no one should benefit under co-operative auspices to the disadvantage of someone else."²³

The changed language around use of surpluses reflected a shift from the British movement's strong focus on patronage refunds, and also the influence of Lambert and others who were prominent in the discussion. The new list of principles discussed co-operative surpluses in ways that echoed wider and deeper traditions of co-operative thought, rather than simply dividing up proceeds individually.

The fourth principle, entitled "Return of Surplus to Members," was worded as follows:

Surplus or savings, if any, arising out of the operations of a society belongs to the members of that society and should be distributed in such manner as would avoid one member gaining at the expense of others.

20 *Ibid.*, pp. 168-9.

21 *Ibid.*, p. 171.

22 *Ibid.* (and ff for discussion).

23 *Ibid.*, p. 213.

The idea that co-operatives must “avoid one member gaining at the expense of others” directly reflects the original purposes of co-operatives, to ensure equitable relations, to eliminate unearned income, and to give each member fully but only what they themselves earned or created. The principle went on to note that this could be realized in practice “by provision for development of the business of the co-operative”, “by provision of common services, or” by patronage refunds. In practice, the subtleties involved were likely lost on many co-operators who used “patronage refunds” as a shorthand way to refer to the fourth principle.

William Pascoe Watkins, who was the rapporteur of the commission that presented the new principles, later wrote that the commission was seeking to stress that co-operatives serve wider purposes beyond the promotion of individual member economic interests.²⁴ Or as the commission put it, “the common element at all times has been that Cooperation at its best aims at something beyond promotion of the interests of the individual members who compose a cooperative at any time.”²⁵

By my reading the commission report and plenary discussion do not contain any reference to the question, which had been of interest in 1937, of how to divide assets on dissolution. The big points of discussion in the 1960s had to do with voluntarism and political neutrality in the context of the Cold War and co-operative membership in Communist countries; perhaps those discussions drove out others. In any event, the 1966 principles reinforced or even strengthened traditional co-operative views of capital and of the importance of equitable, nonspeculative, mutual benefits to members, without being very specific. The ideas embodied in the principles were considered binding and definitional for co-operatives, but their interpretation and application were basically left up to individual co-operatives and their members.

1995

The 1995 ICA “Statement on the Co-operative Identity” was the outcome of a new, systematic attempt to synthesize many generations of co-operative thought in a form more or less equally applicable to all types of co-operatives.²⁶ The statement changed the nature of co-operative principles, because the principles were no longer used to define what was or was not a “true” co-operative or a legitimate member of ICA. Instead, there was now an official international definition of a co-operative in one sentence: “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.” This definition was linked to a list of basic values of co-operative organizations including “self-help, self-responsibility, democracy,

²⁴ Watkins 1986, p. 7.

²⁵ International Co-operative Alliance 1966, p. 160.

²⁶ MacPherson 1996.

equality, equity, and solidarity.” The definition and the values are mandatory for co-operatives; following from them, the principles (now seven) “are guidelines by which co-operatives put their values into practice.”²⁷

The third 1995 principle is “Member Economic Participation,” explained as follows: “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.” The principle also notes that “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.

Thus the concept of indivisible reserves remains entrenched in co-operative guidelines, with a status equal to that of patronage refunds – both being (non-mutually-exclusive) ways to put co-operative values into practice.

The background paper published by the ICA to support the 1995 statement expands on this principle by explaining, “Co-operatives operate so that capital is the servant, not the master of the organisation.”²⁸ The paper goes on to address the nature of collective capital in co-operatives:

as co-operatives prosper, they may create reserves, derived from the retained earnings of the organisation’s activities. Normally, all or a significantly large proportion of these earnings are owned collectively, representing the collective accomplishments of members supporting their co-operative. In many jurisdictions this collective “capital” is not even divided among the members should the co-operative cease to exist; rather, it is distributed to community enterprises or other, associated co-operatives.

The report goes on to say that setting up indivisible reserves “is vitally important to securing the long-term viability of the co-operative.”

Historic co-operative thinking about the nature of capital is also reflected in observations that special investments by members in co-operatives should be remunerated at “a competitive, not a speculative rate: for example, the government or normal bank interest rate.” No doubt a case

²⁷ The current principles are voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training, and information; co-operation among co-operatives; and concern for community.

²⁸ MacPherson 1996, p. 19.

could be made, by extension, that members should also not receive speculative returns in the event of the dissolution or sale of a co-operative, but this is not explicitly addressed.

In short, the 1995 co-operative identity statement and supporting reports reflect long traditions of co-operative thought, including that basic co-operative values are expressed in practices such as limiting the rights and returns to ownership in co-operatives; maintaining the indivisibility of at least some co-operative resources; and transferring net assets to other collective purposes in the event of dissolution. The statement essentially leaves it open to co-operatives to interpret the values for themselves, and it includes signposts for how to do so in most or many cases.

CONCLUSION

There is a rich body of thought, accumulated over nearly two centuries by co-operative leaders and writers, addressing questions of capital, assets, and ownership in co-operatives. Reflecting the international breadth and diversity of co-operatives, this body of thought is less about specific, binding rules, and more about ethics, principles, and the basic purposes of co-operatives. Historically few co-operative leaders and writers specifically discussed demutualization, but they did address relevant topics including the importance of nonspeculative returns, indivisible collective property, and what to do with collective assets in the event of the dissolution of a co-operative. A fair reading of this body of thought suggests that many co-operative leaders believed it would be illegitimate for a present generation of members of a co-operative to sell or privatize accumulated assets and to gain speculative or unearned individual benefits from doing so. Co-operative principles or values are binding and must be taken into account in such circumstances, though the interpretation and application is generally up to co-operative members themselves.

REFERENCES

- Bonner, Arnold, 1961. *British Co-operation: The History, Principles, and Organisation of the British Co-operative Movement*. Manchester: Co-operative Union.
- Carr-Saunders, A.M., P. Sargant Florence, and Robert Peers, 1942. *Consumers' Co-operation in Great Britain: An Examination of the British Co-operative Movement*, rev. ed. London: George Allen and Unwin. (1st ed. 1938)
- Cole, G.D.H., 1944. *A Century of Co-operation*. London: George Allen and Unwin for the Co-operative Union.
- Fairbairn, Brett, 1994. *The Meaning of Rochdale: The Rochdale Pioneers and the Co-operative Principles*. Saskatoon: Centre for the Study of Co-operatives Occasional Paper.
- Hall, F., and Watkins, W.P., 1937. *Co-operation: A Survey of the History, Principles, and Organisation of the Co-operative Movement in Great Britain and Ireland*. Manchester: Co-operative Union.
- Holyoake, George Jacob, 1879. *The History of Co-operation in England: Its Literature and Its Advocates*. Vol. II The Constructive Period – 1845 to 1878. London. Reprinted New York: AMES Press, 1971.
- International Co-operative Alliance, 1937, reprinted 1964. *Reformulation of the Fundamental Principles of the Co-operative Movement*. London: International Co-operative Alliance, Studies and Report. Reproduced at <http://www.uwcc.wisc.edu/icic/orgs/ica/pubs/studies/The-Present-Applications-of-the-Rochdale1/The-Principles-of-Co-operation1.html> as accessed 15 January 2015
- International Co-operative Alliance, 1966. "Report and Resolution of the Commission on Cooperative Principles, and Discussion," in ICA Twenty-Third Congress Report. Vienna, 5-8 September, pp. 154-215.
- Lambert, Paul, 1962. *Studies in the Social Philosophy of Co-operation*, transl. Joseph Létargez. Manchester: Co-operative Union. Original French edition 1959 *La doctrine coopérative*, Paris and Brussels.
- MacPherson, Ian, 1996. *Co-operative Principles for the 21st Century*. Geneva: International Co-operative Alliance.
- Raiffeisen, Friedrich Wilhelm, 1951. *Die Darlehnskassen-Vereine*, 7th ed., Neuwied am Rhein: Raiffeisendruckerei (unaltered reprint of the 5th ed. of 1887).
- Watkins, W.P., 1986. *Co-operative Principles Today and Tomorrow*. Manchester: Holyoake Books.

APPENDIX D –

Federal, Provincial and Territorial Law Dedicated to Co-operatives: THE DISTRIBUTION OF ASSETS ON DISSOLUTION.

BRITISH COLUMBIA CO-OPERATIVE ASSOCIATION¹

Memorandum may provide that assets devolve to similar organizations once liabilities paid. This clause may be unalterable, s.196 and s.173 (housing co-ops) and s.178.1 (community service co-ops). Or co-ops may distribute surplus to members once liabilities paid, s.194.24.

ALBERTA RURAL UTILITIES ACT²

Liquidator to take custody, s.25. Once all liabilities and member equity have been paid, the liquidator applies to the Court of Queen's Bench to formally dissolve the co-op, s.25.9
Distribution to members is on the basis of number of utility contracts held or by alternative method specified by bylaw approved by the members, s.25 (4)

ALBERTA THE CO-OPERATIVES ACT³

The liquidator takes custody of the co-op and:

- Opens a trust account
- Sells any co-op property
- Maintains separate list of members, investment shareholders, creditors and other claimants
- Distribute the proceeds (s.321:322)

SASKATCHEWAN THE CO-OPERATIVE ACT⁴

As provided in by-laws, once liabilities/member equity/charities paid, s.160. Co-ops with statutory reserves or unallocated surplus devolve assets to charities, co-ops or persons designated by Registrar, s.160.

MANITOBA THE CO-OP ACT⁵

A non-profit cooperative MUST disseminate all assets to another non-profit, charity, etc., and a for profit cooperative may choose that option, but it is not mandatory.⁶

1 http://www.bclaws.ca/civix/document/id/complete/statreg/99028_01

2 [http://www1.agric.gov.ab.ca/\\$department/deptdocs.nsf/all/acts9298](http://www1.agric.gov.ab.ca/$department/deptdocs.nsf/all/acts9298)

3 <http://www.qp.alberta.ca/documents/Acts/C28P1.pdf>

4 <http://www.qp.gov.sk.ca/documents/English/Statutes/Statutes/C37-3.pdf>

5 https://web2.gov.mb.ca/laws/statutes/ccsm/c223_2e.php

6 Correspondence with Terri Milne from Manitoba government, 17-4-15

ONTARIO CO-OPERATIVES CORPORATION ACT ¹	QUÉBEC CO-OPERATIVES ACT ²	NEW BRUNSWICK CO-OP ASSOCIATION ACT ³	NOVA SCOTIA CO-OP ASSOCIATION ACT ⁴	PRINCE EDWARD ISLAND CO-OP ASSOCIATION ACT ⁵
<p>After the payment of debts and liabilities, the articles or by-laws may provide that remaining property is to be distributed to members either equally or in proportion to patronage returns accrued over the last five years. Remaining property may also be distributed to other co-ops or charities, s.162. In the case of non-profit housing co-ops, remaining property must be distributed to other non-profit housing co-ops or charitable organizations. s.5(3.1) (c)</p>	<p>Liquidator pays liabilities and member equity as per by-laws. The balance of assets are devolved by the co-op to another co-op, a federation, a confederation or to le <i>Conseil Québécois de la coopération et de la mutualité</i>, s.185.</p> <p>The agri-coop are excluded of this rule s.208</p>	<p>Liquidator distributes remaining assets, after creditors' and members' claims are met, in proportion to shares held by members at the time of dissolution unless other provisions are made in the articles, Reg.47.</p>	<p>After satisfaction of all liabilities and creditors, assets of for-profits are divided among the members, s.60e, or as stated in by-laws, s.61(1). Assets of non – profits are given to another non-profit or charity, s.61G. May specify the non-profit or charity in the by-laws, Reg 29.</p>	<p>When an association is wound up and any amount remains after providing for all claims of creditors and members, such amount shall be paid out according to a resolution passed by a majority present at the final meeting of the association called by the liquidator to the Co-operative Union of Prince Edward Island s.40</p>

1 <http://www.ontario.ca/laws/statute/90c35>

2 http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/C_67_2/C67_2_A.html

3 [http://www2.gnb.ca/content/gnb/en/services/services_renderer.631.Co-operative_\(Co-ops\)_Incorporation.html](http://www2.gnb.ca/content/gnb/en/services/services_renderer.631.Co-operative_(Co-ops)_Incorporation.html)

4 <http://nslegislature.ca/legc/statutes/co-operative%20associations.pdf>

5 <http://www.gov.pe.ca/law/regulations/pdf/C&23G.pdf>

**NEWFOUNDLAND
AND LABRADOR
CO-OPERATIVE ACT¹**

S 115 5 After passing a special resolution under this section the funds of or funds derived from liquidated property and assets of the co-operative, including a statutory reserve, shall be applied as follows:

- (a) first to pay the debts and liabilities of the co-operative;
- (b) second to pay members funds which they are entitled to including the return of original share capital; and
- (c) third to pay to:
 - (i) a non profit corporation, society, organization or co-operative established for charitable or benevolent purposes,
 - (ii) a co-operative established with similar objects, or
 - (iii) a fund to be used for the development of co-operative societies.

**YUKON
CO-OP
ASSOCIATION ACT²**

S 28 Sections 209 to 230 of the Business Corporations Act shall, insofar as they are applicable, apply to an association. R.S., c.34, s.28.

**Business
Corporations Act:**

223 (i) after final accounts are approved by the Supreme Court, distribute any remaining property of the corporation among the shareholders according to their respective rights. S.Y. 2002, c.20, s.223

**NORTHWEST TERRITORIES
CO-OPERATIVE
ASSOCIATION³**

S 32 (3) (e) the intended disposition of any undistributed surplus remaining after the amounts referred to in paragraphs (a) to (d) have been provided for.

**NUNAVUT
CO-OP
ASSOCIATION ACT⁴**

the intended disposition of any undistributed surplus remaining after the amounts referred to in paragraphs (a) to (d) have been provided for 32 (e).

1 <http://assembly.nl.ca/legislation/sr/statutes/c35-1.htm>

2 <http://www.gov.yk.ca/legislation/acts/coas.pdf>

3 <https://www.justice.gov.nt.ca/en/legislation/#gn-filebrowse-0:/c/cooperative-associations/>

4 2007_12_18 : <http://www.justice.gov.nu.ca/apps/authoring/dspPage.aspx?page=CURRENT+CONSOLIDATIONS+OF+ACTS+AND+REGULATIONS&letter=C>

**CANADA
CANADA CO-OPERATIVES ACT¹**

122. Subject to Parts 20 and 21, the articles of a cooperative may provide that, on dissolution of the cooperative and after the payment of all debts and liabilities — including any declared and unpaid dividends, the amount to be paid to the holders of any investment shares and the amount to be paid on the redemption of membership shares — the value of the remaining property of the cooperative is to be distributed or disposed of to any person, including distribution

- (a) among the members at the time of dissolution, in any manner, including equally among the members irrespective of the number of membership shares or amount of member loans, if any, held or made by a member;
- (b) among the members at the time of dissolution on the basis of patronage returns accrued to those members during a stated period before the dissolution; or
- (c) to charitable organizations or cooperative entities.

354 e Non-profit housing: its remaining property is to be transferred to or distributed among one or more non-profit housing cooperatives, cooperatives incorporated in a province that have similar objectives and limitations, or charitable organizations.

360 4 Workers co-op Unless otherwise provided in the articles, on dissolution of a worker cooperative, not less than twenty per cent of the surplus of the cooperative, after the payment of its liabilities, must be distributed to another cooperative, a non-profit entity or a charitable entity before any distribution is made to a member or shareholder.

¹ <http://laws-lois.justice.gc.ca/eng/acts/c-1.7/index.html>

APPENDIX E –

Disinterested Transmission of Assets in Case of Dissolution:

INTERNATIONAL EXAMPLES

Enzo Pezzini

ITALY

In Italy, in case of dissolution of a co-operative, disinterested transmission of assets is part of the mutuality clauses (or “mutual aim” (*scopo mutualistico*)): prohibition to distribute reserves to user-members, obligation to devolve all remaining assets to mutual funds in case of liquidation, ‘partly profit non-distribution constraint’. Prevalently mutual co-operatives “must provide and observe the obligation to devolve in case of liquidation all assets ... to the mutual funds of art. 11, Law 59/1992” (art. 2514 CC); (Fici in Cracogna/Fici/Henry 2013, pp. 489, 490) Pezzini E., 2003 « La réforme du droit coopératif en Italie », Recma n°290. pp.74-86

SPAIN

In Spain, the law requires two obligatory funds to be set up: the obligatory reserve fund and the education and promotion fund. The obligatory reserve fund cannot be distributed among members even if the co-operative is liquidated (LC art. 55). The education and promotion fund is not attachable and distributable (Fajardo Gracia in Cracogna/Fici/Henry 2013, pp. 711, 712).

PORTUGAL

In Portugal, art. 79 CC covers the “destination of patrimony in liquidation”. The amount remaining in the legal reserve after payment of all expenses arising from the liquidation process, payment of debts including redemption of investment securities, bonds and other payments made by members of the co-operative, may never be returned to co-operative members individually (Namorado in Cracogna/Fici/Henry 2013, p. 645).

FRANCE

In France, reserves of co-operative societies are indivisible following the principle of disinterested transmission of assets to prevent the distribution of co-operative assets among members. In case of dissolution, the remaining assets are transferred to another co-operative society or to a charity (art. 19 L 1947, Hiez 2013, p. 263 n. 141.36 and for agricultural co-operatives Hiez 2013, p. 397, n. 1141.31). An exception is made for co-operatives of entrepreneurs/traders (Hiez 2013, p. 263 n. 141.36).

UNITED KINGDOM

In the United Kingdom, on dissolution of a society, the destination of any surplus assets is governed by the society's rules and most co-operatives provide for transfer to other co-operatives, co-operative organisations or charities or other disinterested purposes. Without any provisions on this issue in the society's rules, distribution according to shareholding would be possible. Therefore, inclusion of an appropriate provision in society rules is particularly important (asset lock and disinterested transmission of assets in case of liquidation) (Snaith in Cracogna/Fici/Henry 2013, p. 747).

NETHERLANDS

In the Netherlands, compulsory reserves of the co-operative are either statutory reserves mandated by law (art. 2:373, par. 4 NCC) or reserves provided for in the by-laws. In both cases, a co-operative is not allowed to distribute these reserves nor use them for the redemption of losses incurred by the co-operative (art. 2:58, par. 4 NCC; van der Sangen in Cracogna/Fici/Henry 2013, p. 553).

GERMANY

In Germany, establishment of legal reserves as well as the manner in which such reserves are to be established and disposal of the reserves in case of liquidation of the co-operative is left to the by-laws or to the members to decide (§§ 7 n. 2 and 91 GenG; Münkner in Cracogna/Fici/Henry 2013, p. 421).

JAPAN

In Japan, the residual assets can be distributed among members in case of dissolution. There are no legal provisions for the indivisible reserve fund, although most of the co-operatives have such a provision in their by-laws (Kurimoto in Cracogna/Fici/Henry 2013, p. 517).

FINLAND

In Finland the law does not regulate whether the reserve fund is indivisible, divisible or divisible under certain circumstance. Notwithstanding possible stipulations in the by-laws, the systematic reading of the Act and the rules on taxation gives to understand that the reserve fund is divisible (Henry in Cracogna/Fici/Henry, pp. 386, 387).

NORWAY AND DENMARK

In Norway and Denmark, the rules on the issue of indivisible reserves are different. In Denmark, as long as the interests of the creditors are duly taken care of, the entire equity capital – including surplus from previous years – may be distributed to the members (Fjørtoft/Gjems-Onstad in Cracogna/Fici/Henry 2013, p. 574), while in Norway, unallocated surplus will automatically be part of the general equity – the collective capital – which cannot be distributed to members so long as the co-operative is a going concern (Fjørtoft/Gjems-Onstad in Cracogna/Fici/Henry 2013, p. 572).

APPENDIX F –

Indivisible Reserves in the United States: **EXAMPLES FROM NEW HAMPSHIRE AND NEW YORK**

Statutes > New Hampshire > TITLE XXVII — CORPORATIONS, ASSOCIATIONS, AND PROPRIETORS OF COMMON LANDS (Includes Chapters 292 - 303) > CHAPTER 301-A — CONSUMERS' COOPERATIVE ASSOCIATIONS > Section 301-A:33 Dissolution.

SECTION 301-A:33 DISSOLUTION.¹

The provisions of RSA 292 and 293-A for the dissolution of nonprofit and business corporations shall apply to associations formed under this chapter; provided, however, that the secretary of state shall charge and collect a fee of \$25 for filing articles of dissolution and issuing a certificate of dissolution. In the event of dissolution of the association, the assets, after payment of the association's debts and expenses, shall be distributed in the following manner:

I. The par value or book value, whichever is lower, of the membership certificates or shares shall be returned to the members. Amounts paid on subscriptions shall be returned to subscribers. The amounts allocated in distribution of net savings under RSA 301-A:28 shall be returned to those members entitled to them.

II. Any surplus remaining after the distributions in paragraph I may be distributed as a contribution to any cooperative association or other nonprofit association to which contributions are deductible from income tax under current internal revenue service regulations.

1

Source. 1983, 462:1, eff. July 1, 1983. 2004, 248:27, eff. July 1, 2004.

N.Y. COOPERATIVE CORPORATIONS LAW 17 - VOLUNTARY DISSOLUTION

2008 version

§ 17. Voluntary dissolution. A cooperative corporation may, at any meeting and upon due and express notice previously given, by vote of two-thirds of all of the members or stockholders voting thereon, discontinue its operations and settle its affairs.

Thereupon it shall designate a committee of three members who shall, on behalf of the corporation and within a time fixed in their designation or any extension thereof, liquidate its assets, pay its debts and expenses, and divide the net assets among the members, patrons or stockholders, as they may be entitled under the certificate of incorporation or by-laws. Upon final settlement by such committee, the corporation shall be deemed dissolved. The committee shall make a report in duplicate of the proceedings had under this section, which shall be signed by its members, acknowledged by them before an officer duly authorized to administer oaths in this state, and filed in the offices in which its certificate of incorporation is filed.

In the case of a cooperative corporation which has adopted the delegate plan of voting at a convention, as provided in this chapter, the vote to be taken as provided herein may be taken at a convention meeting and the required vote shall be two-thirds of the delegates present and voting.

After the payment of the corporation's debts and after provision has been made for the retirement of its capital stock outstanding, if any, at par, or other stated dissolution value, and accruals thereon, and other fixed obligations, if any, held by members, the net assets remaining may be distributed to members and/or patrons by distribution based on dollar volume of purchases by members or patrons or other unit of measure or on products marketed as shown by its books of account over the preceding six fiscal years or in case the estimated cost of making distribution by the foregoing method shall, in the opinion of the committee, approximate fifty per centum of the amount available for distribution, the corporation may dispose of its net assets by pricing its inventory downward or raising its advances to members or both to the extent deemed desirable to finally wind up its affairs in the current fiscal year.

APPENDIX G –

the Quebec Experience with the Indivisible Reserve:

HISTORICAL OVERVIEW

It is interesting to track the recognition of the indivisible reserve in Québec's co-op history. In the case of *caisse populaire*, from 1900 to 1911, the reserve was divisible upon dissolution but not during operation. One hypothesis for this rule was that for the first years of the *caisse*, the founder, Alphonse Desjardins, was worried about a possible lack of interest in this new business model.¹ In short, Alphonse Desjardins may have been trying to make the *caisse* model attractive to people that were unaware of the model. Since Desjardins was aware of the indivisible reserve, this choice must have been deliberate.² By 1911, after starting a few *caisse*, and given a growing membership and deposit base, he began to promote the idea of the indivisible reserve to secure the asset base of the *caisse*; these changes were included in a *Loi des syndicats coopératifs* amendment. Since that time, the indivisible reserve remains in place for *caisse* Desjardins, including at the federation level.

For agricultural cooperatives in Quebec, the situation is different. The law that was specifically dedicated to agricultural co-operatives (*Loi des sociétés coopératives agricoles*) was enacted in 1908 without obligation for an indivisible reserve. This lack of obligation was in accordance with the ideas of one of the key founders of the agri-coops, the priest J.A.B. Allaire, who rejected the principle of the indivisible reserve.³ In his view (the reason for this view is not known), if the co-op is dissolved, the net assets must be shared in proportion to the shares held by each member.

Thus, since the first agricultural co-op was formed, the principle of indivisible reserves was never applied to agricultural coops in Québec. While it is unknown how many agricultural co-ops shared the net assets at dissolution, the development of agricultural co-ops in Quebec has been significant, with over 40% of Québec producers becoming members. Since the 1970s the number of co-operatives has fallen because of dissolution or merger.⁴ In the case of mergers, the net assets were transferred to existing co-ops.

1 Discussion with Pierre Poulin, historian at Desjardins.

2 We could find reference to this notion in various writing of Desjardins before 1911 (Girard, Clément: 1998, 14).

3 In 1919, this catholic priest published their hand book on agri-co-op (*Catéchisme des sociétés coopeératives agricoles du Québec*) where he explain the basic principle of such co-op (Leclerc, 1982: 64).

4 St-Pierre; 1997, p, 171.

La coop fédérée (LCF), which has both individual members and is a federation of other co-operatives, was created by special legislation in 1922. The divisible reserve was in force from that time. In the LCF by-laws, the rule that should guide the allocation of net assets is clearly stated:

Provisions of remaining assets upon liquidation of LCF: The remaining assets are distributed to co-ops that were members of LCF (for at least the last three financial years) in proportion to the cases handled by the co-ops with LCF. Members could decide to give in against a sum or all of the funds to another federation or cooperative*

** The period of time over which the business level calculation is made is determined by the Assembly.*

Since its beginning in 1938 in Granby (Québec) up to 2003, the dairy co-op Agropur has operated under the agri-co-op law in Québec, and thus with a divisible reserve. In 2003, after deciding to operate and recruit members in other provinces, it was incorporated under the federal co-operative law. This change did not alter the provisions around the divisible reserves, since there is no requirement for indivisible reserves at the federal level. The precise mechanism for the sharing of the reserves is outlined as follows:

...the remaining assets would be shared with members having done business with the coop over the last 7 years in proportion to their volume of business.⁵

With respect to other co-operatives in Québec (e.g., consumers, workers), the rule of divisible reserves at dissolution remained in place up to 1968. In 1968, after consultation with the Québec co-operative movement (Conseil de la coopération du Québec), the Québec government decided to introduce into the law the indivisible reserve without any exception other than the one related to agri-coops. One reason for the introduction of indivisible reserves at this point in time may have been the fear that the dissolution of the Québec Fisherman Co-op Federation (Pêcheurs-Unis du Québec (PUQ)) could provoke the division of the net assets among current members without any consideration for former members. Other reasons may have been linked to the role of the indivisible reserve in promoting the sustainability of the co-ops, and the view that since co-operative assets have been built up with state subsidies, it made no sense to share this subsidy with the members. The comments made by the deputy in December 1968 during the discussion about the amendments to the co-operative law make it clear that those involved had a good comprehension of the issues around indivisible reserve. For example:⁶

5 See the interview with Lorraine Bédard from Agropur.

6 Translation from the original in French.

(...) it happened cases where, during the reorganization of a cooperative, members of a local cooperative took the opportunity to liquidate the cooperative share the reserves and start over without the advantages of funds that had been accumulated (...)

(...) It happens more than most of the time, at the time of the dissolution of a cooperative, members are no longer the same as at the time of formation or, these are not the members who were when the reserve has accumulated (...)

All the parties unanimously adopted the amendment of the law, including the implementation of indivisible reserves. Since that time, no major changes have occurred in Québec related to the principle of indivisible reserves. In 1992-1994, a task force with representatives of the co-op movement and Québec's co-operative department (DDC) undertook some work on the indivisible reserve; some of the participants put forward the idea of opening the door to divisible reserves, taking into account the specific needs of co-operatives in some sectors. In the end, there was an agreement to retain the *status quo*. In 1998, in order to have an in-depth comprehension of the evolution of the indivisible reserve over the time, the DDC undertook a collaboration with the Chaire de coopération Guy-Bernier (UQAM) on a working paper titled, "The Indivisible Reserve: origin, evolution and current situation" (*La réserve impartageable, origine, évolution, situation actuelle*). A number of the key findings of this report can be found in this current report.

In 2002-2003 there has a new round of discussions related to the improvement of the co-operative law. At the end, there was agreement to introduce into the law a new provision related to the reserve in order to make the co-operative model more attractive. Under the name "enhancement reserve" (*réserve de valorisation*), it is possible for workers, producers and shareholding working co-operatives.

REFERENCES

- Girard, J-P, F. Coggins, M. Clément et M. Cournoyer 1998. "*La réserve impartageable : origine, évolution, situation actuelle.*" Montréal and Québec, Co-operative Chair Guy-Bernier (UQAM), Research paper #96, Co-operatives Directorate, Ministry of Industry, Trade, Science and Technology, Government of Quebec, page 48. <http://chaire-ccgb.uqam.ca/upload/files/96.pdf>.
- Leclerc, A. 1982 "*Les doctrines coopératives en Europe et au Canada*", Sherbrooke, IRECUS.
- Saint-Pierre, M. 1997 "*Alphonse Desjardins entrepreneur*", collection entreprendre, The Transcontinental Inc. editions, The foundation of entrepreneurship edition, the Dorimène Desjardins edition.

APPENDIX H –

List of Interviewees

(QUÉBEC, NEW-BRUNSWICK AND ONTARIO: FRANCOPHONE)

Marcel Arteau*	Executive director (1990-2003), Fédération québécoise des coopératives de travail
Lorraine Bédard*	Senior Vice President, Legal Affairs, Member Relations and Secretary-General, Agropur
Pierre-Marc Bellavance*	Vice President for Legal Affairs and Secretary General, La Capitale groupe financier inc.
Alain Brideault	Specialist of workers co-ops
Bernard Brun	Director, Government Relations, Desjardins Group
Melvin Doiron	Executive director, CDR Acadie, New-Brunswick
Isabel Faubert-Mailloux*	Strategic Development Advisor, RÉSEAU de la coopération du travail du Québec
André Gagnon	Executive director, Fédération québécoise des coopératives en milieu scolaire
Claire Gagnon	Senior Regulatory Officer, Financial and Consumer Services Commission, New Brunswick
Réjean Laflamme*	Former senior staff, Conseil Canadien de la coopération
Colette Lebel	Director, Cooperative Affairs, La Coopérative Fédérée
Yvon Létourneau*	Director investment, Capital régional et coopératif Desjardins
Guylaine Morin*	Expert-Advisor, Direction du développement des coopératives Ministère de l'Économie, de l'Innovation et des exportations, Québec
Hélène Plante*	Secretary General, SSQ Groupe financier, SSQ Société d'assurance vie inc
Denis Richard*	President, La Coopérative Fédérée
Jocelyne Rouleau*	Executive director, Confédération québécoise des coopératives d'habitation
Alain Roy*	Manager, Co-operative Secretariat, Agriculture Canada (1987-2013)
Stéphan Schwab*	Secretary General and Treasurer, St-Albert Cheese Co-operative, Saint-Albert, Ontario

* Recorded.

APPENDIX I –

The La Capitale, SSQ Business and Agropur Models

LA CAPITALE, AND SSQ

In Quebec during the 1990's, many mutual has been engaged in a demutualization process. In order to avoid the lost of control by member, we could identify strategy coming from 2 examples, Capital and SSQ.

- The civil servant insurance mutual La Capitale has been set-up during the 1940's like many other examples around the world. The purpose was to help primarily Quebec government employees or an organization that was within it for death situation. Over the years, the organization grow and developed several additional service including on insurance side. New corporation has been created BUT, as it was shown on the corporation WEB site,⁷ all organizations and all major policy decisions stay under the Board of Directors of the mutual (La Capitale, mutuelle de gestion). By this mean, La Capitale Financial Group Inc, there are always direct link between the development of the organization and the membership base of these mutual that gathering up to 250,000 members.
- In the case of SSQ, in the 1990's, facing major financial needs, the organization created a new corporation, SSQ vie, and welcome outside fund coming from venture capital fund under the control of the Quebec biggest Union, Solidarity Fund (Fonds de solidarité FTQ or FS/FTQ). It was around 30 M \$ so by this set up, FS/FTQ take control of 70% of the SSQ property, the remain portion staying in the hand of the mutual. In 2012, FS/FTQ agree to put an additional amount of /00 M\$ in order to support the buying of AXA group. Since the beginning of the involvement of FS/FTQ (during the 1990's), there are a verbal agreement to kept the majority of the board sit of SSQ Financial Group to the hand of the mutual (SSQ mutuelle de gestion)⁸. This mutual gathering (1 290 473 members) members. In fact, the FS/FTQ which now has assets of just over 10 G \$, considers there engagement in SSQ as one of his best investments in a Quebec company since its birth in 1983.

⁷ <https://www.lacapitale.com/en/about-us/company-profile>

⁸ For a view of the organizational structure of SSQ, p. 26 : https://ssq.ca/documents/10674/56318/SSQ_Mutuelle_2013_FR.pdf/a0212382-4396-4759-8ac9-c41f3edc89d5

AGROPUR

One of the authors of the current report directed a comparative study of Saskatchewan Wheat Pool and Agropur taking into account of the share conversion that occurred at the SWP in the 1990s.¹ One of the key lessons that emerged from this study was the strong will of Agropur to retain control of the business including the funding. When SWP opened the door for external funding, Agropur instead focused on using all the options available to it under the Co-op Act in Québec including various categories of share and fiscal incentives (régime d'investissement coopératif). At the beginning of the 2000s, the Agropur members clearly stated they want to keep their co-operative alive.

When we look carefully the way Agropur was developed since its foundation in 1938, it appears it was mostly done by acquisition or mergers with other dairy co-ops (it has been involved in an impressive number of the years; at last count it was over 140), in each case opening their membership base to new members. This strategy has been focused on Québec up to the beginning of the 2000s; since that time, it is now conducted at the Canadian level but it became very challenging. For instance, over the last year, at least two dairy co-op Agrifood (Alberta) and Scotsburn (NS) sold their asset to Saputo instead of doing business with other dairy co-ops. For Agropur president, Serge Riendeau, as he explained at the 2014 AGM, this situation simply makes no sense:

It appears to me more important than ever to publicly reiterate that the leaders of the dairy cooperatives have a duty to do everything in their power to be transmitted to future generations assets built by their predecessors. At Agropur, this belief is deeply rooted and we are ready to work with the dairy cooperatives in order to achieve this goal.

Hopefully for Agropur, it had success in other cases such as the Farmers Dairy in Nova Scotia and New Brunswick Dairy town. Finally, when we look carefully at the way Agropur is led, we observe, in addition to strong management, a very strong commitment of members to the democratic life of the co-op.² In addition to the AGM, the co-op also organizes regional meetings and a mid-year general meeting. The training programs on co-operative dimensions that are dedicated to members, both new and old, are impressive. The members have a strong concern for the co-operative and its activities, not only because it is their main source of income, but also because their shares in the co-op are part of their pension fund. Finally, from the time Agropur has been under Québec Co-op Act (1938-2003) and then under the federal co-op act (2003 onward), the indivisible reserve was not compulsory.

1 Assoumou Ndong, Franklin et Jean-Pierre Girard (2000) « Développement coopératif comparé, Québec-Saskatchewan: les formes organisationnelles des coopératives dans le domaine de la santé; la capitalisation dans le secteur agro-alimentaire », Sherbrooke, Cahiers de recherche IREC-00-02, Institut de recherche et d'enseignement sur les coopératives de l'Université de Sherbrooke, Université de Sherbrooke, 138 p. <http://productionsips.com/wp-content/uploads/2014/08/IREC00-02-Coop-Compare-Qc-Sask.pdf>

2 A recent book offers an impressive view of Agropur's success: Saint-Pierre, Jacques (2014) La coopération au cœur d'un grand succès, Agropur, 75 ans de passion, Fides, Montréal, 208 p.