

# **The Conversion Syndrome**

## **A Review**

### **of the Conversion of Australian**

### **Co-operatives into Investor Owned Firms**

In June this year, Australia's leading business newspaper, "The Financial Review" carried the story that one of the country's largest and most successful co-operatives was on track to be a listed public company by the first half of 1995.<sup>1</sup> Namoi Cotton Co-operative is the nation's largest cotton ginner and marketer, with an annual turnover of almost \$400M (AUS) and exports of approximately \$280M (AUS).

Such news items are not unfamiliar in the history of the co-operative movement in Australia.

The rate of conversion of some of the country's leading co-operatives into company structures has quickened, as competition and deregulation of the nation's economy intensify. The co-operative sector has lost millions of dollars of turnover to the world of investor owned firms<sup>2</sup>. Many thousands of Australians have lost their direct association with the co-operative movement.

The co-operatives that have converted to companies have not necessarily been the failures of co-operation but rather some of its successes. In particular, agricultural co-operatives and Building Societies have been those most likely to convert.

This paper will examine the experience of general co-operatives which have converted into companies, such as agricultural marketing and supply co-operatives. Reference will be made where appropriate to Building Societies, Credit Unions and other mutual financial co-operatives. The theme of the paper is that Australian co-operatives have tended to convert to investor owned firms in the absence of alternative integrated and supportive co-operative structures and networks. Such structures and networks if present could well provide co-operatives with greater flexibility to deal effectively with the challenges of a competitive market place, without recourse to changes in identity.

#### Relevance of Experience

Is the Australian co-operative movement's experience relevant when considering the wider issues of co-operative structural adaptation and transformation occurring in the Asia Pacific region?

Much can be learnt from an understanding of why, in the context of an economy such as Australia's, and as a response to competitive pressures, some co-operatives would choose the

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<sup>1</sup> "Namoi Cotton gets ready for listing", Australian Financial Review, 22/6/94, p. 27.

<sup>2</sup> Investor Owned Firms and public companies/corporations have been used interchangeably in this paper.

option of converting to a company structure. Such an understanding may be of interest to other countries and movements in the region dealing with similar challenges.

### The Structure of the Australian Co-operative Movement

Does the structure of the Australian co-operative movement, by its very nature, make co-operatives prone to conversion to investor owned firms?

In examining this I would like to use a metaphor to describe the structure of the co-operative sector in my country compared to that of many co-operative movements overseas.

It strikes me that the best description of this situation is summarised in the metaphor:

"The forest versus the paddock".

For those of you who may be unsure of what I mean by the expression paddock, in the Australian context it normally means a fenced field or piece of land, generally with a scattering of trees.

Let me explain.

In Australia we have quite a few large well-developed primary co-operatives such as the cotton co-operative I mentioned at the start of my paper. We don't however, have any developed second or third tier co-operative structures. As a result of the absence of these unifying secondary and tertiary levels, we lack the integration and synergy that characterises more developed co-operative sectors overseas. As Dr Gary Lewis observes in his comprehensive study of Rochdale Co-operation in Australia, "there has never been a co-operative movement, as such in Australia"<sup>3</sup>.

This situation can be best visualised in the "forest versus the paddock" metaphor. In Australia we have a few large mature primary co-operatives (trees) generally isolated (in paddocks) but no developed movement (forest).

Extending my metaphor, we can equate the competitive forces of deregulation, privatisation and globalisation, with the winds of change blowing through the various types of co-operative movements - paddocks and forests. It is apparent which co-operatives are best able to survive the force of the wind. The forest helps support the trees within it; the paddock provides no such protection.

### The Significance of Co-operative Networks

The layers of co-operative activity in the more developed overseas movements clearly give those co-operatives greater opportunity to respond to the competitive forces they face. The Australian co-operatives, generally isolated, are far less likely to be able to resist these forces - one manifestation of which is the conversion syndrome.

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<sup>3</sup> Lewis, Gary: A Middle Way - Rochdale Co-operatives in New South Wales 1859-1986, (Doctoral Thesis, Australian National University), Australian Association of Co-operatives, Brolga Press, Curtin, ACT, Australia, 1992.

I contend that if Australian co-operatives had alternative integrated, supportive structures and networks, the option of conversion to investor owned firms would not have been so readily considered, and embraced by some co-operatives. Such structures and networks could have provided solutions for some of the structural deficiencies of co-operatives, offered precedents in management approaches and practices for dealing with competitive challenges, focused education and advisory services as well as encouraged greater governmental support and understanding for the sector.

The absence of integrated supportive networks, for a sizeable portion of the movement in Australia, has meant that co-operatives have often had to deal with these competitive challenges at the level of either:

- \* the individual organisation, that often resorted to prevailing corporate culture, with its supportive infrastructure for solutions; and/or
- \* within the context of a broader industry response, that may not necessarily be concerned with co-operative sustainability.

### Regional Context

Mr. Robby Tulus, Senior Policy Adviser, International Co-operative Alliance, Regional Office Asia Pacific, (ICA ROAP), although not dealing directly with the conversion factor I am addressing, makes a relevant point in his background paper "Co-operative Competitive Strength: Positioning Co-operatives in the Market-Oriented Economy"<sup>4</sup>. prepared for this Co-operative Ministers' Conference over 26-30 July, 1994, in Sri Lanka. When discussing the question of structural adaptation and transformation of co-operatives Mr Tulus writes:

"Transforming co-operative structures is a vital aspect in the context of economic liberalisation. This includes identification of the gaps and superfluous links within the existing structure. In order to ensure organisational strength and efficiency of the whole system, the structural gaps should be covered, and superfluous units eliminated ..... **The aim should be to improve the operational efficiency of the entire structure both vertically and horizontally, and hence build a working system**".

The wisdom of these words is borne out by the Australian experience. There is an undoubted need for more vertical and horizontal integration in the co-operative movement, if it is to successfully respond to competitive challenges. We need to nurture a "working system" in Australia.

### The Australian Economy

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<sup>4</sup> Tulus, Robby: Co-operative Competitive Strength, Positioning Co-operatives in the Market-Oriented Economy, in Background Papers for the Third Co-operative Ministers' Conference, Colombo, July 26-30, 1994: International Co-operative Alliance, Regional Office for Asia and the Pacific, New Delhi, India.

The challenge to co-operatives are taking place against a background of significant adjustment and what amounts to a gradual restructuring of the Australian economy.

Australian Governments, both State and Federal, irrespective of political allegiance are all committed, in varying degrees, to policies of deregulating the economy and increasing competition, both domestic and international. Such policies include the removal of regulatory restrictions in the financial and rural industries, and the removal of barriers to the importation of many products, thereby exposing Australian industry to full international competition.

Many previously government owned services or utilities have been, or are being, privatised. Government supported agricultural marketing arrangements are being removed, and producers are now expected to make their way in an increasingly competitive environment.

There have been efforts by both Government and industry to link Australia's future development with the fast growing economies of countries in the Asia Pacific area, and to focus policy makers, corporations and individuals on the opportunities in this region.

Various Governments within Australia have developed programs designed to encourage industry to adopt practices to become world competitive. Included among these initiatives are: best practice programs, Total Quality Management, export, trade and value adding enhancements, industry restructuring packages, major new job training programs and innovative investment schemes to mention just a few.

As the Australian economy has become more competitive the position of co-operatives in some industries has been challenged. Many of Australia's more successful co-operatives have developed in industries which in the past have had a large degree of regulation. As these industries are deregulated co-operatives are facing threats to their market share not only from domestic but international competitors. In the face of such challenges, questions are being asked about the sustainability of the co-operative structure.

### Extent of Conversion

The current wave of conversion of co-operatives into investor owned firms, follows on from the period of the late 1950's to the 1980's, when as documented by Dr Gary Lewis "much of the traditional Australian co-operative movement was lost"<sup>5</sup>. In particular, Dr Lewis records that during the 1970's "the backbone of the rural co-operative movement had gone, subsumed within capital", as co-operatives converted to company structures.

In the terms of my metaphor, the trees in the paddock had begun to fall.

The conversion syndrome has occurred in almost all Australian States irrespective of the legislative arrangements existing at the time.

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<sup>5</sup> Lewis, op. cit., p. 339.

A list (incomplete) of Australian co-operatives, which have in recent years converted into company structures is attached (see Appendix 1). This list of 49 co-operatives (including Building Societies) represents hundreds of millions of dollars of annual turnover.

The 39 general Australian co-operatives, (excluding Building Societies) included on the list may not appear numerically significant in the context of the overall number of co-operatives in Australia. It is hard to determine the exact number, no national database exists at present, however, it would appear that (excluding Building Societies, Credit Unions and other financial co-operatives), there are approximately 2300 registered general co-operatives in Australia.

Why the concern about the conversion syndrome, if only 39 of the 2300 have recently decided to convert?

The answer lies not in the actual number but in the size and strategic nature of those co-operatives that have either already converted or are thinking about doing so. As Mr David Williams, Executive Director, Hambros Australia, a merchant banker with considerable experience dealing with co-operatives recently noted in an article in a national dairy industry journal:

"In the past two years there has been a revolution in the Australian bush. There is hardly ... **a significant co-operative that hasn't considered its corporate structure or the adequacy of its capital structure**"<sup>6</sup>.

The problem for the co-operative movement is that it could well represent a trend that will be difficult to stop.

I would like to briefly consider some statistics in relation to New South Wales, which has probably the largest number of commercial co-operatives incorporated under discrete co-operative legislation in Australia, to demonstrate the fragility of the movement.

If the aforementioned cotton co-operative was to decide after a vote of members to convert, approximately 16% of the turnover of the New South Wales co-operative sector would be lost in that one conversion alone. The top four of the eight hundred co-operatives in New South Wales account for over 50% of the \$2.5B (AUS) turnover within the State's sector annually. The top twenty five co-operatives in the State account for 75% of the turnover annually. In other words the New South Wales sector consists of around twenty-five comparatively large primary co-operatives, with a much greater number of smaller less commercially significant co-operatives. Clearly if larger primary co-operatives are going to convert into investor owned firms, as is periodically suggested in the media, then the co-operative sector in New South Wales will be greatly weakened by such actions. A similar situation exists in other Australian States.

Apart from conversions generated from within, a number of major co-operatives, such as New South Wales' largest, Australian Co-operative Foods, have resisted concerted corporate

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<sup>6</sup> Williams, David, "Raising Co-operative Capital" - Why Members Resist, Australian Dairy Foods Journal, April, 1994

takeover attempts, during the last few years. These examples are additional to those listed in this paper.

### *Future Studies*

As far as I am aware, no detailed comparative study has been done within Australia on the subsequent financial results of these converted organisations. Such a study might determine if there has been an improvement in performance as a consequence of the change of ownership and governance structure. Other important questions to be considered might include: - What is the relationship of the former members with the new corporate entity? Do they now have any control over their former co-operative? Does the new company structure continue to serve their interests, or has it gone on to focus on other, perhaps more profitable, pursuits? Has it retained anything of its co-operative heritage?

Such a study is beyond the scope of this paper but has the potential to objectively evaluate the merits or otherwise of conversion.

### Factors Contributing to the Conversion Syndrome

I hope through the metaphor of the "paddock versus the forest" you will gain an impression of the structure of the Australian co-operative movement, and from the listing provided with this paper, an appreciation of the extent to which it is prone (at least in part) to the conversion syndrome.

I have identified twelve specific factors that have helped shape the landscape of the Australian co-operative movement (paddock). These factors illustrate the vulnerability of co-operatives and highlight some of the weaknesses inherent in the Australian co-operative sector. They all in some way affect the achievement of the supportive co-operative structures and networks that I suggest are necessary to offer co-operatives greater flexibility in dealing with competitive challenges. If all were addressed it would strengthen and enhance the ability of the co-operative model to withstand the winds of change, as manifest by the conversion syndrome.

The identified factors are grouped under four headings:

- # Structural
- # Management
- # Education and Advice
- # Government Facilitation

### *Structural*

I have identified seven factors in the structural area relating to the overall shape and nature of the movement in Australia. Some of the factors may be unique to Australia, other factors will be common to most co-operative movements throughout the world.

## 1. Co-operative Capital

Australian co-operatives like their counterparts throughout the world are trying to reconcile the de-emphasised role of capital within co-operatives with the need to obtain sufficient funds to remain competitive.

Co-operative fundraising was the subject of at least two major national conferences in recent years. In particular, the Co-operatives 2000<sup>7</sup> Capital Conference in Sydney in late 1993 dealt extensively with this issue. This Conference focused on the options available to co-operatives to raise additional capital while retaining their co-operative character.

The lack of options available for co-operatives to raise sufficient equity funds is often given as the main reason for a public listing in Australia. A spokesperson for Gresham Partners, the advisers to Namoi Cotton, is quoted as saying "**What Namoi is about is responding to the competitive environment, getting more flexibility in its funding so that it can compete on an equal basis with the corporate processors**"<sup>8</sup>.

While it is true co-operatives have less fund raising options than investor owned firms, it is also true that Australian co-operatives have not been sufficiently innovative in encouraging their members to view the "investment" of funds in their own organisations as worthwhile.

### Equity Features of Australian Co-operatives

It has been noted that there is a wide range of equity structures in Australian co-operatives. Mr Ian Langdon, Chairman of Australian Co-operative Foods, in a paper to the 1992 Agricultural Co-operative Capital Update Conference in Queensland, points out that apart from normal commercial pressures the varying application of co-operative principles has resulted in a range of capital structures in agricultural co-operatives in this country. He reports that:

"There are a number of co-operatives that have a nil or close to nil share capital base and there are a small number who have adopted quasi revolving funds or reserves. These are very much in the minority. The dominant equity feature of Australian agricultural co-operatives is their use of a base share capital plan and extensive use of unallocated reserves"<sup>9</sup>.

### Legislative Options for Fundraising

General co-operative legislation varies throughout Australia in regard to the options available for fund raising. The New South Wales Co-operatives Act, 1992 provides probably the greatest range of available alternatives among the Australian States. The main options

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<sup>7</sup>Co-operatives 2000 is a joint Co-operative/Government initiative in New South Wales, designed to develop a strategic plan for co-operative development up to the year 2000. See Capital Conference Papers for full details of proceedings.

<sup>8</sup> Australian Financial Review op. cit. p. 27.

<sup>9</sup> Langdon, Ian "Australian Agricultural Co-operatives - A Current Perspective", 1992, A paper presented to the Agricultural Co-operative Update Conference, September 17-18, 1992, Queensland, Australia.

include: members shares; entry fees for membership; periodic charges payable by members; loans by members; the new Co-operative Capital Units; and external borrowings<sup>10</sup>. There is no provision within any discrete State co-operative legislation for a second class of share, whether issued to members or non-members.

In spite of the fact that a range of alternatives has existed in the legislation, co-operatives have not maximised the opportunity to raise funds from their members. Within New South Wales, during the ten year period 1982-1992, only approximately 50 co-operatives made use of the compulsory share and loan mechanisms available under the legislation, to raise around \$38M (AUS) in equity and \$6M (AUS) in loan funds from members<sup>11</sup>.

The new co-operative legislation in New South Wales now allows for the issuing of a financial instrument called a Co-operative Capital Unit, (CCU) which may have some of the character of either debt or in some limited sense equity. CCU's can be issued to members and non-members alike. The first issue of CCU's to the public has recently been made by Norco Co-operative Limited, a regional based dairy co-operative. The Chairperson of Norco in the information statement for the CCU issue says "For 100 years Norco has been proving the value of co-operative ownership within the agricultural and food industries. Your investment in Norco Capital Units will help Norco grow even more strongly as it moves into its second century of service to rural Australia"<sup>12</sup>. It is the dairy industry and others like it, which have a strong co-operative presence, but are facing major competitive forces, that are seeking fundraising solutions consistent with co-operative principles.

#### Growth and Co-operative Philosophy

Mr Langdon, in a paper delivered at the 1993 Capital Conference makes the point "the challenge is to find a practical response to the current commercial pressure to grow and **to fund that growth in a manner that is compatible with both survival and co-operative philosophy**"<sup>13</sup>.

"If co-operatives wait until there is an urgent need for funds then in all probability it is too late to have their needs met by members alone ... external equity raises the threat of loss of control"<sup>14</sup>. I have previously noted "the dilemma for co-operatives is that by basically restricting their fund raising to their membership, they maintain control but members are often either unwilling or unable to contribute sufficient funds - either directly, or by way of retained surpluses - for the co-operative to be competitive"<sup>15</sup>.

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<sup>10</sup> Magarey, Donald, "Guide to the NSW Co-operatives Law", CCH Australia Limited, 1994, p. 93.

<sup>11</sup> Cronan, Garry, "Policy Underpinning NSW Co-operative Legislation", 1993, A paper presented at the 1993 Capital Conference, November 1993, Sydney, Australia.

<sup>12</sup> Information Statement Norco Co-operative Limited, Invitation to Invest in Norco Capital Units"

<sup>13</sup> Langdon, Ian "Capital Fund Raising Options for Co-operatives" reproduced in the New South Wales Registry of Co-operatives newsletter "Co-operation", Special Edition, January 1994, p. 2. Mr Langdon is also a director with Phosphate Co-operative Co. of Australia Ltd, and a former Dean, Faculty of Business Studies, Griffith University.

<sup>14</sup> *ibid*, p. 5

<sup>15</sup> Cronan, Garry "The USA/Australian Experience" Australian Dairy Foods Journal, June, 1994

A number of Australian co-operatives particularly in the dairy industry are closely examining the model of the Irish dairy co-operatives that have introduced external equity. Fast rates of growth are achievable using similar hybrid models but if control is to be maintained in the hands of the members they will need, over time, to fund their share of that growth.

It is also worth making the point that general co-operatives in Australia are not very experienced in dealing with external equity. If equity CCU's are, for example, to become popular, co-operatives will need to avoid the conflict of competing interests developing between the members and external equity holders. Ironically one of the outcomes of such conflict may be pressure to convert.

### Value for Members

Co-operatives need to offer value to their members. Mr David Williams, when discussing the issue of co-operative members' reluctance to contribute capital and the related problem of the conversion of agricultural co-operatives into companies, draws the following conclusions in regard to Australia:

"Properly advised, I have found co-operative members to be more than willing to contribute additional capital where this can be shown to provide them an adequate return. Treating them better requires communication, equitable treatment and redeemable shares. In achieving equitable treatment, co-operatives shares need to reflect their realisable value. If they do not, farmers cannot be blamed for saying they have no value. Moreover, unallocated reserves and asset value changes will encourage takeovers or restructurings which would be otherwise not justifiable"<sup>16</sup>.

### Limited Return

The issue of limited return on capital in a co-operative is a core consideration for members contemplating a change from the co-operative model to an investor owned firm. As Mr Langdon notes in his paper "Valuation of Co-operative Shares - Do They Have a Value" also prepared for the 1992 Conference in Queensland:

"It is difficult for co-operatives to raise equity funds if there is limited reward for investment of capital. The prohibition of capital appreciation is a significant deterrent for members to invest in equity. .... The challenge for co-operatives is to devise member based equity structures that link share ownership and patronage so that returns on capital do not breach the equitable distributions of surpluses principle. Such returns could be either in the form of allocations of operating profits or in the form of capital appreciation of shares through bonus issues, but only if shares were held on a patronage basis"<sup>17</sup>.

Shares in Australian co-operatives are normally redeemed at par value. Combining this with the fact that share registers of co-operatives have often contained a majority of inactive

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<sup>16</sup> Williams, op. cit., p50

<sup>17</sup> Langdon, Ian, "Valuation of Co-operative Shares - Do They Have a Value", 1992. A paper presented to the Agricultural Co-operative Update Conference, September 17-18, 1992, Queensland, Australia.

members can mean that a conversion will sometimes be supported simply to unlock the "real" value of the shares.

Active membership requirements have been introduced into New South Wales co-operative legislation to ensure that it is only active members who will vote in co-operatives on questions such as conversions. This however, only addresses one side of the problem. There is still a need to ensure that current and past members receive value from their participation and "investment" in the co-operative. To do otherwise in the Australian context is to ignore one of the major motivations for members to convert their co-operative into an investor owned firm.

## Summary

The combination of deregulatory forces, and increased competition has meant that co-operatives, particularly in some of their traditional industries such as dairying, are no longer able to operate without competitively managing their capital. Their problem is that they may lack a viable capital structure, at the very time they face their most competitive challenge - often in the form of adequately funded investor owned firms, who incidentally may have been previously locked out of these markets by regulation. They can be restricted from quickly accessing adequate funds from either their members or the market because of the operation of co-operative principles.

The nature of co-operative capital and the past practices of co-operatives in this area are often proffered as the main explanations for the conversion syndrome. The resolution of this issue for co-operatives remains central to the long term survival of the movement in Australia.

## 2. Representative Co-operative Organisations

The recent history of representative national general co-operative organisations in Australia has not been encouraging for the long term development of an integrated movement (forest). It has appeared that for one reason or another the national structures which have been created in this country have not been sustainable in the longer term. There is a sense in which its history has been of a stop start nature. Considerable effort has been expended by the movement, but in the end, the national organisations have not been able to effectively build either lasting support from within the movement or broaden their base so that they gain wider community support for their activities.

Within the last two years the peak national organisation the Australian Association of Co-operatives, (AAC) has gone into liquidation. AAC in effect replaced the earlier Co-operative Federation of Australia, (CFA) as the peak national organisation for general co-operatives in the mid 1980's. Both AAC and CFA had themselves sought to develop links with the ICA.

Following AAC's collapse, (due in part to the failure of a banking operation for general co-operatives) a new national structure was established. The new structure was built upon some of the remaining State Co-operative Federations which had not become part of AAC, and newly formed State organisations. This organisation known as the National Co-operative Council of Australia, (NCCA) has as its only members five State Co-operative Federations. Primary co-operatives cannot belong to the NCCA, rather they join their respective State Co-

operative Federations. The NCCA has at this stage decided to focus more on issues of national concern rather than seeking to build and develop contacts with the international co-operative movement.

The NCCA and State Co-operative Federations are also not likely at this stage to pursue a similar commercial course to that of AAC. As a consequence their activities will be restricted to mainly representing the sector to Government. Services such as insurance, legal advice, trade facilitation will not be undertaken.

Apart from financial co-operatives, like Credit Unions and Building Societies, the general co-operative sector's representative organisations are organised not on industry groupings but on geographical regions, specifically, the Australian States. Within the regional State Co-operative organisations there may be some industry sub-groupings.

The failure of AAC and the need for regrouping within the NCCA/State Federation structure has represented a considerable setback for the movement in Australia. At the very time when competitive pressures on the co-operative model are increasing the movement as represented by its national apex organisation is probably at its most vulnerable point for many years.

The collapse of AAC and the subsequent need for New South Wales Government assistance to smaller community co-operatives affected by the fallout, as well as the recent demise of Letona Co-operative, a large fruit and vegetable cannery, and the failure of a major Victorian Building Society, have not helped the public perception of co-operatives. In the last couple of years, there has been no apex general co-operative organisation able to go to the media to argue the case for the retention of the co-operative model. This at the very time the financial and business media are reporting the increasing number of co-operatives contemplating conversion.

### 3. Co-operation Among Co-operatives

The forest of my metaphor requires multi-layered interaction between co-operatives not only in a representative sense but in a truly commercial one. For this to be achieved it requires co-operatives to believe that they can obtain real commercial advantage for their members from active co-operation among co-operatives. Such strong links can ultimately lead to, in the previously quoted words of Mr Tulus, "the improvement of the operational efficiency of the entire co-operative structure both vertically and horizontally, and hence build a working system"<sup>18</sup>.

The history of general co-operation in Australia demonstrates that we have no such working system. The trees in the paddock don't connect. There is no sense in which the growth of one assists with the development of other co-operative organisations. Indeed in some cases co-operatives have seen other co-operatives as their major competitors, rather than organisations they may have interests in common with. While there have been some notable exceptions, (particularly in the credit union movement), the general experience has been that any attempt at commercial co-operation among co-operatives has been short lived.

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<sup>18</sup> Tulus, op. cit., p 25.

By way of contrast the American agricultural co-operative system shows the advantages of doing business the co-operative way. Co-operatives both co-operate and compete with each other at various levels throughout the system. It represents a unique blend of co-operation and competition. There are local co-operatives which may be either supply or marketing co-operatives. These locals then combine together to form regionals, which then combine together to form inter-regionals.

For example the local co-operative agricultural store may sell fertiliser which it obtains from its regional co-operative. The regional is able to offer a good price for this product because it buys in bulk for all its member co-operatives. The regional co-operatives may have come together to form an inter-regional co-operative to bulk produce the fertiliser. Co-operatives at various levels in the system are free to choose whether they will purchase the product from their affiliated co-operatives. It makes sense however, if the price and service is reasonable, to support the co-operative group they are a part of. The system benefits in a competitive sense from these economies of scale, while retaining and building a market presence for co-operatives. Right through from the local to the inter-regional, funds are invested back into the co-operatives, to build a competitive working system<sup>19</sup>.

The American system enjoys some protection from the legislative effects of anti-trust or anti-competitive regulation. To this extent American agricultural co-operatives have had time to develop these working co-operative systems, and so be in a somewhat stronger position, to competitively respond to market challenges such as the conversion syndrome.

Nevertheless, even given that qualification, Australian co-operatives are still not embracing the idea that one of their available competitive responses is far greater co-operation among co-operatives. This is at the time that business literature and government programs are showing corporate Australia the commercial benefits of collaborative or networking strategies.

#### 4. Co-operative Culture

If economic considerations are finely balanced, co-operative cultural values may be the deciding factor in determining whether an organisation remains as a co-operative or converts into an investor owned firm.

In this context I have taken the term co-operative culture to mean the sum of experience, history, values and principles of co-operation, both in theory and in practice.

It would seem that there is only a limited sense of co-operative culture within the general co-operative movement in Australia and little appreciation of such values in the broader community. What historical perceptions may have existed appear to be diminishing as the pace of societal and economic change quickens.

#### Co-operative Character

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<sup>19</sup> These features of the USA co-operative system were observed, when I was member of a study tour, of American agricultural co-operatives, in late 1993. The tour was organised by Monash University, Melbourne, Australia.

Prof. Hans-H.Munkner in a background paper "Structural Changes in Co-operative Movements and Consequences for Co-operative Legislation in Western Europe" prepared for a Co-operative meeting in Marburg, Germany in July last year, points out that co-operatives can be seen as basically either: "**predominantly economic structures, ... or a movement for socio-economic reform**"<sup>20</sup>. Dr Garry Lewis has characterised the history of the Australian co-operative movement, similarly as a struggle between pragmatists and idealists<sup>21</sup>. His verdict was that the idealists were defeated and that the pragmatists achieved some limited success.

Co-operatives in Australia whatever their past history now appear to be predominantly economic structures, as Dr Munkner says, "concentrating their efforts exclusively or mainly on the promotion of the economic interests of their members"<sup>22</sup>. One of the consequences of this is that "in large scale co-operative enterprise with professional management the features resulting from the historical roots of co-operatives and the ethical and moral foundations of the co-operative way of doing business are often considered more to be a burden of the past than a source of strength for the future"<sup>23</sup>.

The challenge for the general co-operative movement in Australia is to draw from its neglected history those distinctive co-operative features which have enduring value, and to marry them with best international co-operative practice to create a relevant and vigorous co-operative culture.

#### The Demutualisation Process

If the history and culture of co-operatives is not fully understood within the movement, there is even less appreciation of the role of mutual organisations, including co-operatives, in the broader Australian community. To this extent the co-operative movement is not alone in Australia in facing the conversion syndrome.

Media attention in New South Wales has recently been focused on a large mutual motorists' organisation, which is considering a public listing. This organisation which was originally started to provide roadside vehicle service to motorists, now has many hundreds of thousands of members. As part of the services offered to members the organisation developed insurance, travel and associated capacities. The insurance business has grown to such a size that it is now one of the State's largest businesses.

The current board and management of the organisation are presently seeking member support for conversion from the mutual structure into what they propose as a more appropriate business arrangement. There has been considerable debate in the media as to the merits of such a change. Many of the points raised in this debate mirror the issues for general co-operatives. It is symptomatic of the general demutualisation of business which has been proceeding, not only within the co-operative sector, but in other areas including the insurance industry.

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<sup>20</sup> Munkner, Hans, "Structural Changes in Co-operative Movements and Consequences for Co-operative Legislation in Western Europe", reproduced in a Report of a Colloquium held at Marburg, 2-3 July 1993, Enterprise and Co-operative Development Department, International Labour Office, Geneva.

<sup>21</sup> Lewis, op. cit., p 233.

<sup>22</sup> Munkner, op. cit., p 59.

<sup>23</sup> Munkner, op. cit., p 60.

The Co-operative model needs to be able to compete in the marketplace of ideas - mutual organisations generally need to address the challenges represented by other ways of doing business. Co-operatives do have a lasting, legitimate and worthwhile role to play in the new internationally competitive environment. However, unless this is articulated and supported by co-operatives themselves, it will be hard for the broader community to see the demutualisation process, as anything other than a historical inevitability.

#### 5. Funding Organisations

General Co-operatives in Australia do not have, as do some of their overseas counterparts, funding organisations specifically established to support them.

As a result co-operatives need to access funds from normal commercial sources. This has sometimes led to the suggestion that they are disadvantaged because such lenders don't really understand co-operatives. Whatever the veracity of these claims, it is clear that co-operatives in this country when compared to say American agricultural co-operatives are the poorer, in terms of choice, for not having organisations such as the Farm Credit Administration and the various co-operative banks, lending funds to either individual farmers or more directly to co-operatives.

Effective long term co-operative development, almost by necessity requires a co-operative bank or equivalent organisation. Often these co-operative lending organisations have grown out of the agricultural co-operative movements. This has not been the case in Australia - this vital piece of the forest has been missing.

For a variety of reasons including legislative restrictions, financial co-operatives as represented by the Credit Unions and Building Societies are not able to lend to co-operatives in any commercially significant way. There has been a recent effort to develop a co-operative bank in Australia based on the credit union movement, however this has as yet been unsuccessful.

In a number of overseas countries the supporting infrastructure of dedicated co-operative lending institutions, whether established by the movement or the Government, have acted as a disincentive for co-operatives to convert to investor owned firms. In Australia in general no such disincentive exists. Exceptions to this are certain taxation entitlements available to agricultural co-operatives for the repayment of Government loans. However, these loans are only effectively being made in one State (Queensland) and are therefore not available to the bulk of Australian co-operatives.

#### 6. Merger Strategy

One of the strategic responses adopted by Australian co-operatives to competitive forces has been, not surprisingly, to merge with other co-operatives in a similar position in an attempt to gain the advantages of greater market power. In both the dairy industry and the Building Society industry such strategies have produced far more effective and efficient organisations.

However, given the absence of developed and integrated second and third tier co-operative structural options in this country, the process of amalgamation has meant that we have ended up with larger and fewer primary co-operative organisations. The larger co-operatives have tended to soak up the smaller co-operatives around them as they strive to become more competitive. Such a strategy is something of a mixed blessing for the longer term development of a more integrated co-operative movement. The result is fewer and larger co-operatives which may convert into companies upon reaching a certain size, or dominance in their particular market.

Limitation on the overall size of any one co-operative and the establishment of linkages between co-operatives are strategies which have been pursued by movements in some countries to combat these tendencies.

## 7. Regulated Industries

I have already noted that many of Australia's most successful co-operatives have developed in the shadow of regulation, the Building Societies and the dairy and sugar co-operatives probably being the best examples. To this extent deregulation has represented a challenge to the sustainability of the co-operative model because the most successful examples of individual co-operatives, or industry co-operative groupings, are also probably the most vulnerable to conversion.

If co-operatives in growing industries which traditionally have a strong co-operative presence, are converting or giving consideration to conversions, then it can create an image that the organisation has outgrown the co-operative way of doing business. That there is somehow an upper limit to the size of co-operatives, given certain market characteristics, and accompanying deregulatory government policies.

Nevertheless, deregulation has also represented an opportunity for co-operatives. Some of the most interesting and innovative new co-operative formations have occurred in industries which have been previously heavily regulated. Members in these co-operatives are looking, in particular, for new ways of marketing their products. Deregulation has also hastened the move from a purely production focus to a more market oriented perspective for many co-operatives.

All Australian governments whether state or federal are considering deregulating their Statutory Marketing Authorities, (SMA's). These organisations have previously had responsibility for marketing many agricultural commodities. A number of SMA's are or have considered converting into co-operative structures. The deregulatory process presents an opportunity for the general co-operative movement in Australia to develop a comprehensive strategy to establish through new co-operative organisations the necessary building blocks for a working, integrated co-operative system in this country. Such a system would be an alternative to industries dominated by large investor owned firms.

### *Management*

I have identified two features of co-operative operation in Australia which may be relevant when considering the conversion syndrome.

## 8. Directors and Managers Skills

### Directors

General co-operatives are sometimes criticised for what some in the financial media regard as less than optimum performance. This lack of performance is often coupled with concern about the skills of directors and managers of co-operatives. Such criticisms often end by suggesting that a solution to this problem lies in gaining additional skills for the board by converting into a company thereby accessing a greater pool of experienced directors.

Directors of co-operatives in Australia have been drawn almost exclusively from within the ranks of the membership of the co-operative. There has not been a tradition in this country of independent, non-active member directors serving on the boards of co-operatives. As a result the boards have reflected the underlying skills of the membership.

Being a director has involved an element of voluntary service on the part of members of co-operatives. For many the remuneration for the service provided has been very low or non-existent.

Often the member will have no previous experience as a director, prior to being elected. There have been very few co-operatives which have offered formal training programs for their new directors. The movement itself is only now once again starting to address the issue of director training.

The expectation of performance for co-operative directors is increasing. Not only are co-operatives becoming larger, more diversified and complex business organisations requiring a greater range of skills to effectively manage them, but government now requires a higher level of accountability and responsibility from directors. The new co-operative legislation in New South Wales has provided co-operatives with greater commercial freedom but has also increased their level of accountability and responsibility.

Provision has been made in the New South Wales legislation for non-member independent directors. Such positions are limited to one in four directors. It is hoped that a pool of experienced co-operative directors can be established, so co-operatives which lack the necessary skills from within their own ranks can have access to experienced directors who will be able to bring a broader vision to the management of the co-operative.

### Managers

It has been suggested that because co-operatives have not had a good image in the business community in Australia, they have had trouble attracting professional and experienced managers to work with them. If such a claim is true, it is probably because co-operatives have not been in a position to match the salaries offered by the private sector. Co-operatives have also had difficulty in knowing how to effectively recruit managers. Given such a

situation the management of some co-operatives may conclude that their interests would be better accommodated if the organisation converted to a company structure.

#### 9. Management Driven/IOF Background

There has been a tendency within some of the larger co-operatives for management to appear to capture the agenda on the future direction of the organisation, without sufficient communication with, or support of the members. It is not surprising in a complex, diversified co-operative that some directors would defer to management in terms of the strategic direction of the organisation. On some occasions this strategic direction has involved the co-operative converting into some other form of organisation.

There are many more corporations in Australia than there are co-operatives. If a co-operative is seeking to recruit new and competent staff it will more than likely find the person it is seeking currently employed in a similarly sized or larger corporation. If recruited these managers will bring a completely new and different perspective to the role of running the co-operative. Some will make the transition to the co-operative way of operating more easily than others. For some the temptation will be to have the organisation, rather than themselves, change to something they are more familiar with.

This situation is not helped by the fact that co-operatives cannot normally include their employees as members. If these employees could identify as part owners of the co-operative they may not be so ready to convert it to another structure.

The issues I have been addressing in regard to directors and managers have also been considered by Mr David Williams. He has summarised his views in the following words:

"All of this is not meant as a dissertation to stamp out public listings of co-operatives, restructuring of co-operatives into corporate entities or external equity raisings. Rather, it is an attempt to discourage the practice of changing the corporate form of co-operatives for no good reason behind the shield of illogical and unsubstantiated claims by management and directors as an excuse for a corporate vehicle with perpetual capital and less direct shareholder accountability than that offered by the co-operative"<sup>24</sup>.

#### *Education and Advice*

The absence of these two factors have been of particular significance for the co-operative movement in this country.

#### 10. Lack of Educational Facilities and Commitment

A well known American writer on co-operation has expressed his views on the importance of co-operative education in the following terms:

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<sup>24</sup> Williams, op. cit., p. 50

"Co-operatives were started by people who believed in them. They were carried through the years of early growth by people who believed in them. They will only be built into the strength and significance our country desperately needs by people who believe in them. However efficient, co-operative business can never achieve real success without the active, daily assistance of its essential companion - co-operative education"<sup>25</sup>.

The ICA have recognised the importance of the role of co-operative education by making it one of the six international principles of co-operation. It has been said that a co-operative will only last for a generation and a half without a commitment to co-operative education.

Despite several attempts to create organisations in Australia devoted to co-operative education, no lasting progress has been made. Within the last two years a new organisation, The Asia Pacific Co-operative Education Centre, has been established in Australia. This organisation will be focused on providing education and training not only to directors and managers of co-operatives in Australia, but throughout the Asia Pacific region. It is a welcome and timely initiative and deserves to be successful.

The absence of effective and continuing co-operative education in Australia has meant that the current generation of co-operative directors and managers have operated to some extent in a co-operative cultural wilderness - returning briefly to my metaphor, in a paddock without a forest in sight. The lack of effective co-operative education over the last ten to fifteen years in Australia should not be underestimated when looking for the reason why some co-operatives have had a tendency to convert into investor owned firms.

#### 11. Lack of Supporting Information and Advice

For the co-operative movement to grow and develop it needs a supporting infrastructure of service providers who can provide objective and independent advice and information. Apart from a few government departments and to a limited extent State co-operative federations and one or two co-operative development and education organisations, no established network currently exists. Where and from whom co-operatives get their advice, particularly for major decisions like conversions, will often influence the final decision.

Large accounting and legal firms as well as merchant banks and other business advisers generally do not know a great deal about the operation of co-operatives. It is natural that they should on occasions recommend corporate structures they are more familiar with to their co-operative clients.

### ***Government Facilitation***

#### 12. Separation of Governmental Responsibilities

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<sup>25</sup> Webb, Glen "Its a Long Way From Toad Lane", American Co-operation 1991, p 21. In this article, Dr Webb quotes a 1954 editorial by Jerry Voorhis.

As I have already stated the responsibility for the regulation and administration of general co-operatives in Australia resides with the various State Governments. The national Government has no direct responsibility and as a result there is no national Minister responsible for co-operatives.

One of the consequences of the States being responsible for co-operative legislation has been that the legislation is not consistent throughout the country. The lack of a national co-operative framework is increasingly being given as a reason why some of the larger more nationally or internationally focused co-operatives would seek to convert into companies. As companies they could operate under Corporations Law which is the national company law framework. There are currently moves under way to address the question of the inconsistency of co-operative legislation. At least a partial solution to this problem is expected within the next twelve months.

The commitment of government resources to co-operative regulation and development vary throughout the States. If major co-operatives continue to convert into other forms of incorporation it may be that the critical mass of the sector is lost as far as government involvement is concerned and resources currently available to support the sector are withdrawn by one or more governments.

### Financial Co-operative Regulation

Following the failure of a major Victorian Building society a new state based national regulatory system was developed for Building Societies and Credit Unions. Previously, these financial co-operatives were, like the general co-operatives, regulated by the various State Government Registries' of Co-operatives. The new financial institutions arrangements have meant that in most States the previous Registries have been split between the new financial regulator and the former Registries of Co-operatives.

These new arrangements represent a historical break as far as government is concerned. The varying types of co-operative organisations are now the responsibility of different government departments and organisations. The policy driving the development of the various sectors of co-operative activity in this country are no longer connected at departmental level. This now also reflects the situation between the sectors on the ground where it appears that there is not any systematic attempt being made to encourage co-operation between Building Societies, Credit Unions or general co-operatives. The forest is not being nurtured.

### Not All Bad News

The explanations provided in this paper for the tendency of some co-operatives to convert into corporate structures may read like a bad report card on the co-operative movement in this country. In some ways it is - but this is not the whole story. There have been examples, within the Australian context, where the forest of my metaphor has developed.

The Credit Union movement represents such an area. It is one of the success stories of the co-operative movement in Australia.

Credit Unions are very competitive with other organisations offering financial services in Australia. Their industry organisations have built strong representative and commercial structures to serve and assist their members throughout the whole country. This has been achieved in an industry which has been very competitive and one subject to major deregulatory changes. Credit Unions have also been at the forefront of many technological advances in the area of customer service. There has been a commitment by the industry to education and training. Of special interest is the fact that they still stress not only to their members and employees, but the general public, their co-operative character.

The experience of the Credit Union industry demonstrates that strong co-operative movements (forests) can be nurtured and developed in Australia.

Apart from the Credit Union experience a number of recent initiatives for general co-operatives have been commenced, particularly in New South Wales, which have the prospect of addressing many of the factors contributing to the vulnerability of the sector to the conversion syndrome. The Co-operatives 2000 Strategic Plan has identified the key issues affecting co-operative development in this country to the turn of the century. These issues are remarkably similar to the factors I have identified as contributing to the conversion syndrome.

The Co-operatives 2000 Strategic Plan is currently being implemented. Other initiatives such as the current ICA/New South Wales Registry of Co-operatives international trade project offers some opportunity to demonstrate to Australian co-operatives the advantages of commercial co-operation among co-operatives.

Again in New South Wales we have new legislation which has made the co-operative structure much more competitive with other forms of incorporation. Over the last few years a record number of new co-operatives have been formed, perhaps the start of the forest.

### Conclusion

This paper has sought to provide an explanation as to why some co-operatives in Australia have decided to change their corporate identity from that of a co-operative to an investor owned firm. I have not attempted to mount an argument that these conversions should not happen, rather to consider the underlying reasons why they occur.

I have pointed out that although Australia is a developed country with a high standard of living its general co-operative movement has not reach the same level of development. A number of factors have been identified as missing from the structure of the general co-operative movement which has made it prone at least in part to the conversion syndrome.

The clear lesson for the co-operative movement is that, if it is to successfully respond to the challenges of an increasingly competitive world environment, than it will need to maximise its strength as a movement through much greater integration. To do otherwise is not to learn from the Australian experience, which has shown that co-operatives are very vulnerable when they are not part of the forest.

Thank you.

Appendix 1

**List Of Recent Conversions**

The State by State list includes:<sup>1</sup>

*Queensland*

- \* Tully Co-operative Sugar Milling Assoc
- \* South Johnston Co-operative Sugar Milling
- \* Babinda Co-operative Sugar Milling Assoc
- \* Port Curtis Dairy Co-operative #
- \* Atherton Tableland Dairy Co-operative #
- \* Buderim Ginger Growers Co-operative Assoc
- \* Queensland Cotton Producers Co-operative
- \* Queensland Primary Producers Co-operative
- \* Queensland Peanut Growers Co-op Assoc
- \* Scarborough Trawlers Fishermen's Co-op Assoc
- \* Queensland Independent Wholesalers Co-operative
- \* The Associated Newsagents Co-operative
- \* Master Builders' Co-operative
- \* Plumbing Materials Co-operative
- \* Associated Milk Service Co-operative
- \* Master Butchers Co-operative

Building Societies

- \* Permanent Building Society

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<sup>1</sup> Assistance in compiling this list was provided by Mr Jim Manwaring and Mr Jayo Wickremarachchi, senior staff members of the Development Branch, New South Wales Registry of Co-operatives.

***South Australia***

- \* Berri Fruit Juices Co-operative
- \* Berri Co-operative Winery and Distillery
- \* Renmark Co-operative Winery and Distillery
- \* Vitor Citrus Co-operative
- \* Red Comb Egg Co-operative
- \* Associated Grocers Co-operative
- \* Eudinda Farmers Co-operative
- \* South Australian Fishermen's Co-operative (SAFCOL)
- \* Southern Farmers Co-operative

Building Societies

- \* Co-operative Building Society of South Australia

***Western Australia***

- \* Teachers Credit Society
- \* Plumbers Co-operative

Building Societies

- \* Perth Building Society
- \* Town and Country Building Society
- \* Permanent Building Society

***Victoria***

- \* Autobarn Co-operative
- \* Drouin Co-operative Butter Factory

Building Societies

- \* Victoria Building Society

- \* Permanent Building Society

***New South Wales***

- \* Producers Distributing Society Co-operative (PDS)
- \* Nepean Dairy Co-operative
- \* Wyong Co-operative Dairy
- \* Farmers Grazcos Co-operative
- \* Wollondilly Abattoirs Co-operative Ltd
- \* Griffith Growers' Co-operative Society Limited
- \* Australian Mushroom Growers Co-operative Society Ltd.
- \* Co-operative Insurance Co (CIC)
- \* Cumberland Cabs Co-operative Limited
- \* Western Districts Taxi Co-operative

**Building Societies**

- \* NSW Permanent Building Society
- \* United Permanent Building Society
- \* St George Building Society

( # In the process of being converted currently)