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Governance as a Determinant
of Success and Failure

What Other Co-ops Can Learn
from Co-op Atlantic

Brett Fairbairn
Murray Fulton
Dionne Pohler

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Centre for the Study of Co-operatives
101 Diefenbaker Place
University of Saskatchewan
Saskatoon SK Canada S7N 5B8
Phone: (306) 966-8509
Fax: (306) 966-8517
E-mail: coop.studies@usask.ca
Website: <http://www.usaskstudies.coop>

Centre for the Study of Co-operatives

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- to develop and offer university courses that provide an understanding of co-operative theory, principles, developments, structures, and legislation
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Our publications are designed to disseminate and encourage the discussion of research conducted at, or under the auspices of, the Centre for the Study of Co-operatives. The views expressed constitute the opinions of the authors.

Introduction

In 2012, Co-op Atlantic observed its eighty-fifth anniversary and was celebrated as the largest co-operative in Atlantic Canada. As a federation of local retail co-operatives, Co-op Atlantic's role was to strengthen and support the member co-ops, in particular by providing wholesale goods and services to them in three core areas: food, petroleum products, and agricultural supplies. Its president told delegates present at the annual meeting that "Co-op Atlantic has shown its ability to transform itself, while remaining an essential link between communities of the Atlantic region."

Three years later, in May 2015, the co-op sold its grocery and gasoline business to rival Sobeys. And after filing for bankruptcy protection, Co-op Atlantic proceeded systematically to sell its remaining assets. In October 2015, the co-op sold its fuel business — Co-op Energy — to CST Canada, another private company. Finally, in November 2015, the co-op announced the sale of most of its remaining agricultural supply business to La Coopérative fédérée du Québec. Farmers and the surviving retail co-ops in the region now obtain products and services from these new suppliers. The dream of a united co-operative system spanning the chain from farmers to consumers has come to an end.

Co-op Atlantic operated for eighty-eight years and helped sustain consumers, farmers, employees, and communities as co-operatives typically do. An enterprise that survives for more than three generations is not a flawed model. However, Co-op Atlantic's demise represents a loss of future possibilities. Could it have been prevented? Can other co-ops prevent such a turn of events?

Co-op Atlantic is not the first federation of retail co-operatives to fail. Others have failed in Québec, France, Germany, and elsewhere. Co-op Atlantic's story is a recent example of a pattern from which others can learn. We believe it is important for other co-operatives to pay attention to lessons from Co-op Atlantic's story — lessons that in our view ultimately come down to governance choices and behaviours.

What Went Wrong?

The demise of Co-op Atlantic's wholesale business was years in the making and involved pressures in the regional economy, inconsistent strategy, and the fundamental dynamics of a co-operative federation.

The competitive environment was undeniably tough. The retail sector is challenging, with narrow margins and large, integrated competitors; in addition, Atlantic Canada confronted a weak regional economy and not only an aging population, but also a declining population in many centres. And the co-ops did not have a foothold in the main, growing market, the dominant regional city of Halifax.

Changing and ineffective strategies made matters worse. Key decisions ten to fifteen years ago began a revolving door of various business strategies and approaches. In the unforgiving economic environment that Co-op Atlantic faced, there is not always time to recover from strategic miscues.

The challenge for a co-operative federation is to find consistent approaches that effectively and efficiently serve the member co-ops, ensure the commitment of those organizations, and address issues in the environment in which they operate. Governance should make sure these things happen. Where plans remain maladapted, inconsistent, or ineffectively implemented over a period of years, this needs to be viewed as a matter of governance.

In this sense, the Co-op Atlantic story highlights that in the long term the most important determinant of a co-operative's success — or its failure — comes down to governance. Sometimes governance is understood as being primarily about how the board and senior manager relate to each other. It is about that, and also far more.

Governance in Co-operatives

We believe there are three basic governance problems that all co-operatives must continually address if they are to be successful in dynamic and changing environments, particularly where there is much uncertainty about the future:

- *Managing strategic interdependencies.* For a co-op to thrive, or even to survive, all those involved need to perform their roles. Member loyalty, director strategic guidance, staff productivity, and management expertise are all necessary to surmount the challenges the co-op faces. Good governance gives key stakeholders the incentives, sense of ownership, and rewards to align their behaviour with what is needed for mutual success. For Co-op Atlantic, the central board, managers, and staff, and the local retail boards, managers, and staff, were among the key, interdependent stakeholders whose work needed to be co-ordinated.
- *Developing the “right” view of the future.* Organizations exist to deal with uncertain environments. Investment, production, employment, and marketing plans require views about what the future will bring. Every group of participants has its own filters and ways of thinking; governance decides whose voice counts and which view of the future will guide the co-op. Success hinges on which view is accepted and how easily and accurately it can be adapted to changing circumstances. For Co-op Atlantic, it was

particularly important, given the economic and demographic pressures, to identify a clear vision and common approach to address the external challenges.

- *Establishing and maintaining legitimacy.* The third governance challenge for a co-op is to establish and maintain legitimacy in the eyes of stakeholders. Without legitimacy, policies will be ignored, incentives will be viewed differently, information may be distorted or not provided, and views of the future will be disregarded. In a federation like Co-op Atlantic, the legitimacy of the central co-operative is essential to tying together diverse and disparate member co-ops.

Although these governance challenges resemble those faced by other forms of organization, co-operatives have a definitive difference — the importance of members. Members of co-operatives are a key group whose loyalty, commitment, and guidance to the organization are critical. The dynamics between the co-op and its members — including their involvement in strategic interdependencies, the operative view of the future, and legitimacy — are especially important factors in success.

Given its environment, Co-op Atlantic would have needed very good governance indeed. The organization and its members did not find sufficient synergies to sustain their system despite many years of trying to find the right formula.

Co-op Atlantic struggled with each of the three key governance problems.

Managing Strategic Interdependencies

The first challenge for co-operatives is to manage strategic interdependencies, including co-operation and co-ordination among stakeholders. In a federation like Co-op Atlantic, a key interdependency involves finding the appropriate economic cohesiveness between the federation and the member retails, whose loyalty and strength is needed for the system

to succeed. The onus is on the central management and board to supply the proficiency and long-range vision to tie the elements of the federation together.

The eventual collapse of Co-op Atlantic's food and gasoline business was preceded by at least fifteen years of efforts to define an effective, cohesive, and integrated relationship between Co-op Atlantic, the wholesaler, and its member retail co-operatives. In the end, repeated restructurings and efforts to save money-losing stores weighed down the whole system, impairing both finances and member commitment.

From 2001 to 2008, Co-op Atlantic amalgamated financially troubled local retails to form Consumers' Community Co-operative (CCC), a centralized, region-wide co-operative with direct individual membership and its own separate board. Many of the retails amalgamated into CCC had previously been direct-charge co-operatives, a form of retail that emphasized low prices and basic retailing rather than the more conventional strategy of value, service, and year-end patronage refunds. Direct-charge was an innovative regional approach, but most of the co-ops were not financially successful and the results burdened the larger system.

This CCC experiment failed to cause a turnaround. While it was designed to give Co-op Atlantic more control over the operations of the local stores, and hence to increase efficiency, it did not have this result. Instead, local members felt less ownership and control, which in turn led to less member business, a decline in system cohesion, and higher costs. According to Co-op Atlantic's 2004 annual report, CCC losses virtually wiped out that year's slim 1 percent net earnings. Co-op Atlantic's investment in CCC encumbered its balance sheet, representing the equivalent of four-fifths of member share capital.

Management may have gained greater scope of action through the centralization of CCC, but autonomous retail co-operatives and individual members did not. Interests were not aligned. Where was the board of Co-op Atlantic in all this? One function of a board is to provide long-

term strategic guidance that prevents a co-op from twisting this way or that with changes in the CEO position. The CCC story, together with frequent modifications in the marketing strategy (see below), suggests that changes in management were driving the co-operative. This would be particularly risky if managers were unfamiliar with the co-op federation model and unwilling or unable to adapt their strategies and approaches to fit.

Governance considerations suggest that the more complicated an organization — the more different structures, powerful stakeholder groups, and objectives it has — the greater the risk that directors and members will fail in oversight and management will go its own way. Did the CCC structure hinder members and the Co-op Atlantic board from being able to get a proper financial view?

One can also ask, where were the local retail co-ops — their boards and managers — in all this? It was not solely the responsibility of Co-op Atlantic to get member retails involved, to educate them, or to make sure their needs were met. In a co-operative, members have voice and power precisely to help make sure the common enterprise serves their needs and is on the right track. Based on the information we have, it is unclear whether member co-ops made compelling arguments and were not heard, or whether they failed to get involved, to educate themselves about the issues, and to speak up.

Developing the “Right” View of the Future

In dynamic and rapidly changing environments, the future is highly uncertain. The sheer volume of information available and the fact that decision makers suffer from both conscious and unconscious biases makes it exceedingly difficult to identify which trends are relevant and to draw the “right” inferences about the future.

In the 2000s, Co-op Atlantic certainly framed a number of inspiring initiatives. Its aspiration to be a force for regional economic develop-

ment led it to form partnerships between producers and consumers, embodied in unique marketing and products such as the Atlantic Tender Beef product and the Rochdale Gold potato. The co-operative also actively promoted co-op values and principles; in 2007, it hired a co-operative difference manager to increase awareness and community partnerships. Along the way, retailing formats varied and changed, including alternate forms such as direct-charge co-ops, the Co-op Basics format, and the Consumers' Community Co-operative.

It cannot be said that Co-op Atlantic had a shortage of ideas. Rather, it tried a variety of strategies in succession. Two things are critical to developing a right view of the future: the view must be suited to emerging external realities, and there must be consistency and a long-term vision. Stakeholders, including member co-ops and individual consumer members, need time to cohere around a common vision and to ensure it is implemented. Co-op Atlantic had a series of ideas, any one of which might possibly have worked, but it did not stick with any of them long enough or effectively enough to find out.

Given this inability to establish a “right” view of the future, it is not surprising that Co-op Atlantic failed over time to coalesce around a coherent identity and consistent strategy suited to the variations among the retail co-operatives. This lack of a coherent identity in turn affected the co-op's ability to manage strategic interdependencies and to maintain legitimacy.

Establishing and Maintaining Legitimacy

An organizational crisis and a legitimacy deficit often go together.

A lack of commitment by some of the retail members to their relationship with Co-op Atlantic was, reportedly, a precipitating cause for the collapse of the organization's grocery business. A development like this is a basic issue of governance: whether members' needs are being met; whether opportunistic behaviour or free ridership are discouraged, whether the interests of different stakeholders are understood to be

aligned. All organizations have such tensions to a degree. Indeed, the definition of a federation includes the fact that the members are autonomous: they may choose to go their own way; they may seek a relationship with a different wholesaler; their business may be solicited by a competitor.

In the face of such temptations, it is the legitimacy of the overall or central organization that typically holds members together.

One of the explanations for weak member commitment may have been a belief that Co-op Atlantic was not doing well. The co-operatives in question must certainly have believed they were pursuing what was best for their own members. Seen in this light, the collapse was not ultimately caused by the defection of the local retailers but by a gradual loss of Co-op Atlantic's legitimacy over many years.

Legitimacy is characterized by consistent shared experiences over time, especially a sense of reciprocity and equity — a clear sense that everyone's needs are fairly and adequately provided for. It is marked by high levels of trust and strong norms of behaviour. Legitimacy, in other words, exists within strong relationships and mutual commitments.

Trust and shared norms are especially difficult when members are heterogeneous. In Co-op Atlantic's case, the member co-operatives were scattered across four provinces, rural and urban centres, and Franco-phone and Anglophone populations, in many cases with strong local identities. Among other factors, differences between groups of Anglophone and Francophone co-operatives undermined trust and complicated governance and management. Even where local culture and identity were not an issue, managers in the wholesale and in the retailers had adversarial relationships and frequently sparred with each other over issues like merchandising, where they needed to work together. Beneath the surface of aspirational communications, the co-operative had a weak sense of "we."

While loyalty and participation are important to the operation of

co-operatives, they can only be maintained if the legitimacy of the whole organization remains strong. Otherwise, centrifugal forces can lead to a break-up. Co-op Atlantic in the end could not retain the confidence of the key members it needed for its grocery business to survive.

Governance Challenges for Federations

Numerous changes of direction, lack of sufficient action or commitment by stakeholders, weaknesses in identity and cohesion, and the ultimate legitimacy crisis all look in retrospect like a downward spiral that originated years ago in governance. Markers of this failure include the inability to define a cohesive economic relationship between the federation and its members, and the lack of a stable management strategy consistent over the whole period with the needs of a co-operative federation.

Federations of co-operatives may be especially vulnerable to disintegration of this kind.

Federated structures bring with them identifiable costs and limitations. Decisions are complicated, involve many autonomous parties working together, and take considerable time. It is difficult to co-ordinate one level of the federation with another. Federated structures increase the risks of “delegate” thinking at the central level rather than holistic and deliberative thinking by the board and members. Selection processes in federations may interfere with their ability to find consistent and balanced competencies for boards. The multiple activities of federations may complicate matters by requiring directors to have knowledge of many sectors of activity.

Some have argued that co-ops are prone to having relatively weak boards and overly strong managers; if this is true of co-ops in general, it is probably even more true of co-op federations. Lack of an outstanding

board can lead to a host of problems, whether it is management that is too powerful, management that is not given sufficient free rein, or management that is simply not aligned with what members need. All long-term problems, including any caused by management, are ultimately the board's responsibility.

Given their drawbacks, federated structures presumably survive because they develop some offsetting strengths that a simpler, unitary, or more integrated organization would not. What defines a federation is the autonomy of the members; if a federation succeeds, therefore, it must be because of something that it does differently and better because of having autonomous members. This elusive something — we might think of it as the federation benefit — could be related to local knowledge, local resources, loyalty, or strategic insights. Economies of scale alone will not be a sufficient argument, because other kinds of competing organizations will likely be able to provide even greater benefits in this area. A federation that cannot demonstrate some unique value associated with its distinctive structure needs to reconsider its long-term viability.

Conclusion

Many co-ops can benefit from reflecting on the lessons in Co-op Atlantic's experiences. All co-operatives are engaged in trying to resolve the ongoing issues discussed in this paper: managing strategic interdependencies, figuring out the "right" frame of interpretation for the future, and ensuring legitimacy. These challenging tasks lie at the core of co-operative governance.

"Good governance" is not a simple concept that can precisely be copied from one organization to another. It is not a checklist of rules. If it were, it would be straightforward and could be taken for granted. Every organization ultimately has to interpret and solve its own gover-

nance problems for its own environment and its own survival. Co-operative leaders need to understand the importance, the complexity, and the subtlety of governance as a way of thinking — a way of thinking applied in particular contexts and not a standardized set of policies or procedures.

Fortunately, there are some principles and concepts of governance that are generally true for co-operatives, even though specific solutions may vary. There are networks of co-ops that share their experiences, so each organization can have access to knowledge wider than its own. Together, we are generating a body of knowledge about what works in co-operatives.

In writing this article, the authors seek to provide an early response to what has occurred in Co-op Atlantic, in order to generate discussion and ideas for other co-operatives. More thinking and more research are needed, not only about what occurred in this one high-profile case, but also in many others, including both failures and successes.

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