Co-operative Governance: the case of Spanish Credit Co-operatives

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Corporate governance is traditionally one of the major challenges of co-operatives and Social Economy (SE) companies. As democratic member-based organisations, they have specific models of governance, but also specific problems. In recent decades, social pressure and market demands on corporate management and governance structures are increasingly pressing as regards both introducing efficient strategies (economic, financial, negotiating and management) and functioning in an ethically friendly manner (socially responsible business operations). Strategies and structures are closely linked in the upper echelons of governance, particularly in the relationships between top management, boards of directors and key owner groups (as well as stakeholders such as employees and local government). Various factors diminish the efficiency of governance systems, however. Prominent among these are conflicts of interest between owners (shareholders) and controllers/executives (board of directors and managers) (Berle and Means, 1932). This problem highlights the magnitude of certain real **failures of corporate governance**. The greatest theoretical and business challenge is to conceive and implement optimum institutional models for these corporate governance relationships, in the form of new governance regulations, codes of conduct of good governance and internal institutional changes.

Introduction

The first co-operative organisations originated as a collective response to a common need (a common bond) that could be meet collectively through the principles of self-help and democracy (friendly societies, consumer co-operatives, farmer associations, co-operative banks). Co-operative banks arose because of funding needs of farmers and small entrepreneurs, or those of the new urban inhabitants in their demand for housing, were being sidelined by the conventional banking system.

The members became multi-faceted: suppliers of financial resources and capital, participants in the decision-making processes and demanders/users of the bank's credit services, making them the owners (in the widest sense) of the organisation. Nonetheless, the common bond that is typical of a closed, tight-knit collective with incentives to take an active part in the society's decisions gradually weakens as the institution grows in size and the bonds between the members evaporate.

This gave rise to the idea that in the very success of the credit unions lie the seeds of their demutualisation. In spite of the inherent advantages of their friendly society nature, in a capitalist environment there are structural reasons that raise doubts about their survival. Firstly, the founders resist sharing their success, so the organisations remains restricted to a very limited local and/or corporative sphere or becomes mercantilised in order to interiorise its profits. Secondly, the power of the members, if taken to its ultimate extreme, can lead to horizontal organisational charts which make it difficult to retain the most competent managers. Again, co-operatives operate in a capitalist context in which economies of scale are the norm, but face difficulties in accessing the capital markets and in giving the managers incentives in the form of stock options.

In response to this situation, the co-operatives have tended to strengthen the power of their managers, as a way to survive in a capitalist environment, at the expense of an increasingly wide and diffuse membership base. This has spread the idea that an organisation's success basically depends on the calibre of its professional managers, so any involvement by the members can be seen as a distortion of economic efficiency. At times this route has led to demutualisation, as has happened with the British building societies and other co-operative groups in Europe. All the same, there are powerful co-operative banking groups that have maintained their dual nature as monetary financial institutions, governed by the principles dominated by business and markets, and co-operative societies, inspired by a social element and the idea of democracy. These characteristics are usually joined by these institutions' having a strongly territorial character and, usually, having close bonds with their local area.

As has happened in other European co-operative groups, the Spanish savings banks have abandoned their original activities to a certain extent and become neighbourhood banks with a considerable presence in the family housing mortgage market. As the membership has become more distant, the power of the

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members has faded and that of the professional administrators has strengthened.

From this point of view, we can ask how far the credit co-operatives still answer to the democratic principles that characterise them; what is the attitude of the members towards their right to participate; to what extent the board of governors reflects the will of the members; and what margin of discretion the managers enjoy.

In order to answer these questions, firstly, we propose a definition of good co-operative governance, secondly, we propose indicators to evaluate governance and, finally, we apply this method to Spanish credit co-operatives.

Good Co-operative Governance

We define good co-operative governance as governance that achieves the maximum level of economic performance compatible with the preservation or development of the co-operative identity, particularly maintaining democratic decision-making principles.

From that perspective, the great challenge for co-operative governance resides in making the following compatible:

(a) the democratic decision-making model
(b) economic performance, especially when the co-operative is experiencing economic growth and managerial development.

By democratic decision-making model we mean the decisions that emanate directly from the General Assembly of Members, the fundamental meeting in co-operative governance, and indirectly through the members' representatives on the Board. We understand that **Democratic Balance** exists when the democratic pattern of decision-making is respected.

By economic performance we mean the level of fulfilment of the society's objectives, especially those of providing services to members, compatible with the economic stability of the society. By **Economic Balance** we mean that a society is both financially profitable and serves the interests of the members.

Finally, we understand **Co-operative Balance**, and therefore good co-operative governance, as meaning a situation where both **Democratic Balance** and **Economic Balance** exist.

Tensions in Co-operative Governance

Economic growth engenders multiple changes in co-operatives, like a membership with a higher level of heterogeneity, the need to bring in salaried professionals (managers), the creation of second tier organisations, etc, all of which significantly alter the number and nature of the actors in play in their internal politics as well as the scenario of the democratic decision process, thus increasing its complexity. These changes constitute sources of democratic imbalances.

Additionally, the managerial development of the co-operatives demands strategies that require effective managers to design them and put them into practice. Inadequate attention to this can cause economic imbalances. Owing to the nature of these managerial functions, which is bound up with the administration of information (one of the sources of power identified by Mintzberg), managers tend to concentrate increasing decision-making power in their own hands. If checks and balances are lacking, that decision-making capacity may end up guiding the path of the society and potentially colliding with the interests of the members and with the democratic model. This phenomenon is also known as the Iron Law of the Oligarchy (Michels, 1911), and some authors (eg Spear, 2004) argue that the big co-operative organisations are the prototype of a managerial corporation in Galbraith's sense.

Studies that centre on this sector conclude that co-operatives behave as prototypes of the technocracy-dominated 'managerial corporation', in Galbraith's sense. These studies have tried to apply models such as agency theory (Jensen and Meckling, 1976, Fama, 1980) or the expense preference hypothesis (Murphy, 1985). Agency theory highlights managerial power and the irrelevance of the concept of ownership of the society. Studies such as those of Bataille-Chedotel and Huntzinger (2004), which analyses the typology of co-operative managers according to their origin, training, length of stay in the post and relation with social value creation, or Cornforth (2003), which establishes different models of manager, centre on the power of managers. Along the same lines, Spear (2004) points out that compared to managers in capitalist companies, co-operative managers enjoy positions of far greater power and much wider margins of discretion, unfettered by the membership, as the attendance rates at the Annual General Assemblies of members tend to decrease with the age and size of the organisation. Again, Akella and Greenbaum (1988) highlight the co-operatives' greater permissiveness towards expense preference behaviour, in other words, the members have a high tolerance of management power. This behaviour is accentuated with a diffuse membership (diffused ownership), which tends to trust in government regulation and is not prepared to bear the cost of effective control.

These tensions have an impact on the co-operatives and alter the above-mentioned balances, resulting in shortcomings in co-operative governance. The following indicators are useful for identifying these tensions:

Indicators of democratic imbalance:

In relation to the General Assembly:

1. Attendance rates at members' meetings.
2. Relevant information given to the members.
3. Members' intellectual capacity to process the information.
4. Existence of institutional mechanisms to increase participation: preparatory assemblies, coalition of votes, etc.
5. Members' interventions in the meetings and the quality of the interventions.

In relation to the Board:

1. Representativeness of the board members in relation to the social structure of the General Assembly.
2. Board members' length of office (especially the Chair).
3. Board's capacity to effectively control managers and employees.
4. Board members' technical and leadership skills.

Indicators of economic imbalance:

1. Managers' and board members' technical skills in the economic activities of the co-operative.

This proposal for the indicators agrees with the works of the French Institute of Administration's working group on co-operative and mutual governance (IFA, 2006) and with the works of the ACI-Europe Research Commission on corporate governance and management control systems in European co-operatives (Volkers et al, 1996). The IFA group offers proposals for maintaining co-operative balance while the ACI commission reveals the main deficiencies in the patterns of co-operative governance among the big European co-operatives, such as:

1. A marked tendency towards falling numbers of members attending members' meetings.
2. The existence of incompetent salaried managers.
3. The existence of salaried managers with little interest in the members but with a considerable interest in the expansion plans of the co-operative and in their opportunities for personal progress.
4. The board members' lack of relevant skills to carry out effective supervision.
5. The board's absence of effective power due to its lacking technical information about the co-operative.
6. Links among board members and salaried managers that call the monitoring capacity of the former into question.
7. Low rotation of board members.

Spanish Credit Co-operative Governance

Few published works have focused on Spanish co-operative governance. Most are included in the recent volume cited above (Chaves & Schediwy, 2004). No one has focused on credit co-operatives and the items in the framework of indicators we propose. Given the lack of data, an empirical study was conducted during the spring of 2004 with the collaboration of the National Union of Credit Co-operatives, UNACC (Chaves and Soler, 2004). The aim of this research was to discover and analyse the nature, composition and control systems of the credit co-operatives.

In Spain, credit co-operatives came into being at the end of the nineteenth century, following the model of Raiffeisen's credit unions. They were linked to farmers' co-operatives and the local area and were called *cajas rurales*, 'rural savings banks'. People's and professional credit co-operatives appeared later, including the Caja Laboral Popular, the biggest Spanish credit co-operative, which belongs to the well known Mondragon Co-operative Group.

A long growth period began in the 1970s, linked to changes in the economy and the liberalisation of credit operations. In the process, the sector underwent major transformations: the number of organisations fell, whether through mergers with other rural savings banks or because of absorptions by savings banks (*cajas de ahorros*), the technical and human resources were transformed, credit operations were diversified and a sector organisation was consolidated.

For this study, the target population was composed of the 83 Spanish credit co-operatives that were active during the spring of 2004. They have over 1,500,000 individual members and a further 70,000 members that are organisations, including 8,000 affiliated (agricultural) co-operatives, and represent over 5% of the Spanish financial industry. Over half are rural savings banks working at a local or district level, six are workers' or professional co-operatives and the rest are rural savings banks of provincial or greater scope. 73 of them are part of the Caja Rural group, clustered around the Banco Cooperativo Español, in which Germany's DG Bank has a stake. Spain's co-operative credit sector is very diverse in terms of unit size: three credit co-operatives have assets in excess of €5,000 million, while 17 have assets of under €50 million and have only one branch. The total deposits give them a 6.1% market share of the banking system. They serve around 10 million clients and have a network of 4,771 head and branch offices staffed by 19,000 employees.

The study sample was made up of the 30 co-operatives that answered the survey, 36% of the total, but their economic and social relevance is proportionally much greater, as they account for 66,1% of the total assets, 61,3% of the total individual members and 58,0% of the customers.

The questionnaire was composed of three large blocks, each focusing on one of the governing bodies. The first block of questions concerned the General Assembly, how it functions, attendance and effective member participation and the means used to energise it. The second block was devoted to the board of governors, as the body representing the co-operative's members; it tackled questions such as the origin, age, sex, qualifications and years of office of the board members in order to evaluate the two central problems: their representativeness of the membership and their efficacy in controlling the governance of the organisation, contributing value to the society. The third block asked similar questions about the management team in order to assess the extent to which it functions autonomously with regard to the instructions of the membership.

Results

Using our indicators of co-operative governance, the main results of the study were as follows:

1. Assistance rates at members' meetings

The members of a co-operative are convened to take part in the General Assembly on the principle of one member, one vote. In Spanish credit co-operatives, this principle is followed strictly in 59% of cases. In the remainder, criteria of proportionality are applied to members that are legal entities, essentially affiliated first-tier co-operatives.

Many of the largest credit co-operatives (27%) hold preparatory meetings to elect area representatives, to make participation easier when the organisation has a far-flung branch network. A rarer procedure (possible in 7% of these co-operatives) is vote coalition, which makes it easier to set up interest groups or member associations.

Nevertheless, the mean participation observed in Spanish credit co-operatives barely surpassed 6% of the members (Table 1), when the attendance at the AGMs of capitalist companies quoted on the Spanish stock markets accounts for 73% of their capital (2004 figures).

Low attendance at assemblies is joined by other worrying indicators. Firstly, the content of the deliberations (Table 2) is mostly confined to approving the accounts and annual report. Secondly, even those attending take little part in the proceedings (Table 3). Finally, the members

	Average Attending
Individuals	6.1
Legal entity	6.4
Of which:	
Co-operatives	23.0
Not co-operatives	1.8

Table 1: Members attending General Assembly of Members (%)

Frequency	%
Never	63.0
Sometimes	33.3
Often	3.7
Total	100.0

Table 2: Discussion at the General Assembly of questions concerning the operation of the co-operative

No of members	%
None	46.4
One	21.4
Two	17.9
Three	10.7
Five	3.6
Total	100.0

Table 3: Members that intervened in the General Assembly discussions

Type of information	%
Balance sheet and accounting results	80.0
Management report	70.0
Corporate governance report	20.0

Table 4: Information given to the members before the General Assembly

are given little information (Table 4), which is practically limited to the accounting reports.

2. Representativeness of the board members in relation to the social structure of the membership

The Board of Governors (*Consejo Rector)* is the body that represents the members and must ensure that the activities of the co-operative are in keeping with the wishes of the membership. Consequently, it must reflect the plurality of interests of the various groups of members from different backgrounds.

In Spanish credit co-operatives (Table 5), 68% of the board members are individual co-operative members, mainly entrepreneurs or farmers; 20% are representatives of the affiliated co-operatives and the rest are managers or employees of the credit co-operative.

3. Board members' technical and leadership skills

The scarcity of external board members is noticeable, in contrast to the large proportion of the members of the Board of Governors who are also members of one of the affiliated co-operatives, which can lead to conflicts of interest.

The mean length of office of the Chairpersons of the Board of Governors is about 10 years, which is longer than the average in private banks and savings banks, even though the most common method of renewing the Board is 50% every 2 years.

Generally speaking, the Boards of Governors of Spanish credit co-operatives show certain shortcomings in their educational qualifications (Tables 6 and 7). 35% are university graduates and a low percentage has any specific training in banking (30%) or the co-operative sector (20%).

Origin of the members	%
Individual members	68.2
Representatives of affiliated co-operatives (1)	19.8
Co-operative managers	4.0
Workers' representatives	4.6
Co-operative employees	1.7
Incoming professionals	1.7
Total	100.0

1) Tier level co-operatives.

Table 5: Origin of the Board members (%)

Qualifications	%
Banking studies	30.0

Table 6: Board Members with specific banking studies (%)

Qualifications	%
Co-operative studies	20.0

Table 7: Board Members with co-operative studies (%)

4. Managers' professional careers

The General Managers of Spanish credit co-operatives are generally promoted from within the same organisation (52%) or are professionals of acknowledged prestige brought in from outside (43%). Generally they are sufficiently qualified (57% are university graduates) or have acquired extensive experience within the co-operative.

5. Managers' length of service

The length of time that General Managers and Assistant General Managers stay in their posts is noteworthy, as the average is 20 years. Additionally, on occasion co-opting is also found, reinforcing the considerable stability and cohesion of the management group.

Conclusions

The empirical results of the study confirm the findings of the ICA Europe report (Volkers and Lees, 1996). Firstly, they reveal a low level of member participation, also known as **membership apathy** (Vierlheller, 1994), characteristic of big and mature co-operatives. This fact is made clear by the low attendance rates at members' meetings, the few times that members speak at these meetings and the very low level of questions referring to the operations of the co-operative that they ask when they do speak. However, statistically they do not demonstrate the relationship between participation and the size of the organisation. At all events, distance from the membership strengthens the autonomous power of the managers. In general, the decision-making bodies of the Spanish credit co-operatives have bypassed the effect that the bond with the members and their participation in the organisation's decisions can have in the sense of being a basic asset for trust in the organisation and for its viability.

This is a further proof that, for the great majority of the members, the exercise of political rights does not confer tangible benefits, particularly in our individualistic self-centered society, in which the sense of the collective has been devalued. Except for minority groups linked to the co-operatives that are affiliated to the credit co-operatives, the members find few incentives to participate, not even when choosing their representatives. Members should feel the call to participate and it is also a clear element of information transparency.

This low level of member participation does not mean a lack of interest. On the contrary: the members have a latent power that becomes evident at important moments for these organisations. There have been occasions when the proposals of the management group or the board of governors have been dismissed out of hand by assemblies attended by an ample majority of members, aware of the proposals being submitted to them. This was the case, for instance, in proposed mergers that were thwarted because the membership interpreted them as a loss of identity of their own autonomous institution and prevented the operation taking place as Caja Rural de Teruel in 1991 and Caja Rural de Vila-Real in 2003). In the same way, the members have also mobilised when they have seen resistance to other merger initiatives as between Cajamar and Caja Rural del Duero in 2007, as being due to outside interference.

As far as the board is concerned, our study finds a good level of representativeness of the

Managers from	%
Internal promotion inside the organisation	51.8
Incoming Professionals	43.3
Professionals from affiliated co-operatives	6.9
Total	100.0

Table 8: Co-operative managers' professional careers (%)

Type of manager	Average years
General Manager	20.4
Assistant General Manager	19.2
General Inspector	19.6
Head of personnel / administration	15.9

Table 9: Average years the managers stay in the co-operative

board members in relation to the membership. However it has detected some deficiencies. One is the low rate of renewal of board-level members. It may be a symptom of paralysis and it will self-perpetuate, reinforced by the passivity of the grass-roots members. The composition of their boards shows little reflection of the new member-customers, fewer of whom are linked to agriculture or the rural world, that the credit co-operatives (most of them 'rural co-operatives') have opened up to in the last two decades. Another of these deficiencies, and one which certainly extends to other big European co-operatives, is that the boards suffer a lack of technical skills in the banking business and a lack of co-operative background: eg only 30% of the board members have previous experience in the financial system. These skills are essential if the Board is to act responsibly and efficiently, applying policies that identify and forestall possible conflicts of interest and ensure that the way the society is run ensures that risks are kept under control and fits in with the interests of the owners.

Lastly, the managers of Spanish credit co-operatives are relatively better qualified than their boards, as much in banking matters as in co-operative matters, and have forged careers at the co-operatives. This last feature explains the long length of stay of the managers within the co-operatives. It is a case of 'local-mountain-climbers' (Bataille-Chedotel y Huntzinger, 2004) who have gradually trained in the culture of their own co-operative. But the risk, with a lack of participation by members, a lack of technical skills and deficiencies in information transparency, is that they become entrenched managers (Chaves y Sajardo, 2004). From this point of view, agency theory and the expense preference hypothesis are fully applicable to the case of Spanish credit co-operatives. Indeed, the membership demands little discipline of its managers, trusting in the limitations imposed by the authorities through the good governance tiers required by Basle II, particularly the requirement for greater accountability in risk measurement and management.

In short, the Spanish credit co-operatives are faced with the challenge of strengthening a participation culture among their members that will act as a control mechanism to ensure that managerial performance responds to the objective of these organisations: to meet the financial needs of their members and users.

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