Stream Strategic Management

Interactive session

Under New Management: Is Democratic Governance the way forward for Organizations?

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ABSTRACT

The purpose of this paper is to compare the governance structure of three large food retail business that all claim to use democratic processes in its governance and compare their financial performance. The businesses are John Lewis Partnership (JPL) in the UK and ICA and COOP in Sweden. In the case of JPL the business is owned by its employees, ICA is majority owned by its independent retailers and COOP is owned by its 3.4 million members. The initial study of the governance structures finds that the governance structures are practically the same and that JLPs and ICAs performs well financially whilst Coop performance is poor. The paper generates a set of propositions for continued research.

Keywords: Corporate Governance, democratic processes, retail organizations

This paper is concerned with democratic style Corporate Governance models in enterprises involved in retailing. There is a rich literature all the way back to the early 1900s when academics and economists debated the benefits or otherwise of cooperatively owned enterprises (Storey et al, 2014). Ekberg (2012) provides a review of three retail cooperatives in Europe 1950-2008 which includes both successes and failures. Ekberg's (2012) study discuss the dynamism of the grocery retail industry as a reason for the two failures and the low level of competition in the successful case. Ekberg also site the political connection as a factor in the two failing cooperatives. The UK based John Lewis Partnership (JPL), owned by its employees through the John Lewis Trust Company, has been debated in the academic literature (Cathcart, 2009, 2013a, 2013b, Guide et al, 2010; Paranque and Willmott, 2014; Purnell and Davies, 2012, Sauser, 2008; Storey et al, 2014) and there are detailed accounts of the origins and thoughts of the founding farther Spedan Lewis (Cox, 2010; Lewis, 1948, 1954). The financial crisis 2008 and public outcry of the dark side of capitalism caused the Prime Minister of the UK David Cameron to propose that a "John Lewis economy" could be part of the answer. Cathcart (2013a, 2013b) suggests democracy in organizations should be understood as contested terrain between management and the workforce whilst some scholars argue there are fundamental differences between political democracy and democracy in commercial organization and that democracy may not be applicable to all types of organizations (Kerr, 2004). The cooperative business Mondragon in Spain is another democratic model built around 261 independent cooperatives employing 74,000 employees

(Cheney, 2002; MacLeod, 1997). Although successful cooperative enterprises can be found the term "degeneration thesis" has been labelled on cooperative enterprises as these tends to fail commercially or the democratic characteristic abandoned (Storey at al, 2014).

The purpose of the paper is to compare the governance structure of three retail organizations with democratic decision processes and compare the financial performance over a five-year period.

METHODOLOGY

This study is a pilot study to inform further research into how Corporate Governance impact the performance of democratic type organizations. It is based on research in the public domain such as company annual reports, research reports and the academic literature. The financial analysis is based on information in the public domain which has limited the depth of analysis since the structures of organizations are surprisingly opaque given the objective of being cooperative enterprises. A limited number of interviews with Partners of the John Lewis Partnership including observation at a JPL branch council meeting have been conducted.

INTRODUCTION TO THE CASE ORGANIZATIONS

John Lewis Partnership

The John Lewis Partnership has a fascinating history – from the origin of the first draper shop opened by John Lewis in Oxford Street, London in 1884. In 1885 John Spedan Lewis is born, son of John Lewis, the founder of the John Lewis Partnership (JPL), and a visionary that continue to influence and guide the spirit and evolution of the Partnership. Today JPL has 91,500 employees, a turnover of £ 9.7 billion from the John Lewis department stores and the Waitrose grocery stores.

By the age of 21 John Spedan Lewis had acquired 25% of the family business and was the new Director of the Peter Johns department store in Sloan Square west London. During the early years working in his father's business he discovered many aspects that he felt was unfair to the employees and in many ways reduced the potential for growth and success of the business. For instance, John

Spedan discovered that John Lewis, Spedan Lewis and his brother Oswald drew £10,000 in dividend on the capital and paid themselves £16,000 in salaries. Whilst the staff of 300 received £16,000 in salary in total. This to Spedan was not a fair distribution of the income from everyone's effort. Spedan had for several years been thinking about how to make the reward of the effort of his staff fair. Peter Jones department store was a public company and in 1918 after a good year Spedan proposed a staff profit sharing scheme to his shareholders. He declared he would take no salary and pay himself no dividend whilst writing down the ordinary share capital. The shareholders where taken aback *"some shareholders clearly felt they were being taken for turkeys and asked to vote for Christmas*" (Quoted in Peter Cox, 2010). This was the first Partnership Bonus however there were doubts among staff that the Preference shares was actually worth something. In response Spedan launched the weekly Gazette in an effort to communicate to and convince staff that they were genuinely owners of the business. The Gazette was open to anyone to write letters to the Chairman or any manager for that matter. The Chairman and manager must respond to all letters. The Gazette is today one of the main channels through which staff and management communicate regularly with each other.

The food retailing part of JPL was developed through the acquisition in 1937of the food retailer Waite, Rose & Taylor. Waitrose is today an admired grocery chain in the UK however, it has not always been seen this way. In the early years of Waitrose was the poor cousin of the John Lewis department store business, the margins where low, competition fierce from unscrupulous competitors, and little had been invested in the business after its purchase. Thus £1 spent in a John Lewis store was worth twice as much in profit as a £1 spent in Waitrose. Winding the clock forward Waitrose now has 305 Waitrose grocery retailing stores. In 2015 revenue was £6.1 billion and £233m in profit (3.8%) and 59,300 Partners (employees). Waitrose has today larger revenues than John Lewis department stores however, operating profitability is higher for John Lewis (6.8%) compared with Waitrose (3.8%). Waitrose today command 5% market share in the UK and is seen as the premium brand for everyday grocery shopping.

ICA

ICA Sweden is a leading grocery retail group and the Swedish part of the ICA Gruppen AB. ICA Gruppen also owns retail operations in the Baltic countries, ICA Bank, ICA Real Estate, ICA Norway and a group of portfolio companies. ICA Sweden represents 61% of revenue of the ICA Gruppen and will be the focus of this report.

The origins of ICA go back to 1917 when Hakon Swenson started Hakon Bolaget as a wholesaler to achieve economies of scale in purchasing and distribution and invited other food retailers to buy into the business. In 1938 ICA was established through the merger of four wholesalers including Hakon Bolaget to further consolidate the purchasing power for the retailers. To manage these relationships the Association of ICA Retailers was established. In 1972 the so called ICA agreement sets out the relationship between the independent retailers and ICA where the founding principle is for independent retail entrepreneurs to access finance and support to become owners of their own business. In 2013 the corporate structure was streamlined and ICA Gruppen AB was listed at the Stockholm stock exchange.

A feature of ICA Gruppen AB is its majority shareholder, the Association of ICA retailers – hereafter referred to as the Association. The Association describes its governance process as a "democratic" process of Governance. Each retailer has one membership vote independent of size, profile or location of the shop. The Association is divided into seven District with a board which then meet at the Annual Council meeting. In 2015 ICA Sweden had revenue of SEK 72.6 billion, operating profit of SEK 3.4 billion (4.6%) and 50% market share in the grocery market. It had 1,306 grocery stores and 8242 employees. This compares to revenue of SEK 71.0 billion and operating profit of SEK 3.2 billion (4.6%) in 2014.

KF/Coop

The cooperative movement in Sweden can trace its roots to the turn of the 20th century when Kooperativa Förbundet (KF) was established in 1899. Over the past 100 year it has evolved and developed in tune with changes in society as well as the type of activities that have a cooperative

ownership model. Nearly 3.4 million people are members of one of Sweden's 31 Cooperative Associations under the umbrella of KF. Through the individual Associations membership in KF the members own the retailer Coop Sverige. A new structure was established in 2014 in response to several years of losses and an unwieldy and sometimes inefficient structure. In 2015 Coop Sverige had revenues of SEK 32.6 billion, operating profit of SEK 140 million (0.4%) and market share of 20% in the grocery market. It had 5218 employees working in the 243 stores owned by Coop Sverige. This was lower revenues of SEK 34.2 billion and loss of SEK -306 million (-0.9%) in 2014.

COMPARING GOVERNANCE STRUCTURES

John Lewis Partnership Governance Structure

It is worthwhile to begin with the purpose and aim of the John Lewis Partnership. In the words of the current Chairman Charlie Mayfield *"The purpose of the Partnership is – the happiness of its members, providing satisfying employment in a successful business, and unlocking the full potential of Partners",* O'Regan & Ghobadian, (2012, p107). This is the same expression that Spedan Lewis established when the Partnership was established in 1929 and have stood the test of time. What stands out is the purpose of the *happiness of its Partners*, which of course in the case of JPL is the employees. The Partnership is owned in Trust for its members, they share the responsibilities of ownership as well as its rewards – Profit, Knowledge and Power. The principles of this is set out in the Constitution.

The Constitution

Purpose: The Ultimate purpose of the Partnership is the happiness of its Partners

Power: Power in the Partnership is shared between three governing authorities, the Partnership Council, the Partnership Board and the Chairman

Profit: The Partnership aims to make sufficient profit from its trading operations to sustain its vitality, to finance its continued development, to distribute a share of those profit each year to its members, and to enable it to undertake other activities consistent with its ultimate purpose

In 1929 the first formal agreement set out the governance structure that still remain today and in 1950 the remaining parts of the shareholding was transferred to the Partnership. Spedan believed that no one should own more than they needed for their personal welfare. Spedan decided to sell his fortune to the Partnership, current and prospective, and be repaid out of future profits. This was a mechanism to give formal ownership to the employees. However, Spedan did not give up power. He elected to work without salary but he was the Chairman of the Partnership hence could continue to manage the business and over-rule decisions he deemed wrong or unwise. The role of the Chairman in the Partnership is central however Spedan also instituted a mechanism to remove the Chairman. The formal mechanism for removing the Chairman is the John Lewis Partnership Trust Company (the Trust Company) that where established in 1929. The Trust Company has a Deputy Chairman and three further trustees which hold 60 of the 100 shares and the Chairman the remaining 40. The three trustees that are elected by the Partnership Council can vote the Chairman out of the business if they so wish. This brings back power to the Partnership. The powers in the Partnership is divided between three bodies; the Partnership Council, the Partnership Board and the Chairman.

The Council is the body that represents the Partners in the governance structure. All Partners are members of the Council and each have one vote when electing members of the Council to represent them. The Council meets twice a year and any question can be discussed at the meeting. The Partnership Board is responsible for managing the performance of the Partnership. This is in practice the executive committee and consist of Chairman, five appointed members - (CEO's of John Lewis and Waitrose, Finance director, HR director, Group development Director), five elected members by the Partners and 3 non-Executives. In addition, the Partnership Board also include one Councillor who has responsibility for encouraging every Partner to play their role as co-owners, seeking to ensure that the Partnership is true to its principles and compassionate to individual Partners. The Chairman role is to ensure that the Partnership develops its distinctive character and democratic vitality. As the senior executive in the Partnership, the Chairman is ultimately responsible for its commercial performance.

Insert figure 1 about here

ICA Governance structure

ICA Gruppen's overall goal is to create long term shareholder value through positive share price development and dividends. ICA Gruppen has two classes of shares, ordinary share and C shares. The C class shares comprises 40.8% of total number of shares, are unlisted and do not carry entitlements to cash dividends. The remaining 59.2% shares are listed ordinary shares with dividend entitlement. At the end of 2014 all the C shares and 10.5% of Ordinary shares, i.e. 51.3% were owned by the Association of ICA Retailers. ICA Gruppen is governed by the Swedish company law and the listing regulation of NASDAQ Stockholm. The responsibility for the company's affairs is with the Board of Directors. It is recorded that several of the Board members are not independent as they may have affiliations either with the Association of ICA Retailer or ownership and board membership of independent ICA retailers. The company's shareholders can exercise their ownership rights in the Annual General Meeting. The AGM approves the financial results and the procedures for the committee's and the Board. The CEO is responsible for the day-to-day administration of the company in accordance with the Board's instructions.

KF/Coop Governance Structure

KF is the parent company to Coop Sverige. The purpose of KF is to manage the Coop group for the benefits of its customer and members. It aims to provide high quality and affordable products and services. The ownership objective is stated as "*Through clarity of purpose and focus on creating value for the members and to be an active owner of its businesse*s". In a membership cooperative the fundamental unit of ownership is the individual member. In 2015 KF had 3,4m members in Sweden. The initial membership cost is SEK 100 and provides the member one vote. Through ageographically dispersed process 94 representatives are elected to vote in the annual KF Council meeting. In the KF Council meeting decisions ratify the financial results for the year, elect the board of directors, chairperson and auditors. In addition, there are regular local membership meetings that connect the members with their local Coop shop. In 2014 21,580 members (0.6% of its members) took part in elections for 2,251 elected members at different levels in the governance process.

Comparison of Governance Structures

Insert table 1 about here

Despite the difference in ownership the top level of the three organizations have similar structures with similar decision rights in the management of the business. It should be noted that in the case of JLP and Coop both organizations apply what they term a democratic governance process. Interestingly, the Association of ICA Retailers refers to itself as a democratic organization and is the majority shareholder of a public company.

After several years of losses in Coop Sverige the governance structure is changing. The KF annual report 2015 states the purpose of KF to be an "active owner" of the businesses within KF. In the seven strategic goals outlined goal #4 emphasise the development of a strong and owner focused organization and to ensure a financially viable organization with clear lines of authority between KF as owner and the operating businesses such as Coop Sverige. The 2015 annual report makes clear that a pre-requisite for strong finances is consolidation through mergers of the local Coop associations to create economies of scale and a stronger balance sheet with which to access finance for investments. Furthermore, KF is aiming to implement the same code for corporate governance that applies in publicly listed companies. KF sets the strategy, appoints the CEO, the board of directors in each business and holds each business accountable for its performance.

P1. *The governance structure at the top level in organizations are the same no matter if the business is shareholder owned, owned by its employees or by its members.*

Financial performance data and analysis

The intention at this stage of the research study was to compare the financial performance of the grocery retailing activities of the three organisations being considered. The financial information included in the analysis is summarised in Table 2 below.

Insert table 2 about here

Financial performance

It is difficult to avoid drawing the conclusion that the impact of the ownership structure may be reflected in the pattern of financial performance with the financial imperative of needing to satisfy shareholders being most directly evident for ICA Sweden. The 'partnership' model within John Lewis with a focus on providing returns to partners in a quasi-shareholder fashion may be a factor relevant to the performance of Waitrose. The cooperative structure is the furthest removed from the financially focussed ownership model and provides the least impressive financial results.

P2. *A shareholder and employee owned organization offers superior financial performance compared with a cooperative organization*

Findings and Discussion

This research study of three grocery organizations with three very different ownerships identify two successful models and one model (KF/Coop) that have struggled financially for several years. The two successful models in the study show that the employee (JLP) owned model and the independent retail owned model (ICA) is growing their businesses profitably. With losses mounting KF has been forced to review and change its Corporate Governance. These findings are interesting in relation to Ekberg (2012) who compared successful and failing retail Cooperatives in Norway, Germany and the UK. Ekberg's analysis suggest that the Cooperative movements can have difficulties responding to dynamic and highly competitive markets such as grocery retailing yet also succeeding which the example in Norway demonstrates.

P3. *Cooperative organizational structures have difficulty responding to dynamic markets such as grocery retailing*

In response to the financial difficulties KF is embarking on a radical overhaul of the Corporate Governance structure which by any comparison is the same as the governance code for publicly listed companies. There is nevertheless commitment to ensure membership influence in KF and Coop. However, there is no clarity at the time of writing how this is going to be achieved?

P4. *A membership cooperative and democratic organization can coexist with a shareholder focused governance structure*

The research has identified that organizations seems to have similar governance structure irrespective of the type of ownership. There is some evidence that the type of ownership has impact on the financial performance of the organization. However, further research is needed to better understand these findings. Further research into the governance mechanisms used at JLP to develop employee engagement and if this may be the source of success. In the case of KF/Coop further research is required to uncover how KF/Coop can create membership engagement whilst embarking on a change to governance that mimic shareholder based governance structures.

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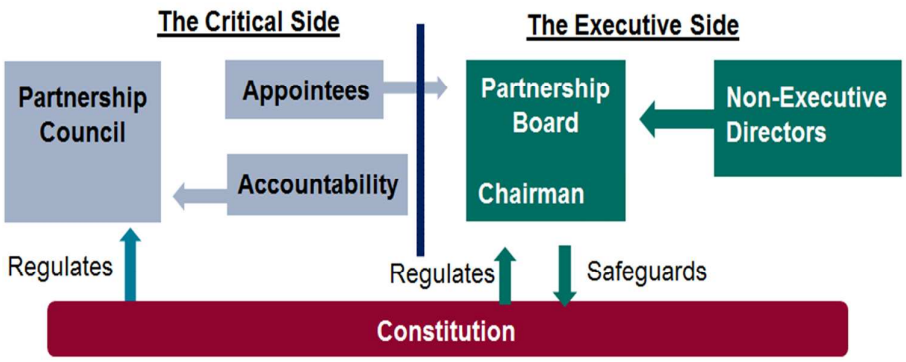


Figure 1. Governance structure at John Lewis Partnership

	JPL	KF	ICA
Top level decision function	Partnership Council	Members meeting (Stämma)	Shareholder meeting (Årsmöte)
Actors in the top level function	Elected Partners (employees)	Elected Members (Ombud)	Shareholders
Main decisions of top-level function	Hold Chairman to account Ratify financial results Agree annual bonus Elect members to the Partnership board	Ratify financial results Elect Executive Board members Elect members of various committees Elect auditors	Ratify financial results Elect Executive Board members Elect members of various committees Elect auditors
Executive Board	Partnership Board	Executive Board (KF styrelse)	Executive Board (styrelse)
Main decisions of Executive Board	Setting strategy and financial goals Responsible for the performance of the business Appointing Senior Executives	Setting strategy and financial goals Responsible for the performance of the business Appoints CEO	Setting strategy and financials goals Responsible for the performance of the business Appoints CEO

Table 1. Governance structure and decision rights

	2011	2012	2013	2014	2015
Waitrose: Sales [SEK m]*	58,328	62,284	66,171	70,552	69,989
Op. profit	3,001	3,358	3,565	2,725	2,679
Operating margin	5.1%	5.4%	5.4%	3.9%	3.8%
ICA Sweden: Sales [SEK m]	62,500	65,691	67,992	71,026	72,624
Op. profit	2,617	2,849	3,058	3,249	3,366
Operating margin	4.2%	4.3%	4.5%	4.6%	4.6%
Coop Sverige: Sales [SEK m]	33,247	34,007	34,076	34,161	32,581
Op profit	(648)	(698)	(222)	(306)	140
Operating margin	(1.9%)	(2.1%)	(0.7%)	(0.9%)	0.4%

Table 2: Financial information. *GBP converted at GBP 1=SEK 11.5