Why Do Cooperative Fail?

Summary & Links to a Variety of Sources

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Source: Cooperatives First

https://cooperativesfirst.com/blog/2017/08/17/20178175-reasons-coops-fail/

The 5 Reasons Co-ops Fail

Overall, co-operatives have a proven track record of being more sustainable than other forms of business – with over 90% remaining successful after 3-5 years.

But, like any business and organizational models, there are reasons co-ops fail. Often this is the result of common issues faced by businesses, such as market dynamics, access to capital, or mismanagement.

Here are five reasons co-ops fail:

Failure to incentivize shareholders

Participation in a co-operative often includes some investment of time and/or money. Shareholders typically participate in a co-operative because they see some form of benefit for themselves that comes from their involvement with the enterprise.

These benefits may include a dividend, a patronage refund, access to a new product or service, greater market certainty, or the ability to get involved in an organization. Failing to provide tangible incentives, or poorly communicating them, will limit member applications and shareholder participation.

Having incentives and clearly communicating them helps co-ops avoid this potential difficulty.

Power becomes centralized

Co-operatives often have more inclusive governance structures and should provide forums for more people to get involved. This inclusiveness and diversity of ideas can contribute to a co-operative's success, and co-ops do best when this is nurtured and properly managed. Platform co-op Stocksy United provides an innovative solution to this problem by rotating members of its executive team as moderators on their online member discussion forum.

When power and authority within a co-operative begins to centralize around a few individuals like boards or managers, shareholders may feel disengaged or excluded from a business in which they are an owner. This can lead to unexpected resolutions and attempts at hostile redirection during annual general meetings — and is one of the major reasons co-ops fail.

The overall strength and longevity of co-operatives worldwide is closely linked to their ability to listen to and serve their shareholders or members. Make sure you have clear communication channels for shareholders and members, and mechanisms for addressing their concerns or suggestions on a regular basis.

Wrong people in the wrong places

Co-operatives, like most businesses and organizations, rely on people working together towards a common goal to be successful. When directors or managers view the co-operative business model or co-operation with contempt, their decisions can undermine the co-operative's ability to function. Often some combination of inadequate board oversight and management hubris that signal a co-operative's failure.

But shareholders also have a responsibility to hold leadership accountable when their actions undermine the co-operative's goals, values, and ideals. Clear, ongoing member and shareholder engagement helps co-ops navigate this challenge.

Lack of market or community support

Co-operatives work best when the idea and development of the business is led by the group that will be involved with the co-operative (e.g. the people that will shop there, work there, or sell products there). This can create a sense of ownership and loyalty not commonly found in other business models.

When a co-op is imposed by a group outside the community or market, this sense of ownership does not emerge organically. In these cases, the community may be mistrustful of the co-operative or have mixed expectations of their role in its operation.

Likewise, just because a service might be needed in a community or market doesn't mean there's a market or appetite for it. Like any business, make sure to do a proper feasibility study and business plan before deciding the idea is good to go — or whether the co-op model is the best fit.

Not planning for succession

Co-operatives, like any other businesses and organizations, need to plan for their future. Leaders and managers will eventually retire or leave the co-operative, creating a need for someone new to fill the gap.

From a broader perspective, co-operatives need to actively recruit new members as older members leave to ensure their business has a sustainable, supportive base. Failing co-operatives have a hard time recruiting. new members or shareholders, which can lead to a variety of challenges, such as reaching quorum at meetings or an insufficient number of directors on the board.

Moreover, developing capacity in members or shareholders over time will help ensure the co-operative has access to the human and leadership skills required to continue over the long term, and potential for raising capital when needed.

Bringing in new, sometimes younger, people also acts as a catalyst for fresh ideas and trends. And this renewal can bring with it good ideas related to operations, but also for governance and policy.

The lowdown

Co-operatives are most successful when they are built on good governance, a clear understanding of purpose, and a potential market. A failing co-operative will show signs early on, and it's never too late to regroup, rework, and reposition the co-op. But it's also important to remember that failing co-operatives do not always need to be saved. After all, there are reasons co-ops fail.

If you like this, you might want to check out this report by Dr. Murray Fulton (Centre for the Study of Co-operatives & Johnson Shoyama School of Public Policy) and Peter Couchman (Plunkett Foundation). The report presents five reasons co-ops fail and highlights important characteristics exhibited by large co-operatives that usually signal their end.

Why Do Cooperatives Fail?.........

https://geo.coop/articles/why-some-worker-co-ops-succeed-while-others-fail

Focused on Worker Co-ops with some good case studies

Cooperative News

https://www.thenews.coop/big-co-ops-fail/

Major co-ops ‘do not go gentle into that good night’. Their final gasps for breath are a violent attempt to put off what is seen as inevitable by outsiders

Factor Five:
The final roll of the dice

Major co-ops “do not go gentle into that good night”. Their final gasps for breath are a violent attempt to put off what is seen as inevitable by outsiders.

Their final years are spent on a series of acquisitions, mergers and restructures. Which form this takes varies, but in all cases there is a final move, portrayed as bold and ground-breaking by management at the time. There is a language of showing other co-operatives how it should be done.

All of these fail to solve the problems they face and hasten their end. Why, when other co-operatives and businesses adopt these approaches and thrive, do these fail? It is not the tactics that are at fault, but the mindset that has already taken place in Factor Four.

Factor Four: Overconfidence

Hindsight lets us see that these final acts were doomed as they will normally be seen to have put too high a value on mergers and acquisitions and to have significantly underestimated the challenges to be overcome.

Murray Fulton’s paper on the Wheat Pools places the blame for this firmly on CEO Hubris – excessive pride or self confidence. He says: “Hubris means that CEOs have an overwhelming presumption that their high valuation of a takeover target is correct, even when it is not. … CEOs will tend to overpay for these acquisitions, and so the investments will often be unsuccessful.”

The management of these co-operatives exhibit significant overconfidence in their ability to turn the situation around. They
will overvalue acquisitions and underestimate the complexity of the tasks needed. A culture is visible in which they see their thinking as superior to their peers and to the members of their

own co-op. Thus this overconfidence is combined with a culture that dismisses any voices challenging the wisdom of their moves.

Factor Three:
Lack of board oversight

None of this would be possible without a lack of board oversight. Murray Fulton wrote: "The relationship between CEO hubris and acquisition premium is greater when board vigilance is lacking— i.e., the less oversight by the board, the greater the overpayment."

Boards in these failed co-ops fail to develop a relationship with their management which gave a clear values base for the organisation, a clear strategic direction linked to the needs of their members and a proper evaluation system of mergers, acquisitions and investments.

Lord Myners, in his report on the failings of the Co-operative Group in the UK, was scathing of the quality of its board system. "It places individuals who do not possess the requisite skills and experience into positions where their lack of understanding prevents them from exercising the necessary oversight of the executive," he said.

Often such failings will be described as a governance failure, but it is important to see them as a failure of governance culture.

The governance system was often in place in these organisations, but Directors failed to use it to exercise the proper levels of oversight.

Factor Two:
The Wrong People

This fatal combination of management hubris and lack of board oversight develops when the wrong people are elected and recruited. Put simply, board members who fail to understand their role in a co-operative appointing managers who have thinly concealed contempt for co-operative values.

Recent failures, most notably in the UK, have resulted in greater discussion on the competence of elected representatives.

This debate is to be welcomed providing competence is defined as competence in the commercial, co-operative and social needs of the co-operative.

It is easy to point fingers at the directors of failed co-ops, but far harder to come up with how the selection process could be improved. It is unlikely to have one single solution, but to be a combination of more rigorous election processes, greater access to co-operative education, drawing from a wider pool of members and stronger support once elected.

The same can be said of the recruitment of managers. Directors who espouse co-operative values seem all too willing to appoint people who don't and who demonstrate little appetite for building solutions through the co-operative identity of their organisation rather than importing mainstream solutions.

A look across the failures also challenges the perception that it is "outsiders" that bring co-ops down. Many of the managers rose through the ranks but remain untouched by co-operative thinking, while some from outside grasped the need for distinctive co-operative solutions.

Factor One:
Seeing co-operation as the problem

The root of the other four factors is a failure to believe in and understand the nature of a co-op. The earliest sign is a co-operative which sees being a co-op as a problem, not a solution. The feeling that their co-op identity is a burden, not a source of pride appears to precede the other four factors. A cynicism about co-operative democracy and member engagement can develop long before the actions which cause the eventual collapse. In many ways, looking for this is the canary in a coal mine.

If not rooted out by active co-operative promotion and education, it will fester and grow into the other factors.

The Early Warning Signs

The most depressing part of these collapses is not that they follow very similar paths, but that the warning signs were there for all to see. These signs are:

Why Do Cooperatives Fail?.........

A CO-OPERATIVE WHICH **FALLS SILENT** ON ITS CO-OPERATIVE IDENTITY AND ITS NEED TO ENGAGE WITH ITS MEMBERS.

BOARD MEMBERS WHO EXHIBIT **LITTLE UNDERSTANDING** OF THE NATURE OF A CO-OPERATIVE BUSINESS.

MANAGERS APPOINTED, EITHER EXTERNALLY OR INTERNALLY, WHO HAVE **NO INTEREST OR BELIEF** IN THE CO-OPERATIVE MODEL.

A BOARD WHICH IS **UNABLE TO EXPLAIN** HOW THE MAJOR CHANGES IT IS PURSUING WILL **HELP ADD VALUE** FOR THEIR **MEMBERS**.

A MANAGEMENT CONDUCTING MERGERS, ACQUISITIONS AND INVESTMENTS WHICH ARE, TO THE OUTSIDE WORLD, **LACKING CLARITY, BUSINESS LOGIC AND AT MUCH HIGHER VALUATIONS** THAT THE MARKET THINKS CAN BE JUSTIFIED.

A SHIFT IN POWER AND AUTHORITY TO A VERY **SMALL GROUP** WITHIN THE CO-OPERATIVE, A GROUP THAT IS **INCREASINGLY ISOLATED** FROM THE MEMBERSHIP AND THE EMPLOYEES (BOTH SENIOR AND JUNIOR).

A SHIFT IN FOCUS OF THE BOARD AND MANAGEMENT FROM **WHAT IS GOOD FOR THE MEMBERS** TO WHAT IS GOOD FOR THEM PERSONALLY

It is never too late to act, but acting on the earlier signs rather than waiting for the inevitable can dramatically reduce the loss of member value and increase the chance of survival.

It can also reduce the damage to the movement of yet another co-op going down in flames. This is why it is everyone's business to raise the alarm when these signs are visible.

Why Do Cooperatives Fail?.........

Co-operatives do fail, and we need to be able to acknowledge this and talk about it in a serious and thought-provoking way, in everything from global conferences to day-to-day conversations.

Fulton, Murray E, and Kathy Larson, 2009
The Restructuring of the Saskatchewan Wheat Pool: Overconfidence and Agency Journal of Co-operatives 23: 1–19

Fulton, Murray E, and Kathy Larson, 2009
Overconfidence and Hubris: The Demise of Agricultural Co-operatives in Western Canada. Journal of Rural Cooperation 37(2): 166-200

Rocky Mountain Farmers Union

https://rmfu.org/co-op-failure/

Factors of Failure Among All Kinds of Co-ops:

- Permitting use of proxies.
- Articles or bylaws poorly drafted.
- Excessive legal and organizing costs.
- Inadequate provision for action by dissatisfied members.
- No regular financial statements or audits.
- Expansion into an innovative field without careful study, and with inadequate capital.
- Difficulty in securing management with strong cooperative experience.
- Did not adapt to changes in the industry.
- Board did not understand its roles and responsibilities, and its relationship to management.
- Lack of reserves to ride out local economic problems or recessions.
- No continuing new member recruitment or orientation program.
- Needs of customers not emphasized in planning.
- No outside agency or organization that can review developing internal problems or insist on regular financial statements or audits.

Why Do Cooperatives Fail?.........

Among newer co-ops, add these factors:

- Inadequate member investment.
- Inexperienced staff and management.
- Inadequate membership base before opening.
- Internal friction on social/political objectives.
- Initial capital budget did not allow for probable operating losses during the first months (or years).
- Sponsoring groups had goals incompatible with those of the co-op.

Among established co-ops, add these factors:

- No provision for management succession.
- Did not adapt to changes in the marketplace.
- Excessive distribution of patronage dividends in cash.
- Did not maintain or replace old equipment and/or facilities.
- Domination by old-timers.

The Co-Op Federation

https://fed.coop/co-operatives-in-australia-a-manual/part-one-understanding-co-operatives/why-they-can-fail/

Why they can fail

When co-operatives fail, it is often due to the lack of commitment and unity of members, or the economic environment in which they operate. Around half of newly formed co-operatives do not survive the first five years. Failure can be the result of:

- Inability to balance benefits to members with retaining/raising sufficient capital to invest in the business.
- Low returns, poor market, or poor product or service.
- Idealistic, impractical, poorly stated or conflicting objectives.
- Inadequate planning or research.

Why Do Cooperatives Fail?.........

- Inability of members to co-operate or offer sufficient support.
- Large users who seek more control.
- Lack of communication and co-operative education.
- Failure to use and control competent consultants or management.
- Hijacking by management or some of the membership.
- Directors not comprehending the needs and motivation of members.
- Ignorance of legislation and legal obligations.

Mountain Equipment Coop

https://news.usask.ca/articles/research/2020/research-the-mec-debacle-is-a-predictable-and-avoidable-governance-failure.php

Mountain Equipment Co-op (MEC) transitioned from a member-owned cooperative to a company in 2020, following a period of financial difficulties and a perceived erosion of its cooperative principles, ultimately leading to its acquisition by a private equity firm.

Here's a more detailed breakdown of the events and factors contributing to MEC's transformation:

The Shift from Co-op to Company:

- **Financial Struggles:**

  MEC faced declining revenues and profits, exacerbated by the pandemic and supply chain issues, leading to a need for a cash infusion.
- **Pandemic Impact:**

  The pandemic restrictions and supply chain disruptions created challenges for retailers, including MEC, leading to inventory issues and financial strain.
- **Private Equity Acquisition:**

  In late 2020, MEC, which had been a co-operative for 49 years, was acquired by Kingswood Capital Management LP, a California-based investment firm, for $150 million.
- **Rebranding:**

MEC was rebranded as Mountain Equipment Company in October 2021, restoring the "twin peaks" mountain logo that had been mostly retired by the co-op in 2013.

Factors Contributing to the Decline of the Co-op Model:

- **Erosion of Member Voice:**

  Some argue that MEC's leadership made decisions that distanced the company from its cooperative roots, including removing the word "co-op" from its marketing and fostering a culture that saw member involvement as a problem.

- **Leadership Team:**

  MEC built a leadership team that lacked understanding of co-operatives and fostered a culture that saw member involvement as a problem rather than a strength.

- **Governance Issues:**

  Critics pointed to management hubris, over-investment, and lax board oversight as signs of a failing cooperative governance structure.

- **Growth Strategy:**

  Expanding retail stores and product offerings resulted in higher debt levels and fixed costs.

- **Liquidity Issues:**
  MEC's net operating losses since 2017 were $80 million, indicating significant financial difficulties.

MEC's Current Status:

- MEC was sold to a US Private Equity group is now run for profit and no longer owned by its members but it currently being sued by suppliers for unpaid bills

  https://www.biv.com/news/retail-manufacturing/financial-struggles-at-vancouvers-mec-suppliers-sue-over-unpaid-bills-10329666

  https://stevejoneshikes.medium.com/we-cant-let-the-mountain-equipment-co-op-story-repeat-itself-5f44f061cd41