

Keeping bad company: building societies – a case study

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Introduction

The title, “Keeping bad company”, is intended to convey a number of assertions made throughout this paper. When building societies converted from mutual building societies to public companies, the erstwhile building societies became bad companies. They were bad because, necessarily, they followed the corporate model dictated by the neo-liberal ideology of the time. So, to put it another way, by incorporating, they fell into bad company. And when you keep bad company, you pick up bad habits.

To substantiate these assertions, I compare two organisational forms – or at any rate, two ideological perspectives on organisational form. These are the management controlled organisation (MCO); and the shareholder value organisation (SVO). I will attempt to assess their relative strengths and to find in that contrast an explanation for the fact that converted building societies, as SVOs, have been part of – indeed central to – the current financial crisis, whereas their MCO counterparts in what one can still call the mutual *movement* have survived largely unscathed. I will draw upon diverse disciplines in order to make this argument, including institutional economics, organisational sociology, labour process theory, political economics and the law.

I begin by examining how the original small terminating societies were usurped by larger permanent societies and the economic developments which led societies to become MCOs.¹ I go on to assess MCO theory and the normative implications of this approach which is both supportive and critical of the MCO. Critics cite MCOs’ hierarchical and oligarchic nature while proponents of MCOs characterise them as a rational mechanism for enhancing production and ensuring economic stability. I then show how theory critical of MCOs dovetailed with the neo-liberal economic and political project, resulting in the reform of building society law. This legislative reform and ideological shift resulted in many societies becoming market organisations; companies governed by shareholder value concerns. I then assess the problems with shareholder value and SVOs and argue

1 It can also be noted here that, given the one-member-one-vote basis of member democracy in mutual building societies, the managerial model better describes building societies than it does the large US public companies it was mainly developed in respect of. This is because, when voting entitlement is based on share ownership, there is always a possibility that wealthy investors, acting individually or as a group, may exercise control over their company’s management, whereas there is no such possibility in a mutual building society.

that they enslave governance to the capital markets with destructive consequences. Finally, I compare the approach of MCO building societies to the current crisis with that of SVO converted societies.

Early mutual building societies and the emergence of the management controlled building society

The first recorded building societies were formed in the last quarter of the 18th century, in newly industrialising cities,² by people whom Hobsbawn might describe as “labour aristocracy”; artisans, highly skilled and relatively well-paid workers. These early mutual organisations had a small membership which saved collectively, making monthly contributions at a set amount with the aim of acquiring privately owned property and escaping high rents. The usual system involved saving sufficient funds to purchase one dwelling place which could be allocated to one member through a lottery. Members would continue to save until all the membership had purchased a property after which the society would come to end. Because of the finite nature of their operation, these societies were known as “terminating societies”.

Early societies operated for over 60 years without any legislation specifically designed for their usage. This left their internal organisation to be prescribed by the members rather than by legislation. Yet, despite the absence of coordination between societies or cohering regulation, most building societies organised themselves in a fairly similar manner.³ There were minor differences in the cost of subscriptions, methods of allocating property and penalties for defaulting members. However, all societies operated under a system whereby members received benefits upon making contributions. That is, all members were both borrowers and savers; beginning as savers, once allocated property they became borrowers until all the members had been allocated property. Likewise, in terms of governance, all members had a single vote and decisions in respect of the society were made collectively. Indeed, this governance approach was noted in an early case which turned on the very issue of member democracy.⁴

After legislation was eventually passed in the form of the Benefit Building Society Act 1836 building societies rapidly grew in both number and size. For 70 years building societies had been small in size. Their membership never exceeded 80, and there were less than 100 known societies.⁵ By 1850, over 2000 societies had registered under the 1836 Act, some with thousands of members.⁶ In the context of the large societies at least, this meant that the traditional terminating societies had become increasingly inappropriate, designed as they were for a small, non-fluctuating group of saver/borrower members.

2 For example, the first known building society was formed in Birmingham in 1775 and took its name from the local hostelry in which it was formed, Ketleys: E J Cleary, *The Building Society Movement* (London: Elek Books Ltd 1965), p. 11.

3 *Ibid.*, p. 13.

4 *Pratt v Hutchinson* (1812) 15 East KB 511. In this case, the guarantor of a member who had failed to keep up his payments sought to avoid liability on the basis that building societies were illegal organisations under the Bubble Act 1720. Building societies contravened the Act, he argued, because, they allocated shares to their members through subscription (shares that could be transferred in many cases) and they did so without obtaining a charter or an Act of Parliament. The court did not agree and instead found that membership-based restrictions on the transferability of shares meant that building societies fell outside of the ambit of the Bubble Act. This Act only applied to organisations which sold “freely” transferable shares and building societies were member-based democracies because in building societies members voted on share transfers.

5 Cleary, *Building Society Movement*, n. 2 above, p. 11.

6 A Scratchley, *Industrial Investment and Emigration* (West Strand, London: John W Parker 1858, 1st edn 1849), p. 50.

The organisational form which became effective in these larger societies was the permanent form. In permanent societies, members would have an individual contract with the society designating them as either investors receiving interest or borrowers paying interest. Investors would be able to withdraw their investment with relative ease, while borrowers would make periodic repayments (usually monthly) over a fixed period of years and would only withdraw their membership after repaying the agreed amount. In this way the society could extend its borrowing according to the amount invested in it and borrowers could join without catching up on the payments made by founder members. In 1849, actuary and key player in the building society movement, Arthur Scratchley published a book describing the permanent system.⁷ Later when the Royal Commission on Friendly Societies set up in 1870 focused on Building Societies, it recommended that the permanent form replace the terminating form.⁸ The resulting 1874 Building Societies Act therefore required that all new societies be registered as permanents, allowing the terminating societies to complete their lifecycle and gracefully depart the scene.⁹ So, although in 1874 most of the estimated 1500 societies were terminating societies,¹⁰ time would soon recalibrate this.

So the 1874 Act provided a framework for the regulation of building societies as distinct financial institutions and to facilitate the monitoring of their activities whilst allowing them certain freedoms in their internal organisation.¹¹ It was intended to maintain building societies as socially useful organisations which facilitated the respectable activities of the “industrious classes”.¹²

However, whilst the legislative framework tightly controlled building societies’ business activities, it could not control the governance issues that arose as a result of their growth. The emergence of the permanent system facilitating a large membership resulted in a dilution of member control and the emergence of management control. The one-member-one-vote approach to governance which reflected the equal nature of members’ financial interests and commitment in small terminating societies, continued to operate in the permanent society. When permanent societies grew in size, the huge numbers of members they represented were unable to exercise control over their management. In societies which had a large membership, voting on a one-member-one-vote basis naturally dispersed power. By the 1930s, almost all societies had a large membership which left management in effective control. Successive annual reports from the Registrar of Friendly Societies show the huge rate of merger activity which further dispersed member control.¹³ In 1890 there

7 Cleary attributes this innovation to actuary James Henry James whose pamphlet on the subject was published in 1845. “Benefit Building Societies, their Advantages if Legitimately Constituted, the defects of the principles generally Applied to their establishment, with Suggestions for their Improvement and their Profitable Union with Life Assurance Societies practically considered”: Cleary, *Building Society Movement*, n. 2 above, p. 47.

8 Royal Commission on Friendly Societies, *First Report from the Commissioners on Friendly Societies* (1870). It thought it probable that permanent societies grew organically from the tendency of larger terminating societies to incorporate members throughout their existence, creating indefinitely existing terminating societies so that “a permanent society is a terminating society to every individual from the date at which he enters”: p. 14.

9 The Building Societies Act 1874, s. 9.

10 Cleary, *Building Society Movement*, p. 119, n. 2 above.

11 The Act established liability for officers of registered societies who allowed loans and deposits which exceeded amounts prescribed by the Act and made them personally liable for the amount received or loaned in excess of this sum. Furthermore, the falsification of accounts could result in their summary conviction upon complaint by the Registrar of Friendly Societies. The Benefit Building Societies Act 1836 established a regulator, the Certifying Barrister for England, Scotland and Ireland who was renamed the Registrar by the Friendly Societies Act 1846.

12 A phrase used in the Act and by the Royal Commission.

13 Reports of the Chief Registrar of Friendly Societies of the Building Society Commission of each year noted.

were 2286 registered societies with 600,000 members but by 1920 there were only 1271 societies. In 1950 there were only 819 societies with a membership of 1.5m and by 1970 the number of societies had nearly halved (to 481) although their assets and membership had increased tenfold (to £10.8bn and 10.9m members). By 1988, just before the first demutualisation there were 188 societies holding assets of £188.844bn and having 48.1m members. Today, most of the major societies have converted, leaving just 59 societies which hold total assets of £369bn.¹⁴ The Building Society Association (BSA) reported over 23m investing members and over 2.9m borrowing members in 2007.¹⁵

Another key factor leading to the rise of management control was the sheer complexity presented by the permanent system. Arthur Scratchley had argued vigorously for a trained management in large permanent societies whose growth necessitated professional managers and risk assessors drawn from the educated middle class.¹⁶ This clearly raised management costs in large permanents in contrast to the small terminating societies whose management was largely voluntary. As statistics from Cleary demonstrate, terminating societies, whose management was drawn from the common membership, had low management costs whereas the large permanents had management costs which were twice as much on average.¹⁷

This layer of professionals became increasingly oligarchic as societies merged into ever larger permanent entities. This expressed itself in the rise of a trade association for building societies which became ever more proactive in building society policy. This organisation, originally called the Building Societies Protection Association was established in 1869 to inform and advise members on such issues as economic and legislative changes. It campaigned for legislative reform and was instrumental in the passage of the 1874 Act. Its journal, *The Building Society Gazette*, began publication in 1869 and provided a central, popular forum and mode of communication to those in the building society movement.

The Building Societies Protection Association (which later became the Building Society Association (BSA)) gradually took a much more interventionist approach to the coordination of building societies and policy responses to crises. During the 1930s' economic depression the lack of demand for money led to lower and lower interest rates and thus increased competition between building societies for borrowing members on whom they relied in order to pay high interest rates to lending members. A market-based resolution to this would have inevitably resulted in the economic ruin of many of the less competitive societies and so the BSA took action to protect its members as a collective. The solution was to annihilate competition through a policy of "recommended interest rates". The rate recommended by the BSA would be the one to which all societies, outside the few that were not members, would be obliged to adhere. As late as 1983, a member who did not

14 Data up to August 2008 at www.bsa.org.uk/keystats/index.htm (last visited 28 November 2008).

15 www.bsa.org.uk/publications/newsbite/june_08.htm (last visited 28 November 2008).

16 Scratchley, *Industrial Investment*, n. 6 above.

17 Cleary, *Building Society Movement*, p. 69, n. 2 above.

adhere to the advised rates,¹⁸ New Cross Building Society, was forced to close following a decision by the Chief Registrar of Friendly Societies.¹⁹

The oligarchy in control of the BSA was concentrated on the largest societies as those societies became dominant in the building society sector as a whole. In 1983, for example, the BSA's policy-making body, the council, consisted of representatives drawn from the 10 largest societies. Moreover, the chairman of the BSA was generally drawn from the largest building society in the context of the five largest societies holding 50 per cent of all the capital of the entire industry and the two largest holding 33 per cent.²⁰ Thus, a large part of managerial decision making for all societies was removed from the executives of individual societies and centralised under the BSA, in an elite management group.

From the 1930s through to the 1970s, scholarship and government policy was orientated around MCOs, of which building societies were a classic example. Some of this scholarship provides support for the MCO, which has a great deal of resonance for building societies. However, much of it is highly critical of MCOs and as we shall see these theories laid the foundation for the subsequent neo-liberal approaches in both scholarship and policy that transformed most large building societies into SVOs.

Theory: the management controlled organisation

I ORIGINS

The notion of management controlled organisations is generally attributed to Berle and Means' famous thesis in which they argued that the largest corporations in the United States were controlled by a salaried non-stock-holding professional management.²¹ Furthermore, they argued, the tendency for corporations to grow meant that the managerial control model would soon subsume other forms of ownership and control.²² In these corporations the owners or stockholders were too widely dispersed and held too small a proportion of corporate stock to be able to assert control over the managers. In Marxist terms, stockholders were money capitalists, contributing funds in order to expand them, not entrepreneurs whose claim on profits was based on their entrepreneurial activity. In this

18 The BSA replaced the "recommended system" with one of advised rates although its affect was much the same.

19 New Cross's chief executive embarked on some radical departures from the standard practices "advised" by the BSA. It operated with a small personnel, few branches, it raised three-quarters of its funds through a mortgage marketing team and by insurance salesmen rather than through its branches. Most significantly, in March 1983 it put up interest rates by 2 per cent for its larger and longer-term investors and extended quick higher-interest loans. Clearly, these two policies ran contrary to the BSA's advised rate. Furthermore, New Cross's customers tended to be of a wealthier variety and not the traditional middle-income family favoured by building societies. The BSA contacted the auditors of New Cross, Dearden Farrow, and advised them to scrutinise more carefully the 1982/83 accounts. On doing so they found certain essentially technical discrepancies relating to "special advances" and, without offering the society the opportunity to redress the problem, the chief registrar issued orders to close the New Cross: C Wolman, "Downfall of a heretic: behind the New Cross closure", *Financial Times*, 21 January 1984, p. 24.

20 P Barnes, *The Myth of Mutuality* (London: Pluto Press 1984).

21 A A Berle and G Means, *The Modern Corporation and Private Property* rev'd edn (New York: Harcourt, Brace and World 1967, 1st edn 1932), p. 108. They further noted that in those corporations categorised as management controlled the dominant shareholding was never over 5 per cent.

22 *Ibid.*, at p. 109. Berle and Means calculated, or in their words "carefully guessed" that 21 per cent of corporations were controlled by legal device, such as pyramiding, and 23 per cent by minority control when assessed as a percentage of corporations, but these figures dropped to 22 per cent and 14 per cent respectively when assessed by wealth.

respect, therefore, shareholders were no different from *rentiers*.²³ Berle and Means viewed the corporation as a productive entity which is not controlled by shareholders or primarily motivated by their self-interest. The normative implications of this radical thesis, therefore, have been vigorously debated.

II NORMATIVE IMPLICATIONS OF THE SEPARATION THESIS: POSITIVE

Berle's own initial position was that the law should vigorously protect shareholders against potential abuses of power by managers.²⁴ In particular, he argued, the law should impose strict fiduciary standards on directors in respect of issuing stock, declaring or withholding stock, acquiring stock in other corporations, powers in respect of mergers and powers to amend the corporate charter. In short, the governance implication of this thesis, as far as Berle was concerned, was the rigorous construction and enforcement of directors' fiduciary duties. In a later revised version of the modern corporation, Berle adopted a more identifiably institutional economic position which emphasised the shift of the corporation away from profit expansion goals into an entity no longer primarily subject to market forces. Accordingly, the corporation was no longer comprehensible according to classical economics. It was not driven by the self-interest of individual entrepreneurs making favourable bargains in a free market. Instead, the corporation was driven by managerial goals such as power, prestige and the personal job security of the manager. In particular these organisations were concerned with growth rather than profit. In the 1967 edition of *Modern Corporation* he argued that the corporation was so socialised into a plurality of goals and the state so involved in its operations that the corporation could not sensibly be understood as a private institution. The profit motive was now just one of the goals of the quasi-public corporation. In MCOs, managers were the risk takers, replacing the risk-taking role of the entrepreneur. In an entrepreneur controlled business the risk taker could personally benefit from risk taking, however, in the MCO there were no such benefits for the manager. Indeed, any loss resulting from risk taking would merely jeopardise the manager's professional position. Because of this, Berle argued, in an MCO, high profit is replaced by stability and good labour standards as the primary managerial goals.²⁵

Following a similar perspective, Galbraith described the waning importance of shareholders in the governance of corporations.²⁶ Like Berle he argued that there was little point in managers pursuing risky high returns when they would suffer greatly for failures but would gain little from success. Galbraith argued that a manager's self-interest was served by steering a steady course for the corporation. Managers would pursue a minimum not a maximum profit and they would seek goals such as sales growth and prestige. Absent powerful shareholders, the large corporation had become subservient to the state, hence to society's needs. The state, thereby, had replaced market relations and steady growth, rather than high returns for shareholders, characterised modern capitalism.

Many theorists considered the MCO to be a progressive development replacing the less efficient market-based entrepreneurial capitalism. In his classic text *The Visible Hand* Alfred Chandler argued that MCOs were a historical response to the problems of entrepreneurial

23 P Ireland, "Defending the rentier: corporate theory and the reprivatization of the public company", in J Parkinson, A Gamble and G Kelly (eds), *The Political Economy of the Company* (Oxford: Hart 2001); R Pollin, "Resurrection of the rentier" (2007) *New Left Review* 46.

24 A Berle, "Corporate powers as powers in trust" (1930-1) 44 HLR 1049.

25 Berle and Means, *Modern Corporation*, n. 21 above.

26 J K Galbraith, *The New Industrial State* (New York: Houghton Mifflin Co. 1967).

capitalism which additionally enhanced efficiency.²⁷ His history of American business shows how the free market was replaced by connected industries drawn together in huge management-led organisations. This shift originated with the construction of the railroads where logistical difficulties and high capital requirements necessitated the emergence of a trained managerial elite to oversee this massive infrastructural development. Many of the methods developed in that context were then used in an industrial context, particularly when industry faced recession and financial crisis. Managing that crisis became the job of trained professionals who gradually came to usurp the control of the original entrepreneurs and their families. For example, the “inventory crisis” of 1920–22 forced companies to write down the value of their stock and led to many companies establishing sophisticated management structures in order to anticipate problems and synchronise activities.²⁸ At General Motors, they developed a multidivisional structure where “autonomous divisions continued to integrate production and distribution by coordinating flows from suppliers to consumers in different, clearly defined markets”.²⁹ These divisions were headed by middle managers, with top management positions taking overarching strategic decisions on their financial and market performance. Recession, argues Chandler, “transformed General Motors from an entrepreneurial to a managerial enterprise”.³⁰ The management structure developed in General Motors was adopted by other large industrial organisation in the 1920s and 1930s.

Chandler also shows that the necessity for trained management was anticipated and catered for by the rapid emergence of professional bodies, journals and business schools at the beginning of the 20th century.³¹ When Harvard opened its Graduate School of Business Administration in 1908 (nearly 20 years before the crash which initiated Berle and Means’ thesis), it did so with a clear emphasis on training managers for large business entities.³² The “professionalisation of managers” was itself a business.

Chandler’s history shows how management enterprises continued to grow between the two world wars as large firms expanded by “adding new units and by internalizing their activities and the market transactions involved”.³³ These large industrial enterprises encompassed research and development activities and diversified into many new product lines, often because of mergers. By 1929 over two-thirds of the personnel employed in industrial research were concentrated in five groups (of industries).³⁴ In retail, the chain store developed, with enterprises often producing their own brands because in-house production reduced the expense of transacting outside of the business; size meant efficiency. Indeed, argues Chandler, even when share dispersal did not lead to management control, so efficient was this model that family-owned businesses would choose to put their business under professional management. For example, he notes, in retail, internally generated profits allowed expansion to occur without recourse to bank loans or dispersed ownership so that, mass retailers could “remain entrepreneurial enterprises much longer

27 A D Chandler, *The Visible Hand: The managerial revolution in American business* (Cambridge, Mass. and London: Belknap Press of Harvard UP 2002, 1st edn 1977).

28 At General Motors, for example, the write-down between 1921–22 was over \$83m: *Ibid.*, p. 457.

29 *Ibid.*

30 *Ibid.*, p. 459.

31 *Ibid.*, p. 465.

32 *Ibid.*, p. 467.

33 *Ibid.*, p. 469.

34 *Ibid.*, p. 474.

than did the integrated industrials".³⁵ However, whilst they could continue to operate as owner-controlled enterprises they did not choose to do so. In Chandler's words,

by 1917 representatives of an entrepreneurial family ... almost never took part in middle management decision on prices, output, deliveries, wages, and employment required in the coordinating of currents flows. Even in top management decisions concerning the allocation of resources, their power remained essentially negative.³⁶

Indeed, he argues, unless a family member was actually trained as a professional manager they would not take part in management.

Likewise, in the banking sector, efficiency was the driving force behind the emergence of large banks which usurped the numerous local banks which characterised the 19th century. By

... 1919, 464 banks operated 1,082 branches, and by 1929, 816 had 3,603 branches. The share of bank resources held by the multi-unit enterprises rose from 16 per cent in 1919 to 46 per cent in 1929.³⁷

So, by the 1930s, the multi-unit management-led organisation dominated. This is particularly significant for our understanding of building societies in England. Although they were not the fully commercial organisations that banks were, they experienced similar shifts in forms. The number of building societies decreased, the number of branches increased as did the number of investors and the resources held. Efficiency is claimed by Chandler as the source of these developments, though building societies were accused of the opposite.³⁸

Whilst Chandler's account is a history of business, its theoretical integrity and its underlying notion of efficiency was posited on the earlier work of Ronald Coase in *The Nature of the Firm*.³⁹ Just a few years after the publication of *Modern Corporation*, Coase's seminal piece sought to explain why commercial organisations or "firms" existed and why they had become the massive entities that characterised American capitalism. Coase's central thesis here was that hierarchical firms exist because they are more economically efficient than discrete market transactions undertaken by small entrepreneurs. Coase argued that markets are the most efficient way to transact *if* the cost of transacting is nil. However, as these costs are in fact high (including the cost of information, contracting and enforcement of contracts) it becomes more efficient to transact within the firm. Price mechanisms directed resource allocation outside the firm and in the market, whilst in the firm "market transactions are eliminated"⁴⁰ and replaced by "the entrepreneurial co-ordinator, who directs production".⁴¹ He concluded that firms would emerge in an exchange economy and when the cost of negotiating the price of each transaction in the market was more costly than if those transactions took place within an organisation under the guidance of the skilled and risk assuming entrepreneur.⁴²

35 Chandler, *Visible Hand*, n. 27 above, p. 471.

36 *Ibid.*, p. 491.

37 *Ibid.*, p. 472.

38 Specifically, in the *Wilson Report* examined later.

39 R Coase, *The Nature of the Firm* (1937) reproduced in *The Nature of the Firm, Origins, Evolution, and Development* (Oxford: OUP 1993).

40 *Ibid.*, p. 24.

41 *Ibid.*

42 This is particularly the case when considering on-going transactions which are service related. That is, if a person's skill and labour is required on a regular basis it is much cheaper to have that person employed within the firm than to enter into numerous contracts with him or her on the market.

Accordingly, to Coase, the size of a business organisation would be determined by the relative effectiveness of these two strategies, firm versus market. Where it was more efficient to organise in-house and expand into many different products or services, the size of a firm would increase. Where it was more efficient to transact on the market, firms would be smaller. Firms might also increase in size under a competent entrepreneur who had possession of good information. However, if the entrepreneur's subjective understanding of existing information was poor, or objectively there was an information deficit, market transacting might become more efficient given that it is the best provider of information (although as noted above there are costs involved). Correspondingly, improvements in managerial technique would tend to increase the size of firms by improving the entrepreneurs' ability to accumulate good information.

Coase's subsequent attractiveness to law and economics theorists is his insistence, in contrast to the managerial theories which dominated from the early 1930s up until the end of the 1970s, on the retention of market forces.⁴³ Coase did not accept the underlying premise of managerialism that the market was subverted by the emergence of the large corporation so that competitive forces no longer determined economic relations. Instead, he described a refinement of competitive forces in which the firm could contract (reduce in size) or even disappear if ordinary market forces proved more efficient. In accordance with this theory, an organisation is large when and because it is more efficient to be so. A Panglossian conclusion perhaps, but one which could be used to defend the emergence of large building societies as an efficient outcome.

Similarly, for Chandler, the MCO emerged only partly because of the shifts in ownership described by Berle and Means which diluted large stock ownership and thus owner control. Chandler maintains that this dilution chiefly arises as an effect of the rational growth of enterprises, where, following Coase's theory, economic efficiency is better achieved by internalising previously individualised market transactions. The demands of a complicated, dynamic and evolving economy with correspondingly complicated business enterprises, necessitated the rise of professional management, rather than entrepreneurial management. Trained management overseeing multi-unit enterprises was key to financial success by promoting efficient methods of production and by preparing for and responding to economic crises. It is a perspective with which Arthur Scratchley would have been very comfortable. Likewise, Chandler's claim that professional managers constituted a coherent group joined by shared knowledge and training, attendance at business schools and engagement with similar literature, echoes the orientation of the BSA.

Chandler's detailed analysis of a history of business which develops in response to social, political and economic change from small concerns into a rational oligopoly managed by a professional oligarchy echoes developments in the building society movement. He demonstrates that the emergence of these forms is progressive and desirable because it allows business better to achieve its goals (production in the case of industry, mortgage lending and savings in the case of building societies) whilst simultaneously protecting these businesses from crises.

Similarly, Marxists Sweezy and Baran, though highly critical of large corporations generally, argued that their management maintained such a high degree of group coherence that it was able to operate as a group and manage financial crises. Capitalism had developed into "monopoly capitalism" where effective control of business resided within a

43 Coase's theory does not expressly associate efficiency with shareholder value and is equally likely to emphasise production, distribution, growth and product development. Furthermore, it does not promote shareholder value.

coordinated small elite.⁴⁴ Indeed, they argued, the dominance of the MCO meant that financial crises could become a thing of the past, a creature of competitive entrepreneurial capitalism, not of today's professionally driven monopoly capitalism. Thus, if we accept the argument that with the emergence of large corporations emerges a small group of elites who have various and often informal mechanisms which allow them to work as a coordinated self-supporting group and thus avoid financial crises, we must accept the following. The correlating developments in the building society movement coupled with the formal institutionalisation of an oligarchy under the auspices of the BSA must be at least as equally adept at avoiding crises.

Likewise, the meritocratic dominance of the professional manager operating in a management bureaucracy must, according to Chandler, be more efficient than power which derives from ownership alone. He applauds an oligarchic economy as one which exceeds the efficiency of pure market transactions. In this respect he reflects the views of Weber's earlier work which emphasised the superior nature of the bureaucratic organisation in all aspects of the social world. Bureaucracy, for Chandler, as it was for early Weberianism, is a neutral good.⁴⁵

The efficiency of large organisations resulting from such factors as trained management, rational hierarchies, rational diffusion of information and so on are evident in building societies to an even greater degree than large corporations. Building society policy has been coordinated by a small group of professionals who have reached the top of their profession by becoming the top managers of the largest societies. The BSA runs annual conferences, coordinates society meetings and has an informative website among many other cohering activities. It liaises with the building society regulator and it has been historically influential in building society legislative reform.⁴⁶

III NORMATIVE IMPLICATIONS OF THE SEPARATION THESIS: NEGATIVE

For many theorists, the MCO perpetuated and assisted the "sectional interests" of management.⁴⁷ It was not justifiable on the grounds of efficiency or on the grounds of effective and just allocation of resources. A small number of MCO-premised critics argued from a Marxist perspective. In *Monopoly Capital* (1976), Baran and Sweezy acceded to the existence of a managerial revolution but did so within a class-based Marxist framework. They argued that although management organisation dominated capitalism in the United States at least, management is neither benign nor neutral. Instead, they argued, management exists to represent a capitalist class interest and will do so with the same degree of commitment as the capitalist class had previously done for itself. They also noted the existence of large investors represented on the board who may directly intervene in the pursuit of their class interest. As previously noted, Baran and Sweezy also viewed monopoly capitalism as an economic form which is capable of transcending the economic cycles and crises which characterise entrepreneurial capitalism. Monopoly capitalism manages crises because of management's expertise, experience, and planning and because management forms a self-perpetuating oligarchy that may act in sufficient concert to avoid severe

44 S Sweezy and P Baran, *Monopoly Capital* (New York: Monthly Review Press 1966).

45 W Weber, *The Protestant Ethic and the Spirit of Capitalism* (New York: Courier Dover Publications 2003, 1st edn 1905).

46 Furthermore, having interviewed many building society executives and attended a number of conferences, I can personally testify to their social homogeneity – they are invariably white, middle-aged (plus) and male.

47 "Sectional managerialists", as Nichols termed those who accepted the existence of MCOs but were highly critical of them, theorised from a number of different perspectives: N Nichols, *Ownership Control and Ideology* (London: Allen and Unwin 1969).

economic collapse. Monopoly capitalism, in other words, sidesteps the destructive nature of the competitive entrepreneurial capitalism which preceded it. In the final analysis though, it is not a benign form of organisation.

Weber's later work bristles with criticisms of the large bureaucratic organisations whose structures, hierarchies and rules are determined by the internal logic of the organisation rather than any substantive rationality. For Weber, large organisations are malignant bureaucracies which infect all areas of society.⁴⁸ Similarly, Harry Braverman demonstrated the destructive nature of managerial power upon labour.⁴⁹ Specifically, he argued that the scientific managerialism promoted by "taylorism" enhanced the social division of labour in these respects. It separated labour from skills, promoting monotonous low-skill repetitive tasks; it separated manual from mental labour; and finally management took possession of information of the whole process thereby separating labour from knowledge. The purpose of the MCO therefore was to secure absolute power for the manager by a conscious disempowering of other actors within the organisation.

Some years before Braverman's work, Burnham too had argued that managers' expropriation of knowledge and skills and their development of bureaucratic organisations had simultaneously deskilled labour and disempowered investors.⁵⁰ According to Burnham, the objective of management in developing these systems is to secure its position by ensuring that investors or other employees cannot unravel its complicated organisational structures. Managers had, thereby, secured a "managerial revolution" wherein their control over society's economic resources had resulted in them becoming the new ruling class. The era of bureaucratic organisations had therefore succeeded both capitalism and socialism. Unlike the former, it did not exist to enrich capitalists nor, like the latter, did it exist to redistribute society's resources. Instead, its rationale was the protection and perpetuation of management itself. All other outcomes were secondary to this goal.

Organisational sociologist Charles Perrow also voiced criticism of the large organisation, much as Louis Brandeis has some decades before, essentially on the grounds of bigness.⁵¹ According to Perrow, networks of small organisations bring greater economic and social benefits than large organisations which either intentionally or by dint of their operation (size) affect society in socially undesirable ways. To briefly characterise his argument, the absence of big public governmental organisations in America (in contrast to European countries such as France and Germany) meant that the state was not equipped to counter the unabated growth of big economic, and private, organisations. In contrast, "big government" European countries where the state is much more interventionist are characterised by smaller economic organisations which are traditionally understood to be "closely held" by family groups. This echoes much of Roe's work on the political determinates of corporate governance.⁵² Like the later Weber, Perrow viewed the large organisation as being a power in itself, of having a "life of its own".

Bureaucratic organizations are the most effective means of unobtrusive control human society has produced, and once large bureaucracies are loosed upon the world, much of what we think of as causal in shaping our society – class, politics,

48 W Weber, *The Theory of Social and Economic Organisation* (New York: Free Press 1947).

49 H Braverman, *Labour and Monopoly Capital* (New York: Monthly Review Press 1974).

50 J Burnham, *A Managerial Revolution: What is happening in the world?* (New York: John Day Co. 1941).

51 C Perrow, *Organising America: Wealth power, and the origins of corporate capitalism* (New Jersey: Princetown UP 2002).

52 M Roe, *The Political Determinates of Corporate Governance* (Oxford: OUP 2003).

religion, socialisation and self conceptions, technology, entrepreneurship – became to some degree, shaped by organisations.⁵³

Accordingly, the large organisation creates a number of negative effects on society. Among these he cited wage dependency, urban crowding, socialisation of members into the organisation's norms and the concentration of power in the economy as a whole. Furthermore, he argued, large organisations are slow to respond to economic change as they cannot, “engage in smooth production” which results in “boom-and-bust cycles and layoffs”.⁵⁴ In contrast, an economy with many small organisations will disperse both wealth and power. And, if these small organisations operate cooperatively, they will be productive and responsive to economic shifts.

Within the broad spectrum of MCO theorists, it is those on the left that are most critical of its operations. An oligopoly is variously criticised for being socially oppressive, determined by its own (irrational) internal logic, inefficient (on that account and on others) and perpetuating the interests of its managers. The normative implications of these MCO theorists informed the criticisms of building societies as MCOs. However, the criticisms might not have developed into policy were it not for the emergence of a critique based on the very different premises of neo-liberalism.

In the next section I will assess the MCO-based criticisms of building societies and show that they dovetailed with the neo-liberal approach of the Thatcher government which legislatively facilitated demutualisation. In so doing it will assess the neo-liberal theories which informed this pro-market approach as against the organisational approach. I will conclude this section by looking at some of the problems of a neo-liberal shareholder value approach.

Building society reform, neo-liberalism and shareholder value

I THE DRIVE FOR BUILDING SOCIETY REFORM

In response to mounting criticisms of the building societies, such as the lack of accountability of building society managers and the huge influence asserted by these large organisations operating as a connected group under the BSA, the *Wilson Report* made investigations and recommendations.⁵⁵ The report noted that building societies had engaged in a number of policy decisions for reasons of stability or even ideology but that these had had the effect of crushing competition and institutionalising discrimination. For example, it noted that as a bulwark against fluctuating interest rates the BSA had required its member societies to increase their quantities of reserves over and above that required by statute and had sustained the policy of recommended rates since 1939. The BSA's strict prudential policies, it maintained, “discriminate against those who find it difficult to raise the necessary deposit”, and, “because of their tradition of encouraging self-help and thrift, they have frowned upon the concept of ‘low start’ mortgages”.⁵⁶ The *Wilson Report* recommended abandoning the policy of protecting weaker societies through the BSA's recommended rates system (set at a rate all societies could afford) and subjecting all societies to a competitive market as a way of opening up the market to more borrowers. Furthermore, the loosening of such anti-competitive practices would facilitate

53 Roe, *Political Determinates*, n. 52 above, p. 3.

54 Perrow, *Organising America*, n. 51 above, p. 14. It is an exact contradiction to the efficiency argument of Chandler, Sweezy and Baran.

55 Committee to Review the Functioning of Financial Institutions, *Wilson Report* (HMSO: London 1980) Cmnd 7937. The committee, which started work in 1977, presented its report to Parliament in June 1980.

56 *Ibid.*, p. 85, para. 289.

the kind of innovation which could turn a profit from the traditionally less desirable customers noted above. Competitive market practice would thereby succeed the oligarchic practices of the BSA.

The only sure way of providing a competitive spur to building societies is in our view to end the recommended rate system, that is, to allow societies to set their own rates according to their circumstances and to break the present automatic link between the rates paid to depositors and those charged to borrowers.⁵⁷

. . . The dismantling of the recommended rate system would give building societies greater freedom to compete with other deposit taking institutions as well as with themselves.⁵⁸

Drawing on the *Wilson Report* and reflecting the broad spread of critics of the MCO, Paul Barnes argued that building societies were inefficient at everything bar the provision of security for their managers. Building society managers were concerned to pursue managerial goals such as personal prestige, job security, status symbols and empire building. Utilising Williamson's "expense preferences" theory, Barnes argued that in the absence of the restraining influence of the profit required by both shareholders and the financial market, managers will make spending decisions in ways that are most satisfying to themselves. When the profit goal is low priority, the preferred expenses are more likely to be "the expansion of staff, the expansion of physical plant and equipment".⁵⁹

Barnes argued that the power, prestige and status which building society managers pursue in their "expenditure preferences" often expresses itself in the empire building activity of opening branches.⁶⁰ Citing statistics correlated by Davies and Davies,⁶¹ he shows the huge increase in branch openings from 1970–78, arguing that this is an example of profit wasting in favour of managerial preferences.⁶² Additionally, he noted, whilst in 1978 smaller building societies (with a total of £3711m-worth of assets in 1978) on average spent 76.7 pence per £100 of assets on operational costs, the operational costs of medium-sized companies (with a total of £14,278m-worth of assets in 1978) on average were 100.8 pence per £100.⁶³

II THE RISE OF NEO-LIBERALISM AND THE MAKING OF THE BUILDING SOCIETY ACT 1986

As we have seen, the model for organisations until the later 1970s was that of the MCO. Management activity was orientated toward developing products within a hierarchical structure and gaining market position and (although a lesser concern) profits through the competitiveness of these products. Other managerial goals were cited as remuneration, job security and empire building. As we have observed, MCO theories covered a number of perspectives but what connected these diverse perspectives was an agreement that the MCO operated as a hierarchy; an institutional mechanism which ordered power within itself and

57 *Wilson Report*, n. 55 above, p. 113, para. 380.

58 *Ibid.*, para. 384.

59 Barnes, *Myth of Mutuality*, n. 20 above, p. 44.

60 The *Wilson Report* showed that whilst in 1968 there were 1662 building society branches by 1978 this number had risen to 4595 whilst the average number of accounts per branch had only risen from 4921 to 5440 in the same period: *Wilson Report*, n. 55 above, p. 114.

61 G Davies and M J Davies, *Building Societies and their Branches: A regional economic survey* (London: Francy & Co. 1981), pp. 172–3. Cited in Barnes, *Myth*, n. 20 above, p. 50.

62 In 1970, the top five building societies had 746 branches but by 1978 this had risen to 1799. In medium-sized societies (those with assets over £100m), they began with 1041 branches and ended eight years later with 2310 whilst small societies began with 229 and ended with 486 in the same period.

63 Barnes, *Myth*, n. 20 above, p. 50.

which benefited people according to their role within it. Broadly speaking, the MCO was conceived as an organisation which was at least partly public in character and therefore justifiably regulated, at least to some degree, by the state. After recession in the 1970s, neo-liberalism spread throughout the academy and into mainstream political thought, in which context it was variously termed Thatcherism or Reaganomics. Neo-liberal ideology rejected notions of institutional and non-competitive practices and instead promoted the free market in which private property owners could contract as the single answer to economic prosperity. Within the academy this approach went under the banner of “law and economics”. In the context of business organisations, law and economics theory cited its roots in the earlier works of Coase.

As noted earlier, Coase probably resonated for the law and economics constituency because he retained market forces in his theory even though he argued that large firms existed because they were better than the “invisible hand” (later followed up by Chandler with his conceit of the “visible hand”). Furthermore, Coase described relationships and resource allocation in contractual terms, whether inside or outside of the firm. Thus, in the law and economic reconfiguration of Coase, the firm could be conceived as operating as an *internalised* market.

Problematically, for neo-liberal theorists, Coase’s theory envisaged the firm as dependent on the existence of the entrepreneur overseeing an organisation that was hierarchical in nature. Coase’s theory promoted hierarchy, in contrast to “law and economics” contractualism and had thereby given the firm texture and validity as an organisation. The firm was an organisation because it was a structure in which people identified each other by their given roles.

It was these attributes of Coase’s theory which the law and economics theorists sought to flush out. A hierarchical organisation necessarily ran counter to the normative values of contract such as freedom, equality and choice. It implied authority, discipline, inequality and involuntarily assumed tasks. Thus, when Alchian and Demsetz published the first *law and economics*-based article on the nature of the business organisation, they sought to deal with the unpalatable characteristics of Coase’s hierarchical firm whilst retaining enough of the original theory that would bequeath their own with some heritage and authority. Tackling the hierarchical issue head on they argued:

It is common to see the firm characterised by the power to settle issues by fiat, by authority, or by disciplinary action superior to that found on the conventional market. This is delusion. The firm does not own all its inputs. It has no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting between any two people.⁶⁴

In their reconstruction of Coase’s theory all relationships in production are non-hierarchical and contractual. The firm is a “team productive process”⁶⁵ whereby “resource owners increase productivity through cooperative specialization”.⁶⁶ The undeniable existence of managers is explained as a mechanism to ensure that the efficiency of all members of the team can be monitored and ensured. The team activity which constitutes the firm can obfuscate individual contributions or lack of them. This creates what they call a “metering problem” which is not present in individual entrepreneurial activity or ordinary market exchange. Proper metering, a mechanism to reward success and monitor shirking,

64 A A Alchian and H Demsetz, “Production, information costs, and economic organisation” (1972) *American Economic Review* 777, at p. 777.

65 *Ibid.*, p. 778.

66 *Ibid.*, p. 777.

an inevitable result of team activity, is undertaken by the monitor, the manager. The issue of who monitors the monitor is resolved in such a way as to justify shareholder claims to profits and other legal privileges. Shareholders monitor the monitor and the reward for their diligence is high dividends.

Having dealt a blow to the notion of hierarchies, Meckling and Jenson continued the project of annihilating the notion of institutions per se. In their argument the firm is a legal fiction. It is not an entity in its own right but a nexus of contracting individuals.⁶⁷ The firm is one form of legal fiction among many but is uniquely characterised by *some* contractors, the residual risk takers (shareholders) having residual claims on the assets and by those same individuals having the right unilaterally to end the contract, unencumbered by the views of other contractors. Accordingly the corporation should not be seen as an organisation formed around an entrepreneur. Indeed, “it makes little or no sense to try to distinguish those things that are ‘inside’ the firm (or any other organisation) from those things that are outside of it”. Economic life was organised around contracts which were generally complete and fair arrangements. However, in the context of the contract between managers and owners the divergent interest between the two meant that costs would have to be assumed in order to bridge those divergences. These costs are famously known as agency costs and underpin modern corporate governance. In Jenson’s analysis these costs include the cost of contracting, the cost of monitoring by the principal (the shareholder), such as rules to control the agent (the manager), the cost of the agent’s bonding expenditures, such as incentives to profit maximise, for example, share options, the cost of residual losses and finally the cost of divergences that cannot be bridged.

Thus, in their analysis, the manager is the representative of the shareholder, engaging in activities and decisions which entrepreneurial shareholders *would* be doing had they not had the foresight to employ somebody to do these things on their behalf. However, by giving the agents the power to represent the principal there are issues that arise from the agent’s possession of that power – these are agency issues. An empowered agent may find that his or her self-interest is better pursued by engaging in activities which do not represent the principal’s interest. Thus, a key part of this ideological approach is to establish mechanisms which make it in the agent’s self-interest to pursue the principal’s best interest. As the shareholder/principal’s interest is in dividends and share price, mechanisms are needed to make the agent’s self-interest aligned to this. Accordingly, the mechanisms are share options and the “market for corporate control”. Offering large share options to an agent means that as the agent will benefit from high dividends through his or her own shareholding it is in the agent’s interest to make the pursuit of dividends and share price a managerial goal. The “market for corporate control” is the proposition that managers who fail to enhance share value, will find their reputation marred on the employment market, and, if shares fall in price, find that their corporation will be subject to hostile takeover bids which would see them out of a job.⁶⁸

The normative implications of the contractualist approach in relation to the business organisation is brought out clearly in Easterbrook and Fischel’s work in which they argue that not only is the corporation a nexus of contracts (in which agent/principal relations

67 M C Jenson and W H Meckling, “Theory of the firm: managerial behaviour, agency costs and ownership structure” (1976) 3 *Journal of Financial Economics* 305. Douglass North argues that all institutions are “contractual arrangement between principals”: “Transaction costs, institutions and economic history” in E G Furubotn and R Richter (eds), *The New Institutional Economics* (Tübingen: J C B Mohr (Paul Siebeck) 1991).

68 H Manne, “Mergers and the market for corporate control” (1965) *Journal of Political Economy* 73.

are worked out) but, by so being, it is the most efficient mechanism for organising business.⁶⁹ Business is more profitable under this model, and jurisdictions which facilitate this model by reducing state inference into the business corporation will have the most successful economies.⁷⁰

Neo-liberalism therefore conceives of MCOs as hierarchical organisations operating as oligopolies which have a negative impact on profitability because they reduce the positive affect of market forces such as free access to information. The normative implication of this conception is to reduce state interference in terms of regulation in business organisations so that individuals can negotiate freely and the invisible hand can function. By subjecting managers to a contractual arrangement with shareholders to enhance shareholder value, efficiency is enhanced and the economy can flourish. The agency problem inherent in this arrangement can be managed by offering share options and other incentives to managers. It can also be managed by subjecting managers to market forces, making their achievements visible through the mechanism of share price.⁷¹ Thus, business organisations from all sectors would vastly improve their performance if subjected to markets forces and competition.

This new ideology impacted at every level of public life and in the context of building societies, whose oligarchic practices were already under great criticism, change was inevitable. The BSA's own *Spalding Report* recommended that societies should be able to convert into companies.⁷² The Conservative government, with the support of actively anti-building society politicians on the left such as Ken Weetch, entered into a process of reform that would bring societies under the same shareholder value/agency costs ideology as corporations.⁷³ The proposals for building society reform were set out in a Green Paper, *Building Societies: A new framework*, which was presented to Parliament in July 1984. Its stated purpose was:

To ensure that the building societies continue primarily in their traditional roles – holding people's savings securely and lending for house purchase – while loosening the legal restraints under which they have operated for a century or more so that they can develop in other fields.⁷⁴

The package of proposals to liberalise building societies involved first allowing societies to develop business in other fields.⁷⁵ The Green Paper proposed that building societies

69 F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (Cambridge, Mass: Harvard UP 1998, 1st edn 1991).

70 Thus, in the context of corporate law in the United States they are one of the chief proponents of the "race to the top" theory.

71 M Jenson and R Ruback, "The market for corporate control: the scientific evidence" (1983) 11 *Journal of Financial Economics* 5–50.

72 "The future constitution and powers of building societies", the *Spalding Report* (chair John Spalding) (London: BSA 1983).

73 In the House of Commons oral answer session of 22 May 1980, Nigel Lawson was required to answer to politicians from right, left and centre (Budgen, Weetch and Grimond) on issues relating to building society inefficiency and oligarchic practices. *Hansard*, oral answer session, 22 May 1980.

74 *Building Societies: A new framework* (London: HMSO 1984) Cmnd 93L6, p. 2.

75 The introduction of market criteria had already begun through other legislation, which homogenised rules relating to taxation of banks and building societies. Tax-paying investors in building societies had previously paid a lower rate because they were paid interest net of a composite rate of tax. This privilege, the report stated, was already now extended to bank investors (from April 1985). In addition, the 1984 budget had already brought corporate tax down to 35 per cent for both banks and building societies, the previous position being corporate tax at 52 per cent for banks and 40 per cent for building societies.

should be relieved from their strict business objects.⁷⁶ It suggested that the business purposes section should now say that, “the *primary* purpose of a building society is to raise funds from individual members for lending on security by mortgage of owner-occupied residential property”.⁷⁷ Other purposes would include the provision of other financial services such as unsecured loans and overdrafts.

The Green Paper also sought to reduce the oligarchy of the BSA thereby introducing more competitive practices. It noted that, in the previous year, the BSA had announced new arrangements whereby the “recommended” rates would be replaced by “advised” rates for ordinary shares and mortgage loans, in response to the criticism of the *Wilson Report*. However, the Green Paper sought to build on that by removing building societies’ exemption from the Restrictive Trade Practices Act 1976. This would allow the Director General of Fair Trading to legally challenge even the “advisory” function of the BSA on the basis that it was contrary to the public interest. A successful challenge on these grounds would result in building societies setting their own interest rates without reference to the BSA, entirely subjecting rates to market criteria and, in the Green Paper’s view, providing “a greater range of choice and a better service to building society members”.⁷⁸

However, the main liberalising proposal was that the conversion of building societies from mutual societies to companies should be possible.⁷⁹ If societies chose the conversion route, the new company would require a licence from the Bank of England under the Banking Act 1979. And, as a company, it would be subject to the Companies Act 1985.⁸⁰ Its directors would owe a fiduciary duty to the company which under case law (and now statute) equates with the interests of its shareholders, that is, profit.⁸¹

The Green Paper proposed that those societies which remained mutual would enjoy some financial liberalisations and could deal in a number of financial products. But their activity would be much more restricted than their corporate counterparts. Thus, the Green Paper proposed that, in addition to raising funds from investing members, societies could also raise moneys from non-retail sources, but such funding would be limited to 20 per cent of building society liabilities.

The central proposal to allow for conversion was duly enacted in the Building Societies Act 1986.⁸²

76 *Building Societies*, n. 74 above, para 2.05. S. 1 of the Building Societies Act 1962, as previous Acts, restricted building society activities to “raising, by the subscriptions of the members, a stock or fund for making advances to members out of the funds of the society upon security by way of mortgage of freehold or leasehold”.

77 Building Societies Act 1962, s. 1.

78 *Building Societies*, n. 74 above, para 6.09.

79 Although, interestingly, it said that the government “does not accept that such a change is needed”: *ibid.*, para. 5.29.

80 Now the Companies Act 2006.

81 *Percival v Wright* [1902] 2 Ch 421.; Companies Act 2006 s. 172.

82 Ss 97–103 in conjunction with Schedules 2 and 17 of the 1986 Act provide for the power of members to convert to plc status from mutual status. S. 97(1) states that: “A building society in accordance with this section and other applicable provisions of this Act may transfer the whole of its business to a company.” As a constraint on conversion the Act provides that there must be an investors’ special resolution and a borrowing members’ resolution. In order to convert, 20 per cent of investing members entitled to vote must vote and, of that, 75 per cent of investors and 50 per cent of borrowers entitled to vote must vote in favour of conversion. When the transfer is to an existing company, as opposed to one specially created for the purpose, then the percentage is 50 per cent of those eligible to vote on the special resolution, or the holders of 90 per cent of share capital must vote in favour.

Since 1989, the vast majority of large building societies have converted, taking over 80 per cent of building society assets out of the mutual sector. As companies, the converted societies were subject to shareholder value ideology as the neo-liberal hegemony caused a rapid shift in management orientation from a more complicated palate of possibilities, such as the stakeholder approach, to a single goal; that of shareholder interests alone. Furthermore, company law reform proposed by both the Law Commission and the Company Law Review Steering Group proceeded on the premise of shareholder value, which is evident in the resulting legislation.⁸³ Thus, prevailing ideology, legislative reform and corporate governance orientation meant that building societies were converting in a context whereby they would become pure SVOs.

III THE PROBLEM WITH SVOs

There is strong circumstantial evidence to support the argument set out here that SVOs tend to enhance economic instability. First, the SVO enslaves managers to the capital market and, secondly, SVOs seem to encourage economic bubbles.

In the SVO the manager is judged by share value alone and he or she is incentivised to pursue profits with little regard to risk and total regard for the share market. Enslaved to the capital market the manager's decisions are designed around its pacification. As even prime SVO proponent Jensen recently admitted, managers will manipulate outcomes to fit target-based corporate budgeting systems by such methods as delaying planned research and development until the next quarter, purely to appease the capital market.⁸⁴ The reason for doing this, he argued, was because the market heavily penalised companies which did not reach their targets by just a fraction but highly rewarded those which exceeded expectation by just a little.

The manager's tunnel-vision pursuit of shareholder value is further exacerbated by the rise of institutional investors as a constituent part of total investment. The role of institutional investors in such activities as monitoring corporate agents, has elicited mixed views.⁸⁵ However, there is general agreement on a number of features of the institutional investor. Most agree that institutional investors have limited expertise in the business in which they have invested funds and will have little interest in the operation of that business.⁸⁶ Furthermore, they are only interested in the businesses in which they have invested as profit maximisers. Institutions will pass their diverse portfolio of shares to their fund managers who will be rewarded according to the achievement of high, short-term returns.⁸⁷ This creates its own dynamic. Where institutional investors dominate ownership of shares in companies and their portfolio is managed by fund managers, managers of companies must undertake strategies which appease these interests. In contrast, it has been observed that managers of companies in Western Europe, characterised by insider ownership, will have diverse considerations when making business decisions.⁸⁸

83 L E Talbot, *Critical Company Law* (London: Routledge-Cavendish 2008), ch. 4.

84 M Jensen, (2005) "Agency costs of overvalued equity" (2005 spring) *Financial Management* 5–19.

85 For an interesting appraisal of this material, see J C Coffee Jr, "Regulating the market for corporate control: a critical assessment of the tender offer's role in corporate governance" (1984) 84 *Columbia Law Review* 1145. The institutional investor formed a key part of the government's thinking on "enlightened shareholder value" (which described responsible share ownership) in which the former act as good monitors with positions on the board of directors.

86 L Roach, "CEOs, chairmen and fat cats: the institutions are watching you" (2006) *Company Lawyer* 27.

87 J Froud, *Financialisation and Strategy* (London: Routledge 2006).

88 H B Hansmann and R R Kraakman assert that this diversity (inter alia) accounts for the inferiority of these models compared with SVO models: "The end of history for corporate law" (2001) 98 *Geo LJ* 439.

The second and perhaps most important problem with SVOs is that the ideology of shareholder value assures investors that their interests are *the* corporate goal. An ideology of corporate governance which promotes shareholder value is therefore likely to promote an expectation that shareholders will receive high benefits from their shares. This expectation is reflected in share price, but what if those expectations are unrealistic, inflating the price and inadequately valuing the real economic strength of a company?

According to neo-liberal governance theorists, this couldn't happen. Shareholder value governance (which characterises Anglo-American governance) has been popularly claimed to be the most effective model in rewarding shareholders.⁸⁹ Part of the reason for the purported success of the SVO in achieving shareholder value is the effectiveness of the capital markets in communicating information about a company's economic performance through share price. Stock which carries more risk, that is, where the return is uncertain,⁹⁰ has the potential to achieve high returns – those that are substantially over the risk-free option of bank deposits or government bonds. There is, in other words, a premium for taking an investment with less certain outcomes. Correspondingly, stock in companies with steady returns will receive returns over the risk-free option, which are less than the risk-full stocks. It is uncertainty of returns coupled with the possibility of high returns and the prevailing rate of interest which determines share price. In law and economics' "efficient market theory", it is the ability of markets to reflect this information which makes markets efficient.⁹¹ Markets, accordingly, are the best mechanisms for reflecting information.

An important assumption in this approach is that if shares are accurately priced, or at least as accurately as they can be, there is little opportunity to "buck the market". Risky investment may give high rewards but then may follow up with losses. Low-return, low-risk investments are less likely to surprise. So, as one of the earliest theorists on share prices and pioneer of financial economics Louis Bachelier illustrated in his 1900 doctoral dissertation, *Theorie de la Spéculation*, when calculated over a long period of time, the returns on investments are fairly even across the market.

However, in the recent period there appears to be a huge disjuncture between expectation and performance. Although dividends over the last 20 years on average only modestly exceed the prevailing rate of interest (at best), share prices have soared. Expectations on share performance seem to exceed actual performance so that the market does *not* seem efficiently to reflect all the available information on share values.⁹² Statistics offered by Froud show that shares in large companies listed in the FTSE 100 and the S&P 500 consistently provide shareholder returns on the basis of share price rather than dividends.⁹³ On average, dividends make up around 25 per cent of total shareholder returns which on average are around 20 per cent. This makes the rate of profit, (the profit made from production) at a rough calculation, around 4–5 per cent. To take a typical example, from the years 1983–2002 companies listed in S&P 500 gave shareholders a healthy 20 per cent return on their investment on average. However, of this, 70.1 per cent was derived from its share price and only 29.9 per cent from dividends.⁹⁴

If the value of shares are calculable according to the expected level of profitability (factoring in risk) above the prevailing rate of interest, the rise in share prices noted above

89 Hansmann and Kraakman, "End of history", n. 88 above.

90 The Sharpe-Lintner-Black model or capital asset pricing model.

91 According to proponents such as Jensen, Fama, Easterbrook and Fischel.

92 The view taken by Doug Henwood in *Wall Street* (London: Verso 1998).

93 Froud, *Financialisation*, n. 87 above, p. 78.

94 *Ibid.*

should be reflecting profitability (because in a shareholder value system profit should be immediately translated into dividend). To give an example, if expected dividends are 10 per cent when the prevailing rate of interest is 5 per cent, share price should double. However if dividends are, as above, around 4–5 per cent when the prevailing rate of interest is just below that, the rise in share price should be much more modest than it has been.

Work by Blair and Scharly also backs the view that the profits from production are modest.⁹⁵ In critiquing Jenson's free cash-flow theory, in which he argues that takeovers, leveraged buy-outs and mergers are market controls over managers who hoard cash that should be returned to shareholders, they contend that such hoarding is rational, explicable and not an example of an agency problem. They show that the cost of capital (the return expected by shareholders) becomes too high when interest rates are high because further investment could not provide returns which exceed prevailing interest rates. They show that managerial hoarding peaked during the high interest rates of the 1980s because it was unwise to invest then, given that further investment would be unlikely to make returns that exceeded previous experience in an industry. They offer the cash-flow-rich nature of corporations during this period as the real reason for the financial restructuring seen in the 1980s, not, as Jenson suggests, market control in operation.

So, how can the disparity between market expectation/pricing and profitability be explained? Henwood argues that the market is simply irrational and inefficient.⁹⁶ Share prices reflect little more than the moods and ineptitude of inexperienced investors. Their disproportionate and unjustifiable effect on companies, he argues, has a correspondingly destructive effect on the productive economy. More moderately, Froud attributes this disparity to three factors; shareholder exuberance,⁹⁷ low interest rates and the injection of capital from institutional savings.⁹⁸ My own view is that there is something in all of the above explanations. The market is often incontinent and shareholder exuberance a very likely consequence of an SVO-based governance model so that rises in share prices may be said to result from ideologically (and often irrational) provoked expectations of share value. However, mass delusion, however hegemonic the causative ideology, seems insufficient to explain this disparity. A rational expectation that managers will pursue shareholder value activities, borne out by experience, must inform share value to some degree. Furthermore, this activity, which I will not examine here, must be grounded in activity other than dividend production.

The modest nature of dividends evidenced above takes us full circle to the institutional economics position held by Berle et al. in the "non"-shareholder value period of the 1930s–1970s. In their analysis, corporations make an adequate profit, but not a huge profit, and returns on investments, if accurately connected to profitability, are equally modest. However, when shareholder value ideology re-emerged with some force after this period and today, the economy did not (and indeed could not) radically change; ideology ran ahead of the objective limitations of the market. The 1970s saw a shift in ideology without a corresponding shift in the capacity of the market.

It has become commonplace to assert that the current financial crisis originates with greedy bankers taking huge risks. But those risks are at least in part attributable to the pursuit of shareholder value when profits are modest but expectation is high. Executives of financial institutions are treated as unconscionable scum. But they have just been rewarded

95 M Blair and M Scharly, "Industry level indicators of free cash-flow", *The Deal Decade* (Washington: The Brookings Institution 1993), ch. 4.

96 Henwood, *Wall Street*, n. 92 above.

97 Based on R Shiller's book *Irrational Exuberance* (New Jersey: Princetown UP 2005).

98 Froud, *Financialisation*, n. 87 above, p. 78.

for doing what shareholder value required of them. Their pay is an agency cost properly incurred to bridge the divergent interests of principal and agent; incentivising executives by giving them a stake in profitability. These costs are borne precisely for the sake of shareholder value.⁹⁹ High executive pay therefore is a product of shareholder value ideology appeasing the capital market.¹⁰⁰

Case Study: SVO (converted societies) versus MCO (mutual building societies)

In this section I will assess the affect of the current financial crisis on mutual building societies and on those societies that have been demutualised and are subject to a shareholder value model. In so doing, two areas of divergence between the mutual and demutualised society will be assessed; first their management's business model and second their response to crisis.

I BUSINESS MODEL

As a recent news article pointed out, building societies are not totally free from the charge of imprudent financing.¹⁰¹ Many societies were exposed to subprime mortgages and a number offered 100 per cent mortgage deals. As late as January 2007, the Coventry Building Society offered a 125 per cent mortgage. And, whilst their losses have been significantly less than the demutualised societies, in large part because they relied less on the wholesale money markets and more on the retail market, it was the BSA which lobbied for the wholesale limits to be raised.¹⁰² Under the Building Societies Act 1986 a building society could not raise more than 40 per cent of its funds from the wholesale market but this was later raised to 50 per cent¹⁰³ because of BSA campaigning as far back as 1992. Unsurprisingly, the societies who backed the BSA in seeking this reform were the very societies who would demutualise in the following years, the Cheltenham and Gloucester, the Bristol and West, the Bradford and Bingley, the National Provincial, the Alliance and Leicester and Northern Rock.¹⁰⁴

However, in practice the societies that remained mutual did not make use of the new wholesale limits and they did not significantly alter their borrowing practices. With variations across the sector, on average, mutual societies raise less than 30 per cent of their funds from the wholesale market.¹⁰⁵ In contrast, two of the societies pushing for lower wholesale limits, the Bradford and Bingley and Northern Rock, once freed from the restrictions of the Building Societies Act 1997, took a huge slice of the wholesale market pie. At the time they collapsed they raised most of their funds from the wholesale market.¹⁰⁶

Northern Rock's over-reliance on the wholesale market was certainly the cause of its collapse. One of the most notable characteristics of Northern Rock was that it was one of the first mortgage companies to engage in mortgage securitisations, collateralised debt

99 Jenson and Meckling, "Theory of the firm", n. 67 above.

100 Jenson recently blamed high executive pay on the target-base corporate budgeting systems noted above: Jenson, "Agency costs", n. 84 above.

101 www.timesonline.co.uk/yol/money/savings/article5859566.ece (last visited March 28 2009).

102 R Thompson, *The Independent*, "Building societies' cash flow squeezed", 22 July 1992.

103 HC Deb, 24 February 1995, vol. 255, cc. 339–41W; Building Societies Act 1997.

104 These societies demutualised in the few years following this debate. The Cheltenham and Gloucester in 1995, the Bristol and West, the National Provincial, the Alliance and Leicester, and Northern Rock in 1997, and the Bradford and Bingley in 2000.

105 www.timesonline.co.uk, n. 101 above. As the article states, the BSA (now run by pro-mutual societies as opposed to the large pro-conversion societies noted above) wouldn't have allowed excessive reliance on the wholesale market.

106 *ibid.*

obligations (CDOs), that is, where mortgages are packaged up as bonds and sold to investors. The popularity of these securitisations meant that Northern Rock had access to cheap funds with which it could offer highly competitive rates to its customers. It rapidly raised its share of the mortgage market by relying on ever riskier, high-return strategies based on securitisation so that “roughly 10 per cent of Northern Rock’s financing was coming from credit lines with a duration of less than one year”¹⁰⁷ and “more than 75 per cent of Northern Rock’s funding came from wholesale markets, a greater proportion than any other UK lender”.¹⁰⁸ This meant that £52.8bn of its funding was raised from securitisation and covered bonds.¹⁰⁹

Northern Rock had never offered subprime mortgages but the American banks that had been securitising mortgage loans for decades had. It is generally accepted that it was investor realisation that many of these American mortgages were to risky investors who were defaulting on payments in a declining housing market that caused a rapid contraction in the securitisation market.¹¹⁰ This meant that “when the credit markets seized on August 9, those financings (those relied on by Northern Rock) were moving on to maturities of less than a month.”¹¹¹ Furthermore, Northern Rock was adversely affected by the “prevailing interest rate environment as well as its timing of transacting hedges for fixed rate mortgages”.¹¹² By September 2007, Northern Rock was forced to borrow heavily from the Bank of England to maintain liquidity. However, following a mass withdrawal of funds by account-holders, famously queuing outside Northern Rock branches in droves, it could not recover. It was “temporarily” nationalised in February 2008.

In its report on the problems at Northern Rock, the Treasury Select Committee placed a major part of the blame on the bank’s directors pursuing this “reckless business model which was excessively reliant on wholesale funding”.¹¹³ Another way of looking at this is surely to say that Northern Rock, a demutualised society, was no longer bound to the constraints of a building society and its particular construction of prudent behaviour. As a plc, subject to a shareholder value model which is short-termist by nature, its executives were bound to pursue profits and, thus, the risks that accompany high profit. Northern Rock delivered this for years and, when profits started to flatten in the early 2000s, its chief executive pursued this strategy even more aggressively. Ultimately, it failed to secure long-term stability, but was that its remit?

Likewise, management at the Bradford and Bingley pursued a risky business model strategy to gain high profits and fulfill shareholder value. At the Bradford and Bingley, it seems likely that this strategy expressed both the pressure to deliver shareholder value and the competitive inclinations of its management. Many executives of building societies expressed the view that the Bradford and Bingley’s top managers were spoiling for the thrill of the market when it was a mutual society.¹¹⁴ Although they had mounted a vocal defence of mutuality – with John Wrigglesworth stating in 1996, “our members would vote for

107 www.telegraph.co.uk/finance/markets/2815859/Why-Northern-Rock-was-doomed-to-fail.html (last visited 29 March 2009). But, by the end of 2008, roughly 50 per cent of the outstanding mortgages in the UK had been sold off in securitisation vehicles.

108 www.bsa.org.uk/policy/policyissues/consumerrelations/nrock.htm (last visited 30 March 2009).

109 www.companyinfo.northernrock.co.uk/downloads/Summary_of_Proposed_Business_Plan.pdf p2.

110 *Ibid.*

111 www.telegraph.co.uk, n. 107 above.

112 Business Plan, n. 109 above.

113 www.bsa.org.uk. Reported by the BSA (30 March 2009).

114 CEOs and chairs interviewed by Talbot at the 1998 BSA Conference (unpublished).

conversion for two quid. We have to show them the benefits of mutuality”¹¹⁵ – they soon embraced the conversion route. In April 1999, the board of the Bradford and Bingley announced its intention to put a vote for conversion to its members after 62 per cent of voting members at an informal vote said they wanted their society to become a bank. In the run up to the conversion vote the management made some policy decisions which seemed to prepare the society for a “yes” vote. In October of 1999, the Bradford and Bingley announced plans to cut or move 385 jobs, which included closing two branches in Leamington Spa that employed 275 staff. Furthermore, the directors announced that all members of the building society would benefit from free shares as “equals”. That is, all of its 3m members, including those who had recently joined would receive a windfall estimated at around £1000. Chief executive Christopher Rodrigous justified the scheme as impartial and not designed to achieve a “yes” vote by rewarding “carpetbaggers” (those who had joined precisely to gain the possible benefits from conversion).

The preparation continued with a rise in mortgage rates and a reduction in savings rates. Profitability was the goal. In the words of Mr Rodrigues, “as a mutual, we gave benefits through better rates. As a Plc, we will give benefits through greater product choice and dividends to shareholders.”¹¹⁶ And later, “the reason for our rate changes was simple: we need to be able to pay dividend to our shareholders and invest for the future. We intend to stay competitive as a Plc.”¹¹⁷ So despite stock market news of falling share prices in the largest converted building societies such as the Abbey National, Halifax, Northern Rock and the Woolwich, the motion in favour of conversion was overwhelming. With a high turnout (70 per cent of savers and 53.5 per cent of borrowers), 94.5 per cent of savers and 89.5 per cent of borrowers voted in favour.¹¹⁸

Bradford and Bingley plc quickly embraced the buy-to-let market as a mechanism to achieve high dividends. It was the biggest buy-to-let lender in the UK and it engaged in the highly risky practice of allowing self-certification of income by borrowers. Its buy-to-let lending rose from £748m in the first half of 2002 to £2.3bn in the first half of 2008. By June 2008 buy-to-let mortgages accounted for £24bn of its £49bn mortgage book.¹¹⁹ Furthermore, 17 per cent of the Bradford and Bingley borrowers were self-certified.¹²⁰ Like Northern Rock it was heavily reliant on CDOs.

As early as 2003, even other banks not known for their cautious business plans were criticising buy-to-let lenders. Barclays stated that such lenders were taking “‘suicidal’ risks with their lending policies . . . lending very high amounts to the value of the property on ‘dizzying’ income multiples”.¹²¹ The Bradford and Bingley, which had increased its buy-to-let lending by 300 per cent that year, was, however, standing by this model. Mr Rodrigues responded to criticisms saying that “the buy-to-let market is not as risky as it is portrayed”.¹²² However, following a series of share collapses and unsuccessful attempts to raise funds through share issue the Bradford and Bingley was sold to Santander in 2008.

115 R Taylor, “Bradford & Bingley cuts mortgage rate to 7.24 per cent”, *Financial Times*, 25 January 1996.

116 N Montagu-Smith, “Money go round: Bradford members weigh up windfalls”, *Daily Telegraph*, 3 June 2000.

117 Ibid.

118 www.independent.co.uk/news/business/news/landslide-vote-for-conversion-at-bradford-amp-bingley-708027.html (last visited 9 December 2009).

119 www.dailymail.co.uk/news/article-1023533/Black-Monday-battered-banks (last visited 1 April 2009).

120 www.usatoday.com/money/economy/2008-09-28-2318700586_x.htm (last visited 30 March 2009).

121 Matt Barrett, the chief executive of Barclays, quoted in www.independent.co.uk/news/business/news/bradford-amp-bingley-defends-surge-in-buytolet-mortgages-589483.html (last visited 30 March 2009).

122 Ibid.

II RESPONSE TO CRISIS

As argued earlier, one of the most significant attributes of an oligarchic MCO is its pursuit of stability over profitability. Building societies, as MCOs which operate as a group controlled by a small elite, pursue this stability goal in many ways. One of those ways is in the group's approach to financial crises.

Historically, building societies have responded to the financial problems of their members within the organisation of the BSA, typically with a financially strong society taking over the business of the failing society. Early on in building society history this approach had been additionally supported by strengthening the powers of the Registrar of Friendly Societies.¹²³ In 1892, the crash of the Liberator which was compulsorily wound up owing over £3m initiated the Building Societies Act 1894 which empowered the Registrar to take a proactive approach to a society's finances.¹²⁴ If it appeared after investigation that the society would be unable to meet its obligations to its members and that "it would be in their benefit that it should be dissolved", the registrar could "award that the society be dissolved".¹²⁵

In the 1970s the fraudulent activities of the top executives of two building societies, which caused huge losses, were managed by the BSA and the registrar. In 1976, the accounts of the Wakefield Building Society revealed a shortfall of £633,000 due to the fraudulent activities of its general manager. The BSA was concerned to protect the Wakefield's business as well as the reputation of building societies per se so, whilst the society's reserves covered the shortfall, the Halifax took transfer of the Wakefield's engagements in order to circumvent any possible bad publicity.¹²⁶ In 1978, the Grays Building Society, whose total assets were stated as being £11m, was found to have deficiencies of over £7m, embezzled by its chairman and secretary Harold Jaggard over a 30-year period. Initially, the BSA arranged for the Woolwich Building Society to take over the Grays' engagements. However, when the full extent of the deficiencies became known, the BSA sought a more collective solution. They set up a rescue fund under s. 43 of the Building Societies Act 1962 to which all societies could contribute. Within three months, the investor members of Grays had access to their money and the Woolwich was able to take over the Grays business.¹²⁷ It was a collective solution to an individual problem made by organisations that operated as a collective.

Today's financial crisis has been dealt with in a similar fashion. Failing societies have merged with stronger societies and pre-emptive mergers have taken place between strong businesses which want to face the crisis as a larger organisation. The proposed merger of the Britannia Building Society and the Co-operative Financial Services (CFS) is an example of the pre-emptive approach. This merger, under the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007, will be voted on by Britannia's members in April. The management of the Britannia is recommending the merger. In statements made on the society's website the merger is characterised as being the key to a brave new (financial world):

The co-operative and mutual movements have never been more relevant. Owing to the damage done by the credit crunch, people have been crying out for a new way of doing business with a financial organisation of substance that truly has

123 Since 2001, the FSA has been the regulator.

124 For a long account of the Liberator's crash, see Cleary, *Building Society Movement*, n. 2 above.

125 Building Societies Act 1894, s. 7(2).

126 M Boleat, *The Building Society Industry* (London: Allen and Unwin 1986, first published 1982), p. 147.

127 *Ibid.*, p. 149.

their interests at heart - this merger will create that organisation and we'd hope to attract many thousands of new customers as a result.¹²⁸

And later:

Britannia members have an historic opportunity to help create a new way of doing business in British financial services by voting to bring together two leading customer-owned businesses with unrivalled reputations for social responsibility, customer satisfaction, employee engagement and member democracy. They can choose to be part of something good.¹²⁹

This new “super co-operative” will join the Britannia with an organisation that boasts 109 retail and corporate centres, £40bn of assets and employs 8000 people. Unlike many contemporary building society mergers, this would seem to be a defensive move rather than a necessary one. There was, “no question” of the companies being forced to merge because of funding difficulties”.¹³⁰ To underline this, members would expect a substantial windfall payment following a vote in favour.

A more common form of merger activity in the recent crisis has been of stronger societies merging with weaker, smaller societies. Such mergers are falling into a typical pattern. First, there are no windfall payments for members and, second, the members of the larger society are typically not asked to vote on the merger. The reasons are clear. Windfalls are not appropriate for members whose society has suffered losses (and thus needs to merge) and transferee society members would probably not vote in favour of the merger because it involves taking on another society's losses. These are decisions taken by an elite management group, not members, characteristic of an MCO. Typical of this kind of merger were those involving the Skipton, Scarborough, Chelsea, Catholic, Nationwide, Cheshire, Derbyshire, Yorkshire, Barnsley and, more recently, the Dunfermline. The merger of the Skipton and Scarborough on the 20 of March 2009 was confirmed by the Financial Services Authority (FSA) under the Building Societies Act 1986, s. 95.¹³¹ The Scarborough was financially vulnerable because of the fall in house prices but also because of the widely accepted problem of small societies being shut out of the wholesale capital market.¹³² Under the Building Societies Act 1986, the FSA may direct a building society to transfer its engagements to another society if it considers it expedient to do so and, given the Scarborough's position, this was clearly the case.

Furthermore, in pursuance of this, a society that proposes to accept a transfer of engagements may do so by a resolution of directors, rather than a shareholder vote, if the FSA is satisfied that the transferee's assets are considerably higher than the transferors and the transferee's members would suffer no significant detriment.¹³³ The FSA was so satisfied and the transferences took place without a shareholder vote.¹³⁴ This was the act of an

128 www.britannia.co.uk/home/_site/corporate/news/press-releases/position-statement.html (last visited 30 March 2009).

129 *Ibid.*

130 www.telegraph.co.uk/finance/newsbysector/banksandfinance/4308247/Britannia-merges-with-Co-op-in-super-mutual.html (last visited 20 March 2009).

131 Decision of the FSA on 20 March 2009 following an application by the Scarborough Building Society and Skipton Building Society to confirm transfer of the Scarborough's engagements to the Skipton: www.fsa.gov.uk/pubs/other/scarborough_skipton.pdf (last visited 9 December 2008).

132 www.guardian.co.uk/money/2008/nov/03/banks-savings (last visited March 28 2009). Mutual societies, though not as reliant on the capital markets as converted societies, still draw a significant amount of funding from this source.

133 Building Societies Act 1986, s. 94(5)(b).

134 FSA decision, n. 131 above.

MCO, not a democratic decision-making body. Furthermore, no members received windfalls in order to preserve the merged society's capital base. This was a defensive action to preserve a preservable society.

Similarly, the Barnsley Building Society was taken over by the Yorkshire Building Society after it emerged it held £10m with the Icelandic banks Kaupthing Singer & Friedlander and Heritable – UK subsidiaries of Icelandic institutions which went into administration in September 2008. The two societies said that the merger followed “swift, pre-emptive action from the board of the Barnsley in approaching the Yorkshire to seek a merger after the identification of possible losses of deposits with Icelandic banks”.¹³⁵ In kind with other similar mergers, there were no windfall payouts to Barnsley members but Iain Cornish, chief executive of the Yorkshire, was keen to put a positive spin on things saying that “this merger is a further step in demonstrating the strength of the mutual sector in the UK, with complete certainty to customers maintained at no cost to the taxpayer”.¹³⁶

In December 2008 the FSA confirmed transfer of the Catholic Building Society's engagements to the Chelsea Building Society¹³⁷ – 94.9 per cent of the Catholic's shareholding members and 94.83 per cent of its borrowing members voted in favour of the merger in a deal that was expected to give some windfall payments.¹³⁸ The Chelsea's members were not asked to vote and, instead, a director's resolution in favour of the merger was allowed as the Chelsea's assets were some 270 times larger than the Catholic's.¹³⁹

Likewise, the merger of the Nationwide with the Cheshire and Derbyshire was in pursuance of a director's resolution and not a members' vote. This strategy is, of course, the faster route to merger. However, it runs contrary to the involved membership which the Nationwide, in particular, has been keen to foster over the last 10 years as a method of advertising the benefits of mutuality and as a bulwark against carpet-bagging.¹⁴⁰ It is at least possible that this merger would not have been supported by the Nationwide's members, as in 2008 the Derbyshire had made a loss of £17m in its subprime mortgages and the Cheshire had made a loss of £10.5m on one loan.¹⁴¹ But as noted earlier, these building societies operate as MCOs with members exercising little control over their activities. It has been ideologically expedient for societies like the Nationwide to emphasise their member-based nature but such concerns will be set aside if they interfere with their practical operation.

The Nationwide mergers were announced in September 2008 and were swiftly confirmed by the FSA in November that year. It was described as a “prudent measure to ensure the financial strength of each Society” in the context of a financial crisis which threatens to destabilise the whole organisation.¹⁴² Likewise, the announced collapse of the Dunfermline Building Society was soon followed by an announcement that the Nationwide would take over the accounts of its members and its prime mortgage lending book, with Dunfermline's head office, its branches and its employees becoming part of the Nationwide. The government and the FSA had ruled out an extensive rescue package for

135 www.guardian.co.uk/money/2008/oct/22/yorkshire-building-society-barnsley-building-society-merger (last visited 30 March 2009).

136 *Ibid.*

137 FSA's written statement at www.fsa.gov.uk/pubs/other/catholic_chelsea.pdf (last visited 30 March 2009).

138 *Ibid.*, p. 5.

139 In accordance with s. 94(5) (b), *ibid.*, p. 6.

140 This strategy dominated discussion in and out of the conference hall in the BSA Conference 1998.

141 *Ibid.* See also www.timesonline.co.uk/yol/money/savings/article5859566.ece (last visited 30 March 2009).

142 www.fairinvestment.co.uk/deals/news/mortgages-news-Nationwide-Cheshire-BS-merger-gets-the-FSA-go-ahead-2609.html (last visited 28 March 2009).

the Dunfermline because of its history of low profitability; estimated by Alistair Darling to be in the region of £5m a year, a sum “insufficient to even service the necessary loan from the government”.¹⁴³ It would appear that the government is underwriting some of the Dunfermline’s more “toxic” loans as a statement from the Nationwide’s chief executive Graham Beale indicates:

This transaction excludes high risk assets: commercial loans and some residential loans were not transferred, and the transaction will enhance the overall value to Nationwide’s membership over the medium term.¹⁴⁴

Conclusion

By the 1900s building societies had become MCOs, the organisational form which would dominate scholarly thought and government policy until the 1970s. Indeed, through the coordinating activities of the BSA, particularly after 1939, building societies had become MCOs par excellence. Many of the MCO theories during this time attributed MCOs with positive qualities and many of these qualities were possessed by building societies. For example, building societies were stable, saw steady but not excessive growth, and operated as hierarchies under trained professionals. Indeed, the power of top management was, under the auspices of the BSA, more centralised and arguably more able to plan and protect than the organisations assessed by Chandler. Like the modern corporations described by Berle and Galbraith, building societies were organisations that were connected to “social” business, they were tightly controlled by legislation and so were effectively public organisations. On the other hand, and in accordance with those theories critical of MCOs, building societies had many negative attributes. The one-member-one-vote governance was unlikely to deliver member control over management in societies with many hundreds of thousands of dispersed members. This enabled building society managers to become a self-perpetuating elite whose decision-making, centralised through the BSA, was often guided by managerial goals such as empire building and personal security. However, it is unlikely that these criticisms would have affected building society organisation without the rise of neo-liberalism. The neo-liberal approach which gathered pace throughout the economic failures in the United States and the United Kingdom galvanised a much stronger attack and promoted a much simpler solution. Building societies were economically inefficient and their managers were unaccountable. This could be solved through the legislative loosening of restrictions on building society business, reducing their privileges and enabling them to become truly market creatures, that is, companies. In this way a clear focus on shareholder value and market accountability would ensure efficient, dynamic profitability. Only it didn’t. Or rather it seemed to for a while and then it didn’t. Why? Because the high octane business of SVOs – pursuit of shareholder value, risk taking and high management rewards – leads to a dangerous enslavement to the capital market.

My argument then is critical of SVOs. However, it is not a call for the re-adoption of MCO forms. It is rather about a consideration of what it means to be a very large organisation, so large that today we call them too big or too complex to fail. MCO theories of the past cited public participation (as employees and consumers as well as investors), stability and state involvement, as reasons for abandoning the notion of business organisations as really private. Rather, these theories held that they should be reconceptualised as public institutions. Today, there is little disagreement about the need for tighter state regulation. However, there seems to be no correlation between state involvement and a consideration of business organisations as *public* institutions. The

143 Radio 4 news, 29 March 2009.

144 www.nationwide.co.uk/popup/dunfermline.htm (last visited 30 March 2009).

private property nature of corporations of all shades remains seriously unchallenged and with it the notion of shareholder value. But these are institutions which can only survive crisis by relying on public money. The society in which they operate can only survive by rescuing, and regulating, them. In these conditions, they cannot plausibly claim to be fundamentally private in nature. However, a new conceptualisation of large business organisations must not return to the inward-looking, self-serving elitism of the MCO. Rather, the challenge is to build a new, *public benefit* organisation to provide the structure for a truly progressive society.