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# Strategic Change in the Evolution of Cooperatives

## 1. INTRODUCTION

Economic and social development is usually slow and stable. So has been the evolution of cooperative enterprises in general. Every now and then there exist, however, times of change; revolutionary phases in the evolutionary process. These are the times when history is broken and new history is made. I call these phases the 'times of strategic change', which means in this presentation changes in the fundamental rules of business and the principles of management.

Two previous presentations have dealt with such revolutionary phases in the history of cooperatives. Antti Kuusterä described the period of the emergence of cooperative banking more than one hundred years ago. In Finland it was the time, when merchant economy was transformed into industrial economy (cf. Tainio, 1990). Gert van Dijk, on the other hand, dealt with more recent changes in cooperatives' competitive environment in Europe. These changes seem to be related to the current transformation of an industrial economy to something that is often called 'post-industrial society'. The word is mostly loosely used in the literature and its precise meaning is seldom clearly defined. Van Dijk, however, perceptively demonstrated that we have reached the end of old certainties of production-driven competition in isolated markets, and we are experiencing the emergence of new rules of 'extended competition' around integrated markets and investment behaviour.

First, the aim of this commentary is to make a few remarks on what kind of a break in the evolution we are witnessing today. Next, we will shortly explore how these new developments affect Finnish corporations in general. Finally, we will discuss what kind of new demands and practical challenges the changes mean for Finnish cooperatives.

## 2. BREAK IN THE EVOLUTION

One of the most fundamental structural changes which have occurred in the world economy during the last few decades has been the continuing integration of the world's financial centers into a single-world financial market place. The maturation of these global, real time financial markets has become possible due to the rapid advancements in information and telecommunication technology.

The numbers of financial instruments (ie. stocks, bonds, options, futures, and derivatives) traded throughout the world have exploded during the last decade. At the same time these huge financial flows have become, to a large extent, disconnected from the trade and commodity flows (Quinn et al.1988). Instead of following goods, as was the case in the industrial era, capital and money are now flowing according to 'their own logic' toward the highest available real interest rates or returns in safer, more stable economic situations.

The power of capital markets is nowadays indisputable. It has changed the rules of business and restructured corporations around the world (cf. Tainio, 1999a). It has made nation-states compete fiercely to provide favourable conditions for the accumulation of capital. Highly mobile capital has made other factors and actors of production look rigid and inflexible. The pressures from the global financial markets have moved production units across regions and borders in a way which has not been typical, nor possible, in the industrial era.

These developments in capital markets have involved two simultaneous and interrelated processes; the rising significance of institutional investors and the activation of owners – even distant and dispersed shareholders. Both of these processes have changed the governance of corporations and the principles of management.

The origins of these two processes can be traced back to the developments in the USA in the 1970s. At that time, and in the early 1980s, the US-based institutional shareholders built massive stakes in the American corporations. By the late 1980s they converted these stakes into active influence through buyout threats, proxy fights, and quiet negotiations. In the 1990s they moved outside the USA while searching for new, attractive investment targets and opportunities (Useem, 1996).

As a result of this the new institutional investors hold now more than 60% of the outstanding stock in the largest U.S. and U.K. companies (Monks, 1999). They have also signifi-

cant stakes in most of the major European, Southeast Asian and Latin American companies.

Shareholders who earlier were quite passive and individually-oriented have become active, professional, and more collective. Unlike individual shareholders, institutions invest "other people's money". Therefore they have a legal fiduciary obligation to take proactive actions to protect their investments against erosion of value (David et al., 1998). Institutional investors may individually have small holdings, but their large aggregate ownership provides them, under certain circumstances, also power over corporate development (Davies and Thompson, 1994, and David et al., 1999). The formation of shareholder organizations in the USA, such as the Council of Institutional Investors, has provided institutional investors a springboard for coordinated and collective action to influence companies and their governance (Davies and Thompson, 1994).

The recent break in the long-term evolution can, from the above perspective, be characterized as a transition from a nationally oriented, production-driven industrial era to a global, investment-driven financial era.

### 3. STRATEGIC CHANGE IN FINNISH COMPANIES

Related to these developments the most significant change in Finnish companies in recent years has been the restructuring of their ownership. After the full liberalization of foreign share ownership on January 1, 1993 the major Finnish companies have become 'actively owned' and 'owner-driven managed'(cf. Veranen, 1996). This is to say that before the 1990s Finnish companies were typically 'passively owned' and 'CEO-driven managed'.

From 1993 on foreign share ownership has increased rapidly in Finnish companies, and currently more than half of the stocks at the Helsinki Stock Exchange are foreign owned. The most significant foreign shareholders are the major American investment and public pension funds.

Foreign investors have become very important for the development of Finnish companies. They are the major source of capital for the growth and renewal of companies. They have also increased the liquidity of the shares, which has made it possible to assess the true market value of Finnish companies.

Foreign owners have created a new ownership culture for Finnish companies. They have brought along an Anglo-American 'shareholder view' to the management of companies. This means that shareholders are regarded as a primary constituency of a company, and therefore their interests are the guiding principles for the management.

Foreign owners are, more than domestic owners, concerned to get prompt returns on their investments. They expect that the value of also their Finnish shares will increase, and they are

active to create conditions, and to put pressures on management, to assure that this will actually happen.

The adoption of the shareholder view in Finnish companies has increased pressures to restructure their business portfolios and managerial incentive schemes, to adopt active dividend policies and capital-based performance criteria, and to redesign their governance structures (Tainio, 1999). Finnish companies are currently going through a managerial revolution, whose consequences are already now, in the late 1990s, beginning to become apparent.

The maturation of global economy and finance-driven companies have most directly affected the ownership structures of Finnish companies. New foreign owners have brought along new ways to control managers, to protect and guarantee the returns on their investments. This has changed the owner-manager relations also in Finnish companies. CEO-domination has been circumscribed and the balance of power has shifted more to the favour of new, active owners.

#### **4. CHALLENGE FOR FINNISH COOPERATIVES**

Finnish cooperatives have been typical examples of companies with strong CEOs and relatively passive owners. The strength of CEOs has, to a large extent, been based on their extensive networks in Finnish business and politics (cf. Karhu, 1999).

Modern cooperatives need both active and competent management and active and competent owners. First of all, they, however, need governance structures which enable an active involvement of both these core groups, when necessary.

The corporate governance of Finnish companies has been based on a two-tier system, where a supervisory board and the board of directors have been distinguished. The major stakeholders of Finnish cooperatives have been represented in supervisory boards. Recently, supervisory boards have been widely criticized for being inefficient in adding value to companies. Foreign investors have publicly blamed them to be passive, distant, and powerless. Partly because of that the role of supervisory boards has weakened in Finnish companies, while the role of the boards of directors has strengthened (Tainio et al. 1999a).

One of the first challenges of Finnish cooperatives seems to be to design their governance structures in a way that serves the new demands of the active owners; potential or real. First, there is a need to rethink the necessity of supervisory boards. Second, there is a need to redesign the role and the composition of the boards of directors.

In the new business environment of the cooperatives, the relatively passive role of the board of directors has turned to be inadequate and no longer effective. Beside the traditional role of control and monitor there is a need for more proactive roles for a board. This means that a board also needs to be actively involved in shaping the current course of action, in

serving as a sounding board for the management, and in suggesting new ideas for company development. These new proactive roles, together with increasing future-orientation, also set new requirements for the composition and action of boards.

In the past the board members of the cooperatives were selected mainly according to the local reputation, industry/sector expertise, or the strength of personal networks. New requirements for the members of the board emphasize, on the other hand, qualities like business expertise, availability of time, and independence.

Traditionally the boards of Finnish cooperatives have been relatively homogeneous and unanimous. Nowadays there is more strive for debate, discussion or even confrontation. The diversity of voices and the acceptance of pluralism have become virtues in order to sensitize threats and opportunities in a fast moving business environment.

Effective boards follow multiple signals of company performance and development. Beside traditional financial performance indicators they pay attention to tacit measures, like the rate of 'routinization' of managerial practices and the development of managerial competencies (Tainio et al., 1999b). These measures often tell more about the sneaking stagnation or problems in organizational learning than the hard performance measures.

Foreign owners are undoubtedly interested in what kind of governance structures exist in the companies they have invested in. They are especially interested in what kind of boards of directors the companies they own actually have. In fact, the major companies are publicly and regularly rated according to the characteristics of their boards (see eg. Business Week, 1996, 1997).

If Finnish cooperatives want to raise their attractiveness and visibility in the global financial markets one of their major challenges is to reform their corporate governance structures. The first step in this process could well be the restructuring of their boards of directors.

## 5. CONCLUDING ARGUMENT

Finnish cooperatives succeeded well in the transition from the agri-merchant economy to the industrial society over a hundred years ago. Now, under the new break in the evolution, they are again facing new demands for a strategic change. In this presentation we have proposed that this change process could start from the apex of the internal control system of a company, the board of directors.

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Our argument is built up in the following way:

The prime engine in the development of the post-industrial society has been the transnational financial network fuelled by modern information and communication tech-

nologies. The leading country in the maturation of a investment-driven development path has been the USA, where the new business principles have already become a part of the reality. In Finland the institutionalization of these principles is still a part of a potential future.

The American capital market-driven financial system and the related 'shareholder view' have rapidly been penetrating the world economy. They have set up new criteria for a financially effective corporation. The 'ideal type' of corporation contains a re-engineered and downsized organization, sharply focused business portfolio, stock option-based managerial incentive systems, capital-based performance criteria, and generous dividend policies. These characteristics provide a broad direction where companies in general, and Finnish companies in particular, tend to move. These features are not, however, fixed nor universally valid. Their current relevance is based on their expected links to effective value creation in the companies.

Finnish cooperatives are also increasingly under the evaluation of global investors and financial professionals. They have become comparable with other companies world-wide. At the moment they are also under the pressure to become 'Americanized'. Whether this occurs or not is dependent on the power of their governance bodies and the strength of Finnish institutional structures. New roles and new composition of the board of directors can help to keep the destinies of the cooperatives in their own hands. An active and competent board has a chance, not only to adapt to the new business principles, but also to create context and period specific variations of them. New boards cannot ignore the new global reality, but the simple imitation of corporations in the leading countries may also make cooperatives vulnerable. The challenge for the boards is to create wider options and special solutions for new kinds of value creation in the future.

Global investors are changing the face of corporate Finland. A successful transition to this new era will again require from Finnish cooperatives a careful analysis of the emerging rules and structures, and creative minds to develop new competitive strengths for the new circumstances. ■

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