COVER SECTION

The Failure of Co-op Atlantic:

A postmortem on one of North America's largest co-op federations

BY TOM WEBB

Editor's note:
The demise of Co-op Atlantic marks the end of its nearly 90 years of producer and consumer co-op services in the Canadian Maritimes. The most recent of many reports on Co-op Atlantic appeared in this publication in 2007, when Tom Webb summarized the consolidation of 28 retail co-op members of Co-op Atlantic—a final attempt at preserving much of its retail base.

For a recent analysis of Co-op Atlantic that focuses on the board of directors and the challenges of federations, see "Governance as a Determinant of Success and Failure," by Brett Fairbairn, Murray Fulton, and Dionne Pohler, published in 2015 by the University of Saskatchewan Centre for Cooperatives and discussed in the previous issue of this magazine: http://usaskstudies.coop/documents/books,-booklets,-proceedings/Co-op%20Atlantic%20final.pdf.

Throughout this report we maintain the Canadian (hyphenated) spelling of "co-operative."

Co-op Atlantic was a cherished institution that grew out of the Great Depression and what became known around the world as the Antigonish movement. Its growth was fueled by market failures that beset farmers, fishers, and ordinary people in Canada's poorest region, the Maritimes. Consumers were often gouged. Farmers and fishers could not get loans for equipment and boats, paid unfair prices for their supplies, and received too little for their products. The co-op had a modest beginning as Maritime Livestock Board in 1927 and incorporated as Maritime Co-operative Services Ltd., changing its name to Co-op Atlantic in 1977.

Co-op Atlantic was a second-tier wholesale and service co-operative owned by local community-owned retail, farmer, and a few other co-operatives across Atlantic Canada. At its zenith, the Co-op Atlantic system had almost a billion dollars in annual sales. In addition to farm supplies and marketing and retail food, it was involved in housing and real estate development, petroleum sales, and energy development across the four Atlantic Provinces and a small part of Quebec.

In the fiscal year ended January 2014, total sales were $642 million. Food sales accounted for $267 million (about 7 percent market share); agriculture sales amounted to $124 million; energy products represented $190 million in sales; and independent business sales were $61 million.

I grew up next to a food co-operative store and ended up working for Co-op Atlantic for seven years, from 1986 to 1993, during what was in retrospect the peak of its strength and the beginning of its end. I remember food cooperative leaders from the United States visiting during the 1990s to admire and learn from what Atlantic Canadians had accomplished.

Profound flaws lead to collapse

In summer 2015, what had become the proverbial house of cards collapsed. To avoid bankruptcy, Co-op Atlantic sold its wholesale food and retail petroleum divisions to its main competitor, Sobeys, which will continue to supply the surviving locally owned co-operatives that choose it. The agricultural supply and feed marketing business has been sold to La Coop fédérée of Quebec, and a poultry operation in Newfoundland has been tentatively sold to another buyer. The energy business went to CST Canada. At the time of this writing, only the real estate operation remains.

Empire Corporation, the Sobeys holding company, has promised to work to help the surviving local co-operatives maintain their identity and has brought in a few of the best former Co-op Atlantic managers to guide that task. Many of those stores compete with either Sobeys stores or Sobeys franchise stores—so how that unfolds will be determined in the fullness of time.

In its heyday, Co-op Atlantic was indeed admirable. Although it was at times a source of tension, Co-op Atlantic linked farmers and consumers, it developed a potentially powerful Atlantic Tender Beef label, created seniors housing, and spawned housing co-operatives. By the late 1980s, it had close to a 20 percent market share of retail food in its geographic area. During that period, it considered a bold new vision with its Initiatives for Renewal, envisioning the extension of co-operation into every aspect of the economy of Atlantic Canada. That vision soon withered.

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What happened?

No organization is flawless or run by flawless managers and boards. That said, there are indeed powerful lessons to be learned from the rise and fall of Co-op Atlantic. The reasons for the collapse are many and complex, but four profound flaws stand out above the mix of less-influential ones—each is discussed below:

- First, it slid into the trap of becoming a discount grocer and sacrificing its co-operative identity.
- Second, it used a badly flawed management agreement system to assist local co-operatives in hiring competent managers.
- Third, management selection was weak from both a co-operative values and business acumen perspective.
- Fourth, the board of directors' education and governance system did not produce boards capable of directing a business with the size and complexity of Co-op Atlantic.

A co-operative discount grocer?

The slide into becoming a discount grocer instead of a distinctly co-operative business was easy. In the 1970s and '80s, by comparison with other regions, grocery prices were 5–10 percent higher in Atlantic Canada than they should have been. Co-op Atlantic experimented with a new type of co-operative—the "direct-charge co-operative." The idea, in simple terms, was to put the groceries on the shelves at very close to wholesale prices and to cover the overheads with a service charge to member families. Sales were to members only.

The model was very successful in a market with inflated prices. Direct-charge co-operatives flourished, and the number of them expanded. The direct-charge model emerged firmly as a discount model whose focus was increasingly on price. While Co-op Atlantic included many "conventional" co-operatives that had emerged before the direct charge model, direct-charge became the preferred new store model of Co-op Atlantic management. Co-op Atlantic management became convinced the lowest price was the essential strategy.

As the market share of the co-operatives grew, the marketplace became somewhat more competitive. But the real challenge came when the Weston Group (Loblaw stores), owned by one of Canada's richest families, decided to go head to head with Empire Corporation (Sobeys stores), owned by one of Atlantic Canada's richest families. Being a discounter in what had become a highly competitive market might have been possible if Co-op Atlantic had had deep pockets lined with capital. Alas, they had lacked the resources for even a medium-length, much less a long, price war.

The direct-charge co-operative stores were, with few exceptions, in trouble. To maintain their "discount" market position, many were experiencing losses year after year. With banks unwilling to extend credit, the only source of financing was Co-op Atlantic. Stores unable to pay their bills were allowed to delay solving their problems by growing their accounts payable to Co-op Atlantic year after year.

As the losses mounted and Co-op Atlantic accounts receivable ballooned, costs had to be pared to the bone. For example, suggestion boxes were removed from the stores, over the protest of the board of the newly merged retails (CCC—see below), because the staff time to respond was too costly. In the early 1990s, almost every local co-operative had a member-relations staff person—a decade later, all but three of these positions had disappeared. A discount business in the midst of a price war with competitors with deep pockets likely cannot be a co-operative and listen to members. It was not an accident that Sobeys was investing more than a million dollars in Sobey's Club while Co-op Atlantic cut its already meager member relations and member education budgets by a third. An organization driven by discount grocery managers saw price as everything and placed no value in a co-operative difference.

The market, having become price competitive, remained so. At Co-op Atlantic, weak financial performance led to reduced maintenance and aging equipment. The growing losses from direct charge co-operatives and a few other weak stores brought pressure from Co-op Atlantic's bankers. The bankers' dismay over steadily rising accounts receivable forced a merger of 28 community co-operatives that were, for all practical purposes, bankrupt.

The hope was that the newly merged co-operative, Consumers Community Co-operative (CCC), would have economies of scale strong enough to turn it around. I was a member of the new co-operative's board. Leading a co-operative deeply in debt to Co-op Atlantic, the board's scope for action was limited. CCC was launched as a deep-discount store before the board even met. It took four years to shift the CCC toward the kind of full-service cooperatives seen in the U.S., with healthy, local, fairly traded, environmentally friendly food, and a growing co-operative process.

Weak management

The total reliance on discounting reflected weak co-operative and business management. In a business in which location is vital, an often-heard line at Co-op Atlantic was, "Build them and they will come." Cheap but poor locations were preferred. Then, with Sobeys and Loblaws engaging in predatory pricing and investing hundreds of millions in new stores in prime locations, bad co-operative location decisions came home to roost.

The co-operative management failure had been fueled by a management development program that had two textbooks: *Mega Trends* by John Naisbett, which waxed eloquent about both the global triumph of democracy and the power of presidents and prime ministers being dwarfed by the power of corporate CEOs; and Sam Walton's *Made in America—the story of Walmart.* But if a co-operative copies Walmart, it will become a second-rate Walmart and deeply erode member loyalty.

New managers were often hired who understood neither the direct-charge co-operative model nor the idea of co-operatives generally, and too often they regarded both with contempt. New or prospective members asked, "Why do we have to pay to shop in this store?" The answer, even from managers, too often was, "It does not make much sense to me either—you would have to ask the big guys in Moncton." With many local managers doubting the wisdom of the direct-charge model, they added shelf margins and special "upcharges." Direct-charge methods became different in every store, and it was less and less possible to describe what the model was. Marketing it across the system became impossible.

A weak financial position creates defensiveness and panic. The organization hired and promoted discounters, not co-operative leaders. Co-op Atlantic management, with board support, decided to make the discount model work by deepening discounts. Environmental, fair trade, co-operative education, and healthy food programs were pared to the bone. Co-op Atlantic stores attracted discount shoppers loyal only to the lowest prices and competitor specials. Co-op Atlantic managers and board members deeply resented the lack of member loyalty. "Those people don't deserve a co-op," was a frequent comment.t Too seldom asked was the basic co-operative question, "What do our members need that we are not providing?"

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Flawed Management Agreement

Co-op Atlantic's Management Agreement was intended to help local co-operatives achieve better management. In effect, Co-op Atlantic management chose the local manager, who was then supervised by an area manager.

I remember meeting a manager who had just finished meeting with two board members. As we walked to his office, he shook his head and said, "Those guys think they own the place." He had been a co-op manager for several years. Management Agreement managers often did not understand co-operatives and often didn't know if they were to listen to the area manager or the local board. The local board often did not know to whom managers listened. As the vice president of retail during the early 1990s

was fond of saying, "A good manager knows how control his board."

Many of the Management Agreement local co-operatives had losses for many years, some for more than two decades. This was not seen as a failure of the Management Agreement system. On one memorable occasion, the vice president responsible for plans to improve the performance of money-losing co-operatives was asked why one co-operative not under Management Agreement but experiencing difficulty was not included in the list of co-operatives receiving special attention. His response: "We don't control that co-op."

To be fair, there were many good, capable, and co-operative managers at Co-op Atlantic, but they did not dominate the management culture. For more than a decade, a strain of ethnic and religious prejudice and sexism played a poisonous role among an influential group within the senior management. At one point during the late 1980s, there was one Acadian manager and a single Acadian supervisor out of 110 managers. Some 36 percent of Co-op Atlantic business was done with French-speaking Acadian co-operatives but with little effort to serve them in their language. There was only one female supervisor and no female managers—men were preferred over competence.

After more than a decade of such unco-operative management leadership, even the nine-year tenure of CEO John Harvie, recognized as one of Atlantic Canada's leading executives, could not turn it around.

A governance deficit

Over the years, the board of directors of Co-op Atlantic consistently deferred to management expertise, even when it was clear that the business was in deep trouble. Board members were not required to take board training, neither to qualify to run for the board nor after being elected. In general, board members were fine and decent people with whom you could entrust your children but not, alas, your co-operative. There were always three or four board members who saw red flags, but when they questioned management too strongly they became isolated and often deeply frustrated. They were sidelined as too negative. Too often board members saw themselves as representing their local co-operatives rather than being responsible for the system owned by their co-operatives.

The board did not possess the expertise to understand the deep-seated problems such as those of the Management Agreement, industry trends, competitive risks, mounting accounts receivable, or the decline in the real value of their cooperative's investment in Co-op Atlantic. Nor did they seek or have access to expertise outside their own management group. In many cases, Co-op Atlantic board members also failed to grasp the decline in the value of member investments in their own local co-operatives.

The accounting, auditing and reporting systems did not serve the board or members well. For example, local co-operatives' membership meetings of co-operatives in difficulty learned of operating losses but were never told that if all their assets were liquidated, they would not have enough funds to refund member shares after the bills were paid. Auditors and managers worked closely together, and reports to boards and membership meetings were "concerned" but soothing. A good annual meeting was one where nobody rocked the boat and troubling issues slid by quietly.

The governance of local co-operatives and Co-op Atlantic remained fundamentally the same over 50 years of growth. Local co-operatives had the same governance structure and processes with 5,000 member families as they had with 600. At Co-op Atlantic, progress with governance was almost always synonymous with cost-cutting rather than with more effective understanding of the business, setting goals, and solving major problems.

Conclusion

Even co-operatives with a strong positive history cannot ignore their purpose, values, and principles without becoming at risk. Nor can they make repeated bad business decisions. The key reasons for the Co-op Atlantic collapse:

- A strategic error in becoming a discount grocer with a diminishing co-operative difference;
- A decade of disastrous business management decisions related to a misuse of accounts receivable, poor store locations, and weak equipment renewal and maintenance;
- A 20-year failure to provide strong co-operative education to board members, managers, and workers, and withholding information from members to ensure "smooth"' meetings;
- Hiring and promotion with no regard for shared co-operative purpose, values, and principles;
- Failure to deal with discrimination based on language and gender; and
- A dysfunctional Management Agreement system that destroyed accountability and eroded governance.

These were profound flaws that every cooperative risks simply by existing in an economy dominated by capitalist business. Each of these flaws would have been corrected by effective reflection on co-operative purpose, values, and principles. The reasons for the Co-op Atlantic collapse are a powerful recommendation for putting the purpose, values, and principles up on the walls of every meeting room and reflecting on whether each decision is aligned with them. ☐

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