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Isomorphism and Corporate Governance Reform:
A case study of the Co-operative Bank (UK)

Dissertation submitted in partial fulfilment of the requirement for the MSc in Corporate Governance & Business Ethics

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ABSTRACT

Purpose of this study: To examine whether isomorphic pressures contributed to the financial crisis within the Co-operative Bank and to understand if there were isomorphic pressures implicit in the subsequent corporate governance reform proposals.

Design/methodology/approach: The research is based upon a single case study of the Co-operative Bank, a subsidiary of the Co-operative Group. The study starts with a discussion of the crisis at the Co-operative Bank. It then presents the main findings which emerged during the research. The study is based on secondary data which is analysed using a critical hermeneutic approach.

Findings: There were elements of mimetic, coercive and competitive isomorphism within the factors that led to the capital shortfall in the bank. These factors included the external environment, regulatory and political pressures as well as competition. The proposed corporate governance reforms also contained elements of normative isomorphism, and if implemented in full, could have steered the Co-operative away from its democratic co-operative roots and closer towards a commercial organisation.

Originality/Value: This research makes an original contribution to the fields of corporate governance and management theory. By utilising the critical hermeneutic approach it also illustrates the application of an alternative means of qualitative research. The practical findings can assist in policymaking related to the co-operative movement as well as the broader financial sector.

Keywords: *Corporate Governance, Isomorphism, Institutional Theory, Co-operative Banking, Mutuals, Board Effectiveness, Boards of Directors.*

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1. INTRODUCTION

In the aftermath of the 2007 global financial crisis there has been increasing focus on enhancing security and stability in the financial system. Commercial banks have been criticised for governance failings which have resulted in bailouts by taxpayers. Co-operative banks, which are owned by members, serve as an alternative to shareholder owned commercial banks. Co-operative banks differ not only in ownership structure but also in terms of control and benefits as each member is entitled to one vote and receives products and services alongside financial returns (Fiordelisi and Mare, 2014).

Advocates of the co-operative approach point to the strengths of its democratic structure and the focus on long-term customer value. Critics of the sector tend to focus on the complexity of the organisations and perceived inefficiencies, but traditionally co-operatives have provided an important source of diversity within the financial system.

In the UK, the overall co-operative sector consists of about 15 million members, and contributes approximately £36 billion to the economy[1]. However, the co-operative sector tends to consist mainly of retail and agricultural organisations. The Co-operative Bank, a subsidiary of the Co-operative Group, is currently the only UK co-operative bank.

Historically, the UK financial mutual sector consisting of building societies and co-operative banks has been strong, but since the late 1980s the sector has shrunk significantly due to privatisation of the building societies. As a result of this privatisation, by the end of 2012, there were only 47 building societies remaining, compared to 131 in 1988 (BSA, 2013: 100).

Stephens (2001) found that there was no single explanation for the wave of demutualisations and privatisations that took place in the 1990s. Instead, he proposed that these privatisations took place as the building societies made strategic decisions to increase efficiency and respond effectively to the commercial environment. In some cases this resulted in the building societies attempting to operate more like profit-maximising banks but not necessarily increasing their efficiency.

[1] http://www.uk.coop/co-operative-economy-2014 [accessed 16.08.14]

DiMaggio and Powell (1983) developed the theory that institutional isomorphism (a set of forces that lead organisations to mimic other organisations in order to respond to their environment) has resulted in the similarity of many organisations. Much research has been undertaken to explore isomorphism in different industries. It would appear that isomorphism might have played a role in the activity of the building societies.

In 2013, the Co-operative Bank reported the worst financial losses in its history. The bank's chairman, Paul Flowers resigned from the bank and was later charged with drug offences (BBC, 2014). To save the banking arm, the Co-operative Group ceded majority control of the bank to US hedge fund investors. As a result of the financial losses and scandals, numerous reviews were launched to investigate the cause of the bank's failings.

It was widely believed that the problems resulted from poor corporate governance. In 2014, two commissioned reviews were completed by Paul Myners and Christopher Kelly. The Myners review proposed radical steps for corporate governance reform of the Group. The findings were challenged by industry representatives and others (Boyle, 2014; Murray, 2014). There has been concern that the recommendations for reform would push the bank away from its co-operative roots. There has also been ongoing debate about the relationship between the governance failure and the co-operative framework. Because of the concerns, the reforms were modified before being adopted by the Co-operative Group in 2014. In chapter 4, the Myners and Kelly report findings will be analysed in more detail.

The focus of this research will be to explore the existence of isomorphism in corporate governance reform. It will seek to uncover whether isomorphism played a role in the recommendations for the Co-operative. As corporate governance reform does not operate in isolation, the research will also examine whether the pressure to adopt similar form and practices as other commercial banks played a part in the Co-operative's downfall. The research will rely on tenets of Institutional Theory to assist in the analysis. This research will also consider the globalisation of the Anglo-Saxon (Anglo-American) form of corporate governance. Whereas there has been research written on the pressure to converge different types of governance internationally, research on convergence within industries is limited.

The research will begin with a literature review to provide an appraisal of existing academic and industry literature and to identify any gaps. This will be followed by an explanation of the methodology used. A case study approach will then be used to answer my research questions: **Did isomorphic pressures contribute to the financial crisis within the Co-operative Bank and were there isomorphic pressures implicit in the corporate governance reform proposals?**

The final chapter will summarise the conclusions arising from the research study and suggest further areas for research. It is hoped that this research will contribute to increasing awareness of the challenges facing co-operative banks and will assist in shaping better policy, regulation and governance of this sector.

2. LITERATURE REVIEW

This section will review the existing theoretical literature that is relevant to the research project. The literature review will focus on the following areas: isomorphism in management theory, globalisation and corporate governance reform, board effectiveness and the corporate governance challenges of co-operative banks. It will seek to uncover the current thinking in these areas and identify any significant gaps.

2.1. Isomorphism in Management Theory

Isomorphism, one of the key concepts underlying Institutional Theory[2], has been the subject of much research since the 1980s (Clegg et al., 2011). DiMaggio and Powell (1983) introduced the terms coercive isomorphism, mimetic isomorphism and normative isomorphism to explain why so many organisations appear similar. Coercive isomorphism relates to the influence of external, powerful institutions that influence the organisation to act in a particular way. This usually relates to governments, regulators and other external parties. Mimetic isomorphism refers to the process of copying the designs and actions of successful organisations in order to mimic their success. Finally, normative isomorphism occurs due to professional training and socialization that influence the adoption of similar organisational practices. These variations of isomorphism are considered to be institutional isomorphism as opposed to competitive isomorphism which occurs as a result of market conditions and the competitive process (Fennell, 1980).

DiMaggio and Powell argued that these isomorphic pressures occur as organisations strive for legitimacy. Legitimacy in this context, refers to a belief that a particular action or structure is valid and just (Clegg et al., 2011). There has been a lot of research conducted to test the assumptions of the theory. Deephouse (1996) tested the central tenet of this theory, that institutional isomorphism increased legitimacy. By examining the strategic actions of a selection of US commercial banks, he found a positive relationship between isomorphism and legitimacy, which supports the work of DiMaggio and Powell. The majority of further research in this area has focussed on mimetic isomorphism (Mizruchi and Fein, 1999). Mizruchi and Fein asserted that undue importance has been placed on mimetic isomorphism at the expense of the other types of isomorphism, which

[2] Institutional Theory addresses the issue of how and why structures and processes within organisations come to be taken for granted (Judge and Zeithaml, 2004: 150).

was not the intention of the original authors. For example, recent studies have looked into mimetic behaviour in bank branch decision making (Barreto and Baden-Fuller, 2006), the adoption of codes of ethics (Long and Driscoll, 2008; Chua and Rahman, 2011), the incidence of corruption in financial institutions (Venard and Hanafi, 2008) and the growth in mergers and acquisitions in the financial sector (Yang and Hyland, 2012).

Dansen (2013) avoided this pitfall by including all four types of isomorphism in his development of a holistic model for the actions of the banking industry during the financial crisis. Dansen included institutional and competitive isomorphism as factors in his study. His study found that mimetic and competitive isomorphism played a significant role during the period 2000-2007 while coercive and normative isomorphism were key drivers in the subsequent period up until 2010. In his paper Dansen also outlines criticisms of the DiMaggio and Powell approach which include the role of competition, the mechanisms and time-frames over which isomorphism is thought to occur and finally the direction of change caused by isomorphism. This final point as discussed by Hambrick et al.,(2004) and Beckert (2010), relates to the theory that the same mechanisms that can cause a shift towards homogenization could also result in a shift towards divergence. They argue that the situation is therefore not as clear cut as proposed by DiMaggio and Powell.

2.2. Globalisation and Corporate Governance Reform

In the aftermath of corporate scandals, there has been a lot of talk of corporate governance reform. An associated debate is the manner in which this reform should take place. One key debate revolves around the globalisation and convergence of corporate governance systems (Clarke, 2004). This usually relates to systems at the national level. Current literature has focussed on exploring convergence to the Anglo-Saxon/Anglo-American model that is popular in the UK and the US. The Anglo-Saxon model is based on the relationship between shareholders and managers and relies on the concept of market capitalism (Gilson, 2001; Cernat, 2004). This differs from continental Europe, which relies heavily on the stakeholder theory of the firm (Cernat, 2004). In recent years there has been pressure on continental Europe to conform to the Anglo-Saxon model. This pressure to conform to the US style of governance has been driven in part by large US investors, who have attempted to influence European governance (Gilson, 2001).

Pressure to change the form of corporate governance is also apparent in developing countries and sometimes proves problematic. Siddiqui (2010) studied the recent corporate governance reforms in Bangladesh. His research found that, similar to other emerging economies, Bangladesh adopted the Anglo-American shareholder model of Corporate Governance although it was not considered completely suitable for emerging countries in light of the differing legal, economic and corporate environment. In fact, a stakeholder based approach might have been more appropriate, but it appears that the shareholder approach was selected to comply with the wishes of international financial agencies. Siddiqui points out that this illustrated an attempt to gain legitimacy rather than increase efficiency. His study suggests the need for further research in the corporate governance area to investigate the suitability of alternative models at the firm level, through the use of different methodological perspectives.

Ahmadjian and Song (2004) illustrated alternative approaches adopted by Japan and South Korea. In the 1990s, both countries engaged in corporate governance reform that affected not only corporate ownership, but also board structure and management decision-making. Both countries were faced with the decision to adopt the Anglo-Saxon form of governance, but responded in different ways. While South Korea adopted a more restrictive framework that mandated board reform, changing ownership structure and promoting the rights of minority shareholders, Japan adopted a less restrictive framework that gave firms more flexibility to operate internationally. The authors argued that the different outcomes stemmed from different dependencies on global capital and different framing of corporate governance. At that time, South Korea was heavily dependent on foreign debt unlike Japan. In addition, South Korea framed corporate governance reform as a way to champion the rights of under-represented shareholders while Japan framed it as a controversy laden trade-off between shareholders and employees and a clash between the US way and the traditional Japanese way. The dependence on global capital and the framing of corporate governance are just two of numerous factors that could potentially influence the adoption of corporate governance practices. Other factors include cultural norms, legal and financial systems and the political environment (Letza et al., 2004).

Dignam and Galanis (2008) argued that it is important to also consider the influence of macroeconomic conditions on corporate governance. Factors such as trade, capital controls and demand all play a role in shaping the way corporate governance operates and this is often ignored in decision making and policy formulation. They refer to the 'outsider' system versus the 'insider' system, where the Anglo-Saxon model is considered to be an outsider model that focusses on shareholders whereas the insider model focusses on stakeholders. The insider model tends to be common in countries such as Germany and Japan. Dignam and Galanis also suggest the importance of the political system on the model of corporate governance that is implemented in a country. They argued that left-wing governments tend to encourage the development of an insider model as they form part of the "protective social infrastructure" (2008: 202), whereas right-wing governments tend to prefer an outsider model.

Convergence in corporate governance models may occur in different ways. Gilson (2001) distinguished between functional convergence and formal convergence, with functional convergence referring to governance that is flexible enough to adapt to changing circumstances without changing the underlying formal structures. Formal convergence, on the other hand, requires legislative action to change the basic governance structure. Gilson examined corporate governance systems in Japan, Germany and the US in order to illustrate the occurrence of functional convergence without formal convergence. His research found that even though the US governance system differed significantly from the German and Japanese systems, they were all able to monitor and replace poor performing senior management effectively without making costly, formal changes to their governance structures.

2.3. Board Effectiveness

Empirical research has tended to focus on the actual mechanisms of corporate governance. Traditionally, corporate governance research has been quantitative in nature. McNulty et al. (2013) found that only 1% of articles on corporate governance were qualitative in nature (2013: 188). The overwhelming focus of research has been on the board of directors (John and Senbet, 1998; Forbes and Milliken, 1999; McNulty et al., 2013).

John and Senbet (1998) found that the key characteristics that determined board effectiveness were board independence, size, and composition. Empirical research has been conducted to test these assumptions in the banking sector (Andres and Vallelado, 2008; Pathan and Faff, 2013).

Andres and Vallelado (2008) conducted a study examining the boards of sixty-nine large commercial banks from Canada, France, the UK, Italy, Spain, and the US over the period 1995–2005. Their study found that contrary to popular thinking, small boards were not necessarily more efficient. They found that increasing board size increased board performance up to a limit of about nineteen directors. They also found that an optimum mix of executive and nonexecutive directors is better poised to create value for the bank as opposed to excessively independent boards.

Pathan and Faff (2013) examined a selection of US banks over the period 1997 to 2011. While their study found that increasing board size negatively impacted financial performance, they also found that there was a negative relationship between board independence and performance. With respect to board composition and diversity, they found that the relationship varied over the period. Prior to the introduction of the Sarbanes-Oxley reform in the US in 2003, gender diversity increased performance, but resulted in weakened performance from 2004 onwards.

John and Senbet (1998) also proposed that corporate governance research should not be limited to the protection of equity shareholders but should include other stakeholders such as debt holders and non-financial stakeholders. This stakeholder approach was also researched by Luoma and Goodstein (1999), who examined the relationships between institutional influences and stakeholder representation on boards of directors. They found that, in large corporations, stakeholder representation on corporate boards had assumed a degree of legitimacy as a means of responding to stakeholder interests.

Forbes and Milliken (1999) emphasised the importance of understanding and improving the work of boards as they considered directors to be "stewards of organizational resources that impact, for better or worse, the whole of society" (1999: 502). To this end, they developed a model using board task performance[3] and board cohesiveness as the key criteria to assess board effectiveness. They also considered the specific requirements of boards that differed from the typical corporate boards such as non-profit boards, boards of small firms and boards of high-technology firms. The boards of co-operative banks are not specifically addressed but there are some common elements that will be explored in

[3] Forbes and Milliken defined board task performance as "the board's ability to perform its control and service tasks effectively"(Forbes and Milliken, 1999: 492)

the following section, for example the boards of high-technology firms (and banks) require industry specific knowledge and skills that exceed other boards.

Banks have specific concerns that could affect their governance. Mülbert (2009) identified five key technical challenges, the foremost being the maturity mismatch between banks' assets and liabilities which acts as a source of liquidity. The other challenges relate to the highly leveraged nature of banks as well as their opaque balance sheets. In addition, banks are very susceptible to credit runs. As a result of these factors and the systemic importance of the financial system, banks are subject to tight regulation and increasing scrutiny since the financial crisis.

Reviews into the governance of the banking sector have been conducted by governments, international bodies and others including the UK government through the Walker review, the OECD[4] and the EU Commission (Mülbert, 2009). These reviews tended to focus on board practices, remuneration, shareholder rights and risk management. The reviews found that there was too little focus on identifying risks and understanding complex banking products. It was therefore critical to have an independent risk committee with authority to implement robust risk practices throughout the bank. With respect to board composition, the reviews found that the number of independent directors was less important than the financial knowledge of the chairman of the board.

Desender (2009) is one of the few researchers to examine the relationship between the ownership model of an organisation and the board of directors. His research examined the experience of companies with dispersed ownership versus those with concentrated ownership and found that ownership structure has an important influence on the priorities set by the board of directors. Desender argued that more research should be done to examine how the model of corporate governance affects organisational effectiveness for different stakeholders. Desender's research was limited to shareholder owned companies and did not consider financial mutuals. It is expected that his findings would apply to member owned companies as well.

[4] The Organisation for Economic Co-operation and Development

2.4. Corporate Governance challenges of co-operative banks

Financial mutuals such as co-operative banks are subject to unique corporate governance challenges. However, the development and implementation of good governance practice that addresses the needs of co-operatives is currently at a very early stage (Shaw, 2006). Current economic literature on co-operative organisations is limited (Kalmi, 2007; Shaw, 2006), which is also reflected in the lower priority shown by regulators and policymakers. However, this is changing.

Cuevas and Fischer (2006) identified the principal source of failure for co-operative financial institutions as resulting from member/owner conflict with management. They found that as a co-operative expands in size, member ownership becomes diluted and managers are correspondingly subject to weaker controls.

Carver (2011) has recently developed a Policy Governance model geared towards non-profit and public organisations. His research is one of the few to consider co-operative boards specifically. He identifies the main challenge of the co-operative board as the need to address the distinction between members' interests as owners and their interests as customers.

Prieg and Greenham (2014) asked the question "should government policy aim to help sizeable co-operatives compete directly with existing commercial banks, or should it help them compete by offering a genuine alternative?"(2014: 2). The idea of co-operatives as a genuine alternative to commercial banks is picked up in the work done by Groeneveld and Llewellyn (2012). They argue that co-operative banks are better placed to handle agency problems than shareholder banks. In addition, co-operative banks exhibit greater stability and customer focus. The evidence they put forward is that co-operative banks came through the financial crisis unscathed. Groeneveld and Llewellyn consider that future governance challenges are a balancing act to reconcile the interests of domestic members and the difficulty of members monitoring the bank due to increased complexity. This corresponds with arguments put forward by Davis, Cuevas and Fischer and Carver.

In addition to internal pressures, co-operatives are subject to unique external pressures. Davis (2001) identified four main threats to effective governance of co-operatives. Firstly, the growth of industrial concentration requires co-operatives to consolidate and expand in order to compete. Secondly, deregulation coupled with technological revolution increases the pace of change and the dependency on experts. Thirdly, social polarisation, dislocation and impoverishment can undermine co-operatives. Finally, materialism and individualism promoted by investor-led firms can create a hostile culture towards co-operative values (2001: 34).

Paulet and Relano (2010) illustrated the pressures on co-operative banks by examining the business activities of a selection of German banks within a corporate social responsibility (CSR) context. Their research included a comparative analysis of a co-operative bank, a traditional commercial bank and a non-traditional “ethical” bank. They found that the co-operative bank played an intermediate role between the ethical bank and the commercial bank; it was neither as socially motivated as the ethical bank nor as profit-maximising as the commercial bank. Paulet and Relano explained that this situation resulted from the influence of globalisation and mimetic isomorphism.

2.5. Result of review

The review of current literature indicates that there are significant gaps in the area of study. Firstly, while there has been substantial research into isomorphism in management actions across a number of industries, there has been very little research into isomorphism in co-operative banking. Secondly, research with respect to corporate governance reform has taken place at the country level and there has been no research into isomorphism in corporate governance reform at the firm level. Therefore, this indicates a pressing need to explore the incidence of isomorphism in corporate governance reform with respect to co-operative banks. It is hoped that this study will add to the body of knowledge of both corporate governance and management theory.

3. METHODOLOGY

3.1. Research Questions

The research seeks to explore the existence of isomorphism in corporate governance reform. As Yin (2003) explains, “defining the research questions is probably the most important step to be taken in a research study”, as it helps to define the research to be undertaken. In light of the topic of interest and the study of existing literature, this research therefore seeks to answer the following two questions:

Question 1: What were the main isomorphic pressures affecting the operations of the Co-operative Bank in the period leading up the capital shortfall in 2013?

Question 2: Were there isomorphic pressures implicit in the corporate governance reforms proposed after the capital shortfall?

3.2. Research Paradigm

A research paradigm refers to the philosophical framework incorporated in the research study. It incorporates the researcher’s set of beliefs which influence the practical aspects of the research (Frenz et al., 2011).

This research follows a critical hermeneutic approach, as popularised by Gadamer and Ricoeur (Gadamer, 1960; Ricoeur, 1981). Hermeneutics is typically defined as the interpretation or translation of text (Myers, 1994; Mills et al., 2010) according to a particular philosophy. Through the combination of a hermeneutic perspective with a critical reflection on social conditions, this approach provides a “structured approach to the analysis of the role of meaning in the ongoing re-creation of organizations and their environments” (Phillips and Brown, 1993: 1547).

Critical hermeneutics is considered useful for case study research and as an alternative form of qualitative corporate governance research. According to Mills et al. (2010), the hermeneutics method “is useful for case study research if the researcher is investigating any sort of textual documents for a deeper understanding into human behaviour, actions, organizational culture and communication.”(2010: 435). Ahrens and Khalifa (2013) advocate the adoption of this type of research as they consider it to be “a useful approach for articulating more holistically the lived experiences of corporate governance practitioners" that could portray effectively "the multiple meanings of corporate governance" (2013: 25).

The critical hermeneutic approach includes elements of both interpretive and critical theory (Myers, 1994). Both interpretive and critical theory rely on the assumption that social reality is socially constructed, unlike positivistic research which is objective and relies on the concepts of 'validity' and 'reliability'(Myers, 2008a: 243). Crotty (1998) explains the difference between positivist and interpretive approaches in the following manner:

> A positivist approach would follow the methods of the natural sciences and, by way of allegedly value-free, detached observation, seek to identify universal features of humanhood, society and history that offer explanation and hence control and predictability. The interpretivist approach, to the contrary, *looks for culturally derived and historically situated interpretations of the social life-world* (1998: 379)

The critical hermeneutic approach is therefore subjective research, but also incorporates an element of theoretical critique that is lacking in pure interpretive research. Critical hermeneutics attempts to improve on weaknesses of the interpretive approach and seeks to understand not only the subjective meanings for individuals but also the social structures and environment which condition and enable such meanings (Myers, 1994). It is a relevant approach to examine the issue of isomorphism in corporate governance reform, as it employs a framework which incorporates theories of meaning, action and experience, which increases the understanding of organisational stakeholders who may have confused or contradictory views on issues (Myers, 1994; Roberge, 2011).

Within this paradigm, an instrumental case study approach was conducted as the research seeks to provide insight into a particular issue (Frenz et al., 2011). The research considers all types of institutional isomorphism including coercive, mimetic, competitive and normative.

The research follows an inductive approach where theory is developed after the empirical study is conducted (Frenz et al., 2011).

3.3. Research Method

The research is of a qualitative nature. Qualitative research is considered to be appropriate for exploring subjects in depth and for studying various aspects of organisations and people, including social, political and cultural aspects (Myers, 2008b).

The research incorporates secondary data. Due to the high profile of the Co-operative Group and the numerous independent investigations already underway or completed, there was a wealth of relevant information available in the public domain. The advantage of the secondary approach in this case, was that the high profile investigations would have had access to a lot more key individuals than would have been possible for a single academic researcher. The inherent disadvantage of using secondary research is that the researcher has no control over the gathering of the primary data that comprised the original research or any biases present in the conclusions drawn.

This research aims to present a new look at the events that took place at the Co-operative Bank and thus includes this researcher's interpretation of the comprehensive results obtained from the secondary sources.

3.4. Research Design

Research design refers to the detailed strategy or plan that guides the research process (Frenz et al., 2011). Appropriate research design ensures that the evidence collected allows the research questions to be answered as clearly and completely as possible.

3.4.1. Case Study

The research design selected was the case study approach. Yin (2003) described a case study as "an empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident"(2003: 13). This research examines the decisions made within in the bank leading up to the point of crisis and recommendations proposed in the aftermath of the crisis. It considers the real-life context in order to identify and understand isomorphic pressures that may have occurred.

The case study approach is commonly used for qualitative research as it allows the incorporation of multiple perspectives which can create a rich and detailed understanding of the object of the study (Gray, 2009). Based on the study of the secondary literature, this research attempts to portray the perspectives of decision-makers within the bank as well as the independent external investigators.

3.4.2. Sampling

The Co-operative Bank was chosen as the single case for the study due to the high profile nature of the bank and the wealth of information available in the public domain as a result of the independent reviews. The Co-operative Bank as a member of the co-operative movement illustrates an ownership structure that differs from conventional shareholder banks. Co-operative banks have also been considered as a way of increasing diversity in the financial sector. In the midst of the media and regulatory attention surrounding the downfall, there has been a recurring theme of the seeming disconnect between an ethical bank experiencing major governance failures just like other banks. Questions have also been raised about the relevance of the co-operative model in the modern financial sector. For these reasons it was felt that the Co-operative Bank would be an important and interesting subject of research in order to investigate the presence of isomorphic pressures in corporate governance reform.

Within the Co-operative, the actions considered in the study were limited to those of the Board members and senior management. Key external stakeholders considered included regulators, government representatives and decision-makers within the wider Co-operative Group. The actions of member owners were only considered in as far as they influenced the adoption of the corporate governance reforms.

3.4.3. Data Collection

The data collected was of a secondary nature and included the bank's annual statements covering the period 2003 to 2013 as well as the findings from the Kelly review (2014) and the Myners Review (2014b). The Kelly review contained data relevant for the analysis of isomorphic pressures in the bank's operations, while the Myners review provided the narrative for the analysis of isomorphic pressures in the corporate governance reform of the Co-operative. Other sources included the Co-operative Bank's publications and press releases, media articles and trade association publications.

3.4.4. Data Analysis

One of the advantages of qualitative research is the flexibility of analysis. Some approaches are deductive in nature, for example content analysis, while the majority of other approaches are inductive (Yin, 2009).

This research incorporated elements of narrative analysis, which within the critical hermeneutic framework enabled the analysis of the corporate governance challenges of the Co-operative bank within its social, cultural and political environment. The text of the Myners report was examined in detail to understand the literal meaning as well as any underlying meaning that may have been obscured. This is in line with the approach suggested by philosophers such as Ricoeur, where text is analysed objectively while incorporating a "hermeneutics of suspicion[5]"(Mills et al., 2010: 435–436).

3.4.5. Ethical Considerations

The research has been carried out in keeping with the general guidelines for qualitative research. While much of the focus on ethical considerations relates to the ethical treatment of interview subjects in primary research there are also ethical considerations inherent in secondary research. As Gray (2009: 199) explains "whatever promises were made about confidentiality need to be followed during the secondary data analysis". This has been adhered to wherever applicable.

[5] Hermeneutics of suspicion refers to methodology that allows cautious interpretation of texts as the literal meaning may "conceal the political interests that benefit some at the expense of others"(Mills et al., 2010: 436).

4. RESULTS, ANALYSIS AND DISCUSSION

This section deals with the research findings and analysis. It begins with background on the Co-operative Bank in order to set the context for the situation. It then proceeds to the synthesis and analysis of the data related to the two research questions. As stated earlier, the first research question relates to the identification of isomorphic pressures within the bank's operations while the second question relates to the possible existence of isomorphism in the corporate governance reform proposals.

4.1. Background

Up until December 2013, the Co-operative Bank was a fully owned subsidiary of the Co-operative Group, the UK's largest mutual business. The Group is currently owned by approximately eight million members and its operations include food, pharmacy, funeral care, banking and insurance among other sectors (Co-operative Group, 2014b). The Co-operative Group also has a political arm, the Co-operative Party, which has been traditionally allied with the Labour Party, which aims to give the co-operative movement a political voice (Boyle, 2013).

The Co-operative Group traces its beginnings back to the Rochdale Pioneer Society established in 1844 with a focus on ethical trading and member ownership. The Co-operative Bank was established in 1872 on an ethical, socially conscious foundation. This is reflected in the bank's stated purpose "…to be a pioneering business delivering sustainable financial services for members and society" and vision "We will become the Compelling Co-operative Alternative in the markets in which we compete." (Co-operative Bank, 2014b). The bank offers a range of financial products including current accounts, mortgages, savings accounts, credit cards and loans.

In 2009, the bank merged with the Britannia building society which increased its market share significantly. In 2013, the bank released a number of shocking reports. In April, the bank revealed that it had withdrawn from talks with Lloyds Banking Group to acquire over 600 bank branches, part of "Project Verde", which would have allowed the bank to triple in size (Treanor, 2013). Then in August, the Co-operative Group announced losses of £2.5 billion for the financial year (up to July 2013) which amounted to the worst results in the organisation's history (Co-operative Group, 2013). The losses resulted mainly from a capital shortfall of £1.5 billion in the bank. By the end of the year, the Group was forced to cede 70% of the bank's ownership to US hedge funds. This represented a terrible failure for the UK's only co-operative bank.

In the wake of the downfall of the bank, a number of investigations were launched to determine what led to this unexpected outcome. Co-operative banks had typically been seen as less risky as they have lower incentives to take on risks (Martin and Hesse, 2007; Fiordelisi and Mare, 2014). During the banking crises of the early 1990s, co-operative banks in Switzerland and France had performed better than their commercial counterparts (Fonteyne, 2007).

In the UK, the Co-operative Bank had seemly survived the 2007 financial crisis unscathed. In 2008, the bank reported that while it was a challenging year, they had emerged in good shape and avoided the "consequences of the market turmoil" and a "cautious and responsible approach to business development limited our exposure to the problems that have afflicted many in the sector."(Co-operative Bank, 2008: 9). During the crisis, a number of banks including the Royal Bank of Scotland, Halifax Bank of Scotland and Northern Rock had either been fully nationalised or received substantial government bailouts.

Around the same time as the release of the 2013 financial results, the Co-operative Group and the Bank, jointly commissioned an independent review into the events that led to the capital shortfall. This review was led by Sir Christopher Kelly. In January 2014, the Group announced another independent review; this one would examine the Group's governance and was to be led by the former City minister, Lord Myners who was also a newly appointed Senior Independent Director. Both reviews were completed in Spring 2014.

4.2. Isomorphism and banking operations (Question 1)

4.2.1. Introduction

At this time, the Kelly review remains the most comprehensive review of the bank's operations in the period leading up the capital shortfall. The factors that led to the bank's downfall have therefore been extracted from the Kelly Review (2014). Additional evidence obtained from the bank's annual reports and other literature has been included where relevant.

The Kelly review covered the period 2007 to 2013 and included extensive interviews with a wide range of internal and external stakeholders. These interviews were supplemented with secondary research into internal and external data, including Board papers, management papers, policy documents, adviser reports and communications with the Regulator (Kelly, 2014). It is noteworthy that the only board member who did not participate in the review was the bank's former chairman, Paul Flowers, so it was not possible for his viewpoint to be included in the review.

Kelly identified a number of failings at the management level and within the governance at the Bank level and the Group level. The factors most relevant to this research were the factors that affected operational decision-making.

4.2.2. Operational factors

Kelly (2014) reported that the underlying factors that led to the bank's capital shortfall included the economic environment, increasing regulatory capital requirements, the impairment of corporate loans (from the Britannia merger), IT replatforming costs, the "Project Verde" bid for branches of Lloyds Bank, Payment Protection Insurance (PPI) mis-selling and other internal factors such as poor management practices, poor risk management framework and ineffective governance (Kelly, 2014).

From this extensive list of factors, the economic environment, regulatory requirements, the Britannia merger, "Project Verde" and PPI mis-selling appear worthy of further investigation. These factors and their relevance to isomorphism are explored in detail below.

4.2.3. Isomorphism

As mentioned earlier, isomorphism refers to the process by which organisations become more homogeneous, and can be categorised as competitive or institutional (DiMaggio and Powell, 1983). Institutional isomorphism includes mimetic, coercive or normative forms.

Economic Environment

The period leading up to the capital shortfall was a period of extreme uncertainty, characterised by low interest rates, high unemployment and liquidity problems in the financial sector. This uncertainty affected all banks, resulted in reduced profitability and undoubtedly affected the Co-operative's decision-making. From a study of the 2007 to 2010 financial statements, it is apparent that the bank had strong concerns about the economic environment. For example, in its 2007 annual statement, the bank reported, "Wholesale sector operating contribution declined by £47.0m. Wholesale margins have been impacted by the increased pressure in the interest rate environment, further compounded by the effects of the credit crisis."(Co-operative Bank, 2007: 9).

A year later, the bank was more optimistic and indicated that "Whilst we are not immune from the economic slowdown, we have a robust business model, strong brand and a clear path for the future of our business, including our proposed merger with Britannia Building Society."(Co-operative Bank, 2008: 17). The 2008 annual statement also reported that "During a time of economic slowdown, which has seen many of our competitors experience difficulties, we have continued to deliver a strong financial performance and award-winning levels of customer satisfaction." (*Ibid.*). However, the annual statement mentioned one issue in particular that would contribute to its later collapse. In the regulatory risk section, the bank indicated that "The most immediate and significant regulatory issue facing our business at present is the Competition Commission investigation of payment protection insurance"(Co-operative Bank, 2008: 83).

Similar to other banks such as Lloyds Bank and Barclays, the Co-operative had continued to engage in the sale of Payment Protection Insurance (PPI) products during the crisis, up until 2009 when the FSA requested all financial institutions to withdraw from the single premium PPI market by May 2009 (Inman, 2009). These insurance products, sold alongside other banking products such as loans and mortgages were controversial yet highly profitable. Introduced in the 1990s, they were subsequently often mis-sold to customers who could never claim on their policies, such as pensioners and the self-employed (Wearden, 2011; Dunkley, 2012).

An ethical bank would be expected to refrain from unfair and controversial product development and marketing, despite the activities of other competitors in the marketplace. However, it is clear that this did not take place in practice, as Kelly (2014) relates,

> Like other banks, the Bank had seen PPI as a highly profitable product to supplement low margins on its other business. Again like other banks, it had made no provision in its accounts for the possibility of compensation payments to its customers prior to May 2011. By the first half of 2013, it had provided for expected mis-selling costs of £269 million – a disappointing outcome for an avowedly ethical bank. (2014: 9)

As at the end of 2013, the bank had made even larger provisions for conduct and legal risks including "Provisions for conduct and legal risks include potential customer redress related to mortgage products of £114m, breaches of the Consumer Credit Act of £110m, PPI of £103m, interest rate swap mis-selling of £33m and others of £52m"[6].

While the Co-operative was one of the first UK banks to launch an ethical policy, back in 1992, and it has been considered a way to differentiate itself from the competition[7], issues such as the breaches noted above, indicate that in practice, ethics was absent in some areas of the bank.

In practice, the Co-operative was apparently undergoing a form of mimetic isomorphism. It can be argued that the economic environment was the actual source of the mimetic isomorphism, and issues such as PPI mis-selling were symptoms of the isomorphism. In response to uncertain economic conditions, the bank had been basing its strategies and products on other seemingly successful banks in the marketplace, despite the clear conflict with its own ethical policies.

According to DiMaggio and Powell (1983) such behaviour occurs in instances when there is conflict over organisational goals and decision-makers therefore "find it easier to mimic other organisations than to make decisions on the basis of systematic analyses of goals since such analyses would prove painful or disruptive."(1983: 155). This interpretation could certainly be applied to the Co-operative.

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[6] The Co-operative Bank p.l.c. Financial Statements 2013, p.4.
[7] The Co-operative Bank p.l.c. *Financial Statements 2004*

Competition

According to Kelly, a major source of the bank's difficulties stemmed from the merger with the Britannia Building Society (Kelly, 2014). Up until the merger with Britannia in 2009, the Co-operative was a small bank with a high cost base which impacted on its competitiveness. Aside from the economic environment, competition is often a key source of isomorphic pressure which presents particular issues for co-operative organisations. As Davis (2001) explained with respect to overall governance:

> There is an additional, pragmatic, external environmental pressure requiring us to consider organisational culture in the context of co-operative governance. That is the growing dynamism and competitive pressure exhibited in the market economy which increasingly all co-operative enterprises are embroiled within as the process of liberalisation of trade and deregulation continue. The market itself is having a big impact on how we must reconsider what good governance means in practice for co-operatives today. (2001: 2)

Because of their ownership model, co-operative banks are constrained in their ability to raise capital and expand, as they are unable to raise capital by issuing shares. Similar constraints apply to other financial mutuals such as building societies. The Building Society Act 1986 allowed building societies to compete with commercial banks and also introduced the concept of "demutualisation"[8](Cook et al., 2001). As a result, a wave of demutualisations occurred in the 1990s as building societies attempted to compete on the same footing. Quite often, this resulted in the failure of many building societies including Northern Rock, Bradford & Bingley, and Halifax Bank of Scotland (HBOS) which were either nationalised or acquired by other banks.

The merger with Britannia was intended to increase the Co-operative's competitive position as Kelly (2014) explains:

> At the time, the Co-operative Bank was a small, full-service bank with a high cost/income ratio, which led to modest profits. The Bank had long been concerned about its lack of scale and high cost base. The merger allowed it to increase its branch footprint at nil cost. It was also forecast to yield integration savings of £88m a year – a material amount when the Bank's annual profits in the three years pre-merger had averaged only £67m. (2014: 5)

However, in the quest to look like the larger competitors, the bank failed to do enough due diligence to understand the complex risks that would become part of the larger

[8] Demutualisation refers to the conversion of a building society into an investor-owned commercial company.

organisation. The bank now carried much higher risk related to the underperforming commercial real estate loans and the new senior management team of the combined entities apparently lacked enough experience to handle these risks (Kelly, 2014). It is worth noting that there was apparently no regulatory or political pressure to undertake the merger, it was an internal decision that seemingly stemmed from the desire to compete at the same level as other banks in the market, which is a type of competitive isomorphism.

Beckert (2010) explains that these types of competitive pressures frequently occur “under conditions of undifferentiated competition focusing primarily on costs”(2010: 162). As a small bank the Co-operative had a strong focus on cost reduction. In 2007, the bank reported that it planned to reduce its annual operational costs by £100m by the end of June 2008 (Co-operative Bank, 2007: 6). This was to be achieved through a variety of ways including increasing efficiency, business simplification and staff reduction. Against this background, it is clear that the merger would have been expected to reduce costs as well. Unfortunately, the merger did not have the expected result of increasing efficiency and profitability, but instead contributed to the bank’s downfall.

Regulatory and political pressures

In addition to competitive pressures, the bank was also subject to regulatory and political pressures. Kelly discussed the regulatory pressures in his review, but is silent on the issue of political pressure. The relevant regulatory authority during the time leading up the downfall was the Financial Services Authority (FSA) which has subsequently been replaced by the Financial Conduct Authority and the Bank of England’s Prudential Regulatory Authority. In response to the financial crisis the FSA increased the capital requirements on all banks. The banks were required to increase the quantity and improve the quality of the capital they were holding. The Co-operative Bank’s capital requirement was increased dramatically from £1.9bn in 2009 to £3.4bn in 2013 (Kelly, 2014: 5). According to Kelly, it was the combination between this increased requirement and the banks strained capital position as a result of the impairments in its commercial real estate loans, the failed IT implementation project and provisions for the PPI mis-selling that ultimately resulted in the bank’s collapse (Kelly, 2014).

In addition to the regulatory pressures which applied to all UK banks, the co-operative was also seemingly exposed to political pressure to purchase branches of Lloyds Banking

Group, also called “Project Verde”. It has been reported that Treasury officials and other ministers may have put pressure on the bank to go through with the purchase (Bennett, 2014; Wilson, 2014). These claims had been put forward by the former chairman of the bank as well as the former chairman of a bank that had entered a rival bid. The claims have subsequently been denied by the Chancellor George Osborne (Jeff, 2014) but seem plausible. According to media reports, the Treasury had worked hard behind the scenes to pave the way for the transaction to take place and the Chancellor had “heralded the Co-op deal as helping to create ‘upstart challengers offering new and better services that shake up the established players’”(Treanor, 2013). At this point, it is unclear how much political pressure actually took place behind the scenes.

However, if the bank had successfully acquired “Project Verde”, i.e. over 600 branches of Lloyds Bank, it would have tripled in size and would have been structurally even more similar to a commercial bank. Whereas the previous merger with Britannia occurred between two financial mutuals, this acquisition would have taken the bank even further from its co-operative roots. It can therefore be argued that regulatory and political pressures would have resulted in coercive isomorphism.

DiMaggio and Powell explain that coercive isomorphic pressures result from powerful external actors who exert formal or informal pressures on organisation to homogenise (DiMaggio and Powell, 1983). Dansen (2013) described the banking industry as “being under high pressures of politics, regulators, rating agencies and other actors directly outside their organizational field. The financial crisis has increased the power of these external actors.”(2013: 25). Though some aspects remain disputed it is clear that the bank was under coercive pressure which contributed to its downfall.

4.2.4. Conclusion

The following factors therefore appear to be isomorphic; specifically the low interest rate environment, the new regulatory capital requirement, political pressure, and the bank’s high cost/income ratio. An examination of these factors suggests that coercive, mimetic and competitive isomorphic pressures were occurring. These factors led to various structural, strategic or policy related outcomes, all of which were ultimately negative.

Table 1 summarizes the key findings of this section. It demonstrates the grouping of relevant factors according to type of isomorphism and illustrates the responses to these isomorphic pressures.

Table 1: Isomorphism in the Co-operative Bank's operations

	Coercive	*Mimetic*	*Competitive*
Source	Regulators and UK government	Uncertain environment	Other banks
Pressure	Capital requirement Political pressure	Low interest rate environment (reduced profitability)	Small full service bank with high-cost/income ratio
Response	Project Verde bid	PPI-mis-selling	Merger with Britannia
Outcome	Capital deficit	Fines, strain on capital	Losses, high debt and impaired assets
Response type	Structural	Strategic, policy	Structural

Data derived from the Kelly (2014) review and the Co-operative's annual statements

While some of these pressures affected numerous banks, the political pressure in particular was unique to the Co-operative Bank. The failure of the bank to deal effectively with these pressures potentially played a role in its downfall. It is worth noting while these isomorphic pressures were all important, none of them in isolation can explain the downfall. It is only through the critical hermeneutic approach, that the whole picture can be obtained. It is of utmost importance to understand not only the roles of specific actors but also the social structures in place that led to the downfall of the bank.

4.3. Corporate Governance Reform and Isomorphism (Question 2)

4.3.1. Introduction

In December 2013, Lord Paul Myners was appointed to the Board of the Co-operative Group as an Independent Director. At that time he became the first non-elected member of the Board. He was also commissioned to conduct an independent review into corporate governance failures within the Group and set forward proposals for corporate governance reform (Myners, 2014b). The review was formally announced in January 2014. Myners had previously conducted research into the governance of life mutuals on behalf of the Treasury (Myners, 2004) and was respected in the financial industry (Quinn, 2013).

It was felt that governance failures at the Group level and within the bank had contributed significantly to the bank's problems (Kelly, 2014; Myners, 2014b). It was therefore of utmost importance that governance issues were investigated thoroughly and clear recommendations put forward, to allow the Group to move forward from the crisis.

An interim version of the Myners report was released in March 2014 and its preliminary recommendations were met with fierce criticism (Ahmed, 2014; Myners, 2014a). Despite the criticisms, the final version of the report maintained a similar stance to the interim report and also proved to be highly controversial. Criticisms originated from a variety of sources including the trade association Co-operatives UK and the Co-operatives Group’s largest independent societies. The general feeling was that the reforms would result in the organisation looking more like a publicly listed company (Ahmed, 2014).

Amid growing opposition to his planned reform, Myners resigned from the Board. His resignation took place a month after the resignation of the Group’s new chairman Euan Sutherland, who was widely quoted as saying the organisation was “ungovernable” (Treanor and Farrell, 2014).

After a series of ever more acrimonious public debates and boardroom upheaval, the Group’s membership voted to reform the Group’s governance subject to finalisation of the reform proposals. The Group eventually revised Myners recommendations, removing the more contentious elements, and these changes were accepted by its members in a special General Meeting in August 2014. Despite the adoption of the reforms, there is still ongoing debate, as opponents claim that the reform does not go far enough (Titcomb, 2014) while others claim that the reforms suffer from “weak democratic legitimacy” (Barber et al., 2014).

4.3.2. Governance Reforms and Isomorphism

It is not unusual for reforms to be met with opposition, but in the case of the Co-operative, the level of disagreement and confusion was astonishing. The key objection was that the reform would take the organisation away from its democratic structure. This section will therefore examine the Myners reform proposal in detail for instances of isomorphism using a critical hermeneutic approach.

At the time of the review, the Group's governance structure included a complex interaction between the members, independent co-operative societies, Area Committees, regional Boards and the Group Board (How is the Co-operative Group run?, 2014). There were also separate boards for the food business, the bank and other specialist businesses. Myners' reforms were concentrated at the Group level rather than at the bank level, but naturally these recommendations would also impact the governance of the bank, even though by that time the bank was no longer a wholly owned subsidiary of the Group. The Group's governance structure at the time of the review is shown in Figure 1 below.

Figure 1: The Co-operative Group's Governance structure in 2013

Source: The Co-operative Group as cited in (How is the Co-operative Group run?, 2014)

Myners (2014b) felt radical change was needed and as such his recommendations revolved around three key proposals. Firstly, "the need to put in place a Group Board that possesses the skills and experience, as well as the commitment to co-operative values that will enable it to match in quality the boards of its primary competitors." Secondly, "the creation of a new National Membership Council, to provide a powerful representative forum of elected members for holding the Group Board and Executive to account, and for acting as the guardian of co-operative values." Thirdly, "… the extension of full membership rights to all Individual Members, consistent with the fundamental co-operative principle of 'one member, one vote' and substantially increasing the scope for genuine participatory democracy."(2014b: 8).

Myners also recommended further changes including the creation of a Nominations Committee to screen and propose candidates for board approval and for election by members. Myners proposed that this committee would consist of five non-executive members, including up to two representatives designated by the Nominations Committee and the balance would come from the Group Board. However, his most controversial proposal was related to the actual composition of the Group Board:

> The Review's first proposal is the creation of a new Group Board made up of an independent chair with no previous association or involvement with the Group, six to seven independent non-executive directors and two executive directors. The non-executive directors [NEDs] will have the skills and experience of NEDs sitting on the boards of The Co-operative Group's primary competitors. (2014b: 18)

This proposal received the sharpest criticism which centred on the lack of democratic representation. It was felt that the board should include lay members that would champion the principles of the co-operative movement and exercise member control (Treanor, 2014). At the time of the review, the Group Board had majority lay director control, including fifteen lay directors elected by individual Regions and five corporate member directors who had been elected from independent co-operative societies (Myners, 2014b).

Due to the attention surrounding the release of his interim findings, Myners addressed these objections directly in his final report. Myners argued that the focus should be on the commercial qualifications and expertise of the directors; that it was unnecessary and detrimental to have lay directors on the board, and the commitment to co-operative principles could be preserved by specifying that the non-executive directors be members of the Co-operative. In addition, these directors would have to demonstrate "strong commitment to co-operative values and principles" (Myners, 2014b: 19). However, Myners did not indicate how this would be demonstrated in practice and it is expected that it would be subject to interpretation.

Interpretation of the language of the Myners review is quite revealing and is a key aspect of hermeneutics (Mills et al., 2010; Myers, 1994). In contrast to his previous report on the governance of life mutuals (Myners, 2004), the language used is much more emotive. This narrative clearly included language that was intended to demonstrate commitment to the co-operative cause. For example phrases such as “commitment to co-operative values”, “guardian of co-operative values” and “genuine participatory democracy” all serve to emphasise a favourable view of the co-operative movement.

In fact, the report begins with an explicit mention of Myners’ viewpoint: “I am a strong believer in co-operative ownership, the benefits it can deliver to individuals, the broader community activities it can support and the social goals for which it stands. I fully recognise the enormous strengths of the co-operative movement around the world.”(Myners, 2014b: 7).

It is also apparent that Myners felt the need to justify his position as he later indicates in the report, “I want to assure all members that the reforms I have set out are fully compatible with the core values and principles of co-operative ownership. I have no interest in advocating the adoption of a plc model, as some of my critics have claimed. But I do want to see a governance structure that works; the present one has lamentably failed.” (Myners, 2014b: 8). This suggests that concerns had been raised about isomorphism in the governance recommendations in the interim report.

There has been much debate in corporate governance research about the effectiveness of boards of directors. While the Anglo-Saxon model of governance defines best practice around particular factors such as board size, independence and composition (John and Senbet, 1998), there remains disagreement around the optimal setup of boards (Andres and Vallelado, 2008; Desender, 2009; Pathan and Faff, 2013). For example, Andres and Vallelado (2008) found that small boards were not necessarily more efficient. Their research suggested that increasing board size up to a limit of about nineteen directors increased board performance. At the time of the crisis the Co-operative Group’s board consisted of twenty members (the addition of Myners increased it to twenty-one). Myners proposals would bring the board down to eleven members.

On the other hand, research conducted by Pathan and Faff (2013) indicated that increasing board size negatively impacted financial performance, but surprisingly there was a negative relationship between board independence and performance. This implies that the situation is not clear cut, and the imposition of traditional Anglo-Saxon model of governance is not always appropriate.

A similar point has been argued by Desender (2009) who stated that “debates have emerged over the appropriateness of implementing corporate governance recommendations mainly based on an Anglo-Saxon context” (2009: 1) and that “much of the policy prescriptions enshrined in codes of good corporate governance rely on universal notions of best practice, which often need to be adapted to the local contexts of firms or translated across diverse national institutional settings” (2009: 18).

Another argument against the perceived superiority of a commercial type structure of governance is based on the failure of other institutions that use that model. As cited in Clarke (2004), “Indeed Finkelstein and Mooney (2003) show that at Enron, WorldCom, Global Crossing, Qwest and Tyco most of the boxes had been ticked in terms of the majority board representation of outsiders, appropriate board size, splitting the roles of Chairman and CEO and ensuring directors had a financial stake in the shares of the company” (2004: 20). These US companies all experienced catastrophic failures. A similar argument could probably be extended to large UK commercial banks such as Barclays, Royal Bank of Scotland and Lloyds Banking Group which have all experienced corporate scandals. Myners addresses this argument in the report by stating, “No governance structure can guarantee success but there is a convincing body of evidence that a structure along the lines I have proposed significantly reduces the risk of extreme failure” (2014: 171).

Ultimately, the Myners proposals were later re-worked and the details unveiled and accepted in a special meeting on 30 August 2014. The new proposals were a compromise and rejected Myners proposal to remove all democratically elected members from the board. Instead the Group board would now include three member nominated directors. The press release for the Group’s interim 2014 results (Co-operative Group, 2014a) described the new governance structure below:

- A smaller, more effective Group Board of 11 people, composed of a majority of Independent Directors including an Independent Non-Executive Chair, five Independent Non-Executive Directors, two Executive Directors (including the Group Chief Executive) and three Member Nominated Directors;

- Testing eligibility criteria for all Directors (independent and elected) including business acumen and a commitment to Co-operative Values and Principles;
- A Council to represent members and as a guardian of the Group's purpose, values and principles with the power to hold the Group Board to account and encourage member participation and their contribution to Society policy development;
- Robust demutualisation protections. (2014a)

In light of the proposals, the criticisms levelled against Myners and the final adoption of a modified form of the proposals, it would appear that isomorphism did play a part in the reform proposals.

In this case, it can be argued that normative isomorphism might have played a role. Normative isomorphism, as mentioned earlier, stems from professional training and socialization that influence the adoption of similar organisational practices (DiMaggio and Powell, 1983). Myners was a former City minister and served as director, trustee and chairman of numerous commercial organisations including the Bank of New York, Coutts, Lloyd's Market Board, NatWest, O2, Orange and Marks and Spencer (Sawer, 2009). Controversially, he was also the director of a hedge fund which profited from the collapse of Bradford & Bingley, through short-selling shares in the bank (Rayner, 2008; Sawer, 2009). It is expected that his commercial background influenced his proposed governance reforms towards commercial norms.

Despite his proclaimed commitment to the co-operative movement, Myners also used language that could indicate his true regard for members of the co-operative. For example, when describing why previous governance reforms failed, Myners stated that "…these [reforms] encountered considerable resistance within the Group, since for a number of activist members this went against what they saw as a fundamental co-operative belief that anyone had the potential to be a board member and that director positions should be the outcome of democratic elections, regardless of relevant skills or expertise."(Myners, 2014b: 46). He uses the term "activist members" somewhat disparagingly for Co-operative members with differing viewpoints, repeatedly in the text. Later in that section, Myners places blame on "activist members" for ongoing governance weaknesses, stating "the need to overcome the serious problem of having the Group's governance controlled by a very small group of long-standing activist members who alone comprised the dangerously limited pool of candidates from which Group Board members had to be elected."(Myners, 2014b: 46)

However, Myners was not the only member of the team that produced the report. The other members include a Chair of the Governance Centre at London Business School, a governance adviser affiliated to London School of Economics and Northwestern University, an experienced Board adviser, a senior civil servant on loan to the Co-operative Group from The Cabinet Office as well as a legal advisor from a well-established law firm (Myners, 2014b). It is expected that their backgrounds were also professional and they would also be subject to similar socialization. DiMaggio and Powell (1983) suggested that "the greater the extent of professionalization in a field, the greater the amount of institutional isomorphic change" (1983: 156). While DiMaggio and Powell were referring to professionals within the organisation of study it is expected that their findings would apply to external professionals as well.

Myners indicated that the review was based not only on interviews with key stakeholders in the Co-operative and the comprehensive study of internal documents but also included the following: "Researching mutual forms of ownership in several sectors to understand better why certain ones have succeeded while others have failed. The Review team has also looked into the governance arrangements at other leading co-operative and mutual organisations in the UK and abroad" (Myners, 2014b: 12). This would seemingly indicate that co-operative governance arrangements were also considered, which leads to some optimism that the reforms were not intended to push towards commercial structures. However, there is no mention of which, if any, of the practices from other co-operatives were included in the final recommendations and generally Myners findings from his review of other mutuals were framed in a negative light.

Even more worrying, perhaps, is the following line from the report which indicates that the review team was also engaged in "Researching the skills and experience of non-executive directors at the boards of the Group's primary competitors" (Myners, 2014b: 12). Since, the Group's primary competitors would not belong to the co-operative movement, it is expected that commercial norms also played a part in influencing the final recommendations. It is unknown how much weight was placed on the examples from the competitors.

Critics from the co-operative movement picked up on this point and identified it as a weakness in the review. In particular one group of critics stated that "There are some weaknesses in the way that the Myners Review, while excellent in many respects, was conducted, as we consider that it overlooked the evidence of governance models in large co-operatives worldwide that was available to it and it was unfortunate in drawing on a theoretical model in which participative governance is assumed to incur costs but not generate any benefits."(Barber et al., 2014: 8).

In fact, Myners' reform proposals seem to tie in well with the Anglo-Saxon form of corporate governance particularly with respect to the role of the board and the structure and composition of the board. As mentioned earlier, there has been considerable debate surrounding the convergence to the Anglo-Saxon model globally. However, there has been limited research into the convergence to the Anglo-Saxon model within industries. The reforms in this case would appear to be an attempt to shift the current co-operative model towards the Anglo-Saxon model.

While the reforms have not been framed in this manner, instead the text indicates that they have been framed as a manner to increase effective governance. For example, Myners states "The present allocation of governance powers to the Regional Boards is severely dysfunctional. It has become a huge impediment to effective governance, whatever its historical usefulness in facilitating mergers with other societies, and, as a separate matter, provides a degree of predator protection against demutualisation." (Myners, 2014b: 49). There is seemingly little regard to the appropriateness of the Anglo-Saxon model for co-operative organisations. Myners uses classical governance terminology such as "the agency problem" and "the private benefits of control" (2014b: 46) in his analysis but does not indicate anywhere the debates around potential weaknesses of the Anglo- Saxon model.

Furthermore, it is difficult to reconcile Myners stated commitment to co-operative values and certain aspects of the review. For example, when referring to the other co-operative movements, Myners states "***International comparisons show that large retail co-operative movements have no automatic right to survive.*** *This is the Review's third finding and it shows that there is no case for complacency. The potential competitive advantage of the co-operative ownership model only works if it is highly attuned to the particular market contexts in which it is operating, and if it is then combined with a* *competitively superior business model*"(Myners, 2014b: 50). In Appendix 3, Myners then provides more detail on what is meant by "competitively superior business model". A discussion of Appendix 3 is outside the scope of this review, but it relies extensively on traditional economic thinking which apparently does not place high value on co-operative business models (Kalmi, 2007). It is therefore debatable if Myners objectively considered the merits of the co-operative model.

4.3.3. Conclusion

In the quest to improve the governance of the Co-operative, reforms that corresponded to a particular norm were selected. In this case, it seems that there were isomorphic pressures within the corporate governance reforms that would lead to the governance of the bank looking more like a commercial bank. These isomorphic pressures appeared to be normative in type.

While this type of reform may improve the governance of the organisation, there is the risk that the focus on the social and ethical goals of the organisation would be disregarded. This is surely contrary to the main goal of good governance, which according to Davis (2001) is "the preservation of the integrity of the organisation to fulfil the purpose for which it was founded."(2001: 3). In the case of the Co-operative Group its co-operative identity would need to be preserved.

There is already unease that the Co-operative has been moving away from its ethical goals. For example, it has been reported that the Group has significantly cut funding to ethical causes (Boffey, 2013).

5. CONCLUSION

The focus of this research was to explore the existence of isomorphism in corporate governance reform using the case of the Co-operative Bank. To better understand the full context, the research also examined whether the pressure to adopt a similar form and practices of other commercial banks played a part in the bank's downfall.

In light of the research findings it is apparent that there were isomorphic pressures in the bank's operations. While there were numerous factors leading to the downfall of the bank, these isomorphic pressures played a key role. This was ignored by the majority of the investigative reviews conducted. Similarly, isomorphic pressures also exist in the corporate governance reform proposals put forward by the Myners review. Although, the primary purpose of the reform was to improve the governance of the Co-operative, it became apparent that the recommendations would move the organisation further away from its co-operative roots.

Ultimately, the Co-operative agreed to reform but did not accept the more contentious parts of the corporate governance proposals. This can be considered to be an effective response to the isomorphic pressures in the reform. It is important to acknowledge that other co-operative organisations undoubtedly struggle with similar pressures.

With any recommendations for improvement, particularly in corporate governance, care needs to be taken to include the needs of all stakeholders and stay true to the organisation's roots. This is of particular importance to the Co-operative in light of the number of other investigations still in progress. According to the bank (Co-operative Bank, 2014a), the current investigations include:

- The Treasury Select Committee has been conducting an ongoing review which began in the second quarter of 2013 and has focused on numerous concerns surrounding the Bank. The Committee will publish a report of its findings, the timing of which is not known;
- The Treasury announced on 22 November 2013 that it would conduct an independent investigation into events at the Bank and the circumstances surrounding them from 2008, including the Verde transaction and Britannia acquisition. The investigation will include a review of the conduct of regulators and Government, but is not anticipated to commence until it is clear that it will not prejudice the outcome of the FCA and PRA enforcement investigations;

- The FCA[9] announced on 6 January 2014 that it will be undertaking enforcement investigations into events at the Bank. The investigation will look at the decisions and events up to June 2013; and
- The PRA[10] announced on 6 January 2014 that it is undertaking an enforcement investigation in relation to the Bank and as part of that investigation will consider the role of former senior managers. (2014: 15)

While it is debatable whether the bank can continue to be considered a co-operative, despite the challenges and negative publicity over the last year, the bank has managed to maintain the majority of its customer base[11], which provides some optimism for the future of co-operative banking in the UK.

This research does not make a judgement on whether the isomorphic elements are justified; instead the purpose of the study is to raise awareness of the existence of these elements. It is hoped that this awareness will assist practitioners in understanding how to develop corporate governance reforms while considering the impact of isomorphic pressures that may obscure the purpose of individual organisations.

5.1.1. Limitations

It is recognised that there may be limitations in this research. Similar to other case studies, the findings rely on just a single case. In addition, the findings could possibly be strengthened in the future by including primary research to test these findings.

5.1.2. Further Research

Within the financial sector, research on isomorphic pressures can be extended to other co-operative banks outside of the UK as well as other mutuals such as building societies, mutual insurers and credit unions. Further research into isomorphism in corporate governance in the non-profit sector would also be of benefit.

[9] Financial Conduct Authority
[10] Prudential Regulatory Authority, Bank of England
[11] The Co-operative Bank plc, *Interim Financial Report 2014*

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