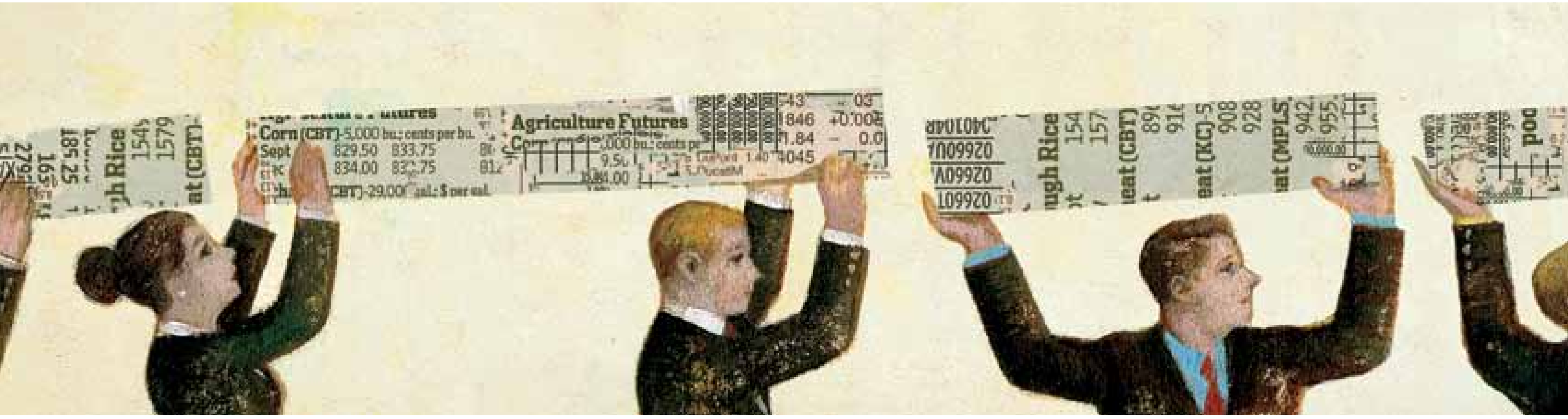


How cooperatives grow

Contrary to popular belief, cooperatives and mutuals grow at similar rates as publicly traded companies. But the way they grow and their key opportunities are different.

Vincent Bérubé, Andrew Grant, and Tarek Mansour

Historically, commercial cooperatives and mutuals have been formed to serve individuals whose needs have not been met by the free-enterprise system. Whereas the primary purpose of a public company is to maximize profits for the benefit of its shareholders, a coop's[1] priority is to provide goods and services to its members over the long term and at the lowest cost possible. This is not to say that all coops behave the same way, but they do tend to have a more long-term, community-oriented focus that often results in less risk taking and a more measured approach to growth.

As a result, coops are often perceived as slower-growing organizations than their publicly owned counterparts. The data tell a different story. Our research shows that coops' growth rates are similar to those of publicly traded companies. However, the way coops grow is different. Using McKinsey's granular-growth-decomposition database (see "Our methodology," page 9), we analyzed how 47 coops grew and compared those results with results for 54 publicly listed companies in the same industries and geographies. Our research covered the four industries where cooperatives have a substantial presence—insurance, banking, retail, and agriculture—spanning Asia, Europe, North America, and emerging markets.

[1] For simplicity's sake, we use "coops" to refer to both cooperatives and mutuals.

Our analysis identifies how much of a company's growth can be attributed to the three main drivers. The first two drivers account for an organization's organic growth. These are gains in *market share* and growth through what we call *portfolio momentum*. Portfolio momentum is the revenue growth that a company experiences through the underlying market growth of the business segments in its portfolio (entering new, high-growth market segments can increase a portfolio's momentum).[2] The third driver is inorganic growth through *mergers and acquisitions*. After assessing the data, we made site visits and conducted additional interviews to document case examples of successful growth strategies by coops. In this article, we outline our findings with respect to each driver and then discuss ideas about where coops might want to focus their growth efforts.

[2] For more information, see Mehrdad Baghai, Sven Smit, and Patrick Viguerie, "The granularity of growth," mckinseyquarterly.com, May 2007.

Coop growth patterns

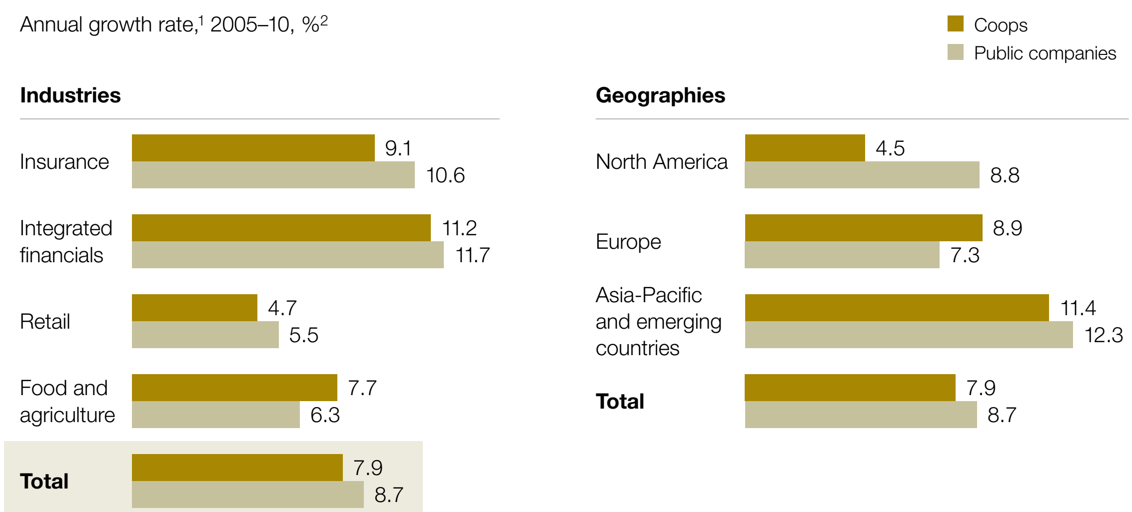
Our research produced some surprising results. From 2005 to 2010, coops grew at nearly the same rate as their publicly held counterparts, with some variation by industry and geography (Exhibit 1).

Although overall growth rates are similar in the aggregate, the composition of that growth is different between these two types of organizations. As Exhibit 2 shows, coops outperformed publicly listed companies on market-share gains, underperformed on portfolio momentum, and were roughly on par in M&A (although their M&A performance was mostly driven by large mergers rather than by acquisitions).

It is not surprising that coops enjoy greater market-share gains. Coops traditionally focus on the

Exhibit 1

Coops have growth rates comparable to public companies.



[1] Analysis based on 47 cooperatives and 54 publicly listed companies.
[2] Considering sample size and availability of data, growth numbers are within 1% confidence interval 75% of the time.

Source: Annual reports; McKinsey analysis

Exhibit 2

Overall, coops are better than publicly listed companies at growing market share.

Annualized growth, 2005–10, %[1]

	Public companies	Cooperatives	Spread
Market-share gain	1.1	2.2	1.1
Portfolio momentum	5.0	3.3	–1.7
Mergers and acquisitions	2.6	2.4	–0.2

[1] Considering sample size and availability of data, growth numbers are within 0.7% confidence interval 75% of the time.
Source: Annual reports; McKinsey analysis

needs of their members, have better proximity to and knowledge of their markets, and generally adhere to a strong set of social values that benefit their members. When we looked at performance by sector, we saw that these advantages were strongest in insurance and diversified financials, where the majority of the coops' customers are also their owners. Retail coops were on par with public companies with respect to market-share gains, and agricultural coops actually fared worse than their public competitors.

Weaker performance on portfolio momentum is a concern for coops. For the companies in our database, portfolio momentum is the most important of the three growth drivers we measure (accounting for over 55 percent of total growth), which should be unsurprising since the ability of a company to grow is primarily related to the health of the sectors and regions in which it operates. In addition, portfolio-momentum growth is strongly driven by an institution's capacity to position its activities against sectors, regions, or segments that are growing fast (for example, by expanding into fast-growing emerging markets or focusing activities on rapidly expanding online channels). Coops underperformed their publicly held counterparts on this measure regardless of industry. We believe there are two reasons for this. First, coops focus more on their members' current needs than on developing innovative new products or actively searching for new markets to serve. Second, because coops tend to have a governance structure that favors consensus over executive decision making, it is more difficult for them to redeploy capital as quickly as public companies can—especially to new market segments where there may not be immediate benefits to the coop's current membership base.

As noted earlier, cooperatives have grown inorganically at roughly the same rate as public companies, and have done better on this measure in sectors where mergers, acquisitions, and alliances brought clear value to their member bases. This has been the case in agriculture, for example, where M&A has helped players develop global distribution channels for their members. The primary laggard on this measure was the insurance industry, where regulations and the lack of access to capital limit inorganic growth. Cooperatives that have successfully grown through M&A have sought out targets that create strong synergies with members' needs, carefully assessed the cultural fit and future governance scenarios, and, in many cases, developed innovative alliances to take advantage of scale without sacrificing autonomy. Such alliances have been formed to pool risk to reduce reinsurance costs for small mutuals, set up rotation programs among coops with different regional footprints to offer high-performing employees international development opportunities, combine procurement efforts to increase purchasing power, and work together to develop and manufacture products when the coops operate in different markets.

Growth opportunities for coops

Based on our analysis, we see two primary growth opportunities for cooperatives. First, coops should play to their natural strengths and continue to pursue market-share gains by delivering a unique member and customer experience. The other big growth opportunity for coops, and probably the one with the most potential, is to more actively pursue opportunities in fast-growing adjacent markets (products, customers, or geographies). As noted earlier, most coops lagged behind their public-company competition on this measure.

Deliver a unique member and customer experience

The coop ownership model—in which customers are also owners—provides a true competitive advantage for growing market share. The cooperatives that stood out from their peers on this type of growth typically displayed three characteristics. First, they placed the interests of their members ahead of the organization's short-term financial interests. Second, they leveraged their proximity to their members to serve them better. Finally, they broke down organizational silos to maximize benefits for their members.

Members first. In exchange for placing the interests of customers ahead of short-term financial gains, a coop can win member loyalty and grow its membership base. Take the example of NTUC Income, a coop insurer in Singapore. In 2006, NTUC's market share had dropped from 16 to 14 percent. It was ranked fourth in Singapore in gross written premiums. To improve its position, in 2007, NTUC decided to focus on being recognized as "the honest insurer." In other words, the coop decided that it was in the business of paying members' claims based on what common sense and goodwill would dictate. NTUC instructed its agents that their job was to find reasons to pay the member.

The organization transformed its customer-service and core processes, simplified its insurance contracts, installed new quick and fair settlement mechanisms, and increased transparency by taking more time to educate its customers about its products and claims decisions. It also stopped paying its agents commissions and instead motivated them to offer the best service and tailored products to members.

To increase customer satisfaction, NTUC also sought to improve its responsiveness. The insurer deployed a special "accident response team," a group of claims agents who patrol Singapore on scooters so they can quickly get to the site whenever a member has an accident. All these strategies required an up-front investment or a reduced focus on short-term profitability, but in the long run, NTUC clearly benefited from the increased loyalty and trust of its members. The insurer's market share grew to 22 percent and its total income has grown annually by more than 17 percent since 2007. By 2010, NTUC ranked first in gross written premiums; it is now Singapore's third-largest insurer.

The proximity advantage. A core advantage of cooperatives is their proximity to their members and customers. By this we do not necessarily mean physical proximity, but rather—and more important—a closer relationship with customers and a deeper understanding of their expectations and needs. This operating model allows coops to tailor products, services, and operations accordingly, leading to a real competitive advantage. For example, BPCE was formed through the 2009 merger of two French financial cooperatives. This created the largest network of branches in Europe. After the merger, the organization established decision-making and performance-management mechanisms that fostered local leadership while leveraging the strength of the group. In the coop's hiring processes, regional entities have the power to hire key executives but must do so from a pool of candidates that the central organization has qualified. As a result, the leader's qualities fit with the local members' and customers' needs, while group standards for the skill profile of the coop's leaders are maintained.

Breaking down organizational silos. When they offer multiple products or services, cooperatives can serve more of their members' needs, increase members' benefits, and grow as a result. But this requires breaking down organizational silos to enable greater cross-servicing opportunities. The Co-operative Group, the largest coop in the United Kingdom, has a strong presence in food retail, banking, insurance, funeral care, pharmacy, travel, and other services. The organization launched a groupwide loyalty and branding effort to make customers more aware of all the different products and services it offers. The Co-operative Group converted its membership card to a "loyalty card" so that members would get additional benefits from doing more business with it. This strategy boosted membership from 800,000 in 2005 to nearly 7,000,000 in 2012. It also allowed the coop to drive member loyalty, deliver maximum value to its members across all product types, and generate a good deal of organic growth.

Organize to grow in attractive adjacent markets

Portfolio momentum is typically one of the strongest growth drivers for public companies, but it's the weakest for cooperatives—regardless of the industry in which they operate. The search for new products and new markets appears to be secondary to serving existing members.

A core advantage of cooperatives is their proximity to customers—they have a closer relationship with customers and a deeper understanding of their expectations and needs.

Our methodology

In 2007, McKinsey published a book on growth strategy, *The Granularity of Growth*.[1] In their research for the book, the authors found that companies that fail to grow are likely to underperform and are less likely to survive in the long term. They argued that to drive and sustain growth, large companies should look beyond industry averages—which can obscure and hide pockets of growth—and be more granular when analyzing markets in which they might want to compete. The book advocates the creation of organizational mechanisms that would allow companies to find these granular opportunities while retaining the benefits of scale.

The first step in determining where granular-growth opportunities lie is to analyze a company's historical sources and possible future drivers of growth. This granular-growth-decomposition analysis divides a company's growth into three parts: market-share gains, portfolio momentum, and mergers and acquisitions. The analysis is particularly useful in large multibusiness companies, which may not recognize their true sources of growth or find it difficult to make meaningful comparisons to their competitors. McKinsey has conducted this analysis for 776 major global companies and maintains a granular-growth-decomposition database that allows companies to benchmark their growth-performance record.

[1] For more information, see Mehrdad Baghai, Sven Smit, and Patrick Viguerie, *The Granularity of Growth*, first published in 2007 by Cyan Books (republished in 2008 by Wiley). For more insight based on the ongoing research using the granular-growth-decomposition database, see Sumit Dora, Sven Smit, and Patrick Viguerie, "Drawing a new road map for growth," mckinseyquarterly.com, April 2011, and Yuval Atsmon, Michael Kloss, and Sven Smit, "Parsing the growth advantage of emerging-market companies," mckinseyquarterly.com, May 2012.

Improving on this growth driver is the largest challenge cooperatives face, and it's also their most significant opportunity. Some cooperatives have done better than the rest using one or more of three practices: systematically exploring members' unmet needs, leveraging distinctive capabilities to expand in new markets or geographies, and designing formal mechanisms to help finance new opportunities.

Understand unmet needs. To effectively explore adjacent markets, coops must systematically research the unmet needs of their present customer base. We have found that many coops lack the marketing expertise to do this effectively, often as a result of their highly decentralized structure. But E.Leclerc, a merchant cooperative and one of the leading food companies in France, provides a good example of a coop that has done this type of research by leveraging the entrepreneurial nature of its store owners. E.Leclerc's store owners are encouraged to seek out opportunities to make certain markets more accessible (for example, by reducing prices or improving distribution) and thus create value for customers. When an opportunity explored by one of these store owners succeeds in providing value to members, it is rapidly scaled up throughout the group.

Following this model, the company entered the gasoline-distribution market during the global oil crisis in the mid-1970s. Taking advantage of its scale, E.Leclerc focused on serving customers and combating high gas prices instead of exploiting short-term profit opportunities. In the 1980s, E.Leclerc entered jewelry retailing to make this product category more affordable for its mostly middle-class customers (under the slogan "Gold for everyone"). Again, this was made possible by the coop's ability to operate at lower margins than many competitors. Today, E.Leclerc is the largest jewelry retailer in France.

Leverage distinctive capabilities. Some cooperatives have been able to expand into new geographies or markets based on unique expertise. For example, Netherlands-based Rabobank is a federation of 141 financial cooperatives with roots in the Dutch agricultural sector. After a failed attempt to compete in traditional investment banking during the 1990s, the bank decided to focus on becoming a global financial leader for the agricultural sector. This strategy to go international was built on two core beliefs: that pursuit of any such opportunity had to be relevant to existing members and that the opportunity had to be related to the organization's distinctive expertise. By leveraging its 100-plus years of domestic expertise serving agricultural cooperatives throughout the world and focusing its international growth in cities where large agricultural members were present and needed banking services, Rabobank achieved its goal. Eighteen percent of Rabobank's growth is now attributable to its activity in the global food and agriculture sector. The challenge for most coops is to recognize which of their capabilities really provide a competitive advantage and are truly exportable.

Crédit Mutuel, one of Europe's largest banking cooperatives, is another example of a cooperative that systematically explores adjacent market opportunities and pursues them by leveraging core competencies. In one case, Crédit Mutuel realized that it could leverage its broad retail network and advanced IT capabilities to enter the rapidly growing mobile-communications market in France as a mobile virtual-network operator. The coop does not own the wireless infrastructure, but rather enters a contract with the owner and then uses its existing expertise in billing, customer service, and sales and marketing to provide mobile-phone services to its members. This arrangement allowed Crédit Mutuel to serve more of its members' needs and position itself to compete in the fast-changing payments market.

Use formal mechanisms to finance new opportunities. Successful growth in adjacent or international markets naturally requires that investments be allocated to these opportunities. That's not always easy for coops because of their democratic decision-making processes and the fact that these adjacent opportunities might not immediately benefit members. FrieslandCampina is a Dutch dairy cooperative whose capital-management strategy has enhanced its ability to fuel long-term growth. The coop holds back 40 percent of its profits as retained earnings and keeps another 30 percent of its earnings as nonnegotiable member bonds that pay a coupon to members. This gives the company access to a major source of capital to finance its growth.

To ensure that investments are made in the long-term interest of members, FrieslandCampina evaluates all potential investments against two metrics. One metric is whether the investment promises high profitability (the performance potential of earnings before interest and taxes) so that it can contribute to performance-premium payments for the coop's member farmers. The second metric is whether the investment will result in higher sales of milk so that it will boost farmers' regular income. An investment that satisfies both criteria will be prioritized. But these criteria also allow FrieslandCampina to build a diversified portfolio that will deliver benefits to members through either higher margins or more sales.

• • •

Cooperatives have different shareholder structures, governance mechanisms, and incentive systems from those of public companies. Yet, just like public companies, coops have a strong desire for growth. In fact, 95 percent of the 48 cooperative leaders we surveyed told us that growth is a top priority for them. In increasingly liberalized markets, coops that don't grow will lose the economies of scale they need to remain competitive. And to better serve and protect the interests of their members, coops must be market leaders who can offer all the products and services their clients need. Those that double down on their unique relationships with their members and organize themselves to fully capitalize on adjacent-market opportunities will substantially outgrow the market. ○

Vincent Bérubé (Vincent_Bérubé@McKinsey.com) is an associate principal in McKinsey's Montréal office, where **Tarek Mansour** (Tarek_Mansour@McKinsey.com) is a principal. **Andrew Grant** (Andrew_Grant@McKinsey.com) is a director in the Singapore office.