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An exploration of governance and accountability issues within mutual organisations: The case of UK Building Societies

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Dedication

This thesis is dedicated to:

My father Ooi Swee Hin and my mother Yong Chiew Peng, for your love, encouragement, prayers and sacrifices throughout my life;

My sisters Sue Lynn, Sue Imm and Wendy Ooi for your constant positivity, support and love;

My nieces and nephew, I hope you will value the power of education and continue to work hard in achieving your dreams; and

My late grandmother, Ng Chiew Yong, who I always remember in my prayers. I hope you are proud of me, grandma!

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Abstract

This study examines the governance and accountability practices and reforms in UK building societies following the 2008 financial crisis. Theoretically, this study explores the notion of mutual accountability and governance systems in delineating the (re)structuring of UK building societies' governance and accountability practices, in response to the crisis. Data for the study are derived from thirty-eight in-depth interviews with key stakeholders in building societies, including executives, non-executives, ex-directors, an auditor, a regulator and customers, as well as publicly available documents and non-participant observation of a number of members' meetings. The findings of the study demonstrate that the industry's internal, intermediate and external governance structures have significantly altered in the post-crisis era with a positive impact on the mutual accountability. Coercive pressure from regulators has led to improvements on building societies' internal governance structures, including but not limited to board composition, internal control and risk management frameworks. Intermediate governance structure, unique to mutual organisations, is embedded within UK building societies as the fundamental mechanism in achieving democracy and mutual accountability. However, the political and economic uncertainty and regulatory reforms in the financial services sector have continued to pose challenges in the governance and long-term performance of regional building societies. Intensifying regulations have increased the costs and workload for building societies and led many of these societies to emphasize the "form" rather than true "substance" of good governance practices. There is the need for regulators and policy makers to realise the difference among building societies and to develop appropriate codes of governance and regulations which are not one-size-fits-all.

List of Abbreviations

AGM - Annual General Meeting
ABS - Asset Backed Security
BCBS - Basel Committee on Banking Supervision
BSA - Building Society Association
BSC - Building Societies Commission
BSOCS - Building Societies Sourcebook
CAQDAS - Computer Assisted Qualitative Data Analysis Software
CCDS - Core Capital Deferred Shares
CDO - Collateralised Debt Obligations
CEO - Chief Executive Officer
CRD - Capital Requirement Directive
ED - Executive Director
FCA - Financial Conduct Authority
FRC – Financial Reporting Council
FSA - Financial Service Authority
FSCS - Financial Service Compensation Scheme
FSMA - Financial Services and Markets Act 2000
IMF - International Monetary Fund
ILO - International Labor Organisation
LSE – London Stock Exchange
MRT - Middle Range Thinking
NED - Non-Executive Director
PIBS - Permanent Interest Bearing Shares
PPDS - Profit Participating Deferred Shares
PLC - Public Listed Company
PCOBS - Parliamentary Commission on Banking Standards
PRA - Prudential Regulatory Authority
SM&CR - Senior Manager and Certification Regime

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CHAPTER 1: Introduction

1.1 Background

The mutual sector in the United Kingdom is socially and economically valuable to the country. It creates diversity in businesses by providing varied types of ownership structures from the investor-owned business, and delivers competition and more options for consumers in a different range of markets (Mutuo, 2015). It employed over 970,000 employees and generated a total income of £115 billion in 2013 (Mutuo, 2013). Mutuo (2013), an advocate for mutuals and co-operatives in the UK, reported that one in three people in the UK continues to be a customer-owner of at least one mutual or co-operative.

A mutual organisation is neither typical charities nor businesses. Rather, its business philosophy, motivation and nature of activities combine the attributes of both entities. The primary objectives of mutuals are to create and deliver social values to their customer-owner-members and they rely on their commercial activities rather than donations and grants to achieve their social objectives and to scale their operations. For these organisations, commercial activities are a means toward social ends. Therefore, mutual organisations are hybrid organisations that combine the attributes of both charity and business at their core values (European Commission, 2003, Drake and Llewellyn, 2002, Hansmann, 1996).

Unlike shareholder-owned firms, mutuals are customer-owned and controlled in such a way that customers hold ownership and control rights and are entitled to the benefits accruing from the business (Birchall, 2013a, Birchall, 2011). Customers of mutual organisations are generally also the investors and members of the entities[1]. They have the rights to decide on the sale and takeover of the business and the right to vote on the appointment and reappointment of the directors and auditors (Birchall, 2013a, Birchall, 2012). Mutuals exist in most societies and are subject to various legal and administrative frameworks, different tax benefits, and in many cases, lighter legal requirements. The types of mutuals also vary across countries in which they operate, and according to their historical movements (Birchall, 2013b, Birchall, 2011). In the UK in particular, history indicates that mutual organisations generally consist of financial mutuals such as building societies, credit unions and friendly societies (Birchall, 2011, Birchall, 2013a).

Although mutual organisations are viewed to create both social and commercial values, they are at risk of mission drift and losing sight of their social missions while in their efforts to generate revenue (Fonteyne, 2007). This concern is greatly highlighted in academic literature that the risks for mutuals and their workforces are diversifying from their purposes and values while in the quest for organisational survival. It has been argued that mutual organisations depend on commercially generated revenue to sustain and scale their operations, and they are inherently at risk of emphasising their commercial activities-to generate revenue and thereby survive-over their social objectives which enable them to achieve their social mission. The consequence of mission drift is severe as it threatens the core reason for their existence which are to deliver social value to their customers cum members (Ebrahim et al.,

[1] The terms ‘customers’, ‘owners’ and ‘members’ are used interchangeably throughout the thesis. Mutuals are incorporated in the first place to serve the needs of their customers who are also the capital contributors of these enterprises. As the capital contributors, they are regarded as the investors and owners of the business, which is similar to shareholder-owned businesses. According to Hansmann (1996), the term ‘member’ is commonly associated with mutual organisations due to their historical movement, which considered the business as a membership organisation.

2014). Mutual organisations thus face a unique challenge in term of the process in which they manage their competing objectives and activities, so as to generate enough revenues without compromising their social objectives.

Governance in mutual organisation is also a rich subject of study as the importance of mutual organisations in delivering social activities has grown and they have come under increased scrutiny. Serious concerns have been raised about the governing board and their effectiveness as key officers and directors had been accused of wrongdoings and had used organisations' funds for personal gain (The Independent, 26 July 2014 , The Telegraph, 16 June 2014). It has also been reported that a lack of effective oversight and a shortage of capable individuals and management had led to the collapse of a number UK credit unions, building societies and friendly societies, such as Equitable Life (HM Treasury 2004, 2014, Jones, 2010).

These concern have led to the credibility of mutuals being questioned and academic interests in the state of their governance and accountability practices (see e.g.Cornforth, 2003, Cornforth and Brown, 2013, Cornforth, 2004). In a review of the research literature, Cornforth (2003, 2004) concludes that empirical and scholarly research relating to governance in mutual organisations is relatively scant, and there were considerable gaps in knowledge. Previous research are arguably context-centric and largely dominated by the work in Canada (see e.g. Ketilson and Brown, 2011, Fairbairn et al., 2015, Fairbairn, 2003), the USA (see e.g. Hansmann, 1996, Schneiberg et al., 2008) and Africa (see e.g. Borda-Rodriguez et al., 2016, Borda-Rodriguez and Vicari, 2014, Mathuva, 2016). Governance research on mutual organisation in the UK is also scarce (Shaw, 2006, Brennan and Solomon, 2008, Gray et al., 2014a) and mostly generated professional interests after the collapse of the mutual organisations such as mutual life insurance companies and building societies (see e.g.

HM Treasury, 2009, HM Treasury 2004, HM Treasury 2014). Therefore, the main aim of this research is to contribute to this subject by exploring and understanding the organisation governance and accountability within a specific mutual organisation, the UK building societies. More specifically, the thesis investigates the responsibilities of the board of directors, the processes by which members' rights are protected, the roles of regulators and auditors, and key governance and business challenges encountered by building societies following the 2008 financial crisis.

1.2 The Motivation for Studying Governance and Accountability in UK Building Societies

UK building societies are among the oldest financial mutuals in the world. They are owned by and run for the interests of the savers and mortgage borrowers who are also the customer-owner-members of the business. Membership is equally distributed on a one-member one-vote basis and not on the basis of amount invested. The first known building societies in the UK were established in Birmingham in 1775. These building societies originally provided collective finance for house purchase and construction for and by members. Over time, building societies evolved as a financial intermediary between savers and mortgagors.

The mortgage and saving markets in the UK was primarily dominated by the building society sector from the eighteenth century until the 1980s. Unlike other European countries such as France and Germany, where mortgages are provided by a variety of institutions, the financial services sector in the UK was highly regulated and controlled by the government. There was very limited competition between different financial institutions, and banks were not significantly involved in the saving and mortgage markets. An array of regulations and control such as the standard tax rate and Supplementary Special Deposit Scheme, also known as the ‘Corset’, were in place to curtail the lending and deposit-taking activities of banks and other financial institutions (Harvey, 2005, McKillop and Ferguson, 1993).

However, the ‘big bang’—the deregulation of the financial market in the 1980s by the Conservative government—put intense pressure on the building society sector to compete with other financial institutions. The sector experienced increasing competition for personal savings and mortgages from banks and National Savings. They also had to compete with banks in other non-price forms of competition, including the usage of advanced technologies and marketing mechanisms. The small scale nature and limited financial resources of a number of building societies posited greater challenges for the building society sector to compete with other financial institutions in a highly deregulated financial market (Boleat, 1982, Boddy, 1989).

The problems prompted the government and building societies to search for new legislation to enable building societies to compete on an equal basis with other financial institutions. The BSA responded by setting up a working group to examine the constitutions and power of building societies. The report, *The Future Constitutions and Power of Building Societies,* published in 1983, rejected the call for new regulations. Instead, recommendations were provided which urged building societies to shift to new ‘banking’ activities. The Governor of the Bank of England and the chairmen and chief executives of building societies shared a concern that a shift towards general banking activities was inconsistent with building societies’ distinguished status and values. They were of the view that building societies should remain as financial mutuals specialising in individual savings and house finances.

In consequence, the *Building Societies Act 1986* came into force on 1 January 1987 (Boddy, 1989, Buckle and Thompson, 2004). The *Building Societies Act 1986* provides building societies an opportunity to be demutualised and converted into shareholder-owned banks. According to Casu and Gall (2016), there were a number of strategic reasons which motivated building societies to convert into a shareholder-owned bank. Conversion into a shareholder bank enabled the demutualised building societies to be freed from the *Building Societies Act 1986*, to obtain additional capital from wholesale funds and to engage in securitisation practices. In accordance with the 1986 Act, 25 per cent of building societies' lending should derive from corporate lending. International operations for building societies are also limited, whereby they are only allowed to operate within the European Union via subsidiaries. Building societies also had the difficulty to access the capital market unlike investor-owned banks (Buckle and Thompson, 2004, Boddy, 1989). A number of building societies such as Abbey National, Halifax, Northern Rock and Alliance & Leicester, therefore, demutualised in order to access the wholesale money market and engage in securitisation practices. Demutualisation resulted in 61 per cent of the total assets in the building society sector shifting to investor-owned banks between the years 1980 and 2000 (BSA, 2015a).

Nevertheless, the 2007/2008 financial crisis witnessed all converted building societies failing and none of them exist as an independent economic entity. The converted building societies' easy access to the wholesale money market and securitisation practices had led some of them to provide subprime mortgage loans to customers, then reselling those subprime mortgages on the international capital market. When the international wholesale money markets dried up and banks ceased to lend to each other, the lack of capital caused the converted building societies to seek emergency funding from government (Klimecki and Willmott, 2009). The National Audit Office in 2015, estimated that £1,162 billion of taxpayers' money has been utilised to bail out the banks such as HBOS, Northern Rock, Bradford & Bingley and Lloyds Bank.

Building societies which are constrained by the *Building Societies Act 1986*, in terms of their funding and investing activities, did not experience the same problems as the shareholder-owned financial institutions. Instead, the building society sector managed to attract new savers in the midst of the 2008 banking crisis. Adrian Coles, the ex-Director General of the BSA, pointed out that the 2008 financial crisis has thus demonstrated that:

> [T]he governance arrangements of building societies have proved rather sounder than those of the heavily "incentivised" bankers. Building society managements may be stuffy and old-fashioned, but at least they don't go blowing their capital on [Collateralised Debt Obligations] CDOs[2] and hare-brained acquisition-making. They have proved better stewards of their businesses than their converted counterparts (The Independent, 07 June 2008).

The coalition government also pledged in its coalition agreement in 2010 to promote the customer-owned business model of building societies by stating:

> We want the banking system to serve business, not the other way round. We will bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry (*The Coalition: our plan for Government*, 2010, p. 9).

Despite the growing profiles and importance of building societies, the response of some building societies during the 2008 banking crisis has raised concerns over their governance structures and accountability practices. Competition from banks continued to exert increasing pressures on the mutual business model. In order to maintain competitiveness, a number of

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[2] A CDO is a by-product of the structured assets backed security (ABS). CDOs involved the 'repackaging' and 'resecuritisation' of the lower ranked and riskier 'tranches' of the ABS. CDOs are sold to investors according to different risks and returns. In some extreme cases, the tranches of CDOs could further be repackaged and resecuritised, and sold to investors.

building societies, such as the Dunfermline Building Society, Britannia Building Society, Derbyshire Building Society, Chesham Building Society and Barnsley Building Society increased their risk-taking by undertaking actions that were not accompanied by appropriate risk management, governance structures and capital backing (Andrew Bailey, Ex-CEO of the PRA at BSA Conference, 2013a). As a result of that, they made losses on loans (specifically on commercial loans), losses due to potentially fraudulent borrowers, losses due to large deposits held with Icelandic banks and losses on mortgage books acquired from other lenders prior to the financial crisis (Casu and Gall, 2016). When the 2008 credit crunch unfolded, many of these building societies encountered problems in maintaining the required level of capital and their capability to handle the crisis was significantly undermined. This forced them to be rescued and merged with other, bigger, mutually-owned financial institutions such as Nationwide and the Yorkshire Building Society.

There is evidence that some building societies were also involved in some high profile scandals such as irregular accounting conduct and selling of misleading products to their members (The Telegraph, 16 June 2014, FRC, 2015). For instance, the auditor (Grant Thornton) of Manchester Building Society was reprimanded by the Financial Reporting Council (FRC) for failures to comply with the required standards in connection with the audits of the financial statements of Manchester Building Society for financial year 2006 to 20011 and provision of inaccurate information or advice in the course of those audits. The finance director of Manchester Building Society was also penalised for negligence in carrying out his duties (FRC, 2015). Yorkshire Building Society was fined by the Financial Conduct Authority (FCA) for £4.1 million and £1.4 million in the year 2014, for failing to deal properly with its mortgage defaulters and the dissemination of misleading promotional materials to customers (Yorkshire Building Society Annual Report 2014, p.4).

Furthermore, Sir Christopher Kelly, an independent reviewer who was commissioned by the board of Co-operative Bank to investigate the capital shortfall in the Co-operative Bank in 2013, concluded that one of sources for the capital shortfall in the Co-operative Bank was due to its merger with Britannia Building Society. Britannia Building Society was not financially strong after the 2008 financial crisis. The then regulator, the Financial Service Authority (FSA), argued that Britannia Building Society would not survive as a standalone entity if it did not merge with the Co-operative Bank in August 2009. This is primarily because Britannia Building Society had ventured into risky loans and "sometimes complete transactions which no other lenders would take on", prior to the 2008 banking crisis. Subsequent to the merger, the newly merged Co-operative Bank failed to plan and manage capital adequately, and a weak governance system led to the failure of oversight in the Co-operative Bank (HM Treasury, 2014, p.15).

These scandals led some observers to criticise building societies for being susceptible to mismanagement and misconduct (Womack, 2010). This thesis maintains that with the growing prominence of building societies as a result of the 2008 financial turmoil, an analysis and understanding of their roles and accountability obligations towards their customers, communities, societies, the general public and other stakeholders is important. Previous studies on building societies mainly focused on the effects of demutualisation on the building society sector and the investor-owned banks (see e.g. Tayler, 2005, Drake and Llewellyn, 2002, Shiwakoti et al., 2008), the implications of the 2008 financial crisis towards converted building societies such as Britannia Building Society, HBOS, Northern Rock, Bradford & Bingley (see e.g. House of Commons Treasury Select Committee, 2009, 2008, HM Treasury 2013, Kelly, 2014), and the resilience of building societies' unique ownership structure in the event of an economic crisis (see e.g. Birchall and Ketilson, 2009, Michie, 2011). This is a gap in the literature in terms of lack of understanding the state of building society governance and accountability practices. This study therefore aims to fill this gap in the literature by exploring and understanding the governance and accountability issues and practices in the building society sector. In particular, the research attempts to address the following **research question**:

- **How does the current UK building societies' governance system achieve accountability?**

In answering the research question, the study attempts:

1. To develop a mutual accountability framework so as to explore and understand the governance and accountability practices in building societies;
2. To review the development of the building societies movement in the UK; and
3. To obtain views from key stakeholders (such as directors, regulator, auditor and customers) with respect to the states of governance and accountability practices and issues in UK building societies.

1.3 Research Design

In order to address the above research question and objectives, this research adopts Laughlin's (1995, 2004) middle range thinking (MRT) as the methodological approach. MRT maintains the mid-point or hybridised ontological and epistemological assumptions of interpretivist and positivist. Laughlin (1995) contends that the approach to engage with social phenomena cannot be operated with minimal intrusion of subjectivity (as in positivist) or very individualistic set of subjective processes (as in interpretivist). Instead, MRT argues the significance of structures around subjective process of discovery in which theory is ‘skeletal’ and serves as the structures to explore the empirical world. Theory will always be incomplete and subject to revision through engagement in empirical world (Broadbent and Laughlin, 2014). In terms of ‘change’ option, MRT is open to change or to maintain the status quo of the social phenomenon (Laughlin, 1995, 2004, Broadbent and Laughlin, 2014).

This study considers the governance and accountability practices in the building society sector are socially constructed and influenced by its key players (e.g. directors, auditors, regulators, and customers)(Laughlin, 2004, Laughlin, 1995, Broadbent and Laughlin, 2014). Knowledge and ‘truth’ are obtained by studying and understanding key players’ contexts, meanings, narratives and accounts about their governance and accountability processes (Willis, 2007, Hallebone and Priest, 2009). Due to the lack of empirical works in mutuals and building society sector, a mutual accountability framework for mutual organisations was developed and served as the ‘skeletal theory’ according to Laughlin (1995, 2004), or the conceptual framework to explore and examine the governance and accountability practices and issues in building society sector. The mutual accountability framework is also regarded as a normative governance and accountability model of mutual organisations.

The mutual accountability framework conceptualised four types of accountability – financial-social dual, compliance, personnel and social accountabilities as the core accountabilities in mutual organisations (Stewart, 1984, Sinclair, 1995, Bovens, 2007, Mulgan, 2000). *Financial-social dual accountability* entails elected representatives to be *financially and socially accountable* to customer-members in term of financial performances and social impacts that businesses create to customers (Ebrahim et al., 2014). *Compliance accountability* regards mutuals to comply with rules and regulations set out by policymakers and regulator (Stewart, 1984, Mulgan, 2000, Bovens, 2007), and *personnel accountability* requires mutuals to be responsible and accountable to their staff by ensuring that proper systems and mechanisms are in place to support employees' benefits and welfares, as well as personal and professional development (Sinclair, 1995, Stewart, 1984). *Social accountability* requires mutuals to be responsible and accountable to environment, local community and general public by doing good deeds and serving the needs of individuals who are disadvantaged, marginalised and helpless (Gray et al., 2014a). The integrated governance model introduced by the Confederation of Finnish Co-operatives and subsequently modified by Ketilson and Brown (2011) - which outlines the internal, intermediate and external governance structures is mobilised to understand and evaluate the governance processes in achieving the financial-social dual, compliance, personnel and social accountabilities of mutual organisations. Furthermore, this research takes the approach of 'open to change'. Change is promulgated towards the end of the research after in-depth understanding into the governance practices in building societies.

Analysing the states of governance and accountabilities practices in building societies involves adopting a certain mode of analysis, which involves tracing the conceptualisation of the practices from research participants. The thesis uses semi-structured interviews, documentary analysis and non-participant observation as the research techniques in exploring and understanding the practices. A total of thirty-eight semi-structured interviews were held in two stages, between July and November 2015 and between January and February 2016. The interviews were conducted with executives, non-executives, ex-directors, regulator, auditor, representative from Building Societies Association (BSA) and customer-members. The executive and non-executive directors were selected on the basis that they have direct and vast knowledge with respect to building societies' governance arrangements. The inputs from ex-directors, auditor, regulator, BSA representative and members are vital to complement and contradict with the insights of executives and non-executives (Bryman, 2012, Patton, 2002).

All interviewees were sent a broad outline of issues to be discussed prior to their interview and the purpose of the research was reiterated before the commencement of each interview. Each interview was audio recorded, fully transcribed and lasted between forty-five minutes and one hour and thirty minutes. Interviewees were reassured that their participation was voluntary and their names and organisations would not appear in the thesis. Instead, a pseudonym would be used to substitute their names (Rubin and Rubin, 2011, Spencer et al., 2014). Notes were taken throughout each interview, and an analysis of field notes with interview transcripts aided in developing issues that require clarification and elaboration for subsequent interviews (Bryman, 2012, Yeo et al., 2013). Furthermore, information was referenced from public sources such as the *Building Societies Act 1986*, HM Treasury reports, BSA yearbooks, annual reports, press releases, newspaper articles and websites. Data from non-participant observations at members' meetings were also used to supplement, reinforce and contrast with interview and documentary evidence and to provide clearer understanding of the governance and accountability practices (Bowen, 2009, Patton, 2002).

1.4 Structure of the Thesis

This thesis is organised into nine chapters as depicted in **Table 1-1**:

Chapter	Brief Description	Aims of Each Chapter
1	Overview of the Study	Chapter 1 provides an introduction to the PhD thesis. It highlights the research background, case context under study, research question and objectives, research design and the structure of the thesis.
2	Mutuality and Governance in Mutual Organisations	Chapter 2 provides a review of existing literature on governance practices in mutual organisations and co-operatives in order to identify the empirical and theoretical gaps that form the basis of the research objectives and question. The chapter considers the definition and attributes of mutuality in mutual organisations, corporate governance reform in the UK and the distinguished features of mutual organisations' governance. The chapter also delineates previous theories on governance in mutual organisations and prior governance and accountability research in mutual organisations.
3	Conceptual Framework	Chapter 3 examines how governance mechanisms serve as valuable mediums through

Chapter	Brief Description	Aims of Each Chapter
		which accountabilities are met and discharged to wider constituents. The chapter also discusses the natures of accountability and the limitations of previous theories on mutual organisations' governance. In addition, the chapter introduces and discusses the 'mutual accountability framework' developed. The research considers the mutual accountability framework which serves as the 'skeletal' theory to explore and understand the governance and accountability issues in the case context.
4	Introduction to the Case Context: The UK Building Societies	Chapter 4 explains the reasons the UK building societies were selected as the background and context of the study. The chapter also examines the development of the UK building society sector since its emergence in the 18th century and the impacts of deregulation and demutualisation in the building society sector. The chapter also highlights the effects of the 2007/2008 credit crunch on all demutualised building societies and the responses of building

Chapter	Brief Description	Aims of Each Chapter
		societies through the crisis. Lastly, it explains the governance and regulatory reforms in the sector, and justifies the significance of studying governance and accountability practices and issues in UK building societies.
5	Research Methodology and Methods	Chapter 5 develops and rationalises the research design underpinning the study by delineating different types of research paradigms in social science research. The chapter also explains the reasons MRT has been chosen as the methodological approach and the rationales why semi-structured interviews, documentary analysis and non-participant observation were considered the relevant research techniques. The procedures utilised for data analysis as well as the issues of validity and reliability in qualitative research also formed part of the discussion in this chapter.
6	Internal Aspects of Governance and	Chapter 6 analyses and delineates the internal dimension of governance and accountability

Chapter	Brief Description	Aims of Each Chapter
	Accountability: An Analysis of the Views of Key Stakeholders	practices in building societies. It reports and presents directors' understanding and views on the importance of governance and accountability. The overall state of the internal governance practices in building societies is mentioned as well. The final section of the chapter highlights the mechanisms employed by the sector in discharging personnel accountability.
7	Intermediate Governance Structures and Democratic Practices: An Analysis of the Views of Customer-Members, Directors and Regulator	Chapter 7 presents the findings from interviews conducted with directors, regulator and member-customers, and evidence from documents and non-participant observation. The chapter discusses members' roles in building societies and the extent to which intermediate governance structures are employed to discharge financial-social dual accountability and to foster democracy in the building society sector.
8	External Aspects of	Chapter 8 discusses the external aspects of

Chapter	Brief Description	Aims of Each Chapter
	Governance, Accountability: An Analysis of the Views of Key Stakeholders	governance and accountability practices in the building society sector. It presents the views of directors, regulator and auditor pertaining to the roles and development of external audit practices and the state of corporate social responsibility and accountability practices in the building society sector. The chapter also deliberates the regulatory and legislative framework in building societies.
9	Theoretical Contribution: Mutual Accountability Framework	Chapter 9 discusses the theoretical contributions of the thesis. The chapter explains the mutual accountability framework which developed from the empirical findings and academic literature and the distinctions between the framework and the skeletal conceptual framework presented in chapter 3.
10	Discussion, Summary and Conclusion	Chapter 10 is the concluding chapter. It restates the research background, summarises key findings and provides conclusions that address the research question. The chapter also proposes

Chapter	Brief Description	Aims of Each Chapter
		some practical reforms for the building society sector. The concluding segments of the chapter highlight the shortcomings of the study, proposed recommendations for future research and contributions of the thesis.

Table 1-1: The structure and organisation of the thesis

CHAPTER 2: Mutuality and Governance in Mutual Organisations

2.1 Introduction

The main purpose of this chapter is to present a detailed review of the existing literature on governance practices in mutual organisations, so as to identify the empirical and theoretical gaps that form the basis of the research question and objectives. The chapter is structured in eight parts. The first part of the chapter, Section 2.2 outlines the definition and attributes of mutuality in mutual organisations. Section 2.3 conceptualises governance in mutual organisations and Section 2.5 discusses corporate governance reform in the UK. While Section 2.5 highlights the distinctive features of governance in mutual organisations, Section 2.6 discusses previous theories on mutual organisations' governance practices. Section 2.7 highlights the importance of studying governance in mutual organisations and Section 2.8 provides concluding remarks for the chapter.

2.2 Conceptualisation of Mutuality in Mutual Organisations

Mutual organisations have been variously defined depending on the countries in which the organisation is incorporated (Hyndman et al., 2002). In Canada, mutual organisations and co-operatives are regarded as the same type of entity (Birchall, 2013a, Shaw, 2006). However, in the UK, mutual organisations, unlike co-operatives, were developed from different historical movements and 'ownership structure'. The origin of co-operatives could be traced to the 'Rochdale Pioneers', and it adheres to the seven universal co-operative principles (i.e. voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training and information; cooperation between co-ops; and concern for community) and comprise four major forms: consumer, worker, producer and shared services co-operatives (Birchall, 2011, Borda-Rodriguez et al., 2016).

Mutual organisations in the UK were historically set out to help those in need by providing goods and services that were not provided by other entities and they remain the same now. They were created during the industrial revolution, in which people collectively grouped together searching for a solution to the social and economic problems that they encountered. Individuals then pooled some funds together to help one another (Woodin et al., 2010). This is depicted in the case of friendly societies, which enable the poor to contribute to: funeral, employment and sickness expenses; the building societies which make it possible for people to save and build their own houses; and credit unions which provide pay day loans to individuals (Woodin et al., 2010).

In the current economic context, mutual organisations compete in an open market alongside other private businesses such as investor-owned organisations, sole proprietors and partnership firms. However, they are distinguishable from other types of business in terms of their ownership structure, where they are customer-owned and controlled. Birchall (2013a, 2012) states that a customer-owned business means that customers have *ownership rights, control rights* and *benefits* accruing from the business. *Ownership rights* mean that the owners have the power to decide if a business continues to exist, is sold off or wound up. In another words, a mutual organisation cannot be sold without its customers' permission. In the case of UK building societies, the board and managers have to campaign among the customers cum owners to get them to agree to convert into shareholder-owned banks, even though many customers have never before been consulted and many are unaware that they are the 'owner' of the business.

Ownership usually also gives control rights to customers to vote on the audited accounts or the appointment and reappointment of the directors and auditors. Customers also have the right to remove the board that fails to serve their interests, entitled to share in the benefits derived from the business and to decide on how the benefits are allocated (Birchall, 2013a, Birchall, 2012). Besides ownership structure differences, Gough (1982) and Michie and Blay (2004) contend that mutual organisations have a different philosophy towards profit which is 'optimising' rather than 'maximizing'. This is primarily because mutual organisations were chiefly established in the eighteenth and nineteenth centuries as a self-help mutual to meet the needs of individuals which were not fulfilled by other economic entities. Historically, customer-owners of mutual organisations were not concerned with the profit of the business as long as they could use the services or products provided by the organisations. As a result of that, *profit in mutual organisations was non-distributing* to the customers in term of cash dividends or share options (Hansmann, 1996, Cook et al., 2002). Instead, profit is either paid to customers as 'mutual dividends (or patronage dividends)' or to reinvest into the business in order to increase the retained earnings of the business for the future development of the entity (European Commission, 2003, Drake and Llewellyn, 2002, Hansmann, 1996).

This is as depicted in the case of the UK building societies. The savers or depositors of building societies supply funds from which house purchase loans are made. The difference between the rate of interest received from the borrowers, and that paid to savers, represents the margin which enables a building society to meet all its operating expenses (e.g. staff costs, utilities expenses). The 'profit' or 'loss' is derived after deducting all the operating expenses which would either be reinvested into the financial reserves of the business or paid out to customers under a 'mutual dividend'. In profit-maximising firms, profit is distributed to shareholders in share options or dividends to compensate them for the risks that they take in investing in the firms. In contrast, customers of building societies receive a 'mutual dividend' in the form of a higher interest rate for their savings or a lower interest rate for their house loans, or in the form of a loyalty scheme (Gough, 1982, Drake and Llewellyn, 2002).

Furthermore, Dyson (2002) argues that the primary objective of a mutual organisation is to deliver social value to its customers. They rely on trading activities instead of donations or grants to assist them to achieve social objectives, in particular, the provision of mutual aid and solidarity without discrimination of the background of those who need help. This suggests that membership discrimination of any kind, whether social, racial, religious or political is against the fundamental principle of 'mutuality and mutual aid'. For instance, both credit unions and building societies typically provide savings and lending facilities to individuals who were not able to obtain personal and mortgage loans through mainstream banking (Leadbeater and Christie, 1999, McCarthy et al., 2002, Hyndman and McKillop, 2004).

In summary, a mutual organisation is a type of organisation that is owned and controlled by customers. They compete in an open market alongside other types of business organisation. However, mutual organisations embed social ethos and the idea of mutuality in their business philosophy and operations. They provide products or services to individuals whose demands are typically not fulfilled by other types of business organisations. Mutual organisations' pursuit of profit is the means to their social ends, but rather than an end in itself, like in most profit-maximizing firms. Mutual organisations in the UK include building societies, friendly societies and credit unions. The notion of mutuality is embedded in the governance and accountability structures of a mutual organisation, and the latter is crucial in achieving their social ethos and purposes. The governance and accountability issues are discussed next.

2.3 Governance in Mutual Organisations

Governance is a contentious and elusive concept. Basically, there is no generally accepted definition of governance (Almquist et al., 2013). In its broad understanding, the term governance derives from the Latin word, ‘gubernare’, which has its roots in the Greek term ‘kybernan’ (Hyndman and McDonnell, 2009). It means to rule, direct or steer. Using this definition, if the organisation is a ship, then the role of governance is to steer or pilot the ship to its goal or destination (which is the accountability, organisation’s goals or mission and vision) (Collier, 2008).

In corporate governance literature, governance is variedly defined as a structure, rules, procedures and mechanisms for proper steering and controlling of the organisation towards the achievement of organisation’s mission and vision (Almquist et al., 2013, Solomon, 2013, Rezaee, 2008). It has also been regarded as the system by which firms are directed and controlled (Cadbury, 1992) and is primarily concerned with the accountability relationship between firms and their wider constituents, such as the states, employees, communities and members of the public. Corporate governance has also been defined by OECD (2004) as a set of relationships between a company’s management, its board, its shareholders and other stakeholders, that provides both the structure through which the objectives of the company are set, and the means of attaining those objectives and the monitoring of performance are determined.

Despite these many definitions of corporate governance, the above definition of governance is largely shaped from the governance approaches in investor-owned firms. There is a very limited definition of what governance is in mutual organisations. This research claims that the definition by the Working Group of the UK Co-operative Group (2007) covers the governance attributes of mutual organisations, which is:

> Corporate governance comprises what all of the organs of the corporate entity do, not just what the board of directors does, and that corporate governance is a means to an end, not an end in itself. It also concluded that the overarching aim of corporate governance is to establish arrangements which meet the needs of the business, to ensure that those responsible for the business have the necessary skills and experience to do the job, to provide a framework of accountability, and to drive the efficiency and success of the organisation. The prompt availability of appropriate trading information to the appropriate levels for members and members' representatives is needed to assist in driving such efficiency and success (p.16).

The key issue in mutual organisations as well as co-operatives is for the entity to be a successful business and achieve its mutuality and social values. The above definition is useful for the thesis, because it reflects two key features: recognizing the importance of organisation's values and principles, and the supremacy of customers' and stakeholders' rights and obligations in the business which is intrinsic principles of the business. Hence, the thesis regards governance in mutual organisations as structures, mechanisms, systems and practices that enable the mutual organisations to achieve its mission, accountability and responsibility to customer-owners and other stakeholders (O'Dwyer and Unerman, 2008, Cooper and Owen, 2007, Cornforth and Brown, 2013). The following sections deliberate the governance reform in the UK and the implications of the reform towards mutual organisations.

2.4 Development of Corporate Governance in the UK

The late 1980s and the 1990s witnessed the rise of awareness of corporate governance issues in the UK. The collapse and failures of Barings Bank, the Bank of Credit & Commerce International (BCCI), Polly Peck and the Maxwell Group led the regulators, media, employees and taxpayers to question the state of corporate governance in the UK. It has been claimed that weak regulation had allowed directors to mismanage and misrepresent their companies' financial positions and led to the collapse of many corporations (Veldman and Willmott, 2015).

In response to the crisis, the Financial Reporting Council (FRC), London Stock Exchange (LSE), and Institute of Chartered Accountants in England and Wales (ICAEW), established the Corporate Governance Committee in 1991. The committee was chaired by Sir Adrian Cadbury and looked into aspects of corporate governance relating to financial accounting and accountability of corporations (Veldman and Willmott, 2015). *The Cadbury Report* was published in 1992 and recommended that firms improve accountability, transparency and financial reporting (Solomon, 2013, Mallin, 2011). The report was regarded as the first formal corporate governance report in the UK which was subsequently adopted by many countries around the world (Rayton and Cheng, 2004). In 1995, there was a big concern about directors' remunerations. Too often, directors, specifically in privatised utilities companies, were alleged to have receive high salaries and lucrative share options while the companies underperformed and employees were not well-paid (Elliott et al., 2000). The Greenbury Committee was established in 1995 to look into directors' remuneration and the *Greenbury Report* recommended the significance of the disclosure of the director's reward package in annual reports, the creation of a remuneration committee and the importance of linking directors' remuneration to corporate performance (Solomon, 2013, Mallin, 2011).

Following the success of both Cadbury and Greenbury, the Hampel Committee was set up in 1998 to review the implementation of the Cadbury and Greenbury reports. The *Hampel Report* (1998) supported the majority of the requirements of the Cadbury and Greenbury reports, but promoted disclosures as prominent aspect of accountability to shareholders (Short, 1999). *The Combined Code*, which was published in 1998, further embraced some of the principles of the Hampel, Greenbury and Cadbury reports. *The Combined Code* emphasised directors' responsibilities in maintaining an effective system of internal controls and in disseminating the state of the firm's internal control to the shareholders (Solomon, 2013, Mallin, 2011).

The importance of companies' internal control was emphasised again when the Turnbull Committee was established to respond to the internal control provisions in *The Combined Code*. The *Turnbull Report* (1999) provided an overview of the system of internal control in UK companies and made clear recommendations for improvements needed in firms' internal control (Elliott et al., 2000). Nonetheless, the collapse of Enron and Parmalat led to debate about the role and effectiveness of non-executive directors (NEDs). The *Higgs Review (2003)* was set out to review the role and effectiveness of NEDs and suggested revisions to *The Combined Code*. The review also recommended a greater proportion of NEDs were needed on the board and NEDs should assume the responsibility as a champion of shareholder interests (Solomon, 2013, Mallin, 2011).

Following the publication of the Higgs Review, the *Tyson Report* (2003) and *Smith Report (2003)* were respectively commissioned by the UK government to look into the effects of diversity, skills and experience of NEDs and the role of the audit committee in UK corporate governance. The *Tyson Report* indicated that greater boardroom diversity could help to improve firms' relationships with corporate stakeholders. On the other hand, the *Smith Report* addressed the relationship between auditing firms and audit clients, as well as the responsibilities of audit committees. Following the reviews of these reports, the FRC in 2003, 2006 and 2008 amended *The Combined Code* by taking into consideration recommendations made in the Higgs, Tyson and Smith reports (Solomon, 2013, Mallin, 2011).

The 2008 financial crisis further triggered the UK government to commission Lord Turner and Sir David Walker to review the causes of the financial crisis. *The Turner Review* and *The Walker Review* both identified excessive remuneration as a key element of risk taking by financial institutions and therefore both reviews called for better alignment between remuneration policies and effective risk management and internal control in financial institutions. For example, *The Turner Review* recommended that the remuneration policies of banking executives should be designed to avoid incentives for undue risk-taking, and risk management considerations should be closely integrated into remuneration decisions (Turner Review, 2009a). *The Walker Review* further suggested that remuneration committees should replace the board in overseeing the pay of high-paid executives, increased public disclosure about high-paid executives and employees (for those earning above £1 million) and short-term bonuses of directors should be paid over a period of three years (Walker Review, 2009b).

In 2010, following an extensive consultation with companies, auditing firms, academics and shareholders, the FRC updated *The Combined Code*. It incorporated a number of recommendations made by *The Walker Review* (e.g. director's remuneration should align to corporate performance) and introduced four new principles: (i) the chairperson's responsibility for leading the board, (ii) the need for directors to devote sufficient time to their responsibilities, (iii) the requirement for NEDs to constructively challenge the policies and strategies of executive directors, and (iv) the need for the board to have a balance of skills and experience (FRC, 2010). *The Combined Code* was also renamed as the *UK Corporate Governance Code* in 2010 and is currently adopted and complied by most companies listed at the LSE.

2.5 Distinctive Features of Mutual Organisations' Governance

While the above provide a brief review of the development of corporate governance in UK, it is highlighted that most of those reforms mainly affected big corporations or public listed companies in the UK, rather than mutual organisations. This is primarily because the majority of mutual organisations are small and medium-sized businesses. They are customer-owned and do not exist solely for the purpose of profit making. Their directors are elected among the customers and may not be well versed in business (Leadbeater and Christie, 1999, Ketilson and Brown, 2011). Hence, some of the governance issues encountered and experienced by big corporations or public listed companies, such as issues of directors' remunerations and the diversity and expertise of NEDs, may not necessarily be applicable and relevant to mutual organisations (McCarthy et al., 2002, Hyndman and McKillop, 2004, Ketilson and Brown, 2011).

The Confederation of Finnish Co-operatives (2000) and Ketilson and Brown (2011) suggest that the ways to understand the governance practices in mutual organisations is to look into the organisation's *internal, intermediate and external governance structures*. These three different but related governance structures arguably provide a holistic overview of a mutual organisation's governance practices.

The internal governance structure is the internal governance mechanism that assists board of directors to achieve its objectives and fulfil its accountabilities and responsibilities. It also enables board of directors to monitor management in the interest of customers and other stakeholders (Keasey and Wright, 1993). Each different mutual organisation has distinguished internal governance structures. For instance, Ketilson and Brown (2011) argue that credit unions in Canada are gradually moving towards a corporate model where the board structures (e.g. board size, board committees, director term and tenure) and board development (e.g. leadership, director recruitment, director training and evaluation) of credit unions are similar to private sector organisations in Canada. On the other hand, some mutual organisations in the UK have shifted towards a corporate model of governance, while others have remained regionally and locally managed by communities, customers and volunteers (McKillop and Wilson, 2011, Hyndman et al., 2004). Hyndman and Mckillop (2004) argue that Irish credit unions are run and managed by local volunteers of the credit unions who have limited experience in accounting-related matters. In contrast, building societies and friendly societies are run by a board of directors who are 'skilled individuals' and also the customers of the business (BSA, 2010b, Birchall, 2013a). Nonetheless, information related to the extent of the board structure, board development and internal control structures of mutual organisations in the UK are limited. This is one of the motivations for this study.

Spear (2004) and Cornforth (2004) further suggest that mutual organisations are by virtue created and owned by their customers. In order to foster members' involvement in the business and to ensure that the elected board of directors are accountable to customers, most mutual organisations would have in place 'intermediate (or democratic) governance structure' (Ketilson and Brown, 2011, Leadbeater and Christie, 1999, Pearce, 2003). The purpose of intermediate governance structure is to promote democracy, ensure that customers could exercise their *control rights* over the business and to foster customer engagement in the business (Birchall, 2013a, Birchall, 2012). This, according to Fairbairn (2003), is also the defining feature of customer-owned business. The structure is argued to help developing and maintaining a strong relationship between customers and their mutual organisations:

> One common way of seeing [mutual organisations] is to think of them as businesses like others, except that they have a democratic member-control structure. The structure, in this view, makes the mutual organisation. The problem with considering only a structural view is that it is ultimately unsatisfying. Why do the members have a democratic control structure, if the business is no different from other businesses? Can a democratic control structure be an end in itself, worth the effort of creating a [mutual organisation]? Would it not be more efficient to deliver the same services without the apparatus of member control? Such questions are often asked by those who have doubts about the [customer-owned] model (p.6).

Figure 2-1 reflects the function of the intermediate governance structure. With the intermediate governance structure, the elected representative, NEDs and management can provide an effective link between customers and board. This link is important to enable the customers to inform the board of their needs as well as enable the board to communicate to customers on issues that the business is experiencing (Cooperative Group, 2007).

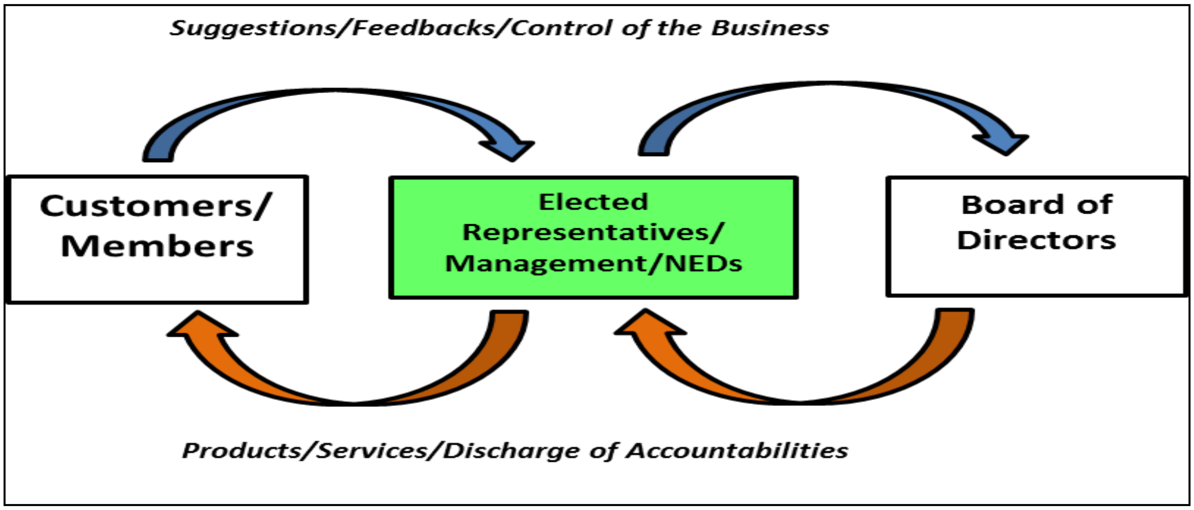

Figure 2-1: Function of Democratic or Intermediate Governance Structure (Source: Ketilson and Brown, 2011; UK Co-operative Group, 2007)

It also enables the board to remain accountable to the customers, so that the customers are encouraged when the business is doing well and constructively criticised when the business underperforms and needs to adjust its approach (Cooperative Group, 2007). The implication of such an approach is to enrich customers' loyalty and trust (Fairbairn, 2003), align the interests of customers with those of the board and managers and enable customers to control the business, which could ultimately increase the likelihood of the business' success (Birchall, 2012). Included among the intermediate governance structures are the representatives' structures (e.g. control structures) and participatory structures (e.g. member council, AGM, any other communication measures), which are further highlighted in Chapter 3.

Furthermore, similar to any type of business, mutual organisations are subject to varying degrees of regulations and legislations. External governance structure set the external parameters within which mutual organisations operate such as: the industry specific legislations or national and international regulations, and the roles of auditors. Regulations help mutual organisations to achieve good and effective governance (Hyndman and McDonnell, 2009). The next section provides a review into theories on governance in mutual organisations.

2.6 Theories on Mutual Organisations' Governance Practices

An array of theories have been developed and used to explain corporate governance practices due to different researchers have distinguish perspectives of the role of accounting theory. For instance, some researchers believe that accounting theory such as *positive accounting theory* should seek to explain and predict particular phenomena (as opposed to prescribing particular activities) (Deegan and Unerman, 2011). Research "is designed to explain and predict which firms will and which firms will not use a particular [accounting method]" but not on which method a firm should use (Watts and Zimmerman, 1986, p.7). Research is also to be undertaken to see if particular results can be replicated in different settings and observation or empirical evidence helps to test and refine the theory (Deegan and Unerman, 2011).

Meanwhile, other researchers believed that accounting theory such as *normative accounting theory* is to prescribe (rather than describe) particular accounting approaches (such as based on particular perspective on the role of accounting) and should be based on the values or beliefs held by the researchers proposing the theory (Tinker et al., 1982). Empirical evidence is not evaluated on the basis of whether theories reflect actual accounting practices. In fact, the purpose of most normative research is to suggest radical changes to current practices (Deegan and Unerman, 2011). In the next sub-sections, other theoretical perspectives that seek to theorise corporate governance practices in mutual organisations are considered and discussed. Specifically, democratic theory, agency theory and stewardship theory are discussed next.

2.6.1 Democratic Theory

Goodin (2003, p.386) defines democracy as to:

> …internalize the perspective of the others. Differences of opinion exist within the network…but assured that they are all aiming at the same goal, participants in networks respect one another's opinions, explore the bases for their differences and try in good faith to resolve them.

Democracy in mutual organisations means that every customer of a mutual organisation has an equal voice in the business operations. The elected representatives or board of directors are regarded as representatives who represent the interest of customers and run the business on the customers' behalf. Board of directors are appointed by customers in an open election process and on the basis of a 'one member one vote' basis. Regardless of the percentage of capital a customer invests in the business, no individual customer has a superior position over other customers. All customers have only one vote in the organisation's governance matters (Michie and Blay, 2004 Cornforth, 2004, Spear et al., 2009).

Leadbeater and Christie, (1999) and Cornforth (2004) further suggest that democracy in mutual organisations means that any customer in the organisation can put himself or herself forward for election as an elected representative. Although expertise may be desirable on the board of mutual organisations, Cornforth (2004) claimed that expertise should not be the central focus of the board. Instead, any layperson or non-professional member could put his or her name forward to be appointed as a board member. This is primarily because mutual organisations are incorporated in the first place by the customers, to help out other customers.

Hence, customers, regardless of their background and experience, should have equal opportunities to be elected as board of directors or elected representatives (Cornforth, 2004).

Nonetheless, the democratic theory argues that when membership becomes too large, dispersed and diverse, there is a greater difficulty for mutual organisations to maintain a strong common purpose with their customers and, to promote and preserve democracy in mutual organisations (Leadbeater and Christie, 1999). However, Ketilson and Brown (2011) and Jones and Kalmi (2012) suggest that having in place intermediate governance structure (as explained in Section 2.5) could maintain democracy within individual mutual organisation and enhance organisation's accountability.

2.6.2 Agency Theory

Agency theory is grounded on an economic rationalist perspective and is a dominant theory in the corporate governance literature on corporation and shareholder-owned companies. It describes the principal (owner/shareholder) and agent (manager) relationship and assumes that agents and principals have different interests. The interest of the principal is to maximise his own profitability (e.g. maximizing his own dividend) rather than that of the agent. Similarly, the interest of the agent is to maximise his/her own bonuses rather than that of the interests of the principal (Mallin, 2011). In order to align the goal of the managers and shareholders, Spear (2004) claimed that pressures from major shareholders, the threat of mergers and takeovers as well as the influence of the rewards structure will affect the way in which managers will act in the interests of the shareholders.

Applying agency theory to study governance in mutual organisations is not entirely straightforward. This is primarily because agency theory assumes that the customers are the owners and 'principals' of the business and the elected board of directors are regarded as the agents. Agency theory also assumes that principal and agent often have competing interests and that market control such as threat of takeover, pressure from major shareholders and attractive reward packages will align the interest of the principals to the agents (Spear, 2004).

Nevertheless, the majority of mutual organisations are incorporated in the first place to serve their customers and mutual organisations need to make a sufficient amount of profit but are not under pressure to maximise the profits of their investors as in most investor-owned companies (this is one of the core principles of mutuality: profit optimisation rather than maximisation) (Spear, 2004). Members, as argued by Cornforth (2004), are not interested in the profitability level of the mutual organisations. Instead, members focus on the 'mutual dividends' that they receive in terms of higher interest rates for their savings accounts and better services from the organisations. The board of directors (or agents) are therefore, not under the pressures to maximise shareholders' dividends which is in contradict with the assumptions of agency theory that having in place a reward structure (e.g. promotion, disciplinary action, pay linked to share values) would align the interests of agents to principals.

Second, most members do not monitor their mutual organisations and the majority of mutual organisations do not have access to the capital markets. Mutual organisations therefore are not subject to monitoring and controlling from professional or major investors as in investor-owned organisations. This also means that mutual organisations may not be subjected to threat of takeover and discipline from the capital market (Spear, 2004, Cornforth, 2004). Managers may have greater opportunities to run and manage the mutual organisations as their personal business (Buckle and Thompson, 2004). According to Hyndman and McDonnell (2009), legislative and regulative frameworks may balance the power of managers. If managers believe the regulator is monitoring the mutual organisations effectively, they will consider the potential for opportunism to be reduced.

However, Spear (2004, p.50) notes that agency theory mainly focuses on the relationship between managers and customer-owner-members and downplays "collective, social or organizational factors " and also "tends to ignore non-financial motivations such as mutual, reciprocal benefits, trust, and other features of social economy ideology that often helped initiate and support such enterprises." Ketilson and Brown (2011) therefore argue that in order to understand governance practices, it is necessary to develop an approach that provides a holistic overview apart from looking at principal and agent relationship.

2.6.3 Stewardship Theory

The stewardship theory assumes that board of directors are the stewards or custodian of the business. The board of directors have good intentions and the desires to do a good job and act as an effective custodian of organisation's resources (Donaldson and Davis, 1991). They also have the responsibilities of preserving and enhancing organisation's performance, value of the assets under their control and to balance the various claims on those assets. This theory also notes that board members should be selected on the basis of their expertise, knowledge and skills so that they are in a position to add value to the organisations' decisions (Cornforth, 2004).

Spear (2004) states that the stewardship model of governance may be appealing to mutual organisations' boards because mutual organisations are owned and controlled by their members:

> If this model is applied to democratic member owned organisations, it is clearly more attractive from the point of view of emphasising the social dimension of

> DMOs [democratic member-based organisations], where trust and social economy values can be functional for good performance and good board/manager/ member relations. Most DMOs would recognise the importance of considering the interests of all stakeholders, but they would expect some privileging of member interests (p.52).

However, Kay and Silberston (1995) and Spear (2004) acknowledge that the potential weaknesses associated with the assumptions in stewardship model in mutual organisations' governance are first, the problem of resolving and prioritising the divergence of goals of different stakeholders and measuring the performance against them (rather than the focus on clear goal of shareholder value). Second, Spear (2004) highlights the lack of oversight of management and an over-reliance on an expert board contradicts with the democratic principles of mutual organisations, in which all customers cum owner-members should have an equal opportunity to be appointed as board members. Cornforth also emphasises that because directors are democratically elected, it might be impractical to expect high levels of expertise, knowledge, and experience from board members as promulgated by stewardship theory. As a result, Spear (2004) and Cornforth (2002, 2004) claim that stewardship theory may not appropriately reflect the role of board of directors in some mutual organisations.

This section has thus shed light into a few theoretical perspectives that have been adopted to explain governance in mutual organisations. Each of these theories defines a different way of how the board of directors works and also the paradoxes of the theory when applied to study governance in mutual organisations. The next section discusses the nature of previous governance and accountability studies in the mutual and co-operatives industry, and the researcher motivation in conducting research on the governance issues in mutual organisations.

2.7 The Importance of Studying Governance and Accountability in UK Mutual Organisations

Governance and accountability remains a vital subject in the UK as there have been a number of highly publicised scandals involving mutual organisations over the years. These include the capital shortfall of Co-operative Bank in 2013 subsequent to its merger with Britannia Building Society. The new merged bank's board was reported in *The Kelly Review,* headed by Sir Christopher Kelly, as unsuccessful in overseeing the executives, and that the executive directors failed to exercise sufficient prudent and effective management of the firm's capital and risks (HM Treasury, 2014). The collapse of UK credit unions was also associated with a weak standard of governance, internal control and financial accounting system. It was reported by Jones (2010) that the lack of effective governance and management led to the collapse of many large UK credit unions. Lord Penrose, a reviewer appointed to investigate the downfall of Equitable Life (a life insurance mutual in the UK in 2004), also contended that the failure of the mutual insurance company was due to ineffective scrutiny by executives and the board of directors lacked sufficiently skilled individuals (HM Treasury, 2004). Therefore, the collapse of some of these mutual organisations had led to the concern and debate about the state of governance and accountability in UK mutual organisations (Michie, 2013).

Nonetheless, many previous governance studies that had been carried out in the UK mainly focused on large private corporations (Brennan and Solomon, 2008, Solomon, 2013). Notably, there is very limited academic research which studies the governance and the operations of the board in UK mutual organisations (Shaw, 2006). Previous studies that had been conducted about mutual organisation in the UK include but are not limited to the following literature:

- Studies that investigated the extent of disclosure of financial information in Irish credit unions (see e.g. Hyndman et al., 2004, see e.g. Adam and Armitage, 2004, Michie and Llewellyn, 2010, Birchall, 2002, Hyndman and McKillop, 2004);
- Studies that explored and understood the motivation behind members' participation and monitoring in mutual organisations and co-operatives (see e.g. Birchall and Simmons, 2004, Birchall, 2013a);
- Studies which investigated the relevance and resilience of customer-owned business in financial institutions, football clubs, water utilities companies, or public sector organisations (see e.g. Birchall and Ketilson, 2009, Michie, 2011, Michie, 1999, Michie and Blay, 2004, Birchall, 2002);
- Studies which compared and contrasted how theory, such as democratic theory, agency theory and stewardship theory can be extended and applied to study governance in mutual organisations (Cornforth, 2002, Cornforth, 2004, Spear, 2004);
- Inquiries which were carried out by the House of Commons Treasury Committee to investigate reasons of the breakdown of mutual organisations such as mutual life insurance and building societies (HM Treasury, 2009, HM Treasury 2004).

This thesis addresses the limited but much needed research in the governance and accountability of mutual organisations and building societies. The rationale in which building societies have been selected as the context of this study are mainly because the UK. Building societies are one of the oldest types of mutual in the world and the UK. The sector was argued to have survived the 2008 financial crisis better than most investor-owned banks. Nevertheless, there were increasing financial scandals, governance and accountability problems surrounding the industry. Some of these issues received very limited attention from policy makers, academics, media, and members of the general public. The next chapter provides a review of the conceptual framework developed to explore and understand the governance and accountability issues in UK building societies.

2.8 Summary of the Chapter

This chapter has discussed on the importance of studying governance in mutual organisations. The chapter argues that there are increasing debates and discussions about mutual organisations' governance practices. However, research in this area receives very limited attention from scholars and practitioners, whether in the emerging economy market or the advanced economy market. The chapter also argues that previous theories (e.g. agency theory, stewardship theory and democratic theory) on mutual organisations' governance are mainly concerned with the role and responsibilities of the board of directors. There have been few studies which attempt to explore and understand the holistic state of governance practices in mutual organisations. This chapter concluded by emphasizing the significance of studying governance and accountability issues in mutual organisations, specifically within the UK building society sector. The next chapter outlines the conceptual framework of the research in studying and exploring the governance and accountability issues in mutual organisations, vis-a-vis the building society industry.

CHAPTER 3: Conceptual Framework

3.1 Introduction

In order to understand governance and accountability practices and issues in mutual organisations and building societies, the purpose of this chapter is to discuss how governance mechanisms provide a valuable medium through which accountability is met and discharged to various stakeholders. The chapter is structured into six main parts. Section 3.2 introduces and deliberates the nature of accountability. Section 3.3 highlights forms of accountability, which were drawn by prior research, to study accountability practices and processes in various economic entities. Section 3.4 justifies the reasons that the ideas of accountability are drawn, in order to study governance in mutual organisations. The section also discusses the limitations of previous theories of mutual organisations' governance. The summary of the chapter is highlighted in Section 3.5.

3.2 Nature of Accountability

The accounting literature on accountability is diverse. Some studies have examined accountability practices within specific contexts, such as the public sector (Sinclair, 1995), the private sector (Gray et al., 1995, Owen, 2008) or civil society organisations (Agyemang et al., 2009, O'Dwyer and Unerman, 2008, O'Dwyer and Unerman, 2007). A large body of literature has also concentrated on developing a conceptual framework based on accountability (see e.g. Dubnick, 2002, Roberts, 2009, Mulgan, 2000). Important issues pertaining to accountability as delineated in literature are discussed in the following sections.

3.2.1 Accountability as a Relational Concept

Accountability as a concept is arguably 'chameleon-like', abstract and complex in nature. It is variously defined in different disciplines and means different things to different people (Edwards and Hulme, 1996, Ebrahim, 2003a, Sinclair, 1995, Mulgan, 2000). According to Dubnick (1998), the meaning of accountability in English (or the Anglian concept) is different from Romance languages (e.g. French, Spanish and Italian) and Northern European languages (e.g. Dutch, Danish, and German), or in other words, from a *linguistic aspect*. In Romance languages, the term 'responsibility' is used in lieu of English accountability, and in Northern European languages, accountability is associated with *duty or obligation* (Dubnick, 1998).

From the *political science* aspect, Dubnick (1998) argues that to understand accountability requires tracing the roots of the English idea of accountability. According to the author, the history of accountability can be traced to the reign of William I, after the Norman Conquest of England. Twenty years after the Norman Conquest, William I required all property holders under his realm to 'render a count' of what they possessed to the royal surveyors. This exercise was not merely for tax purposes, but served as a foundation for royal governance (Bovens, 2007, Dubnick, 1998, Dubnick, 2002). Since the reign of William I, accountability has then moved from accounting (e.g. bookkeeping and financial administration) to include equitable governance and the accountability relationship between citizens holding the sovereign to account (Dubnick, 2002). For instance, ministers and public officials are required to publicly explain and justify policies to the general public, and to show willingness to admit to and provide remedy for errors (Licht, 2002).

Despite diverse ideas on accountability, Robert and Scapens (1985) and Gray and Jenkins (1993) contend that accountability is to make *ones assume the responsibility* for their conduct. This idea requires one to be *answerable,* or to provide an account with information through oral or written evidence and not always financial accounts, in order to demonstrate the actions that one is responsible for (Gray et al., 1996). According to Gray and Jenkins (1993), the right for the accountee to hold the accountor accountable for his action is due to the *accountability relationship* between them, that is *mediated by a formal or informal agreement.* An account is discharged when the accountor provides an account of the actions that it has taken up or foreborne to the accountee. The accountee will, in effect, evaluate the account and performance rendered, as well as have the right to probe further and request for additional information (Mulgan, 2000). As a result of the performance and account evaluation, the accountee will apply sanctions and rewards (e.g. formal or informal) to the accountor (Bovens, 2007, Mulgan, 2000). However, in certain cases, the accountor has a right to protect privacy and is entitled to withhold some information from the accountee if it disadvantages other accountees (Ijiri, 1983).

Mulgan (2000) views the original concept of accountability provided by Gray and Jenkins (1993) and Gray *et al.* (2014) was very much about the external accountability relationship between accountor and accountee. According to Mulgan (2000, p.556), accountability has also included “an internal sense which goes beyond the core external focus of the term”. The internal aspect of accountability, as argued by Roberts and Scapens (1985), is the means by which we seek to remind each other of our reciprocal dependence. Such reciprocal dependence is due to individual morality values and beliefs that humans are bonded with each other, not simply in narrow, calculable ways, but also more broadly in intended and unintended ways. Therefore, accountability can be understood from a number of different perspectives involving *reciprocal rights and moral responsibility*, as well as *duties and obligations*.

Similar to the notion of accountability provided by Mulgan (2000), Gray and Jenkins (1993) and Gray *et al.* (2014b), this thesis considers accountability to be derived from the *accountability relationship* between two or more parties (not necessarily defined by economic or legal contracts). It entails one to be *answerable for one's conduct and responsibilities* and *accounting information* is typically an instrument drawn to discharge the accountability. Governance is considered the structure, system and mechanisms in place to control and monitor the achievement and discharge of accountability. Accounting, accountability and governance are therefore inter-related. The next sub-sections synthesise multiple forms of accountability as explained in the literature.

3.3 Synthesis of Accountability in Literature

As accountability is derived from relationships, Ebrahim (2003a, 2010) and Fry (1995) contend that accountability encompasses dual aspects: formal and informal dimensions. Laughlin (1990) considers *formal accountability* as resulting in written forms of recording and defining expectations such as contractual and legal obligations. On the other hand, *informal accountability* is derived as a consequence of internal, private, morally right or voluntary reasons and the accountability is commonly discharged in less structured settings (e.g. in a social setting where defined roles are unclear between colleagues) (Roberts, 1991). The following subsection summarises different types of accountabilities as debated in the literature under the categorization of formal and informal accountabilities.

3.3.1.1 Formal External Accountability

Formal external accountability is conceived as a type of accountability that is based on an external accountability relationship between an accountor and accountee. It is a type of accountability that is short term in orientation and favours accountability to group of external stakeholders who are mainly influential, powerful and resourceful-such as institutional shareholders, NGOs' donors, regulators and enforcement bodies. These stakeholders generally have formal oversight, control or influence on directors, managers and organisations (Ebrahim, 2003b, O'Dwyer and Unerman, 2007).

In most situations, powerful external stakeholders can instil a sense of anxiety or vulnerability in managers. Managers must continually strike to demonstrate 'performance' or adherence to rules and procedures set out by those dominant external stakeholders (O'Dwyer and Boomsma, 2015). Performance tends to be measured around resource use, measuring immediate outcomes using short-term quantitative targets, or standardised indicators which focus exclusively on financial performances, project outcomes and mission achievement (Edwards and Hulme, 1996). Punishment will be imposed by powerful external stakeholders if rules are not followed or missions have not been achieved (O'Dwyer and Boomsma, 2015).

However, according to O'Dwyer and Unerman (2008) and Ebrahim (2003b), overemphasis on formal external accountability has damaging effects on an organisations' ability to act as an effective catalyst for social change, and may divert the attention of the accountable entity to be accountable to less powerful stakeholders (e.g. employees, beneficiaries, communities, environment and societies). Specifically, in the setting of the third sector organisations

(TSOs)[3], overemphasis of formal external accountability could threaten and re-orient the underlying *raison d'être* of the social operations and missions of the TSOs (O'Dwyer and Boomsma, 2015, Ebrahim, 2005).

This is as exemplified in the setting of microfinance in Zimbabwe. Dixon *et al.* (2007) observed that loan officers of a Zimbabwe microfinance organisation were faced with powerful formal external accountability pressures from donors of the microfinance. The threats of donors to withdraw funding from the microfinance entity had put immense stress on loan officers to pursue inappropriate methods to compel repayment from defaulters. Consequently, there were detrimental effects on the microfinance's short and long-term survival as clients' trust and loyalty towards the organisation diminished over time.

The examples of formal external accountability include that of *hierarchical, functional and imposed accountability* as promulgated by O'Dwyer and Unerman (2008), Edwards and Hulme (1996) and O'Dwyer and Boomsma (2015). **Table 3-1** further summarises other instances of formal external accountability that are at times intertwined with formal internal accountability.

3.3.2 Formal Internal Accountability

Formal internal accountability focuses on an exchange of accounts that takes place within an organisation. There are various forms of formal internal accountabilities that are debated in the literature, such as managerial accountability, the 'individualising form of accountability'

[3] Third sector organisation is regarded as value-based organisation which embraces social purposes in the organisations' operations and objectives. Profit is utilised to finance the achievement of the social objectives of the organisations. The HM Treasury considered voluntary community organisations, social enterprises, and mutuals and co-operatives as types of TSOs in the UK.

or 'hierarchical accountability' (Roberts, 1991, Stewart, 1984, Sinclair, 1995). These accountabilities generally attempt to look into accountability practices between managers and subordinates, in terms of managers holding subordinates accountable for the performance of delegated duties (Sinclair, 1995), or subordinates holding managers accountable for their functional responsibilities (Stewart, 1984), or how each functional department in an organisation achieves its own predefined tasks and predetermined objectives which are in congruence with the overall vision of the organisation (Messner, 2009).

Various mechanisms have been implemented to measure or control the achievement of formal internal accountability. These include the implementation of performance management and assessment tools such as a balanced scorecard, benchmarking, budgetary planning and control, staff improvement programmes and staff performance evaluations (Lindkvist and Llewellyn, 2003, Connolly and Kelly, 2011). An array of management accounting literature has specifically studied the implementation and implications of these accounting mechanisms (see e.g. Roberts, 1991, Messner, 2009, Roberts and Scapens, 1985). However, it is beyond the scope and intention of the present research to review each of the management accounting mechanisms.

Lindkvist and Llewellyn (2003) and Roberts (1991) argue that overemphasis of formal internal accountability could cause negative consequences for the staff and organisation. This is primarily because formal internal accountability is often associated with achievement of targets, rewards and punishment of staff and the hierarchical system in an organisation. Over-prioritization of these mechanisms and structures could cause employees to be strictly guided and controlled by rules and plans, and forget the interdependence between themselves and their colleagues. The long term effects of this could transform employees into mindless 'automatons' (Lindkvist and Llewellyn, 2003), and to be in a constant mental state of nervous preoccupation with as to how they are seen by others (Roberts, 1991). Due to that, Roberts (1991) argues that a 'socialising form of accountability'—a type of informal internal accountability—could serve to neutralise the experience of work and mitigate individuals from the impersonal harshness of hierarchy system in organisations. This informal internal accountability is further discussed in the next section and **Table 3-1** summarises other sub-types of formal internal and external accountabilities under accountability for compliance, resources, performances, procedures and leadership that are synthesised from the literature.

Nature of the Accountability	**Overall Definition**	**Form of Accountability**	**Definition of the Form of Accountability**	**Examples of Accountability Mechanisms (e.g. Process, Tools or Practices)**
1) ***Compliance-*** Fulfilling legal obligations	This accountability is to fulfil legal and contractual obligations	Legal	Ensuring that power given by law is not exceeded (Stewart, 1984).	Filling annual financial and tax return, meeting legal and regulatory standards.
			Specific responsibilities are formally and legally conferred upon authorities and legal scrutiny is based on detailed legal standards, prescribed by laws and standards (Bovens, 2007).	
		Professional	Associate with professional and expertise integrity. The sense of duty that one has as a member of a	

Nature of the Accountability	**Overall Definition**	**Form of Accountability**	**Definition of the Form of Accountability**	**Examples of Accountability Mechanisms (e.g. Process, Tools or Practices)**
			professional or expert group, in which the individual occupies a privileged and knowledgeable position in society (Sinclair, 1995).	
			Accountabilities towards professional bodies. Professional bodies generally lay down the codes for acceptable practices that are binding for all members and the members' practices are monitored and enforced by the professional supervisory bodies (Bovens, 2007).	

Nature of the Accountability	**Overall Definition**	**Form of Accountability**	**Definition of the Form of Accountability**	**Examples of Accountability Mechanisms (e.g. Process, Tools or Practices)**
			Requires the practices of acquired techniques and values of the particular profession and the exercise of professional judgment during the practices, typically in an unsupervised context (Mulgan, 2000).	
2) ***Resources***- Proper management of resources	To ensure that organisational resources and funds are properly	Efficiency	No waste of use in resources (Stewart, 1984).	Annual reports, waste management programme, environmental management system.
		Administrative	Monitoring the processes by which input is transformed (Sinclair, 1995).	

Nature of the Accountability	Overall Definition	Form of Accountability	Definition of the Form of Accountability	Examples of Accountability Mechanisms (e.g. Process, Tools or Practices)
	handled and used in accordance with the authorised manner.		Exercising regular financial and administrative control (Bovens, 2007).	
		Fiduciary	Concerned with the professionalism in which organisations are run and the safeguarding of organisations' funds, assets and future (Dhanani and Connolly, 2012).	
		Financial	Concerned with financial performance of organisation. Management needs to account for	

Nature of the Accountability	Overall Definition	Form of Accountability	Definition of the Form of Accountability	Examples of Accountability Mechanisms (e.g. Process, Tools or Practices)
			the financial position and to convey operational continuity, stability, viability and efficiency of the organisation (Dhanani and Connolly, 2012).	
		Fiscal	Ensuring that funds have properly been utilised in accordance to stipulated constitutions (Leat, 1990).	
3) ***Performance***- Meeting standards and	To ensure that performance of organisations	Performance	Linked with the performance of organisation and whether it meets with required standards (Stewart,	Performance assessment and evaluation (e.g. balanced scorecard,

Nature of the Accountability	Overall Definition	Form of Accountability	Definition of the Form of Accountability	Examples of Accountability Mechanisms (e.g. Process, Tools or Practices)
objectives	meet required standards.		1984).	benchmarking, social return on investment).
		Result	Concerned with outcomes (e.g. whether good consequences are resulted). The nature of the account is by giving an adequate account showing what has been done to produce good effects and results (Goodin, 2003).	
4) ***Procedures***- Undertaking correct activities	To ensure that correct activities have been undertaken to	Programme	Concerned with whether works carried out by an organisation had met its objectives (mission) (Stewart, 1984).	Continuous improvement through training and organisational learning; monitoring and

Nature of the Accountability	Overall Definition	Form of Accountability	Definition of the Form of Accountability	Examples of Accountability Mechanisms (e.g. Process, Tools or Practices)
	meet organisational goals.		Organisation continuously identifies and interprets its own standards of acceptable practice (Connolly and Kelly, 2011).	reputational sanctioning by peers; stakeholder engagement.
		Process	Relate to internal organisational operations and are designed to confirm that management processes and procedures embody societal norms and beliefs (i.e. look at how organisations achieve their objectives) (Dhanani and Connolly, 2012).	

Nature of the Accountability	**Overall Definition**	**Form of Accountability**	**Definition of the Form of Accountability**	**Examples of Accountability Mechanisms (e.g. Process, Tools or Practices)**
			Ensure proper procedures have been followed in accordance with the organisation's constitutions (Leat, 1990).	
		Action	The nature of the account is to show whether what has been done is right or acceptable (Goodin, 2003).	
5) ***Leadership***- The role of management in setting up	Management and directors ensure that organisations	Managerial	A person's location within a hierarchy in which a superior calls to account a subordinate for the performance of delegated duties	Staff's performance appraisal, learning and training, promotion and

Nature of the Accountability	**Overall Definition**	**Form of Accountability**	**Definition of the Form of Accountability**	**Examples of Accountability Mechanisms (e.g. Process, Tools or Practices)**
and meeting goals	have carried out and met organisational objectives, mission and vision.		(Sinclair, 1995).	demotion, bonuses.
			Accountability of a subordinate to a superior in an organisation (Stewart, 1984).	
			The process of calling to account takes place along the strict lines of the chain of command (Bovens, 2005).	

Table 3-1: The typology of various formal internal and external accountabilities (Source: Synthesis based on the above mentioned authors)

3.3.3 Informal External Accountability

Informal accountability focuses on account giving by an organisation or individual that is not subjected to formal control mechanisms. Instead, this form of accountability is driven by a sense of responsibility, possessing an *ethical, moral or value based dimension* which is largely absent in formal types of accountability (Roberts, 1991, Messner, 2009, Lindkvist and Llewellyn, 2003). Gray (2006, p.335) contends that informal forms of accountability take precedence over formal forms of accountability, particularly in the majority of TSOs as:

> …relationships between NGOs [or TSOs] and their stakeholders—and especially their funders—is not a purely economic one (unlike that between shareholder and company). It is a more complex relationship and reflects more complex attitudes and interactions between the organisation and its stakeholders. Furthermore, the relationship may not be—nor needs to be—as formal and as distant as that between shareholders and company (the yardstick against which all accountability relationships appear to be judged). Matters such as trust, emotion, conscience, social contracts, mutuality etc. all enter into the relationship and to reduce such complexity to monotonic performance measures is to demean the complexity of the relationship.

There are two types of informal accountabilities that are deliberated in the literature: informal external and informal internal. *Informal external accountability* prioritises account-giving to less powerful external stakeholders in a more informal setting. Unlike formal external accountability in which external stakeholders have the power to influence an accountable entity to be accountable, external stakeholders of informal external accountability generally have less power to impose, enforce and monitor the accountor to undertake certain duties or require formal account from them (e.g. to verify that the formal account has been discharged) (Osman, 2012, Boomsma and O'Dwyer, 2014). This is mainly because informal accountability is based on normative reasons and moral responsibility. However, in certain conditions, some external stakeholders of informal external accountability have great influence on firms' activities. Specifically, in countries with strong human rights advocacy and democratic values, external stakeholders such as NGOs and media have a strong power to influence accountors to be accountable. This has been reflected in the social accounting research where Belal and Owen (2007) and Islam and Deegan (2008) found that the media plays a prominence role in influencing companies' disclosure of social and environmental matters.

Even so, informal external accountability typically prioritises closeness in which a closer relationship requires less formal accountability mechanisms, but more opportunities for accountee and accountor to communicate, collaborate, elaborate, clarify and question the accountability issues (Gray et al., 2006, Taylor et al., 2014, O'Dwyer and Boomsma, 2015). This means that mechanisms of accountability tend to be less guarded and flow of communication is more personalised, such as face-to-face interaction, open dialogue or stakeholder engagement. According to Agyemang *et al.* (2009), tension often arises when there is a contradiction in the discharge of formal external and informal external accountabilities. The dominance of formal external accountability, which is enforced by powerful stakeholders, may at times lead informal external accountability to receive less attention. Therefore, operationalising informal external accountability in practice can sometimes be difficult. However, Vu and Deffains (2013, p.335) argues that this form of accountability could be enhanced and enforced through "norms of governance, ethics, trust, identity, professional advancement, or reputation". The most commonly discussed informal external accountability in the NGO literature is the *downward accountability*. Downward accountability in NGOs is often associated as accountability towards beneficiaries.

3.3.4 Informal Internal Accountability

The literature on informal internal accountability can be characterised under two main categories: 'individual, personal or felt accountability' (Lindkvist and Llewellyn, 2003, Sinclair, 1995, Fry, 1995) and the 'socialising form of accountability' as defined by Roberts (1991, 2001). *Felt accountability* is conceived as an accountability through which organisational actors takes voluntary intrinsic responsibility to be accountable and answerable to themselves and others due to their personal values (Sinclair, 1995, Fry, 1995). The individual personal values are influenced by both the nature of the organisation and by wider contextual factors such as shifting societal values and beliefs (O'Dwyer and Boomsma, 2015). For instance, Sinclair (1995) claims that an individual's felt accountability may be driven by an individual's role and responsibilities in the organisation, as well as his historical traditions, personal experience, religious and ethical sources. Sinclair (1995, p. 231-232) also asserts that individuals with strong felt accountability are more peculiar and they "won't do what's required by them, if they think it's required for the wrong reasons". These individuals would define the scope of their responsibility according to what they feel is right and their 'calculus of accountability' is drawn from their moral values. Further, individuals who are largely driven by felt accountability have the tendency to be initiative and creative (Lindkvist and Llewellyn, 2003). Rather than being imprisoned by the hierarchical system of social orders, individuals with strong felt accountability conform less to other expectations and has the propensity to be creative to engage in imagination (Lindkvist and Llewellyn, 2003). However, Unerman and O'Dwyer (2006) caution that over-prioritization of felt accountability by the accountor may encourage priority towards morality and ethical values alone. This could ultimately lead the accountor to be uninterested in assessing organisational impacts towards other external stakeholders as the individual is blindsided by his own perception of what is morally and ethically right (O'Dwyer and Boomsma, 2015).

Roberts (1991) claimed that the '*socialising form of accountability'* is another form of informal internal accountability. It is an accountability which is based on reciprocal and mutual understanding between an accountor and accountee, particularly between managers and subordinates. The 'socialising form of accountability' is established through face-to-face interactions among individuals through informal spaces of organisation settings (e.g. lunches and after work drinks, toilets, corridors), or unsurveilled back regions of organisational life where there is no bureaucratic system of accountability structuring the relationship.

The importance of informal interactions and talks is that they reflect and reinterpret the official version of organisational reality as well as providing the basis to shape loyalties ties, friendship, mutual understandings and dependence among individuals. In this sense, socialising forms of accountability serve to humanise the experience of work and "cushion the individual from impersonal harshness of hierarchy especially at lower levels of the organisation" (p. 364). It also helps to establish trust and mutual understanding among organisational members, and make expensive and time-consuming control systems unnecessary (Lindkvist and Llewellyn, 2003). Even so, Roberts (1991) contends that the relationship between accountor and accountee in socialising and individualising forms of accountability is reciprocal. If a socialising form of accountability is not properly governed, the effect would lead to abuse of power, nepotism, favouritism and abandonment of wider responsibilities beyond the group. In this sense, a bureaucratic system of individualising forms of accountability is in place to inhibit the personal abuse of power and the fraudulent potential of a local group (Edwards and Hulme, 1996).

The above sub-sections have synthesised different forms of accountability discussed in the literature. There is no single accepted definition of accountability, but all previous studies agree that accountability is basically derived from the *accountability relationship* between accountor and accountee. In order to understand the accountability relationship, it is important to determine who the accountor is and to whom the accountability is directed. The discharge of the types of accountability (i.e. accountability for what) by an accountable entity is also influenced by the nature of the accountability relationship and is liable to change in different contexts (Roberts, 1991, Ebrahim, 2005, Ebrahim, 2003b).

An accountability relationship between an accountor and accountee in a profit-maximising firm would be different from an accountability relationship in a mutual organisation. The accountability relationship in similar types of organisations may also vary depending on the shifting societal values and beliefs affecting the organisation (O'Dwyer and Boomsma, 2015). Due to these differences, previous research on accountability has developed various frameworks to study accountability processes and practices in different types of economic entities (see e.g. Hyndman and McDonnell, 2009, O'Dwyer and Boomsma, 2015, O'Dwyer and Unerman, 2007, Najam, 1996, O’Dwyer and Unerman, 2008). The following section introduces the forms of accountability particularly relevant in the present study and the importance of governance systems in achieving the accountabilities.

3.4 Conceptualising Governance and Accountability in Mutual Organisations

Due to the increasing governance and accountability issues relating to mutual organisations and building societies, this research is therefore motivated to study and understand the state of mutual organisations vis-a-vis the UK building societies governance and accountability practices and issues. In order to understand the state of mutual organisation’s governance and accountability practices, the research extends and modifies the governance framework initially proposed by the *Confederation of Finnish Co-operatives* (2000) and Ketilson and Brown (2011), to include applicable forms of accountability as delineated in the above sections and literature.

Chapter 2 has highlighted that the framework proposed by the *Confederation of Finnish Co-operatives* (2000) and Ketilson and Brown (2011), was drawn to understand the governance and management control in mutuals and co-operatives, includes looking into the organisations' internal, external and intermediate governance structures. The framework is modified in the present research mainly because first, the governance framework was designed based on the context of co-operatives and mutuals in Finland and Canada. Since mutual organisations are different depending on the country of origin and historical movement, therefore, modifying the initial governance and management framework to be in line with the UK context is crucial. Second, many previous studies commonly adopt agency theory, stewardship theory and democratic theory to understand governance practices in mutual organisations where these theories examined one dimension of an accountability relationship (Cornforth, 2002, 2004). For instance, agency theory mainly emphasises the conformance role of the board of directors to ensure that mutual organisations are run in the best interests of customers. Equally, stewardship theory emphasises that the role of the board of directors is to drive forward organisational performance through adding value to the organisation's strategies. When mutual organisations are performing well financially, stewardship theory argues that the organisation is then adding value to customers' interests (Donaldson and Davis, 1991).

It can be argued that stakeholder theory as promulgated by Freeman (2010) focuses on the accountability relationship between an organisation and its multiple stakeholders rather than the owners, and it may probably be relevant to study governance in mutual organisations. Nevertheless, the scope of stakeholder theory (specifically the managerial branch), as argued by Deegan and Unerman (2011), Deegan (2002) and Gray (2010), has too narrow a focus on dominant stakeholders. The dominance of stakeholders is determined by the resources provided by them on which companies rely to survive. This suggests that the more powerful and important the stakeholders, the more efforts will be made by companies' managers to respond and manage the demand of powerful stakeholders (Deegan and Unerman, 2011; Gray, 2010, Gray et al., 1997). In this regard, the research contends that stakeholder theory may not be adequate in satisfying the normative (moral) rights demands of accountability for all stakeholders (Gray et al., 1997). While stakeholder theory is not adopted to study governance practices and issues in the present study, it should be acknowledged that an understanding of stakeholder theory has been helpful in identifying and defining the potential stakeholders of mutual organisation and the types of accountability associated with the stakeholders.

In this thesis, it is argued that all organisations, regardless of whether they are NGOs, private firms, social enterprises, mutual organisations or co-operatives, have accountabilities and responsibilities to all stakeholders whose stakes may be affected by the organisation's actions and activities (O'Dwyer and Unerman, 2008, Gray et al., 2006). As such, studying governance in mutual organisations based on divergent types of accountabilities reflects a multitude of accountability relationships between mutual organisations and wider constituents, rather than a single aspect of accountability relationship, as propagated in agency theory, stewardship theory and democratic theory. The integrated governance model proposed by the *Confederation of Finnish Co-operatives* (2000) and subsequently modified by Ketilson and Brown (2011) outlines a full range of governance structures for mutuals and co-operatives to achieve accountability to customers and regulators. However, their models disregard mutual organisations' accountabilities towards personnel, community, societies and environment.

Since accountability is a dynamic and multifaceted concept and consists of various forms (Stewart, 1984, Sinclair, 1995), studying the multiple forms of accountabilities (i.e. for what and to whom), the practices and process of accountability (i.e. how), the reasons specific forms of accountabilities are important (i.e. why) and how governance structures foster the achievement of accountability, will therefore provide clarity and an overview of the whole governance and accountability practices, process and issues in mutual organisations. The study therefore developed a conceptual framework (namely a mutual accountability framework) in order to understand accountability and governance practices and issues in building societies. Within the mutual accountability framework, four types of accountabilities—*personnel, financial-social dual, social accountabilities and compliance accountabilities*—have been identified as the main and important forms of mutual accountability.

Figure 3-1 depicts the four types of accountabilities or the *mutual accountability framework* expected to prevail in mutual organisations. *Personnel accountability* requires mutuals to be responsible and accountable to their staff by ensuring that proper systems and mechanisms are in place to foster employees' benefits and welfares, as well as personal and professional development. *Financial-social dual accountability* requires elected representatives to be *financially and socially accountable* to customer-members in terms of financial performances and social impacts that businesses create to customers. On the other hand, being *socially accountable* requires mutuals to be responsible and accountable to the environment, local community and general public by doing good deeds and serving the needs of individuals who are disadvantaged, marginalised and helpless. *Compliance accountability* entails mutuals complying with rules and regulations set out by policymakers and regulators. External governance structures (such as soft and hard laws) facilitate the achievement of compliance accountability. The achievement of mutual accountability encapsulates the four types of accountabilities. Internal, external and intermediate governance structures are designed to add value to business and foster the achievement of mutual accountability.

The thesis suggests that the mutual accountability framework as presented in **Figure 3-1** provides clarity to researchers and practitioners in understanding the types of accountabilities expected to exist in mutual organisations (e.g. to whom, for what, how and why the entity is accountable). The mutual accountability framework is also considered the normative conceptual framework or ‘skeletal theory’ to understand and evaluate the governance and accountability practices in mutual organisations and UK building societies.

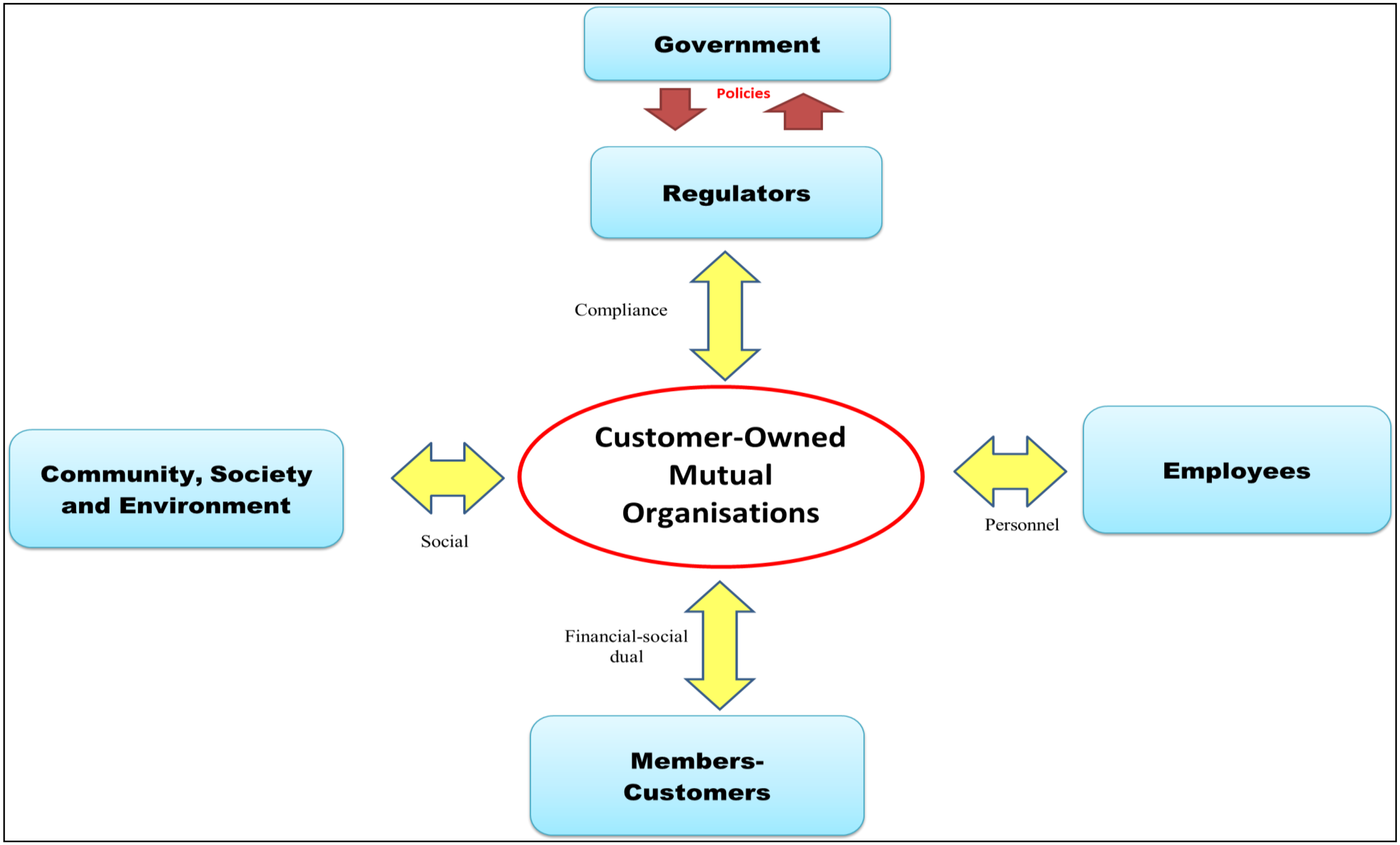

Figure 3-1: Possible Mutual Accountability Framework in Customer-Owned Mutual Organisations (Source: Author)

3.5 Summary of the Chapter

This chapter reviewed the concept of accountability in academic literature. The review in this chapter suggested that accountability derives from the relationship between parties and this relationship is socially, morally and legally determined, which confers a responsibility from the accountors to the accountees. The chapter maintained that accountability is related to governance because governance affects the achievement of accountability, and accountability bolsters governance. Due to that, the chapter conceived the mutual accountability framework and the expected governance mechanisms in customer-owmed mutual organisations. The mutual accountability framework is regarded as the normative conceptual framework of this research in understanding the empirical practices. The following chapter introduces and discusses the development of UK building societies and emphasises the significance of selecting this industry as the case context.

CHAPTER 4: Introduction to Case Context: The UK Building Societies

4.1 Introduction

This chapter justifies the rationales that the UK building societies serve as the background and context of study. The chapter first discusses the development of the UK building society sector since its emergence in the 18^{th} century. Section 4.3 explains the socio-geographic history of the UK leading to the development of the building society sector. Section 4.4 highlights the effects of the *Building Societies Act 1986* (amended 1997) towards the building society sector. Section 4.5 discusses the implications of the 2008 financial crisis for the demutualised building societies and Section 4.6 argues that the building society sector did not escape the crash unscathed. Section 4.7 considers the implications of the failure of some building societies during the 2008 banking crisis and the consequences of the banking regulatory reforms. While Section 4.8 introduces the governance structures of building societies, Section 4.9 provides the rationales for investigating the governance and accountability practices and issues in the industry. Concluding remarks are provided in Section 4.10.

4.2 A Brief Historical Movement of UK Building Societies

The UK building society is a type of financial mutual that specialises in savings and mortgage lending. It is incorporated under its own legislation, the *Building Societies Act 1986*. As a type of financial mutual, the financial reserve of a building society is owned by its customers, who are also the savers and borrowers. The emergence of building societies can be traced back to the 18^{th} century during the industrial revolution, when peasants came to town and cities searching for factory jobs. Due to poor living conditions in the overcrowded urban areas, workers grouped together to save for decent homes.

Building societies at that time were considered as ‘terminating societies’ in which funds were pooled from savers to buy land and construct property. Once all members had been housed, the building society would be dissolved (Barnes, 1984, Ingham and Thompson, 1993). In this regard, building societies were not an economic entity and they did not make any profit. Instead, they were groups of people coming together, helping out another group of people, and the group terminated after it achieved ‘mutual aid’(James, 2000).

It was the basis of the terminating societies from which permanent societies then evolved. The formation of permanent societies was based on the notion that money would be pooled from those interested in saving (e.g. savers), but did not want to own a house. The surplus of money would then be lent to those interested in owning a house (e.g. borrowers), but did not have enough capital. There was such a rapid expansion across Britain in the 19th century that all terminating societies ceased, and those in place today are exclusively the permanent societies. Through the establishment of permanent building societies, the latter have since become the financial intermediaries between borrower members and investing members (Barnes, 1984). The first permanent building society was founded in 1845, The Metropolitan Equitable, and the first legislation which gave building societies their official recognition was the *Regulation of Benefit Building Societies Act 1836* (BSA, 2013c).

Building societies grew rapidly in Britain in the 19th century due to their historical movement as a financial mutual that specialised in provision for house ownership. In 1890, there were 2,286 building societies and the number of building societies reached its peak at 3,642 in 1895. Due to intense competition among building societies in the 1900s, the number of building societies decreased continually from 1,723 at 1910 to 726 by 1960 (Boleat, 1982). Deregulation in housing and financial markets in the 1980s intensified the competition between banks and building societies. Some building societies demutualised and converted into shareholder-owned banks. This led to the number of building societies decreasing from 481 in 1970 to 67 in 2000 (Stephens, 2007, Gough, 1982). At the date of writing, there were only 44 building societies remaining and they accounted for an average of 20 per cent of the total outstanding mortgages and for 20 per cent of all retail deposits in the UK (BSA, 2015a).

4.3 The Socio-Political and Economic Environment In United Kingdom

The next sub-sections discuss the implications of the socio-political and economic conditions of the UK towards the UK building society sector. The sub-sections shed light on the development of the building society sector prior to the 1980s, and the implications of neoliberal reforms introduced by the conservative government towards the building society industry.

4.3.1 The Development of the Building Society Sector Prior to the 1980s

After the First and Second World Wars, Britain, together with many countries involved in the wars, were fearful of the return of such catastrophic events. Many of these countries focused on growing their countries' economies, politics and societies. The macroeconomic policy of the pre-1980 UK government was that the state should fully control the economy, actively intervene in industrial policy and set standards for social wages by constructing a variety of welfare systems (e.g. housing, healthcare, education). Private firms and the banking sector were highly regulated and controlled by the state, whereby the focus of the financial services sector was on stability rather than competition and innovation (Harvey, 2005, Steger and Roy, 2010).

The building society sector managed to monopolise the savings and mortgage markets due to their history as specialist mortgage and savings providers and the government's macroeconomic policies which enhanced the sector's competitive advantages (Boleat, 1982, Barnes, 1984). For instance, the Supplementary Special Deposit Scheme (also known as the 'Corset'), which was introduced in 1973, required banks and finance houses (with the exception of building societies) to place special deposits with the Bank of England. Many banks and finance houses were reluctant to expand their businesses into the mortgage market as they were constrained by the amount of funds they could lend and they were effectively penalised if their liabilities exceeded their assets (Stephens, 2007).

Furthermore, building societies were allowed to deduct tax from savings accounts using a 'composite rate' rather than the 'standard rate' of interest (Stephens, 2007). This arrangement has been in place between the sector and Inland Revenue since the 1890s to facilitate tax collection by the Inland Revenue (Boleat, 1982). The composite tax rate arrangement assists building societies to attract more savings from taxpayers as the composite rate was normally lower than the standard rate. The composite tax rates in 1955 and 1975 were at 24.17 per cent and 27.75 per cent respectively. On the other hand, the standard tax rates in 1955 and 1975 were at 42.5 per cent and 35 per cent respectively (Boleat, 1982, McKillop and Ferguson, 1993).

The building society sector operated as an oligopoly in the mortgage and savings markets by the end of 1970s. The sector accounted for 50 per cent of the savings market in 1973 and between the years 1973 and 1979, the average annual mortgage lending of the sector was 82 per cent and reached its peaked at 96 per cent in 1977 and 1978 (Boleat, 1982, Gough and Taylor, 1979, Stephens, 2007). However, the dominance of building societies was under threat towards the end of 1970s. They were constantly criticised for being discriminatory in their lending, responsible for inadequate lending to meet demand and were insufficiently accountable to their members (Barnes, 1984, Beecher, 2011). The BSA cartel, which was established to recommend and advise on savings and mortgage interest rates for the whole sector, was also criticised as being a political instrument used by political parties such as the Conservatives and Labour to keep interest rates at a politically sensitive number[4] during election times (Klimecki, 2012, Boleat, 1982, Barnes, 1984). Due to these criticisms and along with Margaret Thatcher's neoliberal reforms, the mortgage and financial services markets, which were heavily politically protected by the government, were then transformed into one of the most deregulated markets in the 1980s (Klimecki, 2012).

4.3.2 Deregulation of the Financial Market and Demutualisation of the Building Societies

The 1980s opened up a new economic era in Britain whereby emphasis was placed on neo-liberalist ideology (Jessop, 2003). In the early 1970s, Britain suffered from severe stagflation where unemployment and inflation were very high (Harvey, 2005). Inflation rose from 9 per cent in 1973 to 16 per cent in 1974 and peaked at 24 per cent in 1975, the second highest inflation rate since World War 1 (Pettinger, 2011). On the other hand, unemployment increased in the mid-1970s, to 4 per cent and reached a climax of 13 per cent in 1982 (Denman and McDonald, 1996). Due to these factors, the country suffered huge deficits and required a bailout by the International Monetary Fund (IMF) in 1975 and 1976.

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[4] This approach was initially developed in 1939 when competition between the societies was so intense that the BSA fixed the share and mortgage rate for the whole industry, in a way that the inflow of funds matched the outflow, as well as providing the building societies with sufficient surplus to add to reserves. However, the cartel was considered to be a political instrument used by the government to gain votes at election times. It has been reported that on a number of occasions the BSA was given donations by both the Labour and Tory parties in order to keep the interest rate below a politically sensitive number.

The IMF provided two options to the UK government: to either cut back the state budget or declare bankruptcy. The then government (i.e. the Labour party) opted to cut the state budget which led to dissatisfaction among taxpayers. Consequently, the Labour Government lost public support and the 1979 election to the Conservative party of Margaret Thatcher (Harvey, 2005). As Prime Minister, Margaret Thatcher was opposed to the Keynesian economy of increasing the taxes on private wealth to resurrect the country's economy. Instead, Thatcher unleashed numerous neoliberal reforms by:

a) **liberalization**: promoting free market forms of competition (as opposed to monopolistic or state monopolistic ones) as the most efficient basis for market forces;

b) **deregulation**: giving economic agents greater freedom from state control and legal restrictions;

c) **privatization**: reducing the public sector's share in the direct or indirect provision of goods and services to businesses and community alike;

d) **(re)commodification**: of the residual public sector, to promote the role of market forces, either directly or through market proxies;

e) **internationalization**: encouraging the mobility of capital and labour, stimulating global market forces, and importing more advanced processes and products into Britain as a means of economic modernization; and

f) **reduced direct taxes**: to expand the scope for the operation of market forces through enhanced investor and consumer choice (Jessop, 2003,p.5).

The impact of neo-liberal reforms towards the housing and financial markets included the eradication and replacement of the traditionally favoured council housing with individual property ownership (Boddy, 1989). The Conservative Government supported the idea that personal home ownership encouraged independence, and council housing was alleged to cause a waste of state resources[5] (Klimecki, 2012). The Conservative Government therefore implemented the 'Right to Buy'[6] initiative which opened up an opportunity for council tenants to purchase their own properties with discounts depending on the length of their tenancy, through the *Housing Act 1980*. More than a million social housing units were sold by the end of 1990s (The Guardian, 17 April 2013) and around 2.3 million homes were added to the private market by the end of 2004 (Williams, 2007).

In order to facilitate the sale of council housing, the Conservative Government had also liberalised the financial market to allow the entrance of banks and other mortgage lenders into the mortgage market. The Wilson Committee and Bow Group considered that restricting the interest rate competition between banks and building societies would be anti-competitive and discriminated against homebuyers (Boddy, 1989). Major regulatory and legislative changes were made by the government and these include: the removal of foreign exchange control and the 'Corset' in 1979 and 1980 (Buckle and Thompson, 2004), the abolishment of the BSA cartel and composite tax, the removal of the asset requirements which required banks to lodge 12.5 per cent of their assets in specified range of assets, the abolishment of building societies from the exemption of competition, credit control and legislation, and the

[5] It has been argued that Labour traditionally favoured the development of council housing, while the Conservatives promoted individual property ownership. These contrary ideological positions on housing were often marginalised by the opposed administration after World War 2, depending on whether Labour or the Conservatives were in power.

[6] The Right to Buy scheme is a policy in the UK which gives the council tenants and some housing associations the legal right to buy, at a large discount, the home they are living in.

introduction of ‘Big Bang’ and the *Financial Service Act 1986*[7] (Gola, 2009, Marshall et al., 2012). **Figure 4-1** summarises the major changes in the legislation and regulations between 1962 and 2000 which affected the building society sector.

[7] The ‘Big Bang’ was considered to enable London to become one of the top global financial centres in the present day. It opened up the ‘clubby’ LSE to entities outside the LSE and “led to the creation of large and complex banking financial conglomerates engaged in the whole range of universal banking business” (Gola, 2009, p. 16).

Table 1. Major changes in legislation and regulation affecting building societies

1962	Building Societies Act—delimited the activities of building societies to mortgage lending using retail funding.
1979	Ending of exchange controls.
1980	'Report of the Committee on the Functioning of Financial Institutions' argued collective 'cartel' arrangements gave building societies an artificial competitive advantage and had negative impacts on the mortgage markets.
1980	Ending of the 'corset' (supplementary special deposit scheme) introduced to curb bank lending.
1981	Scrapping of building society exemption from Competition and Credit Control legislation.
1981	Abolition of reserve asset requirement requiring banks to lodge at least 12.5% of their deposits in a specified range of liquid assets.
1982	Ending of hire purchase restrictions.
1983	Collapse of the building society cartel.
1983	Building societies given access to wholesale money markets.
1983	Building Societies Association report 'Future Powers of Building Societies' argued they should be allowed to undertake a wider range of activities, and conceded that building societies should no longer operate as a cartel.
1984	Green paper 'Building Societies: A New Framework' closely followed the earlier BSA report.
1986	Building Societies Act—societies allowed to diversify into new markets and participate in wholesale money markets up to 25% of their total deposits and demutualise. Established a Building Societies Commission responsible for regulation.
1986	Withdrawal of mortgage lending guidelines.
1987	Schedule 8 clarifies Building Societies Act. Societies able to buy life assurance companies, own up to 15% of a general insurance company, offer full fund management services and a wider range of banking services.
1991	Composition tax on building societies deposits abolished. Deposits charged at basic rate of tax.
1994	Stage one of a review of the 1986 Act announced that new powers to be granted to building societies. Societies can increase their wholesale funding limit from 40 to 50% of funds, establish subsidiaries to make unsecured lending and the power to own life insurance companies.
1995	Stage two of the review of the 1986 Act confirmed that building societies to be allowed to pursue any activities allowed in their memorandum of powers, so long as they raise at least 50% of their funds from members and at least 75% of their lending is secured on residential property.
1996	Government announces it will enact legislation to reduce restrictions on building society activities and confirms the 50 and 70% limits on fund raising and lending. The new rules allow building societies to put 25% of their lending into any asset, as long as it is able to convince the Building Societies Commission that it has sufficient financial and managerial resources to take on the activity. Societies wishing to merge while remaining mutuals were to be protected from hostile take-over.
1997	A new Building Societies Act amended the 1986 Act. This was less restrictive concerning the principal purpose of a building society (which under the 1986 Act restricted societies to the making of loans which were secured on residential property and funded by members). The new emphasis followed more closely the legal frameworks set out under the Companies Act and the Banking Act.
1999	A change to the rules regarding the voting threshold required to force a society to convert. For a conversion vote to be put by the Board to be passed it must have support from 75% of savers, and a majority of borrowers on a 50% turnout.
1999	Changes to secondary legislation increase the number of members required to propose a Member's Resolution from 50 to a maximum of 500; to call a Special General Meeting from 100 to 500; to nominate a Board candidate up to 250 members in a large society
2000	Financial Services and Markets Act consolidates previous building society legislation and incorporates societies under the regulatory umbrella of the Financial Services Authority.

Figure 4-1: Major changes in regulation and legislation affecting building societies (Source: Marshall et al., 2012, p. 166)

These neoliberal reforms, coupled with the increase of owner occupation and sale of council houses, attracted banks and other lenders into the mortgage markets and into competition with building societies. Banks outcompeted building societies and monopolised the savings and mortgage markets by the mid-1990s (Boddy, 1989). This is as supported with the market shares in **Table 4-1** whereby the personal and housing finance market shares of banks prior to 1979 was 32 per cent and 5 per cent respectively. The mortgage market shares of banks increased significantly from 5 per cent in the year 1979 to 72 per cent in year 2000. Customers' deposits with banks also increased from 32 per cent to 70 per cent in the year 2000. On the other hand, the savings and mortgage market shares of building societies decreased tremendously from 47 per cent and 82 per cent in the year 1979 to 16 per cent and 20 per cent in the year 2000 respectively (Boleat, 1982).

Furthermore, the deregulation of the financial services sector and the abolition of the BSA cartel in 1983 impaired building societies' ability to cope in a post-cartel[8] world of highly competitive financial markets. The growing competition experienced by building societies led the BSA and government to recognise that new legislation was required to enable building societies to compete with other financial institutions on a more equal basis. The Governor of the Bank of England, chairmen and chief executives of building societies, as well as opposition Members of Parliament, shared a concern that building societies should not shift towards general banking activities which were inconsistent with building societies' distinguished status and values. They were of the view that building societies should remain financial mutuals, specialising in individual savings and house finances (Boddy, 1989). The

[8] Subsequent to the abolition of the cartel, the mortgage rates of the building societies had moved in line with the money market interest rate.

Building Societies Act 1986 received royal assent in 1986 and came into force on 1 January 1987 (Buckle and Thompson, 2004).

Year	**Market Share, Personal Sector (%)**			**Market Share, Housing finance (%)**	
	BS	**Banks**	**NS&I**	**BS**	**Banks**
1977 *(i)*	47	32	15	80	5
1978	47	32	15	82	5
1979	**The Administration of Margaret Thatcher's Conservative Government**				
	46	34	12	82	5
1980	46	35	11	81	6
1982	48	37	15	75	14
1984	51	33	16	76	16
1986 *(ii)*	52	33	15	76	18
1988(iii)	51	32	12	70	23
1990	44	43	10	60	34
1992	45	40	10	62	32
1994	46	38	11	62	35
1996 *(iv)*	41	43	12	55	39
1998 *(v)*	18	67	11	23	70
2000	16	70	10	20	72
2002	18	64	8	18	69
2004	17	66	7	18	62
2006	18	66	7	18	56

Year	Market Share, Personal Sector (%)			Market Share, Housing finance (%)	
	BS	Banks	NS&I	BS	Banks
2007	18	65	7	17	53
2008	19	63	8	17	48
2009	17	62	8	15	59
2010	18	59	8	17	67
2011	18	58	8	16	68
2012	17	58	7	17	68
	Monetary Financial Institutions		**NS&I**	**BS**	**Banks**
2013	92		9	18	67
2014 *(vi)*	92		9	20	66

Table 4-1: Changes in retail and mortgage balance market shares (by percentage)
Sources:
Row (i)-(ii): Building Society Fact Book 1988
Row (iii)-(iv): Building Society Yearbook 1998/1999
Row (v)-(vi): Building Society Yearbook 2013/2014 and 2016/2017

4.4 Legal Framework: The Building Societies Act 1986 (Amended 1997)

The *Building Societies Act 1986* transformed building societies' power and introduced a new regulatory framework for the industry. It represents the first piece of coherent legislation for building societies since the *Building Societies Act 1874* and implemented proposals in the *Treasury Green Paper Building Societies: A New Framework,* published in 1984 (Marshall et al., 2012, Boddy, 1989). Under the *Building Societies Act 1986,* power was given to the

Building Society Commission (BSC) and HM Treasury to make statutory instruments (e.g. regulations, orders), which provide Parliament approval to amend and supplement the *Building Societies Act 1986* (BSA, 2013b). This role was previously operated by the Chief Registrar of Friendly Societies.

The *Building Societies Act 1986* states explicitly that building societies are predominantly concerned with lending for house purchase and are primarily funded by members, in which Section 5(1) stipulated that a building society "is that of making loans which are secured on residential property and are funded substantially by its members" (BSA, 1986, pp. 4). Nonetheless, building societies are allowed to venture into other financial activities such as unsecured lending, estate agencies, insurance broking, consumer credit, money transmission and foreign exchange services (Boddy, 1989, Ingham and Thompson, 1993, Tayler, 2005). The *Building Societies Act 1986* further formalised building societies' access to the wholesale money market[9], in which:

- at least 75 per cent[10] of the 'business assets'[11] of a building society must be loans fully secured on residential property (Section 6 of the *1986 Act*); and
- at least 50 per cent of societies' funds must be raised from individual members and another 50 per cent through the wholesale money markets[12] (unlike banks which do

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[9] Wholesale funding is funding derived from federal funds, foreign deposits and brokered deposits, among others. Most financial institutions would opt for wholesale funding when it is expensive to source a retail deposit (e.g. when customers do not save in a financial institution due to the low interest rate offer). Retail funding is a deposit that is generally derived from customers (savers) or small businesses (Buckle and Thompson, 2004).

[10] No statutory restriction on what categories of assets might be included in the remaining 25% of business assets.

[11] Business Assets = Total assets + provision of doubtful debts – (fixed assets + liquid assets + long term insurance funds).

not have any restriction to the amount of capital raised from wholesale markets) (Section 7 of the *1986 Act*).

The *Building Societies Act 1986* also requires building societies to prepare annual accounts, an annual business statement, a directors' report and a summary financial statement. A copy of the annual account should be submitted and filed to the BSC. Since coming into force, the *Building Societies Act 1986* has been extended and amended, subsequently replacing the 'prescriptive regime' of the 1986 Act—which means the activities of building societies were deemed to be illegitimate unless specifically permitted—with the 'permissive regime' of the *1997 Act*, in which the activities of building societies would be legitimate unless otherwise stated (Stephens, 2007).

The establishment of the *Building Societies Act 1986* provided the opportunity for building societies to demutualise and convert into a shareholder-owned bank. Conversion initially required 20 per cent of the member vote and was later raised to 50 per cent and 75 per cent. After conversion, the demutualised building societies are protected from takeover for a period of five years (unless the building society has taken over another company) (Buckle and Thompson, 2004). The first building society which converted was Abbey National (in 1989). This was followed by Northern Rock (1997); Halifax (1997); Alliance & Leicester (1997) and Bradford & Bingley (2000) (BSA, 2013c). The list of building societies which have demutualised since 1989 and their current conditions are summarised in **Table 4-2** below:

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[12] Through the *Building Societies Act 1986*, building societies were initially allowed to raise 20 per cent of their funds from the wholesale markets, a figure that rose to 40 per cent by the end 1986 and 50 per cent in the 1994 review of the Act.

Demutualised Building Societies	Year of Demutuali-sation	Successor	Current Condition
Abbey National	1989	Santander	Floated as a public listed company in July 1989. It was acquired by Banco Santander on November 2004 and rebranded as Santander in January 2010.
Cheltenham & Gloucester	1995	Lloyds TSB	Taken over and became part of the Lloyds Banking Group in August 1995.
National & Provincial Building Society	1995	Abbey National plc	Taken over by Abbey National in 1996.
*Alliance & Leicester	1997	Santander	Floated as a public listed company in April 1997. It was acquired by Banco Santander in October 2008 and rebranded as Santander in 2010.
*Halifax	1997	HBOS/ Lloyds	Floated as a public listed company in June 1997 and merged with Bank of Scotland to form HBOS in 2001. In Sept 2008, Lloyds Bank agreed to take over HBOS and it became part of Lloyds Banking Group in

Demutualised Building Societies	Year of Demutuali-sation	Successor	Current Condition
			January 2009.
Woolwich	1997	Barclays	Floated as a public listed company in July 1997 and it was later taken over by Barclays Bank in October 2000.
Bristol & West	1997	Bank of Ireland	Became part of Bank of Ireland in 1997, but its savings and branch networks were transferred to Britannia Building Society in 2005. The latter than merged with Co-operative Financial Services in 2009.
*Northern Rock	1997	Virgin Money	Floated as public listed company in Oct 1997 and it was nationalised in Feb 2008 due to the financial crisis. It was acquired by Virgin Money in January 2012.
Birmingham Midshires	1999	Halifax plc	Taken over by Halifax in 1999 and it is now owned by Lloyds Banking Group.
*Bradford & Bingley	2000	Santander	Floated as public listed company in December 2000. However, the mortgage book was nationalised in September 2008 and the retail savings was transferred to

Demutualised Building Societies	Year of Demutuali-sation	Successor	Current Condition
			Santander in September 2008. It was rebranded as Santander in January 2010.

Table 4-2: The current condition of building societies which demutualised between 1989 till 2000 (Source: *BSA Yearbook 2015/2016* and Casu and Gall, 2016, and analysis by author)

(The symbol * indicates the demutualised building societies which existed as a shareholder-owned bank prior to the 2008 financial crisis)

According to Casu and Gall (2016), there were a number of strategic reasons which motivated building societies to convert into shareholder-owned banks. Conversion into shareholder-owned banks enabled the demutualised building societies to be freed from the 1986 Act and to obtain additional capital from wholesale funds and securitisation practices. Building societies are constrained under the 1986 Act to undertake corporate banking (such as 25 per cent of their lending being on corporate lending) building societies have to generate capital internally as they have no shares to sell and no access to the equity market. Their international operations are limited whereby they are only allowed to operate within the European Union via subsidiaries (Buckle and Thompson, 2004, Boddy, 1989).

Many building societies converted into shareholder-owned banks in order to finance their lending activities through inter-bank borrowing on the global wholesale money market and securitisation (Michie and Llewellyn, 2010, Beecher, 2011). The wholesale money market provides banks access to global funds (at an interest rate that is often lower than the retail funds) and allows them to borrow the funds for a short term (depending on their credit rating) to finance their lending. Under good economic conditions, banks can easily renew their maturing borrowing from the wholesale funding and perhaps take advantage of the lower interest rate. However, these banks may face short term liquidity problems if the market confidence is affected (Branston et al., 2009).

On the other hand, securitisation enables banks to bundle up their illiquid assets together with other high credit risk assets (e.g. credit card loans, personal loans, car loans) into another security, either an asset-backed security (ABS)[13] or a Collateralised Debt Obligation (CDO). The ABS and CDOs are then sold to investors globally based in different risk categories and returns. Investors, banks and credit rating agencies were very attracted to ABS and CDOs due to the higher returns and profits they receive and can make (BBC, 7 August 2009, Klimecki, 2012). Nonetheless, securitisation lessens the banking sector ability to monitor loans and evaluate their risk, as securitisation products often blended the very risky assets with very high quality assets (HM Treasury, 2008, Branston et al., 2009).

There were other opportunistic and less strategic reasons that triggered building societies to opt for conversion. Financial advisers, accountants, investment bankers and lawyers received handsome fees and bonuses for successful conversions and mergers (Klimecki and Willmott, 2009). The BSA has calculated that the total cost of legal, accounting and public relations fees for those building societies who have converted was £550 million. The Halifax conversion itself cost £171 million (Birchall, 2013a, ACCA, 2013).

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[13] ABS is a type of security that is backed by pools of illiquid assets. ABS could further be classified into mortgage-backed securities if it is backed by a mortgage, residential mortgage-backed securities if it is backed by a residential home loan, and commercial mortgage-backed securities if the mortgages are made to corporations. ABS is often sold in different ‘tranches’ (or sections) based on different risks and returns. The most senior tranches are less risky and the most junior tranches are the riskiest. The rationale in which the ABS are structured into different tranches is mainly because in the case of early redemption of the ABS (e.g. times of low interest) or credit event such as default, the junior tranches will absorb all the losses and the senior tranches receive repayment first.

The management of building societies also benefited through enhanced reward packages subsequent to the conversion (Shiwakoti, 2005, Birchall, 2013a). A short enquiry by the *All-Party Parliamentary Group for Building Societies & Financial Mutuals* found that there had been substantial increases in the directors' remuneration of those demutualised financial institutions. The salary and bonuses of directors of Halifax rose by 38 per cent from 1996 to 1997 when it converted. In a similar vein, the directors of Alliance & Leicester, Bradford & Bingley and Northern Rock benefited from 26.8 per cent, 40.2 per cent and 32.4 per cent increments in their remunerations and benefits subsequent to their demutualisation (ACCA, 2006).

While demutualisation enabled directors to obtain better remuneration and reward packages, it had also attracted the 'carpetbagger' phenomenon, in which individuals joined building societies merely to put forward a motion to convert the building societies. A successful conversion rewarded 'carpetbaggers' with personal compensation or 'windfalls' or stakes in the organisation in the form of shares which could rise up to thousands of pounds after the initial public offering of the companies' shares. **Figure 4-2** shows that a member typically received free shares in the converted organisations which valued at the lowest at £130 and at the highest at £2,423.

Windfalls to members at demutualisation

Institution	No. of free shares per member	Offer price at demutualisation (pence)	Approximate value of average windfall at demutualisation per member (£)
Abbey National	100	130	130
Alliance & Leicester	250	533	1,333
Bradford & Bingley	250	248	620
Halifax	200-1381	733	2,423
National & Provincial*	-	-	1,300
Northern Rock	500	451	2,250
Woolwich	450-2900	315	2,194

*Offered in cash but could be taken as Abbey National plc shares

Figure 4-2: Windfalls that were paid to members after demutualisation of the building societies (Source: ACCA, 2006, p. 19)

The attractive windfalls attracted an increasing number of 'carpetbaggers' to save with building societies merely to vote for the conversion of the building societies (Dayson, 2002, Talbot, 2002). Nonetheless, these 'carpetbaggers' were outwardly despised by the building society sector. A number of building societies, such as Nationwide and Yorkshire Building Society, who intended to remain as mutuals, saw the dangers that customer-owner-members might force their building societies to convert into shareholder-owned banks against their will (Birchall, 2013a). Various means of defence against carpetbaggers were developed by the industry to fight off carpetbaggers, such as the requirement for members to sign away their windfall gains to assigned charitable organisations if their building societies converted (Cook et al., 2002). Nationwide was the first building society to introduce the 'windfall assignment clause' to its customers in November 1997, and the remaining 43 building societies introduced a sign-away clause by October 2001 (Dayson, 2002). Further, many building societies leveraged their mutuality by providing more benefits to their members through higher interest rates in savings and lower interest rates in mortgages (Buckle and Thompson, 2004).

The *Building Societies Act 1986* (amended 1997), also altered the turnout and voting outcome level required for board to accept proposal and resolution. For instance:

- for a conversion vote to be put by the board to be passed, it must have support from 75 per cent of savers and a majority of borrowers on a 50 per cent turnout;
- the number of members required to propose a member's resolution increased from 50 to a maximum 500; and the number of members required to call a special general meeting rose from 100 to 500; and the number to nominate a board candidate rose up to 250 members in a large society.

While many existing building societies successfully fought off carpetbaggers, Bradford & Bingley was the last building society to demutualise against the board of directors' advice. The board of directors of Bradford & Bingley was defeated by the carpetbaggers who succeed in forcing a vote on conversion in 2000 (News, 29 September 2008 , Cook et al., 2002).

The impact of demutualisation reduced the asset size of the building society sector from £318 billion of total assets in 1996 to around £156 billion in 1998 (KPMG, 2013). **Table 4-1** shows the decreasing trend of building societies' mortgage market shares from 1980 to 2014. The table exhibits that the mortgage market shares of building societies declined from 81 per cent in the 1980s to 20 per cent in 2000, and decreased to 17 per cent before the 2008 financial crisis. Nonetheless, the failure and bailout of a number of banks during the crisis weakened consumers' trust and confidence in banks. During this period, the building society sector managed to attract new customers in both the mortgage and savings markets, whereby their market shares in both markets rose by 3 and 1 per cent respectively.

Subsequent to the wave of demutualisation in the 1990s, the government, in December 2001, introduced the *Financial Services and Markets Act 2000* to the financial services sector. Under the *Financial Services and Markets Act 2000*, the prudential function of the BSC was superseded by the Financial Services Authority (FSA) and the BSC's power to make statutory instruments was transferred to HM Treasury (BSA, 2013c). The *Financial Services and Markets Act 2000* also established the financial ombudsman scheme which helps to settle disputes between customers and all authorised financial institutions in the UK.

Further, the act established the Financial Services Compensation Scheme (FSCS) which provides a compensation scheme for customers of authorised financial institutions. In the event of failure of the financial institutions, customers are compensated initially at £35,000. Under the *Financial Services and Markets Act 2012* which was enforced after the 2008 financial crisis, the amount compensated per individual, per firm was fixed at £75,000.

4.5 The Demutualised Building Societies Through the 2008 Financial Crisis

All demutualised building societies grew rapidly after their conversion into shareholder-owned banks. They grew rapidly by offering mortgage products to customers whose employment, credit or business records had previously excluded them from entering the housing market (Klimecki and Willmott, 2009). They also lent aggressively through securitisation and borrowing from wholesale money markets. When there were crises in the US subprime market and the wholesale money market collapsed, as well as a retail run in the banks, the lack of capital consequently caused the converted building societies (such as Northern Rock, Bradford & Bingley, HBOS and Alliance & Leicester) to seek government support and mergers with other financial institutions (Beecher, 2011). None of these converted financial institutions exist as a standalone entity any more (Michie and Llewellyn, 2010, Beecher, 2011, Branston et al., 2009). The following sub-sections highlight the responses of Northern Rock, Bradford & Bingley, HBOS, and Alliance & Leicester through the 2008 financial crisis.

i. Northern Rock

Northern Rock was demutualised and floated on the LSE in 1997. Northern Rock had grown rapidly and entered the FTSE 100 in September 2001 and became the fifth largest mortgage lender in the UK, subsequent to demutualisation. Northern Rock's capital and liquidity problems started when its wholesale funding in US, Europe, Canada, Far East and Australia were closed down due to the collapse of US subprime mortgages. It funded most of its lending and expansion from the wholesale money market and securitisation, in which 75 per cent of its funding was derived from the wholesale money market when it was nationalised (House of Commons Treasury Select Committee, 2008). It also had a lack of an insurance policy to insure against liquidity problems (Klimecki and Willmott, 2009). The announcements and the leaking of a 'backstop' arrangement made between the organisation and the Bank of England caused a retail run and illiquidity in Northern Rock. Consequently, it was nationalised on 20 Sept 2007 (The Guardian, 26 March 2008, House of Commons Treasury Select Committee, 2008).

ii. Bradford & Bingley

Bradford & Bingley was the UK's second largest building society prior to its demutualisation in 2000. In March 2006, the shares of the organisation were valued at £3.2 billion and by

September 2008, it was worth £246 million. Similar to Northern Rock, it was nationalised whereby the government took control of £50 billion of its mortgages, and £20 billion of its savings units and branches were sold to Santander (Klimecki and Willmott, 2009). The problem with Bradford & Bingley was similar to Northern Rock in which the organisation relied on 42 per cent of wholesale funding and securitisation to expand its business. It also lent heavily in subprime markets and it had mortgage arrears that were above the industry average during the 2008 financial crisis (House of Commons Treasury Select Committee, 2009).

iii. HBOS[14]

HBOS was formed under the merger of Halifax Building Society and Bank of Scotland in 2001. The merger of both organisations was intended to help HBOS to increase market and product penetration opportunities and to enable HBOS to become one of the challengers to the 'Big 4' banks (Barclays, HSBC, Lloyds and RBS). HBOS benefited from the merger in which its pre-tax profitability grew strongly from £2,630 million in 2001 to £4,808 million in 2005 (HBOS Annual Report 2001 and 2005). Similar to Northern Rock and Bradford & Bingley, HBOS relied on the wholesale money market, securitisation practices and lent heavily on risky housing, property and corporate markets (Klimecki and Willmott, 2009). HBOS's liquidity problem surfaced when the UK economy weakened in 2007 and many 'subprime' borrowers defaulted on their borrowings with the organisation. HBOS had to be

[14] HBOS was previously a building society under the trading name Halifax Benefit Building and Investment Society. However, it converted into a plc in 1997 and merged with Royal Bank of Scotland to form HBOS in 2001.

taken over by Lloyds Banking Group in Sept 2008 when it could not renew its borrowings in the wholesale money markets (HM Treasury, 2015a).

iv. Alliance & Leicester

Alliance & Leicester was floated in the LSE in 1997 and managed to be listed in the FTSE 100 in 1997. Similar to Northern Rock, HBOS and Bradford & Bingley, it relied heavily on the wholesale money market and securitisation to lend aggressively. At the time it was taken over by Santander on October 2008, 57 per cent (or £45.2 billion) of its funding was derived from the wholesale money market and 39 per cent (or £30.8 billion) of its capital was received from retail deposits (*Alliance & Leicester Annual Report*, 2007, p. 12). Although Alliance & Leicester's mortgage accounts were of a high quality (with only three months arrears, which was lower than half of the industry average), it bought structured credit assets that lost value in the credit crunch. It wrote off £209 million of those assets but still suffered losses of £70 million in its wholesale funding costs. Due to that, Alliance & Leicester agreed to be taken over by Santander for £1.26 billion after a reported pre-tax profit of £1.8 million from £290 million for a six-month period in June 2008 (Alliance & Leicester Annual Report, 2008, p. 36).

The above examples demonstrate that many converted building societies expanded their businesses through securitisation practices and funding from the wholesale money market after demutualisation. When the wholesale money market collapsed and depositors withdrew their money during the height of the 2008 financial crisis, the lack of capital caused the converted financial mutuals to seek support from the government and larger financial institutions. The National Audit Office (NAO), estimated in 2015 that £1,162 billion of taxpayers' money has been utilised to bail out those banks and the amount is still mounting (NAO, 2015).

Building societies which are adverse to risk and adhere to a customer-owned model did not receive any capital injection from government and taxpayers (Michie and Llewellyn, 2010). The sector attracted new customers in the first half of 2008 with £6.3 billion of deposits in contrast to £3.8 billion during the first half of 2007[15] (The Independent, 03 August 2008). Adrian Coles, the ex-Director General of the BSA, argued that "against a backdrop of economic uncertainty and stock turbulence, people saw building societies as safe places for their cash, with brands names they can trust" (The Independent, 03 August 2008). The UK government also emphasised that the customer-owned model of building societies and co-operative banks is one of the strongest ownership structures, which the government has a clear commitment to support. The government highlighted at the coalition agreement in 2010 to "promote mutual and create a more competitive banking industry" (*The Coalition: our plan for Government*, 2010, p. 9).

4.6 Building Societies Through the 2008 Financial Crisis

Building societies arguably survived the financial crisis better than investor-owned banks as a whole (although they were not immune to the crisis) (The Independent, 23 October 2010, Michie and Llewellyn, 2010, Michie, 2011). This can largely be attributed to the following: first, both by regulation and strategic choice, building societies limited their dependence on wholesale funding markets and securitisation practices. Second, they focused on serving the

[15] However, in line with the global economic problems, lending had slowed from £8.4 billion in the first half of 2007 to £3.4 billion between January and June 2008.

interests of their members rather than the short-term pressure from their shareholders (HM Treasury, 2012). Third, the primary source of funding in building societies is derived from retail savings and not the wholesale money market. Therefore, building societies did not experience funding and cash flow problems like banks through the financial crisis (Michie and Llewellyn, 2010).

However, a number of building societies were greatly impacted by the 2008 credit crunch which led to their mergers with other financial mutuals. The competitive pressure from banks had put increasing pressure on the mutual business model. Some of the boards of building societies had looked at ways to keep up with the competitors and increased their risk-taking in ways that were often not accompanied by appropriate risk management, governance structures and capital backing (Andrew Bailey, Ex-CEO of the PRA at BSA Conference, 2013a). They made: losses on loans (specifically on the commercial loans), losses due from potentially fraudulent borrowers, losses from large deposits held with Icelandic banks and losses on mortgage books acquired from other lenders prior to the financial crisis (Casu and Gall, 2016). When the 2008 credit crunch unfolded, they ran out of capital and capabilities in handling the crisis and consequently sought mergers with larger financial institutions. **Table 4-3** summarises the list of building societies which were affected by the financial crisis and the years in which they were rescued by other larger building societies, the Co-operative Bank and other banks.

Building Society	Year of Merger	Merged into
Catholic	2008	Chelsea Building Society
Cheshire	2008	Nationwide
Derbyshire	2008	Nationwide
Barnsley	2008	Yorkshire Building Society
Scarborough	2009	Skipton Building Society
Dunfermline	2009	Nationwide
Britannia	2009	Cooperative Bank
Chelsea	2010	Yorkshire Building Society
Stroud and Swindon	2010	Coventry Building Society
Chesham	2010	Skipton Building Society
Norwich and Peterborough	2011	Yorkshire Building Society
Kent Reliance	2011	One Saving Bank plc
Shepherd	2013	Nottingham Building Society
Century	2013	Scottish Building Society
City of Derry	2014	Progressive Building Society

Table 4-3: Building societies which merged subsequent to the 2007/2008 credit crunch (Source: Casu and Gall, 2016 and analysis by author)

Although the building society sector did not seek bailouts from the government (with the exception of Dunfermline Building Society), the failure of some building societies shed a different light on the sector. Womack (2010) argued that the failure of some building societies during the credit crunch had actually shown that many of the them “were just as greedy for growth and as prone to mismanagement as the worst of their banking rivals.”

Graham Beale, the ex-CEO of Nationwide, was also reported in disclosing to the Treasury Select Committee that building societies which suffered the most during the crunch were those which had expanded their operations without proper understanding of the risks and strategies that the organisation pursued:

> *Typically where building societies have expanded their activities and gone into areas of risk that they either have not fully understood or where they did not have the right resource in place to be able to deal with them…[For example, with] the Derbyshire…the risks were beyond the capacity of the balance sheet (House of Commons Treasury Select Committee, 2008, p.31).*

Due to the failure and mismanagement of building societies, a number of regulatory and governance reforms were made to the building society industry, which are discussed below.

4.7 Regulatory Reform in Building Societies since the 2008 Financial Crisis

Following from the 2008 financial crisis, a number of changes were made to the banking regulations. The reformation mainly stemmed from poor risk management, lack of governance and personal accountability in the banking sector (HM Treasury, 2013). Among those banking regulation reforms that affect the building society sector, include but are not limited, to the implementation of the *Financial Service Act 2012*, *Building Societies Sourcebook (BSOCS)*, *Senior Manager & Certification Regime (SM&CR)*, *Butterfill Act* and *Capital Requirements Directive IV (CRD IV).*

i. Financial Service Act 2012

Due to the failure and bailout of the banks during the financial crisis, the coalition government had in effect introduced and passed the *Financial Service Act 2012* in December 2012. The *2012 Act* made substantial amendments to the *Financial Service Act 2000*. It gives the Bank of England responsibility for protecting and enhancing stability in the financial system. The act also abolished the FSA and created a new regulatory system consisting of the Financial Policy Committee, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) (BSA, 2013c).

ii. Building Societies Sourcebook (BSOCS)

The Building Societies Sourcebook (BSOCS) was introduced by the FSA on 26 March 2010. A number of building societies diversified away from their core business operations by undertaking risks of which the board of directors did not have a proper understanding. Due to that, some building societies such as Dunfermline Building Society, Cheshire Building Society and Derbyshire Building Society failed. BSOCS was introduced to enhance supervisory guidance for building societies and to prevent a similar collapse of building societies as in the 2008 financial crisis. BSOCS sets out guidance for the approaches to lending as well as the treasury management approaches that building societies should undertake (BSA, 2011).

iii. Senior Manager and Certification Regime (SM&CR)

The Parliamentary Commission for Banking Standards (PCOBS) was appointed by Parliament in June 2013 to look into ways to enhance directors' accountability in the banking industry. The PCOBS claimed that there had been lack of personal accountability in the banking industry, in which directors and management hide behind an accountability firewall and engaged in high profile misconducts (e.g. PPI mis-selling, the LIBOR rate-rigging) without being prosecuted (BSA, 2016). In order to improve professional standards and senior management responsibility and accountability in the UK banking industry, the PRA and FCA introduced the Senior Manager and Certification Regime (SM&CR) which came into effect in March 2016. The regime applies to banks, building societies, credit unions and all PRA-regulated investment firms (HM Treasury, 2015b).

iv. Banking Reform Act 2013

The Banking Reform Act 2013 which is introduced and based on the recommendations of the Independent Commission and Banking (and reported in a Vickers Report) outlines new suggestions such as: 1) the UK banks are required to ring-fence their deposits from retail and small and medium-sized businesses; 2) the PRA are required to review and ensure that banks separate their retail from the investment activities; 3) allow for the application of bail-in to building societies and the power for BOE to convert building societies to company; 4) introducing criminal sanctions for reckless misconducts that leads to bank failure; 5) providing protections to depositors under the Financial Services Compensation Scheme. The provisions of the Act are expected to come into force in 1 January 2019 and are expected to affect the building society sector

v. Capital Requirements Directive IV (CRD IV)

The quality and quantity of capital issued by financial institutions was considered not sufficient to absorb losses during the 2008 financial crisis (BSA, 2010a). The capital requirement for financial institutions has therefore been enhanced and increased under the Capital Requirement Directive (CRD) which was approved by the Basel Committee on Banking Supervision (BCBS). CRD IV introduces more stringent requirements for financial instruments to be classified as Tier 1 capital. It requires building societies and banks to have a higher quality and quantity of capital due to changes in the definition of capital. It also has new liquidity and leverage requirements, new rules for counterparty risks and macro prudential standards. CRD IV also makes changes to rules on corporate governance such as director's remuneration, and standardised EU regulatory reporting (BSA, 2010a).

vi. The Building Societies (Funding) and Mutual Societies (Transfers) Act 2007

The *Building Societies (Funding) and Mutual Societies (Transfers) Act 2007* or *Butterfill Act* was the result of a private member's bill sponsored by a Conservative MP, Sir John Butterfill. The enactment of the Act enabled the government via secondary legislation to amend the building societies legislation and allow 75 per cent of building societies funds to be derived from wholesale market. The Act also allows merger between different types of mutual before the demutualisation of building societies. The act was enforced when Britannia Building Society merged with Co-operative Bank. Nonetheless, the 75 per cent rule in which building societies fund could be derived from the wholesale market has never been introduced (Casu and Gall, 2016, HM Treasury, 2014).

vii. UK Corporate Governance Code

Unlike the above mandatory regulations, building societies are required to 'explain or comply' with the *UK Corporate Governance Code (The Code)* (2014)[16] which was first published by the FRC in 1992. *The Code* was fundamentally addressed to public listed companies. As a best practice, building societies are encouraged by the PRA and the BSA to comply or give their reasons for their non-compliance with *The Code* in their annual report (BSA, 27th November 2014).

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[16] This thesis refers to the *UK Corporate Governance Code* (hereafter referred to as *The Code)* published in 2014. It is acknowledged that *The Code was* revised in 2016. However, interview data was collected and analysed in 2015, and the research therefore refers to *The Code* of 2014.

4.8 Governance of Building Societies

While the legislation and regulations governing the building society sector have continuously been reformed and strengthened, the internal governance arrangements in the industry have also developed over time. The original governance structures in building societies were based on monitoring and supervision by customer-owner-members who live in the local community. If elected representatives were to abuse their power and position, they would be reprimanded by other members (Casu and Gall, 2016).

Since building societies have grown in size, structure and scope, the current internal governance arrangements in the sector are similar to corporations and public listed companies. Building societies are run and managed by a board of directors and the directors are members of different committees, such as audit, remuneration, nomination and risk committees. The directors are also the customer-members of the organisations and are subject to election or re-election. Directors are required to continuously undergo training to strengthen their skills and knowledge (BSA, 2014b).

Furthermore, as a type of financial institution, building societies are required by the PRA and FCA to implement the best practice *three lines of defence model* in the business. The three lines of defence model provides a simple and effective way for organisations to communicate risk management and control by clarifying the roles and duties of staff and management. The first line focuses on business management, maintaining effective internal control and executing risk and control procedures. The second line focuses on a set of specialist control functions covering risk, regulatory, compliance, legal, finance and human resources issues. The establishment of these functions is to ensure that the first line of defence is properly designed and operated as intended, to develop risk management and control for the whole organisation, and to provide training on risk management processes. The third line focuses on the internal audit which provides independent assurance on organisation's governance, internal control and risk management, including the manner in which the first and second lines achieve risk management and internal control objectives.

Senior management and governing bodies such as the audit committee and board of directors are the main stakeholders served by all the lines. Senior management and governing bodies has the accountability to achieve organisation's objectives, setting strategies to achieve these objectives and helping to ensure that the three lines of defence model reflects the organisation's risk management and control processes. The roles of regulators and external auditors are to perform an independent and objective function such as to assess the first, second or third line of defence with regard to compliance with rules and regulations.

The rights of members have also been enriched in legislation. Members have the right to receive notice and to take part in a building society's AGM and put forward resolutions to be discussed at the AGM. Members can also request a special general meeting be held, subject to meeting certain conditions such as getting the support of a number of other members. All members have one vote in the governance matters of building societies despite the percentage of their shareholding. However, a criticism of member democracy and the "one member, one vote" principle is that widely dispersed ownership of members causes limited effective control over management (Spear, 2004, Leadbeater and Christie, 1999).

4.9 Motives for Studying Governance and Accountability in UK Building Societies

The above discussion has therefore reflected that prior to the 2007/2008 banking crisis, there were doubts and scepticism towards the mutual ownership model and the adverse risk approach adopted by building societies. It was claimed that the *Building Societies Act 1986* and the customer-owned business structure have prevented building societies from competing and growing rapidly like banks (Klimecki, 2012, Michie, 2011). As a result of that, a number of building societies converted into shareholder-owned banks in order to be freed from the legal restrictions placed on them.

Nevertheless, the financial crisis witnessed all demutualised building societies collapsing and none of them surviving as an independent entity. Demutualisation had led all converted building societies to rely heavily on wholesale money markets and securitisation practices in order to lend aggressively (Klimecki and Willmott, 2009, Beecher, 2011, BBC, 7 August 2009). When the US sub-prime market collapsed and investors stopped to purchase the ABS and CDOs, and banks ceased to lend to each other, all demutualised building societies experienced difficulties in renewing their short-term funding from the wholesale money market. In consequence, the demutualised building societies suffered from lack of capital and liquidity which caused them to seek financial assistance from the government (BBC, 7 August 2009). In comparison, building societies which did not demutualise survived the credit crunch better than all the converted building societies. In the midst and aftermath of the financial crisis, they were able to attract new customers and garnered the coalition government's support to promote financial mutuals in the financial services sector (Klimecki, 2012, Mutuo, 2015).

Despite the growing prominence of building societies, in recent years, there have been highly publicised scandals in the industry. For instance, Yorkshire Building Society was fined by the FCA for £4.1 million and £1.4 million for failing to deal properly with its mortgage defaulters and disseminating misleading promotional materials to its customers respectively (*Yorkshire Building Society Annual Report 2014*, p. 4). Before Norwich and Peterborough

Building Society was merged with Yorkshire Building Society, the former building society was also fined £1.4 million by the FCA for mis-selling investment products to older people (The Telegraph, 18 April 2011).

Manchester Building Society was also accused of engaging in hedging accounting which led to the restatement of the organisation's pre-tax loss of £17.8 million for the year ending 2011 (Manchester Building Society Annual Report 2011, p. 29). The finance director and auditor (e.g. Grant Thornton) of Manchester Building Society were reprimanded by the FRC for being negligent in their duties (FRC, 2015).

Furthermore, Sir Christopher Kelly, an independent reviewer who was commissioned by the board of the Co-operative Bank to investigate the capital shortfall in the Co-operative Bank in 2013, concluded that one of sources for the capital shortfall in the Co-operative Bank was due to its merger with Britannia Building Society. The then regulator, the FSA, argued that Britannia Building Society would not survive as a standalone entity if it did not merge with the Co-operative Bank in August 2009. This is primarily because Britannia Building Society had ventured into risky loans and "sometimes complete transactions which no other lender would take on". Following the merger, the newly merged Co-operative Bank failed to plan and manage capital adequately, and a weak governance system led to the lack of oversight by the board (HM Treasury, 2014, p.15).

Directors of building societies were also often criticised for receiving high remuneration without regard to their customers' best interests. For example, the board and management of Skipton Building Society was accused of disregarding its customers appeals for lower mortgage and higher savings rates during the 2008 financial crisis but paid a staggering £682,000 to its former finance director for the financial year end 2010 (Skipton Building

Society Annual Report 2010, p. 40). Customers of Henley Economic Building Society also accused the directors of their building society for not prioritizing their rights and best interests by financing a property development project, which is outside the field of expertise of a small building society (The Daily Mail, 13 December 2009).

In another noteworthy example, Nationwide was criticised for financing more than £30 million of commercial loans on the Heron Tower project. The tower, which was built from 2008 to 2011, was claimed to have had difficulties in attracting occupants in the aftermath of the recession, and conflict allegedly took place between key shareholders of the property (e.g. Heron International, State General Reserve Fund of Oman and members of the Saudi royal family) (Financial Times, 19 September 2013). Due to that, borrowers defaulted on their loans and the involvement of Nationwide Building Society alongside other foreign banks and Middle East royalty were heavily criticised for undertaking activities that were being inappropriate for a financial mutual. A representative from the campaign group Save Our Savers stated that “given that Nationwide prides itself on being a mutually-owned building society and not a bank, many of its members will be surprised that so much of their money has gone, not to support home-owners, but a rather riskier property company” (The Daily Mail, 20 September 2013).

Due to these issues, a number of observers have questioned the extent ‘mutuality’ is still embedded in building societies and the real difference between banks and building societies (The Daily Mail, 2 November 2012). It has been claimed that building society is a financial mutual which is owned by its customers and hence should be run in the best interests of its customers. However, many of the building societies were accused of being fuelled by executive greed and prone to mismanagement (The Daily Mail, 23 May 2009). Harrison

(2009), a consumer advocate, pointed out that "sometimes the reality of meeting their members' interests (rather than managers'), and the levels of actual member participation and quality of customer service [in building societies] have often been some way behind the rhetoric".

This thesis maintains that with the growing prominence of building societies as a result of the 2008 financial turmoil, an analysis and understanding of their roles and accountability obligations towards their customers, communities, societies, the general public and other stakeholders is important. Previous studies on building societies mainly focused on the effects of demutualisation on the building society sector and the investor-owned banks (Tayler, 2005, Drake and Llewellyn, 2002, Shiwakoti et al., 2008), the implications of the financial crisis towards converted building societies such as Britannia Building Society, HBOS, Northern Rock, Bradford & Bingley (House of Commons Treasury Select Committee, 2009, 2008, HM Treasury 2013, Kelly, 2014), and the resilience of building societies' unique ownership structure in the event of economic crisis (Birchall and Ketilson, 2009, Michie, 2011). There is a gap in the literature in term of lack of understanding of the nature of building societies' governance and accountability practices. This study therefore aims to fill this gap in the literature by exploring and understanding the governance and accountability issues and practices in the building society sector. The next chapter explains the research methodology and methods used in the thesis for exploring and understanding the governance and accountability practices in the industry.

4.10 Summary of the Chapter

This chapter justifies the reasons for studying governance and accountability practices in the building society sector. The chapter argues that the deregulation of the financial market in the

1980s led to the demutualisation of a number of building societies and a total of 30 and 61 per cent of building societies' savings and mortgage market shares were shifted to the shareholder-owned banks between 1980 and 2000 (Drake and Llewellyn, 2002). The implications of demutualisation came to the forefront during the 2008 banking crisis, when all demutualised building societies such as Northern Rock, Abbey National, Bradford & Bingley, Alliance & Leicester collapsed and were taken into state ownership.

The chapter further argues that the building society sector did not escape the crisis unscathed. A number of building societies (e.g. Dunfermline Building Society, Chelsea Building Society and Derbyshire Building Society) failed during the 2008 financial crisis and were rescued by other larger building societies. The building society sector has also been experiencing an increasing number of governance and accountability scandals. It has, however, not been subjected to academic, practitioners and policy maker's attentions. As a result of that, the final part of the chapter justifies the reasons the building society industry has been chosen as the context of study. The next chapter justifies the choice of research methodology and research methods of the study.

CHAPTER 5: Research Methodology and Research Methods

5.1 Introduction

This chapter serves the purpose of linking the previous chapters on background literature and conceptual framework to ensuing empirical chapters. The purpose of this chapter is to provide the methodological underpinnings of the thesis, Section 5.2 compares the different research paradigms and highlights the reasons for the chosen methodological assumptions with respect to ontology, epistemology and their implications for the conceptual framework and chosen data collection methods. Section 5.3 discusses and justifies the data collection techniques used to answer the research question. While Section 5.4 explains the data analysis processes, Section 5.5 addresses the ethical concerns and research quality issues in the thesis. Section 5.6 provides concluding remarks on the chapter.

5.2 Research Paradigms in Social Science Research

In any research, there is an underlying philosophical assumption[17] on which the entire study is based. The assumption behind the research philosophy undertaken by the researcher dictates the choice of theory and the research approach opted for, which in turn affects the choice of research method and form of analysis (Silverman, 2013). Each level of this philosophy of science, theoretical framework and research method is reciprocal and they are influenced by one another (Willis, 2007). The choice of a research paradigm depends on the

[17] The philosophy of science is sometimes synonymous to other concepts such as worldview or paradigm. In this thesis, these terms are used interchangeably.

researcher's belief about what reality is (ontological assumption) and how valid knowledge (epistemological assumption) should be accepted. Ontology is concerned with the researcher's assumption about the nature of the reality and epistemology refers to the manner in which knowledge is gained. Ontological assumption regarding reality can be positioned along a subjectivist continuum, in which reality is viewed as the projection of human construction or imagination, to an objectivist assumption, in which reality is perceived as a concrete structure (Burrell and Morgan, 1979).

A researcher's ontological assumption will influence the manner in which the knowledge is assumed and obtained (i.e. the researcher's epistemological assumptions). For instance, the *positivist* perspective rests in the belief of physical realism, where objective reality exists independently of human beings (i.e. ontological assumption). Truth is known or knowledge is achieved when researchers correctly discover the objective reality, rather than being inferred subjectively through sensation, reflection and intuition (i.e. epistemological assumption) (Chua, 1986). The aim of positivist social science research is to identify the causal relationship and fundamental laws that explain commonalities in human social behaviours (Easterby-Smith et al., 2012). In terms of the methodological approach, most positivist research tend to be quantitative rather than qualitative, and adopt the objective method of natural science, or the scientific method, to study social reality (Hallebone and Priest, 2009).

However, critics of positivism suggest that understanding human actions is far too restricted for universal laws and would prevent from interpreting the rich data sources that help in understanding the reasons why some human activities occur (Swanson and Chermack, 2013). Proponents of the *interpretive* paradigm consider that reality has no meaning until human beings ascribe meaning to it. Reality is subjective and socially constructed (Saunders et al.,

2009) and valid knowledge is generated by making sense of human actions, which contains individual aims and a social structure of meanings (Chua, 1986). Interpretive philosophy, therefore, focuses on understanding the world as it is and understanding the fundamental nature of the social world through subjective experience, where “explanation can be obtained within the realm of individual consciousness and subjectivity” (Burrell and Morgan, 1979, p. 28).

Paradoxically, critical research, which is popularised through the Frankfurt School, German School, and the Marxist School,[18] believe the nature of reality is objectively constructed and could be “transformed and reproduced through subjective interpretation” (Chua, 1986, p. 622). According to Myers (2008, p. 42), both critical and interpretive research are similar “to large extent, [in which] the epistemological assumptions of interpretivism…apply equally well to critical research.” However, the difference between both paradigms is that critical research focuses on the issues of inequalities and power struggles (Hallebone and Priest, 2009), and has the desire to make a change to the current status quo (Laughlin, 1995). For instance, critical research starts with identifying a specific group of people whose needs are not satisfied by the current system. The intention of the researcher is to enter into the participants’ world to gain understanding of their inter-subjective meanings and the culture that has been created by all other actors in their world. The researcher then figures out how the current social condition came to exist with historical and empirical analyses (Willis,

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[18] The term critical theory or critical social research is synonymous with criticalist research as defined by Hallebone and Priest (2009). For the purpose of this thesis, the term criticalist research is applied throughout the whole thesis.

2007). The use of critical theory[19] or ideologies are very crucial to guide the research and to illuminate the social actions and practices (Creswell, 2007, Guba, 1990). Rather than simply describing and accepting the current knowledge as it is in interpretive research, critical research challenges those prevailing beliefs, values, and assumptions that might be taken for granted (i.e. challenges the status quo with the aim of causing change to happen) (Gray, 2013, Laughlin, 1995). According to Fisher (2007), critical researchers generally believe that the purpose of research should be to change society for the better (Guba, 1990). These researchers basically have strong critical, socio-political and economic ideologies in place to support their claims about social inequality and unjust social systems (see e.g. Sikka, 2015a, Sikka, 2015b, Sikka, 2009).

Having outlined some aspects of the three main research paradigms, the next section examines the ontological and epistemological assumptions of the present study and the rationales in which Laughlin's middle range thinking (1995, 2004) is chosen as the methodological approach of the thesis.

5.2.1 Chosen Methodological Approach: Middle Range Thinking (MRT)

This section justifies the rationale in which Richard Laughlin's (1995, 2004) middle range thinking (MRT) is adopted as the methodological approach in this thesis. According to Laughlin (1995, p.65), "all empirical research is partial and incomplete and…theoretical and methodological choices are inevitably made whether appreciated or not." MRT concentrates on continua of *theory, methodology,* and *change* for which the choice for a mid-point has to

[19] Critical ideologies include the thoughts of Marxist, German Critical Theory and French Critical Theory among others.

be made. These choices are influenced by the research philosophical assumptions, such as ontology, epistemology, and the role of the researcher (i.e. the researcher's influence in the research process) (Burrell and Morgan, 1979). MRT maintains the mid-point or hybridised ontological and epistemological assumptions of the interpretive and positivist school of thought. Ontologically, it recognises that reality is different from our interpretations and is influenced by our 'perceptual biases', which ultimately influence the epistemological standpoint. MRT provides a deliberate instrumental choice process that encourages the researcher to have some understanding of the underlying methodological assumptions of the positivist and interpretivist approaches and the combination of their features may be useful to extend our understanding. Laughlin's (2004, p. 268) claim for such hybridisation is that:

> The way to engage with this empirical reality cannot either be left to some seemingly abstracted methodological approach, which is intended to be operated with minimal intrusion of subjectivity…or should it be left to an inevitably variable and sometimes very individualistic set of subjective processes…Middle range thinking sets up structures around the subjective processes, which recognise and accept the subject in the discovery process, yet also set some limits on how that subjectivity can be operationalised.

Under MRT, theory should be used in a 'skeletal' manner to be later fleshed with empirical details from data. *Theory* in MRT does not follow positivist paradigm, nor the hypo-deductive approach proposed by Chua (1986). However, theory guides the process of discovery and serves as a skeleton upon which the empirical flesh from the data may be fitted. In the case that empirical details do not suit the 'skeletal theory', the empirical data provide a basis for extending and/or reforming the 'skeletal theory'. This is very crucial because theories and empirical investigation only help us gain a partial understanding of the phenomenon as it is difficult to make claims of absolute truth (Laughlin, 1995, 2004). For instance, Broadbent and Laughlin (2014) contend that:

> MRT requires the need to be explicit about the theories that are used in all research projects. The "skeletal" theories provide a language that allows researchers to discuss the empirical situation and are used reflexively with the empirical data. Just as the theoretical "skeleton" needs empirical "flesh" to give it meaning, so the empirical flesh is given shape by the theoretical frame. This is middle-*range* in that it provides a framework with which to explore an empirical situation but not to define it…the use of the framework is not to test a theory, but to provide a language to enable discursive processes to develop understandings of the social world [p. 257-258].

The 'skeletal theory' according to Laughlin is not pre-given but needs to be discovered:

> Through extensive engagement with empirical situations [e.g. documentary analysis], initially to formulate their nature and then subsequently to provide a framework for understanding further empirical situations which, in turn, provides the base for developing their ongoing nature (2004, p. 268).

Pertaining to *methodology*, MRT permits the design of a methodology which sets up "structures around the subjective processes which recognise and accept the subject in the discovery process yet also set some limits on how that subjectivity can be operationalised" (Laughlin, 2004, p. 268). According to Laughlin, being structured "specifies in more precise and abstracted terms what is involved in this engagement process whilst, at the same time, not trying to squeeze out the intuitive, imaginative properties of individual observers" (2004, p. 274).

This thesis maintains that studying accounting practices and processes should be structured and framed. MRT takes the middle position that the "social world is not rule governed but is, instead, interpretively constructed". MRT considers the significance of not being heavily theoretically driven in describing empirical practices and also not to enter the field work theory-less (Broadbent and Laughlin, 2014, Laughlin, 2004, Laughlin, 1995). Theory guides and justifies the scope of the research and should have the attributes of conceptual pragmatism "to assist empirically oriented researchers to move from micro through meso to macro levels of analysis using conceptual tools that are flexible and open-ended" (Llewelyn, 2003, p.666).

The mutual accountability framework discussed and justified in Chapter 3 guides in exploring and understanding the nature of the governance and accountability practices in the building societies and the key issues experienced by the sector. This conceptual framework is regarded as a 'skeletal theory' (according to Laughlin's MRT, 1995, 2004) of this thesis and it is also considered as a normative[20] governance and accountability model of customer-owned mutual organisations. The framework justifies for what, why and how mutuals should be accountable to its vision and missions, employees, customers, regulators, community and environment.

Furthermore, qualitative rather than quantitative approach is chosen as the research approach of the present study. Quantitative research mainly focuses on investigating numbers and based on the ontological assumption that 'empirical reality is objective and external to the subject and the researcher' (Ryan *et al.*, 2002, p. 41). Humans are considered passive actors that pursue their assumed roles in a rational manner. Knowledge is assumed to be gathered through positivist approach which is based on verification and sought to identify relationships between variables in order to construct explanations by combining these relationships into general theories. On the other hand, qualitative research mainly focused on examining the meaning of words and is based on the ontological assumption that reality is 'emergent, subjectively created, and objectified through human interaction' (Chua, 1986, p.

[20] Normative means a statement of values like 'what should be' and not 'what is'.

615). Knowledge in qualitative research is assumed to be gathered by 'study[ing] things in their natural settings, [and] attempting to make sense of, or interpret, phenomena in terms of the meanings people bring to them' (Denzin and Lincoln, 1994, p. 2).

A qualitative research approach was chosen in this research mainly because first, the focus of the study is on 'how' research question within a 'real life' accounting practices, a focus that makes a qualitative research approach most appropriate methodology to adopt (Silverman, 2013, Patton, 2002, Bryman, 2012). Second, this research aims to explore and understand to what extent the governance system in building societies are appropriate in achieving accountabilities. Given that governance issues are key topics in financial services sector following the 2008 financial crisis, setting parameters (through quantitative approach such as questionnaires and statistical regression) will restrict in exploring and learning the governance issues in building societies. This will also rule out many interesting phenomena relating to what people actually do in their day-to-day lives in their companies with respect to governance and accountability issues.

In terms of *changing* option as promulgated by Laughlin, MRT is open to maintaining or changing the status quo. This means that it is optional for the researcher to call for change or to understand a phenomenon before change is promulgated. Laughlin (2004, p. 269) maintains that:

> We cannot say that our understanding must inevitably lead to change in the phenomena being investigated—adopting this position means that everything is 'wrong' and in need of development. The argument for a 'middle position' is that there needs to be mechanisms to judge when change should be pursued.

While it is possible that the understanding stemming from this research may promote change, it is not the immediate concern of the research. This is primarily because the purpose of the research is to uncover and explore the state of governance and accountability matters in mutual organisations vis-à-vis the building society (i.e. an exploratory study). Hence, to propagate change in the first place may not be appropriate. Rather, in-depth understanding and discovery of the phenomenon and issues should be carried out first before change can be propagated[21]. The next section explains in detail the choice of the data collection techniques.

5.3 Research Method

According to Silverman (2013), research methods are the specific techniques or tools used by researchers to answer the research questions and achieve the research objectives. In order to answer the research question of the present study, the research mobilises three research methods: semi-structured interviews, documentary analysis, and non-participant observation. The reasons why these research methods are adopted are justified next.

5.3.1 Semi-Structured Interview

Interviews with informants formed a major part of this research. An interview is basically defined as a type of research method which facilitates “conversation between two or more people” (Matthews and Ross, 2010, p. 219). According to Gray (2013), in-depth interview is an appropriate method when the objective of the research is largely exploratory involving, for

[21] However, it is highlighted here that there are a number of criticisms with respect to the MRT model (see Lowe, 2004). Lowe (2004) argues that it is difficult to determine the ‘exact’ mid-point that is promulgated by Laughlin (1995). Laughlin recognised this limitation and states that the ‘descriptors “high”, “medium” and “low” are not precise, definable, or measurable’ (1995, p. 68). However, what is more important is the MRT recognition of schools of thought (e.g. French and German critical thinking) and locating one’s work away from such extreme to a middle point if the two extreme points are reducible to a numeric value. Likewise, Laughlin (2004) addresses that there is the possibility for other theories and schools of thought fitting into the middle point and it does not exclusively have to be the German Critical Theory that he initially promulgated. For example, Laughlin states that: “Whilst ‘middle range thinking’ has been inextricably linked to German Critical Thinking, and Habermas…two things need to made clear on this association. First, it doesn’t have to be so. I am trying to argue for characteristics of an approach (‘middle range thinking’) but this does not mean that it is only this set of ideas that possess these characteristics. Second, whilst our work has been informed by Habermas, we have taken the liberty of adding new elements to his thinking over many years” (2004, p. 269).

instance, understanding of *experiences, opinion, attitudes, values* and *processes* about a particular matter or phenomenon. There are three main types of interview that are commonly discussed in social science research: structured, semi-structured, and unstructured interviews (Saunders et al., 2009, Rubin and Rubin, 2011).

The semi-structured interview is chosen as the core method in this study. The semi-structured interview is a non-standardised interview approach in which the interviewer has a list of issues and questions to be covered, but may not deal with them in each interview. Additional questions will be asked, including some that are not anticipated at the start of the interview. The advantage of using semi-structured interviews as compared to structured and unstructured interviews is that semi-structured interviews allow for probing of views and opinions, where it is desirable for interviewees to expand on their answers. In contrast, structured interviews have a set of similar questions in predetermined order like questionnaires (Gray, 2013). Semi-structured interviews also impose some structure on the interview conditions, as opposed to unstructured interviews, and assist in framing subsequent analysis (Liew, 2005).

Given that this research is exploratory in nature and aims to understand how the interviewees construct and attribute meanings to the governance and accountability practices in building societies, the semi-structured approach is deemed a more appropriate approach. This is primarily because: first, some of the governance and accountability issues identified through documentary analysis require participants' views and opinions. Semi-structured interviews through identification of predefined questions provide an avenue to seek in-depth views of interviewees in an open-ended manner. Second, the semi-structured interview provides the flexibility to ask predetermined questions to fellow 'elite' interviewees (such as chief executives, non-executive directors, regulator and audit partner). According to Rubin and Rubin (2011), some interviews are one-shot, in which the researcher has no possibility to follow up. The time allotted for the interview may also be short and the researchers are allowed to ask critical questions. In this respect, predetermined interview questions allow the researcher to prioritise and be selective on the questions interviewees are asked.

In total, thirty-eight interviews were conducted over a six-month period, between July and October 2015, and between January and February 2016. The interview normally lasted between forty-five minutes and one hour and thirty minutes. Throughout the data negotiation process, issues of confidentiality, anonymity, privacy, and security of information were stressed to interviewees. Interviewees were notified upfront through email that their names, personal information, and organisation would not be revealed. Instead, pseudonyms are used to substitute for their actual names. The invitation letter also stated that if an interview was granted, the interview would be audio recorded with the consent of the interviewees. Interviewees were permitted to validate the interview transcripts, if they wished. The following sub-sections highlight the selection of the research interviewees.

5.3.1.1 Interviews of Directors

Three main key stakeholders are identified in the study. First, organisation directors are regarded as the key stakeholders in this research. Following O’Dwyer (2003), who interviewed senior executives to explore managerial conceptions of corporate social responsibilities, this study also interviewed the executive directors (ED) and non-executive directors (NED) of building societies. The individuals are considered to have wide experience and understanding on the governance and accountability matters in their organisations based on their strategic positions.

Interviews were also conducted with ex-directors of the building societies. In some cases, the executives and non-executives were hesitant to go in-depth into the governance and accountability matters of building society sector. Inputs from ex-directors are vital in complementing and contradicting views provided by existing directors, as well as to triangulate on the narratives provided by other interviewees (Bryman, 2012, Silverman, 2013).

The executive directors were identified through a review of the BSA website. A list of spokespersons and the contact details of forty-four building societies were available on the BSA website. On the other hand, non-executive directors and ex-executive directors were identified through the review of the annual reports of building societies. Because there might be different issues faced by building societies depending on the size, forty-four building societies with different sizes were invited to participate in the research. Sixteen building societies took part in the research. **Table 5-1** presents the number of interviews conducted with building societies from different sizes based on their total asset values.

Size of Building Societies [22]	**Asset Size**	**Number of building societies**	**Number of interviewees**
Peer Group 1 (PG1)	Asset size over £ 1billion	9	14
Peer Group 2 (PG2)	Asset size of between £300 million and £ 1billion	5	6
Peer Group 3 (PG3)	Asset size of less than £300 million	2	4

[22] The classification of building societies (based on asset size) is in consistent with the categorisation by KPMG‘s Annual Building Societies Database 2015.

Total	**16**	**24**

Table 5-1: Number of interviews conducted with building societies based on the asset size of the organisations (Source: KPMG 2015, analysis by author)

Once potential interviewees had been identified, emails and invitation letters were sent to invite these individuals to participate in the research. Both letter and email included a broad outline of the research being undertaken and the topics to be addressed. According to O'Dwyer (1999), this may enable interviewees to consider the issues and matters being addressed prior to the interviews and to seek clarification, if required. *Appendix 1, Appendix 2, Appendix 3, and Appendix 4* provide examples of the invitation letter, email, consent letter, and interview guide.

5.3.1.2 Interview of Customer-Members

The study also sought the participation of member-owner-customers of building societies. Customers are the *raison d'être* for building societies to be incorporated in the first place. Building societies play a pivotal role in serving their members. Nonetheless, it has been reported that some of the board of directors and management of building societies were running and managing the organisations as their personal business rather than for the benefits of members (see e.g. Financial Times, 7 August 2013 , The Daily Mail, 13 December 2009). With respect to this, members were invited to take part in the research in order to obtain their views pertaining to their accountability relationship with their building societies. A total of nine members were interviewed. They were the researcher's circle of friends and individuals that the researcher met during her attendance at AGMs and member forum events organised by building societies. Although the number of participants interviewed was not predefined, it was deemed sufficient as all the participants were saying the same thing (see e.g. Baker et al., 2012).

5.3.1.3 Interview of Regulator, Auditor and a BSA Representative

Following Hyndman et al. (2004) who interviewed regulators to understand the discharge of financial accountability by Irish credit unions, this study also interviewed the UK banking regulator (e.g. the PRA) to seek their opinions pertaining to the state of governance and accountability practices of UK building societies. The FCA[23] and PRA[24] are considered to have major influence over the governance and accountability practices in the building society sector because of their role in supervising and monitoring the conduct and prudential states of individual building societies (HM Tresury, 2013). As one of the key stakeholders in the industry, their perspectives were therefore sought.

Emails and phone calls were made to the FCA and PRA in June 2015 and a follow-up phone call was made in August 2015 to invite the regulators to participate in the research. However, the researcher was informed by the call centre at the FCA and PRA that it was against both regulatory bodies' policies to take part in academic research because of massive numbers of

[23] The main function of the FCA is to ensure that the regulated firms make the interests of the customers and market the central focus of how the businesses are run. These include securing "an appropriate degree of protection for consumers, to protect and enhance the integrity of the UK financial system, and to promote effective competition in the interests of consumers" (FCA, 2015, p. 6). The FCA is accountable to HM Treasury, who are accountable to Parliament.

[24] The functions of the PRA include supervision and regulating on the prudential matters of the building societies. In particular, it has two statutory functions, which are to promote the safety and soundness of the banks, building societies, credit unions, investment firms and insurance companies, and to secure protection for policyholders. The PRA is the subsidiary of the Bank of England and it works alongside the FCA. It is accountable to the Bank of England and HM Treasury, who are accountable to Parliament.

requests for and invitations to research participation. Nonetheless, through invitation from LinkedIn, one representative from the PRA agreed to take part in the study.

Attempts were also made to invite the auditors to take part in the research. The input of auditors was crucial to the research as the financial statements of the building societies are audited by the external auditors and many of the audit firms provide professional training, e-governance and internal auditing services to the building societies. On top of that, Sikka (2009, 2015) argues that auditors play a prominent role in the construction of regulatory arrangements for financial institutions through governance arrangements such as those relating to accounting and auditing. They are expected to monitor company directors to ensure that company conduct is appropriate and the accounts they produce are meaningful. Arguably, auditors indirectly have an impact in the success and failure of firms.

With respect to that, requests were made to some directors to refer the researcher to their auditors and regulators. Nonetheless, the researcher's requests were rejected a number of times. The researcher personally contacted the auditors based on emails obtained from the published works of audit firms on building society sector. An audit partner who has more than twenty years of experience in the financial services and building society industry consented to take part in the research. Furthermore, the views of a representative from the Building Societies Association (BSA) were obtained. The BSA is an association that represents forty-four building societies to audiences such as regulators, the government and Members of Parliament, the Bank of England, the media and the general public (Morris, 2015). In this sense, the input from the BSA representative was paramount for the research.

5.3.1.4 Interview Process

In total, thirty-eight interviews were carried out. Participants interviewed were from sixteen building societies of varying sizes. **Table 5-2** and **Table 5-3** present an overview of the interviews undertaken and the pseudonyms associated with the research participants (Rubin and Rubin, 2011, Spencer et al., 2014). All interviews were conducted on a one-on-one basis at venues convenient for both interviewer and interviewees. For instance, interviews with directors, the auditor and regulator were conducted at the interviewees' offices. On the other hand, interviews with members were carried out at the AGM venues or a cafeteria.

No	Organisation Code	Participant Code	Size of the Building Societies	Date	Duration	Position
1	BSL01	CEO-1	PG2	9-July-2015	42 minutes	CEO
2	BSR02	CEO-2	PG1	14-July-2015	48 minutes	CEO
3	BSL03	FinDir-1	PG2	17-July-2015	30 minutes	Finance Director
4	BSL04	CHAIR-1	PG2	27-July-2015	1hour and 45 minutes	Chairman
5	BSR05	CEO-3	PG1	04-Aug-2015	1hour and 45 minutes	CEO
6	BSL06	CEO-4	PG3	05-Aug-2015	1hour 08 minutes	CEO
7	BSN07	CEO-5	PG1	11-Aug-2015	1hour 15 minutes	CEO
8	BSR08	RiskDir-1	PG1	13-Aug-2015	58 minutes	Risk Director

No	Organisation Code	Participant Code	Size of the Building Societies	Date	Duration	Position
9	BSR08	CHAIR-2	PG1	13-Aug-2015	55 minutes	Chairman
10	BSR08	CEO-6	PG1	13-Aug-2015	1hour 09 minutes	CEO
11	BSR09	NED-1	PG1	18-Aug-2015	59 minutes	NED
12	BSL10	CEO-7	PG2	20-Aug-2015	40 minutes	CEO
13	BSL11	CEO-8	PG3	25-Aug-2015	2 hour and 15 minutes	CEO
14	BSL11	HC	PG3	25-Aug-2015	45 minutes	Head of Compliance
15	BSL11	FinDir-2	PG3	25-Aug-2015	1 hour 30 minutes	Deputy CEO
16	BSL12	CEO-9	PG1	03-Sept-2015	1 hour	CEO
17	BSR13	CEO-10	PG1	25-Sept-2015	1hour 15 minutes	CEO
18	BSR14	CEO-11	PG1	30-Sept-2015	1 hour and 30 minutes	CEO
19	BSR15	CEO-12	PG1	27-Oct-2015	1 hour 15 minutes	CEO
20	BSR16	CEO-13	PG1	29-Oct-2015	1hour 25 minutes	CEO
21	BSL17	CEO-14	PG1	12-Nov-2015	1hour 20 minutes	CEO

No	Organisation Code	Participant Code	Size of the Building Societies	Date	Duration	Position
22	BSL01	NED-2	PG2	07-Jan-2016	1 hour 01 minutes	NED
23	BSL01	NED-3	PG2	11-Jan-2016	50 minutes	NED
24	BSR14	NED-4	PG1	23-Feb-2016	50 minutes	NED

Table 5-2: Interviews undertaken with directors of UK building societies (Source: Author)

No	Name of Stakeholders	Participants Code	Meeting Date	Approximate Duration
1	Member	MEM-1	29-June-2015	40 minutes
2	Member	MEM-2	30-June-2015	55 minutes
3	Member	MEM-3	7-July- 2015	42 minutes
4	Member	MEM-4	8-Aug-2015	15 minutes
5	Member	MEM-5	10-Sept-2015	15 minutes
6	Member	MEM-6	3-Oct-2015	35 minutes
7	Member	MEM-7	14-Oct-2015	30 minutes
8	Member	MEM-8	14-Oct-2015	30 minutes
9	Member	MEM-9	14-Oct-2015	25 minutes

No	Name of Stakeholders	Participants Code	Meeting Date	Approximate Duration
10	BSA Representative	BSA	31-July-2015	58 minutes
11	Ex-Director	ED-19	23-Sept-2015	1 hour 10 minutes
12	Ex-Director	ED-20	21-Jan-2016	1 hour 40 minutes
13	Regulator	REG	05-Feb-2016	50 minutes
14	Audit Partner	AUD	10-Feb-2016	40 minutes

Table 5-3: Interviews undertaken with key stakeholders of the building society industry (Source: Author)

Different sets of interview guides were used to structure the interviews between directors, members, auditor and regulator. However, the list of questions asked varied, depending on the flow of discussion and the organisational setting. All interviewees were informed prior to the commencement of the interview that their participation in the research was voluntary. They were free to express themselves or withdraw from the interview sessions if they felt uncomfortable with the interview questions (see e.g. Saunders et al., 2009). Interviewees were also assured that all information disclosed during the interview was regarded as confidential and would be safeguarded properly. Their names and organisations would not appear in the thesis or future publications, but would be substituted with generic names. All interviewees consented to have the interview audio recorded. Detailed notes were taken throughout each interview such as key phrases made, and non-verbal communication and body language. Analysis of the field notes assisted the researcher to build up new and follow-up questions for subsequent interviews as well as pace the flow of the interviews (Patton, 2002). Field notes from the interviews also aided in analysing and interpreting initial empirical findings prior to formal data processing and interpretation of the information gathered (O'Dwyer and Unerman, 2008).

Despite the importance of interviews in qualitative research, Easterby-Smith et al. (2012, p.130) state that qualitative researchers have often encountered 'interviewer biasness' in which the interviewer imposes "their own reference frame on the interviewees, both when the questions are asked and when the answers are interpreted". In order to reduce interviewer bias, the interviews were carried out with a variety of stakeholders who have direct or indirect experience and encounters with building societies. This is in-line with the recommendations of Saunders et al. (2009) that seeking, corroborating and properly analysing insights provided by different stakeholders provides the likelihood of gaining a big picture of the studied phenomenon. The interview evidence was corroborated with data from documentary analysis and non-participant observation, and all interviewees were invited to validate the interview transcripts. Having discussed the interview process in this research, the next sub-sections explain the secondary data collection techniques such as documentary analysis and non-participant observation.

5.3.2 Documentary Analysis

Documentary analysis is a technique used in qualitative research to review, analyse, and interpret various forms of documents like interview notes and transcripts, journal articles, newspaper articles, acts and websites (Rubin and Rubin, 2011). Potential biases often occur in qualitative research and to reduce this threat, documentary analysis is often used in combination with other qualitative methods as a means of triangulation, to seek corroboration with different sources of data and methods of collection (Bowen, 2009, Patton, 2002).

The importance of documentary analysis in this research is that it helps to provide initial understanding into the building societies movement. The method also helps to identify and problematise the governance and accountability issues in the sector. According to Goldstein and Reiboldt (2004, p. 246), while "interview data helped focus specific participant observation activities, document analysis helped generate new interview questions." The reading and analysis of many sources of documents proved valuable in generating and refining the interview guide of the present research. Documents that have been used and analysed include building societies audited financial statements, BSA press releases, HM Treasury reports, Bank of England reports, newspaper articles, industry reports, information leaflets, and web-based information. These documents have provided important sources of information and to some extent they have been used to support and corroborate the interviews and non-participant data collected.

5.3.3 Non-Participant Observation

Slack and Rowley (2001) argued that some interviewees in qualitative research may not provide in-depth explanations on the issues that the researcher are interested in. This may be due to the sensitive issues discussed and time constraints in covering all matters. In this regard, observation provides an avenue for the researcher to obtain information that may escape the researcher's knowledge as well as enable the researcher to seek further clarification from interviewees on the subject under observation (Slack and Rowley, 2001, Alvesson, 2010). Rather than participate in the research as a customer or employee in participant observation, the researcher 'stands to one side' and observes the environment and phenomenon under study (this is regarded as non-participant observation) (Slack and Rowley, 2001).

Non-participant observation data helps the researcher to compile and supplement the oral and documentary evidence. It also assists the researcher to obtain initial understandings and to seek clarification on issues that the researcher is uncertain about. For instance, it has been reported in newspapers that some building societies were not accountable to their customers (see e.g. The Daily Mail, 9 April 2011, The Daily Mail 13 December 2009). However, the researcher's attendance at two AGMs and one member forum event between August and October 2015, in the south and north of the UK, confirm that the meetings were properly convened and carried out in accordance with the *Building Societies Act 1986*. Directors of building societies were in attendance to answer customers' questions and to seek customers' opinions on the present and future products offerings. Hence, the researcher observation as non-participant in the meetings clarified the ambiguities that the researcher had after the reading of the newspaper articles.

Moreover, during attendance at the meetings, the researcher listened and took notes throughout the meetings. Any discrepancy between what the researcher witnessed in the meetings and issues reported in newspaper articles, led the researcher to seek in-depth clarification from the directors during the interviews. The following section explains the process by which the data collected are analysed.

5.4 Data Analysis

Data analysis is an on-going process in qualitative research that can be performed along with the data collection. It does not only begin when the researchers complete the data collection (Spencer et al., 2014). In this study, preliminary data analysis started after every interview. A brief summary was written about the main findings after each interview. Once all interviews had been transcribed, the researcher comprehensively reviewed again all interview transcripts and journal articles, listening to digital recordings, and read the notes taken during and after each interview. The main purpose of this process was to ensure that researcher obtained an overview and understanding of the state of governance and accountability practices in the building societies. This was also to identify any potential issues and tensions experienced by the sector.

After the initial stage of comprehensive reading and reviewing the documents, the interview data was then translated into relevant data. The process of reducing the messy and massive interview data to relevant data includes identifying which data should be included and excluded (Miles et al., 2014). At this stage, the researcher classified the interview and documentary data based on main themes, subthemes and open codes (or illustrative quotations which do not relate to both key themes and sub-themes). For example, participants frequently spoke about the significance of the 'shared service model' in building societies. Although issues about the shared service model probably relate more to business challenges, categorising those illustrative quotations under 'open codes' enabled the researcher to examine the reasons the interviewees shed light upon the subject at a later phase. NVivo, a computer-assisted qualitative data analysis software (CAQDAS) package was used to record all key themes, subthemes and open codes identified from the interview transcripts and document sources (Wiredu, 2014).

After the identification and classification of the interviews and document sources, all key themes, sub-themes and open codes were displayed by creating detailed matrices. NVivo, in this regard, helped to generate overviews of quotes automatically and to generate matrices that illustrated the number of quotations per theme. The matrices and overview produced by NVivo assisted in recognising the regularity and patterns of explanations in the evidence collected (Bazeley and Jackson, 2013). At the data display step, the reading of the matrices and initial illustrative quotation helped the researcher in preparing mind maps, condensing open codes into main themes, and reformulating the open codes and main theme matrices for both documentary and interview data using NVivo.

The final step in the data analysis process is data interpretation, which involved interpreting and explaining the reduced data for both documented, non-participatory observation data, and for interviews. In this step, all the matrices, summaries of initial findings and mind maps were examined and revisited in order to obtain a 'big picture' of the narrative outline created by the interviewees. Subsequently, a full description of the findings using the big picture and documentary analysis were developed. The analysis of documentary data and academic literature on governance and accountability in mutual organisations continued throughout the entire research process in an iterative process in order to conceptualise the findings. As initial interpretation of evidence emerged, the researcher went back and forth between the emerging narrative, field notes, interview transcripts, summaries of initial findings and the analytical framework that emerged, drawing on concepts of internal, external and intermediate governance structures, and financial-social dual, compliance, personnel and social responsibilities and accountabilities. During the analysis phase, additional interviews were carried out with interviewees between January and February 2016 in order to clarify certain issues that had emerged and to gain elaboration and confirmation on initial findings.

5.5 Research Quality Criteria

Research validity and reliability are the two most important criteria in judging the quality of research. A piece of research is considered *reliable* if the findings of the research are replicable, and *valid* if the extent of the research findings accurately represent the whole phenomenon under study and can be generalised across social settings (Lewis et al., 2013, Saunders et al., 2009). Lewis et al. (2013) and Bryman (2012) argue that it is a barrier for qualitative research to be concerned with reliability or validity issues. This is primarily because the extent to which the qualitative research findings can be repeated and provide similar results has been questioned on numerous occasions. However, Seale (1999, p. 158) still cautions qualitative researchers of the importance to show "the audience of the research studies as much as is possible of the procedures that have led to a particular set of conclusions." Rather than considering reliability and validity as the criteria in evaluating a piece of qualitative research, this research adopts the research quality criteria proposed by Guba and Lincoln (1994), such as **trustworthiness.** According to Bryman (2012, p. 390), trustworthiness is similar to reliability and validity in quantitative research and it consists of four criteria:

- credibility, which parallels internal validity;
- transferability, which parallels external validity;
- dependability, which parallels reliability; and
- confirmability, which parallels objectivity.

Table 5-4 below summarises the research quality criteria proposed by Guba and Lincoln (1994, as adapted from Bryman, 2012) which were adopted in the present study, and the approach undertaken by the researcher in meeting those criteria.

Quality Criteria and the Process of Achieving Them
Credibility Guba and Lincoln (1994, as adapted from Bryman, 2012) state that credibility in qualitative research is to ensure that the study is conducted according to good practices and to submit the research findings for participants' validation and review. In order to ensure that this research is credible, the researcher has used multiple techniques in collecting the data such as semi-structured interviews, documentary analysis and non-participant observation. Findings from these multiple sources were also corroborated and correlated with established literature in order to enhance the credibility of the findings. At the same time, interviewees were invited to validate the interview transcripts, in order to ensure that interviews have been carried out and data were not fabricated and created by the researcher. Out of thirty-eight interviews conducted, only two interviewees requested copies of the interview transcripts.
Transferability The purpose of transferability is to establish whether a study's findings can be generalised beyond specific research settings (Bryman, 2012). However, it is a challenge to generalise the findings of qualitative research to different milieus. This is primarily because each different setting has different contextual factors, such as different culture and values (Saunders et al., 2009). Hence, this research does not claim that the findings may be transferable to other

Quality Criteria and the Process of Achieving Them
contexts. Instead, it is maintained that the concept of transferability and generalisation in this study is 'analytical' and not 'empirical' (Polit and Beck, 2010). Yin (2010) contends that analytic generalization is making projections about the likely transferability of the findings to the theory. This means that the purpose of the mutual accountability framework developed in Chapter 3 can be adopted as a conceptual framework to study and explore on the governance and accountability practices of building society industry as well as other mutual organisations in the UK, such as credit unions and friendly societies.
<u>Dependability and Confirmability</u> Dependability and confirmation in qualitative research entail peers to act as 'auditors' during and at the end of the research. It also includes proper documentation and filing of all the records for the purpose of verification (Bryman, 2012). All the works in this thesis have been reviewed by supervisors and all data are available for verification and examination, if requested. The details of how the findings of this thesis are dependable and confirmable are already presented in Sections 5.3 and 5.4 for data collection and analysis.

Table 5-4: Research quality criteria (Source: Author)

5.6 Summary of the Chapter

This chapter has discussed the methodological assumptions made in this thesis and how they have influenced the choice of different research methods. The chapter has also discussed the research question and how it is associated with the conceptual framework and research methods. Semi-structured interviews were the main data collection method in this thesis and the evidence from interviews was triangulated with evidence from documentary analysis and non-participant observation. The chapter also describes how the research quality criteria (such as credibility, transferability, dependability, and confirmability), as promulgated by Guba and Lincoln (1994), were addressed in the study. The following chapters discuss and report the findings of the research.

CHAPTER 6: Internal Aspects of Governance and Accountability: An Analysis of the Views of Key Stakeholders

6.1 Introduction

Having discussed the methodological choice and methods of this thesis in Chapter 5, this chapter, chapter 7 and chapter 8 discuss and report the empirical findings of the research. These empirical chapters refer to the mutual accountability framework as presented in Chapter 3 to examine and explain the governance and accountability practices. The data analysis is divided into three main parts. This chapter reports the first part, which includes the views of interviewees (directors, ex-directors, an auditor, members and a regulator) with respect to the internal aspects of governance and accountability in the building society sector. In Chapter 7 and Chapter 8, the second and third parts are respectively discussed, examining the intermediate and external governance structures of building societies.

This chapter is divided into six main sections. The next section, Section 6.2 presents directors' understanding of governance and accountability. Section 6.3 reports interviewees' views on the importance of governance and accountability and Section 6.4 highlights the state of internal governance arrangements in building societies. Section 6.5 sheds light on the employment and internal mechanisms employed by the sector to achieve personnel accountability. Section 6.6 summarises and highlights key internal governance issues in the building society sector.

6.2 Understanding the Meaning of Governance and Accountability

The interviewees were asked about their understanding of governance and accountabilities in building societies. All of the directors recognised that they were the "stewards" or "custodians" of the business and they had the responsibility to safeguard the organisation in the best interests of past, present and future members:

> *I got the responsibility to past membership, to current members and to future members. We need to make sure we are here for a longer period of time [CEO-11].*

A similar perspective was voiced by another director:

> *I am highly conscious that this is an organisation that was formed 165 years ago and my job is to take it forward and hand it over to the next generation in a better condition than I took it over. As chief executives, we cannot pretend that we are the owners of the business. Full stop! We've got all the people [who] have [for] all of those years built up the organisation and it's my job to make sure the organisation moves forward [CEO-2].*

Governance in building societies is to ensure that proper control structures are in place to enable customers to voice their opinions and to participate in business operations, and to ensure that organisations are run and managed by qualified individuals. For instance, a director stated:

> *Governance is the structure that we have in place that ensure we have got proper check and balance in everything that we do, to make sure that the right decisions has been made, the right risk appetite is being adhere, appropriate due diligence that we have been making the major decisions [CEO-5].*

In emphasizing the importance of effective governance, a non-executive director expressed the view that:

> *The whole corporate governance arrangement is important. For instance, there should always be clear lines of responsibilities between executive and non-executive directors, the number of NEDs should be more than executive*

directors and proper structures should be in place to facilitate the discussion of directors' remuneration and managing the accountability relationship between directors and members. It is also important for building societies to have governance on product innovation, product review, lending policies and making sure that [borrowers] are able to repay their mortgages. All of these aspects are important. It's difficult to say one particular aspect is more important [NED-1].

When the interviewees were asked about the differences between banks and building societies' governance structures, the majority of interviewees highlighted that the differences centred on customers' rights. Customers have the right to vote on governance matters of building societies, such as the pay policy of directors. Conversely, the customers of banks did not have the opportunity to vote on directors' remuneration. Some interviewees also explained that building societies contrasted with banks in terms of their commitment and responsibility to the community, society, environment and staff:

With certainty the ownership structure is different. The regulation is the same here. But, what I like to think are the people we have here. There are special elements that we have got. Whether the staff is customer-facing or not, most of our staff really do care about customers and felt good to have conversations with customers [CEO-10].

Another director elaborated:

I think banks do the charity works and things like that. How wholeheartedly they go into that, I don't know. But, our engagement with the community is the essence of our business [FinDir-1].

Even so, most interviewees contended that members were neither interested in voting for the pay policy of directors, nor the election or re-election of directors, nor in approving the audited financial statements. Members were mainly interested in building a business relationship with building societies by opening savings accounts and/or obtaining mortgages. Chairmen are commonly appointed by members as their proxies. As one member stated:

> *I have a savings account with [SSS] building society because it offers good ISAs rate. But, I don't generally vote for the directors or read the AGM pack that I received each year [MEM-9].*

The analysis of the responses suggests that the directors had a reasonable understanding of their roles and responsibilities in accordance with the UK Code of Corporate Governance (*The Code*). Repeatedly, directors commented that they were the stewards of the building societies and their main responsibilities and accountabilities were directed towards customer-owners. Directors also recognised that they had a responsibility and accountability to wider constituents such as the community, environment, regulators and employees.

6.3 Importance of Governance and Accountability in the Building Society Sector

In the literature on the importance of governance for organisations, it was often found that good governance enhanced firms' financial performance and access to external financing, lowered firms' cost of capital and increased firms' efficiency (Claessens, 2006). There was a consensus among interviewees about the significance of good governance in all types of financial institutions. Interviewees said that good governance assists their organisations to make long-term decisions in the interests of current and future members and to provide safe and secure financial institutions for customers. For instance, a finance director mentioned that:

> *The fundamental part is to make sure that the governance of this organisation is such that we do not make a mess and lose the depositors' capital. On the other side, our business is lending money. We have to make sure we have proper governance in our lending policies, product review and innovation. If we don't get that right, we don't make any money either. We are out of business [FinDir-2].*

A risk director emphasized the critical nature of effective governance in improving organisations' decision-making processes, individual accountability of the director and also the financial performance of the business:

> *I think the important element of having a governance framework is it helps in our decision-making process and also made us accountable for our decisions. We wouldn't want a board where they said management did that and we didn't know what was going on. So, I think the important element is having a governance framework that enables us to work out who is accountable and responsible for what. I also think that effective governance enables us to demonstrate to our members and other stakeholders about the performances of our business [RiskDir-1].*

Another CEO accentuated that good governance heightens the confidence of regulators:

> *I feel that governance has become more important since the financial crisis, because of the facts that the regulators have become very nervous and therefore want to make sure that everything has been done to avoid future failures. On that basis, we have to demonstrate that we are doing a good job to the regulators [CEO-4].*

One of the NEDs expressed that governance should never be overlooked and added that the failure of some building societies during the 2008 financial crisis had made governance more essential in the industry:

> *If you look at the reasons for the failure of 15 of the building societies during the financial crisis, they often came down to governance, a weak board, a weak chief executive or the opposite, the dominant chief executive. So governance is extremely important… There are corporate governance failures in the building societies that exposed during the crisis, that makes corporate governance really important [NED-1].*

A similar view was expressed by another CEO:

> *If you look across all [the building societies] that failed, the reason that they failed is that the governance was inadequate. In many cases, it had a very strong chief executive, who the board didn't control. I think governance is important regardless if we are mutual or bank [CEO-7].*

In addition, external stakeholders such as the regulator and auditor seconded the views of the directors that effective governance could enhance accountability to the members of building societies:

> *The building societies are trusted with their members' reserves. These are millions of pounds. In my view, effective governance could help them to demonstrate greater accountability to their members [REG].*

However, there were a number of interviewees who were in doubt as to whether excessive attention to governance by the regulators since the 2008 financial crisis was beneficial to the business. The collapse of all demutualised building societies such as Northern Rock, HBOS, and Bradford & Bingley had led the FCA and PRA to strengthen their supervisory roles on financial services firms. Nonetheless, the interviewees suggested that overemphasis of governance by the FCA and PRA had led some of the small and medium-sized building societies (particularly those building societies categorised under Peer Group 2 (PG2) and Peer Group 3 (PG3)) to increase their focus on managing risks, internal control and governance structures, rather than on administration of business. This is as explained by the following director:

> *It seems that governance and risks is what we have talked about more often. We don't seem to talk about the business these days. We just need to get the pattern right around the place… It is good to talk and think about good governance. It is good to have strong governance, and well-run society. There has been time where we have been in a position where, we just focus on it too much [CEO-8].*

The comment implicitly highlights that building societies have overly emphasized the 'form' of governance and could have neglected the actual essence of the business.

In summary, interviewees' responses reveal that the aims of governance in building societies were to enhance the confidence and trust of various stakeholders such as customers and regulators, to increase the accountability of directors and to achieve growth in the business. Nonetheless, there were scepticisms among a minority group of interviewees on the benefits of excessive focus on governance by the PRA and FCA since the 2008 financial crisis.

6.4 State of Internal Governance Structures and Practices

The thesis maintains that internal, intermediate and external governance structures foster the achievement of effective accountabilities (see e.g. Ketilson and Brown, 2011, Fonteyne, 2007, Group, 2007). Interviewees highlighted the importance of internal governance structures such as the functions of the board of directors, board committees, risk management and internal control frameworks, disclosures and reporting, in achieving the overall organisation vision and mutual accountability. The following sub-sections consider the internal governance structures and practices in the building society sector.

6.4.1 Board of Directors

The board of directors has been recognised as an important governance mechanism (Uddin and Choudhury, 2008, Claessens, 2006, Solomon, 2013). In the building society sector, the organisations are run by a board of directors that comprises executive directors (EDs) and non-executive directors (NEDs). The board is regarded as the steward of the organisation and is accountable to the members for the overall affairs of the business (BSA, 2010b).

Under Section 58 of the *Building Societies Act 1986*, every building society shall have at least two directors and one of the directors shall be appointed to be chairman of the board of directors. An analysis of the composition of the board of directors in building societies for the year ending 2014/2015 revealed that there were at least two executive directors and four non-executive directors. This is in line with the requirements under *The Code* that at least half of the board should consist of independent NEDs.

Table 6-1 presents the number of directors serving on the boards of building societies. Based on the table**,** PG1 building societies were inclined to have more directors on their boards. There were at least two executive directors and five NEDs in PG1 building societies. On the other hand, there was at least one executive director and four NEDs in PG 2 and PG3 building societies. The minimum number of NEDs in the building society sector was in line with the requirement of *The Code*, in which there should at least be two NEDs in the companies (Para B.1.2).

Categories	Building Society (in size order)	Number of directors: Executive Directors	Non-Executive Directors	Total
PG1	Nationwide	4	7	11
	Yorkshire	5	8	13
	Coventry	4	7	11
	Skipton	2	8	10
	Leeds	4	8	12
	Principality	3	7	10
	West Bromwich	3	7	10
	Newcastle	4	9	13
	Nottingham	3	6	9
	Cumberland	4	6	10
	Progressive	3	5	8
	National Counties	3	4	7
	Saffron	2	6	8
	Cambridge	3	8	11
	Monmouthshire	3	7	10
PG2	Leek United	3	5	8
	Furness	3	6	9
	Newbury	3	6	9
	Ipswich	2	6	8
	Hinckley & Rugby	2	4	6
	Darlington	3	5	8
	Manchester	2	6	8
	Market Harborough	2	5	7
	Melton Mowbray	2	6	8
	Marsden	2	7	9
	Scottish	1	6	7
	Tipton & Coseley	3	5	8
	Hanley Economic	2	5	7
	Dudley	2	5	7
	Harpenden	2	5	7
PG3	Vernon	2	6	8
	Loughborough	3	7	10
	Mansfield	2	6	8
	Bath Investment	2	7	9
	Stafford Railway	2	6	8
	Teachers'	2	4	6
	Swansea	2	5	7
	Chorley & District	3	6	9
	Buckinghamshire	1	6	7
	Beverley	3	6	9
	Holmesdale	2	4	6
	Ecology	2	7	9
	Earl Shilton	3	6	9
	Penrith	2	5	7
	TOTAL	**115**	**266**	**381**

Table 6-1: Number of board of directors (Source: Annual reports for the year ending 2014/2015, analysis by author)

Directors were elected by the customers at the AGM. Under Sections 60 and 61 of the *Building Societies Act 1986*, members could nominate themselves or other people as the candidate for the board of directors. Nevertheless, candidates without the right credentials, skills and knowledge would experience greater difficulty in getting appointed. This is because Section 59 of the *Financial Services and Markets Act 2000 (FSMA)* requires all appointed directors of a building society to be an 'approved person' who is approved by the regulator:

> …authorised firms are required to ensure that individuals seeking to perform one or more of the PRA-designated Controlled Functions seek PRA approval prior to taking up their position. Non-approval prior to taking up the role may lead to enforcement action against the firm and/or the individual.[25]

This is in contrast with the argument made by Cornforth (2004, 2002) who asserted that under democracy theory, any 'lay person' member could nominate him/herself as a board member. Although expertise may be desirable, Cornforth (2004) argued that expertise should not be the central focus of the board of directors in democratically owned membership organisations like mutuals. In order to ensure that members with the right credentials and skills could be appointed as directors, all members were invited to write an application to be nominated as directors of the building society (BSA, 2014b). The interview data reflected that members rarely nominate themselves to serve on the board of building societies. Members mainly regarded building societies as service and mortgage providers. The power

[25] (http://www.bankofengland.co.uk/pra/Pages/authorisations/approvedpersons/default.aspx)

to run a building society is delegated to the board of directors. Due to members' passive roles, a director depicted the role of members as merely to:

> *…rubber stamp the appointment of directors and changes in the constitutions of the organisations. This is because of the requirements of regulators to have people with the requisite skills and experience to be able to run an organisation like the building societies [FinDir-2].*

Members' lack of interest in the business had led some directors to raise their concerns as to whether the board of directors is 'truly and genuinely' serving the best interests of members. Investor-owned organisations in recent years have come under scrutiny by investment analysts and professional or institutional investors who own a large block of shares and have been exercising their rights in corporate governance (such as the appointment and removal of directors). Directors and management in these organisations can be steered towards the maximisation of shareholders' interests, either through stock market pressures or through direct intervention by a large shareholder. Paradoxically, the aim of a mutual is to maximise the 'mutual dividend' of the customer-owners. The 'one-member, one-vote' principle and absence of stock market pressures means that the directors and management of mutuals could arguably be less accountable to members than the directors and management of investor-owned organisations (Buckle and Thompson, 2004, Adam and Armitage, 2004, Spear, 2004). For example, directors voiced a danger in mutual organisations that individuals who were working in it could be running the organisations for themselves:

> *Because you don't have the obligation to explain to institutional investors, some of whom are quite smart in what you are doing. If they are unhappy with what you are doing, they are either going to replace you or doing something different. Nonetheless, in mutual you don't really feel that your members are monitoring you [CEO-9].*

The responses suggest that building societies were unlike other traditional mutual organisations such as credit unions which were run and managed by lay persons or volunteers (Hyndman et al., 2002). Building societies are managed by directors who are highly qualified individuals approved by the PRA and FCA and also by investing customers of the business.

6.4.2 Board Committees

The majority of interviewees emphasized that board committees play an increasingly important role in supporting and ensuring accountabilities of board of directors. A chief executive explained that:

> *…we have a committee structure that focuses on specific topics and holds individuals accountable. For instance, our governance structures are built on having individual accountability, three-line defence model and independent oversight and challenge [CEO-13].*

Another director expressed the importance and contributions of board committees to their building societies, specifically highlighting the knowledge and expertise brought in by an individual director:

> *…board committees are absolutely vital in this organisation. We want directors with right skills and competence…applying the right level of challenges in the committees [CEO-14].*

The auditor acknowledged that:

> *…the board committee structures in building societies are critical and have been strengthened and made more extensive and more robust since the last five years [AUD].*

Board committees in the building society sector consist of the audit and compliance committee, risk committee, nomination committee, remuneration committee and executive committee. Executive committees in the building society industry include the conduct operation committee, asset and liability committee, lending or credit committee, product and marketing committee and IT. These committees are also regarded as 'management committees' and are chaired by the chief executive who reports monthly to the board. A number of building societies invite NEDs to attend the meetings of the executive committee. NEDs act as an observer and the representatives of the board of directors. NEDs are not allowed to enforce decisions in the executive committee meetings.

Table 6-2 presents the composition of board committees in the UK building society sector. It is noteworthy from the data in the table that the majority of the board committee members in the audit and compliance committee, risk committee, nomination committee and remuneration committee consist primarily of NEDs. These correspond to the BSA and PRA recommendations to comply with *The Code*. For example, while *The Code* (Para B.2.1) requires a majority of members of the nomination committee to be independent non-executive directors, Para C.3.1 requires the board to establish an "audit committee of at least three, or in the case of smaller companies, two, independent non-executive directors".

No	Building Society	Remuneration	Audit and Compliance	Risk	Nomination	Prudential Risk	Conduct Risk	Executive Committees					
								AICO	Lending/ Credit	Other	Conduct Operation	Marketing & Development	IT
1	Bath												
	NED	3	4	6	3	-	-	2	-	-	1	-	-
	ED	0	2	2	0	-	-	2	-	-	2	-	-
2	Beverley												
	NED	3	4	5	1	-	-	3	3	-	-	-	-
	ED	0	0	3	1	-	-	3	2	-	-	-	-
3	Buckimhamshire												
	NED	3	3	4	6	-	-	2	-	-	4	-	-
	ED	0	0	2	0	-	-	2	-	-	1	-	-
4	Cambridge												
	NED	4	3	5	2	-	-	-	-	-	-	-	3
	ED	0	0	3	1	-	-	-	-	-	-	-	1
5	Chorley												
	NED	2	3	3	2	-	-	2	-	-	-	-	-
	ED	0	0	0	0	-	-	3	-	-	-	-	-
6	Coventry												
	NED	4	4	4	4	-	-	-	-	-	-	-	-
	ED	1	0	0	0	-	-	-	-	-	-	-	-
7	Cumberland												
	NED	6	3	3	6	-	-	-	-	-	-	-	-
	ED	0	0	0	4	-	-	-	-	-	-	-	-
8	Darlington												
	NED	4	3	3	2	-	-	-	-	-	2	-	-
	ED	0	0	0	1	-	-	-	-	-	2	-	-
9	Dudley												
	NED	3	3	5	5	-	-	-	-	-	-	-	-
	ED	0	0	0	0	-	-	2	2	-	-	-	-
10	Earl Shilton												
	NED	3	3	3	3	-	-	5	-	-	-	-	-
	ED	0	0	0	0	-	-	2	-	-	-	-	-
11	Ecology												
	NED	2	3	3	3	-	-	1	2	-	-	6	-
	ED	0	2	2	1	-	-	0	1	-	-	1	-
12	Furness												
	NED	4	4	2	3	-	-	-	-	-	-	-	-
	ED	0	0	1	1	-	-	-	-	-	-	-	-
13	Hanley Economic												
	NED	3	4	5	5	-	-	2	-	-	-	-	-
	ED	0	0	2	2	-	-	2	-	-	-	-	-
14	Harpenden												
	NED	4	3	3	4	-	-	3	5	-	3	-	-
	ED	2	2	2	2	-	-	2	2	-	2	-	-
15	Hinkley and Rugby												
	NED	3	3	4	4	-	-	-	-	-	-	2	-
	ED	0	0	2	0	-	-	-	-	-	-	0	-
16	Homesdale												
	NED	4	3	3	3	-	-	2	-	-	-	-	-
	ED	2	2	2	2	-	-	2	-	-	-	-	-
17	Ipswich												
	NED	4	3	6	3	-	-	-	-	-	-	-	-
	ED	0	0	2	1	-	-	-	-	-	-	-	-
18	Leeds												
	NED	4	4	6	3	-	-	3	3	-	3	-	-
	ED	0	0	0	0	-	-	3	4	-	2	-	-
19	Leek United												
	NED	4	2	2	3	-	-	-	-	-	-	-	-
	ED	0	0	0	1	-	-	-	-	-	-	-	-
20	The Lougorough												
	NED	4	3	5	3	-	-	3	-	-	-	2	-
	ED	0	0	0	0	-	-	3	-	-	-	3	-
21	Manchester												
	NED	4	3	4	4	-	-	0	0	-	1	-	-
	ED	0	2	2	0	-	-	2	2	-	0	-	-
22	Mansfield												
	NED	4	4	5	4	-	-	-	-	-	-	-	-
	ED	0	0	2	0	-	-	-	-	-	-	-	-

Table 6-2: Board committee structures in the UK building society sector (Source: Annual reports for the year ending 2014/2015, analysis by author)

No	Building Society	Remuneration	Audit and Compliance	Risk	Nomination	Prudential Risk	Conduct Risk	Executive Committees: AICO	Lending/ Credit	Other	Conduct Operation	Marketing & Development	IT
23	Market Harbourough												
	NED	3	4	3	3	-	-	3	-	-	-	-	-
	ED	0	0	0	0	-	-	2	-	-	-	-	-
24	Marsden												
	NED	3	3	3	3	-	-	2	-	-	-	-	-
	ED	0	0	0	0	-	-	1	-	-	-	-	-
25	Melton Mowbray												
	NED	4	3	5	4	-	-	0	-	***0	-	-	-
	ED	0	0	0	0	-	-	2	-	2	-	-	-
26	Monmoutshire												
	NED	7	5	6	6	-	-	-	-	-	-	-	-
	ED	1	0	3	1	-	-	-	-	-	-	-	-
27	National Counties												
	NED	4	3	3	2	-	-	-	-	-	-	-	-
	ED	0	0	0	1	-	-	-	-	-	-	-	-
28	Nationwide												
	NED	3	5	5	5	-	-	-	-	*2	-	-	5
	ED	0	0	0	0	-	-	-	-	2	-	-	0
29	Newbury												
	NED	4	6	6	4	-	-	5	5	-	-	3	-
	ED	0	0	0	0	-	-	2	2	-	-	2	-
30	Newcastle												
	NED	4	5	4	4	-	-	-	-	-	-	-	-
	ED	0	0	0	0	-	-	-	-	-	-	-	-
31	Nottingham												
	NED	4	5	6	2	-	-	-	-	-	-	-	-
	ED	0	0	3	1	-	-	-	-	-	-	-	-
32	Penrith												
	NED	5	3	2	2	-	-	-	-	-	-	-	-
	ED	2	0	2	1	-	-	-	-	-	-	-	-
33	Principality												
	NED	4	3	5	7	-	-	-	-	-	7	-	-
	ED	0	0	2	0	-	-	-	-	-	2	-	-
34	Progressive												
	NED	3	5	-	2	5	5	5	-	-	-	4	-
	ED	2	3	-	2	3	3	3	-	-	-	3	-
35	Saffron												
	NED	6	6	6	3	-	-	6	6	**6	-	-	-
	ED	0	2	2	0	-	-	2	2	2	-	-	-
36	Scottish												
	NED	5	3	-	5	2	2	3	3	-	-	-	-
	ED	0	0	-	0	1	1	1	1	-	-	-	-
37	Skipton												
	NED	3	4	3	8	-	-	-	-	-	-	-	-
	ED	0	0	2	0	-	-	-	-	-	-	-	-
38	Stafford Railway												
	NED	5	4	3	3	-	-	4	-	-	-	-	-
	ED	0	0	0	0	-	-	0	-	-	-	-	-
39	Swansea												
	NED	3	5	3	3	-	-	5	-	-	2	-	-
	ED	1	2	0	1	-	-	2	-	-	2	-	-
40	Teacher												
	NED	3	5	5	2	-	-	-	-	-	-	-	-
	ED	1	1	1	1	-	-	-	-	-	-	-	-
41	Tipton and Cosley												
	NED	3	3	3	3	-	-	2	-	-	-	-	-
	ED	0	0	0	1	-	-	2	-	-	-	-	-
42	Vernon												
	NED	4	4	3	3	-	-	-	-	-	-	-	-
	ED	0	0	2	1	-	-	-	-	-	-	-	-
43	West Brom												
	NED	3	4	4	3	-	-	-	-	-	-	-	-
	ED	0	0	2	0	-	-	-	-	-	-	-	-
44	Yorkshire												
	NED	4	4	4	3	-	-	-	-	-	-	-	-
	ED	0	0	0	0	-	-	-	-	-	-	-	-

* denotes result approval committee
** denotes change committee
*** denotes executive committee

Table 6-2: continued

The selection method of the compliance committee, risk committee, nomination committee and remuneration committee members was based on expertise, skills and knowledge of individual NED. For instance, the audit committee would generally comprise individuals with an accounting background, while the risk committee would consist of individuals with financial sector experience. This was commented on by a finance director:

> *We are currently looking to recruiting new chair of audit committee, which is NED chair. Generally, we want someone who has the experience in accounting, auditing and if it is possible in the financial services as well [FinDir-2].*

Even so, a CEO was exasperated that the purpose of some board committees is merely to meet the superficial requirements of the regulator rather than truly adding value to the business:

> *We had a visit by the PRA, who said that what we like you to do is to create a risk committee. The problem is all the risks in this organisation are basically covered in these previous committees that we had. So, what the heck does the risk committee do apart from ticking the regulator box? The regulators didn't explain really why they want the risk committee. They just want to have the risk committee. So we had the risk committee [CEO-8].*

It has also been acknowledged by PG2 and PG3's directors that some building societies faced challenges in recruiting and appointing suitable directors on the board committees due to tremendous regulation changes and lower NED fees:

> *A lot of the comments that come back to us are for what you are paying, you are paying someone £20,000 to do this job. It is not going to be someone. The rumours are coming back that some of the recruitment agency are advising potential NEDs to stay clear from the financial services because it is too risky. I actually think the biggest issue that we have is too much and too fast regulatory change, which drives away individuals [FinDir-2].*

The above demonstrates that there are numerous board committees in the building society industry. These include the audit and compliance committee, risk committee, nomination committee, remuneration committee and executive committee. Some directors valued the significance of board committees to their business, while a few regarded the structure as set up only to meet the regulators' requirements.

6.4.3 Independent Non-Executive Directors

Independent NEDs have been recognised as one of the most important internal corporate governance mechanisms. NEDs have the responsibilities of monitoring the management and provide an independent voice in the boardroom in order to avoid 'groupthink' and herd behaviour (Hopt, 2013). NEDs are also expected to bring in independent judgement to the board and be able to draw upon extensive experience to challenge and be supportive to executive directors (BSA, 2010b). Furthermore, independent NEDs of building societies are expected to communicate and engage with members in order to better understand members' needs and demands. This is to ensure that NEDs can better represent members' interests on the board (BSA, 2010b).

The executive directors agreed that NEDs are more accountable since the 2008 financial crisis. It was perceived that prior to 2008, extensive power resided in executive directors and management rather than the board of directors. Executive directors and management had full control of the board of directors because NEDs displayed "*absence from board meetings*" *[CEO-8]* or merely attended board meetings for *"2 hours, cup of tea, just a while, and go home" [CEO-13]*. Another interviewee illustrated the governance conditions in the building society sector before the banking crisis as:

> *Some small building societies really just had a mutual ethos and that's the way the whole organisation works. Some of the medium size ones, the CEOs would have been quite ambitious and the reason was because they were quite well-paid individuals. They had very strong views and they would control, if they*

> *could, the board and the NEDs. There were instances where CEOs were too autocratic and controlling and some CEOs didn't approve the NEDs meeting separately from the rest of the board [NED-2].*

The regulator interviewed also raised concerns about the independence and effectiveness of NEDs: "*pre-2008 banking crisis the NEDs were just the people that building societies knew such as directors' friends and colleagues*" [REG]. Nevertheless, the time after 2008 witnessed all building societies utilising formal means to recruit directors such as through advertisements, consulting firms, accounting firms and headhunters. All interviewees unanimously agreed that NEDs are more independent, accountable, and knowledgeable and provide more constructive criticisms to the board. This is also acknowledged by the regulator interviewed:

> *I think building societies improve greatly on diversity over the last five years. But, there is still more work to be done. By diversity, I mean the skills and thinking style of NEDs [REG].*

The auditor expressed that coercive pressures by regulators and desire to strengthen accountability to wider constituents have in effect led building societies to enhance the diversity, skills and capabilities of their NEDs:

> *I think corporate governance in the building societies has been improving steadily for many years. I think that the financial crisis probably prompted from the regulators to regulate corporate governance more tightly. Building societies have also done that directly themselves. The structure and the membership of the board, the quality of NEDs, the experience of NEDs, the quality of information and briefings and materials provided to board has also improved [AUD].*

Chief executives also elaborated that there was more contact between NEDs and regulators following the financial crisis. NEDs spent greater time communicating with regulators in terms of recruitment and businesses. A number of CEOs commented that the extent of pressures exerted by NEDs on executive directors and management is at times "*too much*"

[CEO-7]. NEDs are perceived to have "*greater day-to-day sway on organisation's operation these days than any individual members*" [CEO-12]. A huge amount of time is also spent by management on providing information to NEDs:

> *I have to spend a huge amount of time making sure that NEDs are fully briefed and fully understand what we're doing. And in turn, they have to make sure that they've got processes so they can double-check that what I'm telling them is true. So, that's been the biggest change I would say in terms of the accountability. In the level of involvement, non-executive directors now have been monitoring and overseeing the business in more detailed level whereas previously, they had an overview position. They've come down more into the business [CEO-2]*.

Another chief executive had a similar view:

> *I would say the role of NEDs is much more accountable in its own right. I spend quarter of my time thinking about how do I interface with the board, particularly the NEDs and the information that provide, apparent information that we send to them and nature of decisions we want them to take [CEO-12]*.

While NEDs' accountabilities have been enhanced since 2008, a number of chief executives stated that NEDs should be critical and supportive individuals to executive directors, rather than merely challenging management team:

> *To be effective, the board has to work in such a way that it's not the NEDs and us as the management. There is almost a bit of them and us. If the NEDs are merely criticizing the executive directors, that doesn't work. The NEDs should also be there to encourage, to suggest new better ways and to be constructive friend to management [CEO-12]*.

Another CEO cautioned that NEDs should not interfere with the duties and responsibility of management:

> *Sometimes the NEDs were too much involved with the management in the running of the company. And really, we need to keep them out. 'We actually said, right, management is going to run the company and you are going to make sure that we are doing it well and we have got a good approach to risk' [CEO-8]*.

The above commentaries indicate that the devastation caused by the failure of banks and building societies during the 2008 financial meltdown have in effect led regulators to strengthen their supervisory approach to financial services firms. The coercive pressures from regulators and the intention to be more accountable have led the board of building society to strengthen the skills, composition, knowledge and accountability of NEDs. It was reported that NEDs are more accountable and knowledgeable since 2008. Some NEDs were nonetheless inquisitive and meddling with the responsibilities of executives.

Term and Tenure of Independent Non-Executive Directors

The importance of NEDs in contributing fresh and new perspectives to organisation (UK Cooperative Group, 2007, Claessens, 2006) is widely recognised by academics and practitioners. This is primarily because NEDs and chairman may be passive and unlikely to oppose to executives' decisions and policies if they serve long-term on the board (Pass, 2004). Organisations therefore, benefit greatly from a regular influx of new ideas and perspectives.

Although there is no hard legislation to state the term of office of a director in a mutual organisation, Para B.1.1 of *The Code* states that "the board should state its reasons if it determines that a director is independent…including if the director has served on the board for more than nine years from the date of their first election." An analysis of the forty-four building societies' annual reports for the year ending 2014/ 2015 revealed that nine out of the forty-four building societies had NEDs who had served more than nine years. Out of the nine building societies, two building societies were categorized under PG1, four building societies were under PG2 and three building societies were under PG3. Furthermore, ten out of forty-four building societies had a chairman who had served more than nine years. **Table 6-3** illustrates the size of building societies in which the term and tenure of NEDs and chairman were more than the nine years.

Size of Building Societies		Chairman> 9 years	NED > 9 years
PG1	Assets over £1bn	2	2
PG2	Assets £300m to £1bn	4	4
PG3	Assets under £300m	4	3
Total		10	9

Table 6-3: Number of building societies which the tenure of the NEDs and chairmen were more than 9 years (Source: Annual reports for the year ending 2014/2015, analysis by author)

In relation to this, some interviewees had a mixed stance on the suitability of NEDs serving more than nine years. Executive directors perceived that continuity for more than nine years is important to the business if the NEDs contribute relevant skills and knowledge. This was as expressed by a CEO as:

> *I do not lie away every night thinking, 'oh my goodness me, somebody has been on my board for nine years and it is about times we kick them off'. I think actually we can be a bit over consumed by good governance. I think actually, good business management is as important as good governance. I think you got to get the balance right. As I said, you can have very well governed companies that fail [CEO-8].*

The auditor and an NED nonetheless claimed that to ensure 'independent' and 'fresh' perspectives are brought to the board, NEDs and chairmen should not serve more than nine years:

> *I think 9 years is probably plenty to know about what is going on in the business and NEDs may also have cosy relationships with executives and therefore difficult to remain independent [AUD].*

An NED likewise expressed:

> *That applies to the chairman as well. But I think, if you apply the nine-year rule, it is forcing you always to refresh yourself to think in you. You got the new perspective because the human nature becomes too complacent after nine years [NED-3].*

Although some NEDs and chairmen have served more than nine years, the regulator contended that building societies should disclose in their annual reports the reasons their organisations were not adhering to the provision of *The Code*:

> *I think it is not a black and white rule. The Code might say nine years and you are out. But there should be clear statements why they have chosen not to follow The Code [REG].*

The majority of building societies with NEDs and chairmen who served more than nine years did not provide information in their corporate governance statement on the process in which NEDs and chairmen are evaluated to be independent. For instance, Cumberland Building Society reported in its corporate governance statement that after a review of directors' independence, it was concluded that directors were independent. There was less information on how directors were determined to be independent after their long service on board:

> *Michael Pratt [the chairman] completed 18 years of service on the Board on 29 September 2014 and David Clarke [an NED] completed 10 years on 14 February 2015. In the view of the Board, all the non-executive directors are independent in character and judgement, are free of any relationship or circumstance that could interfere with the exercise of their judgement, and bring wide and varied commercial experience to Board deliberations [Cumberland Building Society's annual report, 2014, p. 11].*

Hinckley and Rugby Building Society reported similarly:

> *The Board comprises two executives, five non-executives and the Chairman. All non-executives (to include the Chairman on appointment) are considered by the Board to be independent in character and judgement and free of any relationship or circumstance that could interfere with the exercise of their judgement [Hinckley and Rugby Building Society's annual report, 2014, p. 12].*

The above indicates that some building societies were adhering to *The Code* without a requirement to comply. Although they do seem to be conforming to the 'form' of recommended governance practices, the substance and spirit of good governance practices are questionable. This is particularly evident in terms of the independence of the non-executive directors.

6.4.4 Incentive System

In the 1990s, directors' remuneration was a huge issue due to the less attractive remuneration paid out to senior management and directors. Many directors opted to demutualise their building societies in order to get into the share and bonus schemes to boost their remunerations (ACCA, 2006, Birchall, 2013a, Shiwakoti, 2005). Today, none of those demutualised building societies exist independently. They were all bailed out and merged with other financial institutions (Michie, 2011, Birchall and Ketilson, 2009).

With respect to the current state of directors' remuneration, all interviewees agreed that there are proper governance procedures in place to determine directors' remuneration. For instance, all building societies have a remuneration committee in place to review and determine executive directors' remuneration packages as well as to monitor the comparative remuneration packages within the financial services sector. In order to discourage irresponsible risk-taking and short-termism among the directors of financial services firms, the regulators have also amended the remuneration structure of all UK financial institutions including building societies (Bank of England, 23rd June 2015). With effect from January 2016, the PRA and FCA extend the deferral of directors and management variable pays (e.g. bonuses) to five and seven years for senior management depending on their senior positions, and three years for staff who are material risk takers in the financial service firms. The FCA have also introduced clawback rules in which senior management and affected staff are required to return part or all of the variable incentives that they have received to their employers under certain conditions, such as if there is reasonable evidence of firms suffering material downturn due to staff and management misbehaviour or material errors (Bank of England, 23rd June 2015). In light of this, a director claimed that the directors' remunerations are in a more controlled condition:

> *We had our remuneration committees meeting a couple of weeks ago—just to discuss three directors' bonuses, salary and board performance to ensure that they achieve the target that has been set. And the next meeting that we have is next month, to ensure that the target for next year is realistic. They are just not easy. They will have to perform well to get a decent bonus [NED-4].*

The auditor likewise expressed:

> *I think the directors' remuneration of building societies is generally set in line with the market rate. They are set within strong governance structure, with remuneration committee. You are not going to make your fortune working in building societies. There are no share options anything like that [AUD].*

The annual reports of building societies such as Nationwide, Yorkshire Building Society, Coventry Building Society and West Bromwich Building Society reflected that the incentive structures of building societies mainly consist of a basic salary and benefits and the incentive component. The incentive component has an annual bonus scheme which is determined on the basis of performance-related criteria, such as customer satisfaction, financial efficiency of the organisation (e.g. cost-to-income ratio), personal performance of the directors, a growing customer relationship, and employee satisfaction towards the organisations. In contrast, typical shareholder-owned banks incentivise their management based on profit and net assets, and rarely make reference in their directors' remuneration reports to the non-financial performance criteria involving employees or customer satisfaction which exists in the building society sector (Cook et al., 2002).

The NEDs of building societies are remunerated by fees which were determined and approved by the board of directors on recommendation from the CEO. NEDs are prohibited from receiving any variable remuneration from the organisation (Bank of England, 23rd June 2015). Some building societies have policies which restrict NEDs' fees exceeding a certain limit based on the annual salary of the lowest-paid individuals in the organisation. This is to ensure proper balance and proportion between the NEDs' fees and staff salary. However, two key issues pertaining to directors' remuneration were the 'regional focus' of some building societies, and these building societies paying comparatively lower NED fees than investor-owned banks. An NED commented that:

> *I suspect there are some building societies who haven't quite got the full range on board. It is difficult because some of them are very small and regional, and you ask about how they recruit people? It is sometimes very difficult. It is a mixture of remuneration, but the main thing is how regional they are. Our building society is in A [the location of the building society]. It is nowhere near London. We searched high and low to get the people that we want on our board [NED-2].*

This is further supported by the PwC (2016) research that reported that chairmen and NEDs of financial services firms in the FTSE 100 received an average of £370,000 and £65,000 respectively in the year 2015. **Table 6-4** shows the fee levels for chairmen and NEDs of financial services firms in the FTSE 100. The lowest and highest fees paid to NEDs of financial services companies were £59,000 and £ 71,000 respectively. On the other hand, the lowest and highest fees received by a chairman of financial services firms in FTSE 100 companies were £330,000 and £515,000 respectively.

FTSE100	Total Board Remuneration	
	Chairman	NED
Lower quartile	£330,000	£59, 000
Median	£370,000	£65,000
Upper quartile	£515,000	£71,000

Table 6-4: Fees of chairmen and NEDs of financial services firms in FTSE 100 in 2015 (Source: PwC report on *FTSE 100 Non-Executive Director Fees* in 2015, analysis by author)

Comparatively, **Table 6-5** presents an in-depth analysis of the building societies board of directors' remuneration and incentives for the year 2014/2015. NEDs in PG1, PG2 and PG3 received an average of £56,000, £28,000 and £18,000 respectively, and £35,000 per year. On the other hand, a chairman in PG1, PG2 and PG3 received an average of £94,000, £42,000 and £24,000 respectively.

Size of Building Societies		Number of directors			Total Board remuneration, £000						
Categories	Asset size	Executive Directors (A)	Non-Executive Directors (B)	Total number (A)+(B)	Exec (C)	Non Exec (D)	Chairperson (E)	Total (C+D)	Average Exec (C/A)	Average Non Exec (D/B)	Average of Chairperson (E/44)
PG1	Assets over £1bn	47	96	143	23,599	5,371	1,408	28,970	502	56	94
PG2	Assets £300m to £1bn	37	89	126	5,855	2,521	627	8,376	158	28	42
PG3	Assets under £300m	31	81	112	3,790	1,447	340	5,237	122	18	24
Total		115	266	381	33,243	9,340	2,375	42,583	289	35	54

Table 6-5: An analysis of building societies board of directors' remuneration and incentives for the year ended 2014/2015 (Source: Annual reports for the year ending 2014/2015, analysis by author)

It can be seen from **Table 6-4** and **Table 6-5** that the fees received by chairmen and NEDs in PG2 and PG3 were generally lower than the lowest fee paid to chairmen and NEDs in financial services firms in FTSE 100 companies. Nonetheless, to encourage diversity and ensure that NEDs with the necessary skills and expertise could serve on the board, some building societies commented that they had taken initiatives to ease the hurdles for NEDs to travel to their regional building societies, while others still struggled in this regard. For example, some building societies provide travelling and subsistence allowances to the NEDs. Board members are also supplied with information in a timely manner. This was as explained by the following NED:

> *People tend to travel now, which previously they didn't. So, now, building societies, they got to look far beyond their local boundaries for the right people. I think they are available, but they have to make it easy. So for example, we received information about issues that would be discussed usually 2 days before the meetings. The building societies I am with then arrange for us to stay in a hotel, we had a meal, and it is easy for people to travel. You don't have to travel so much in one day. So, building societies must make it easy for the NEDs [NED-2].*

As a result of the steps taken to attract better quality NEDs, some interviewees remarked that NEDs were considered more willing to travel and were more widely dispersed around the country. This implies that 'common bonds' which are shared between board members and local community are gradually being eroded.

6.4.5 Risk Management and Internal Control Structures

The onset of the 2008 financial crisis has led the regulators to strengthen the risk management framework and internal control structures in the financial services sector. As a type of financial institution, the building society is expected to have a clear statement of risk, a translation of risk appetite into a clear guidance and clearly execute the business' risks by having the right credible individuals for monitoring and managing the risks. Independent auditors are expected to provide assurances to the governing body, such as the risk and audit committees, with comprehensive assurance on the effectiveness of the organisation's risk management, governance and internal control structures (HM Treasury, 2014). Many interviewees agreed that since 2008, *"the nature of board discussion has focused on risks and becomes more defensive*" [CEO-9]. A director further expressed that:

> *There have been huge focuses on risk and risk management since the 2008 financial crisis. So risk appetite has been restated. It's more expansive now in terms of the things that it covers. There is more reporting in the risk committee [CEO-5].*

The majority of building societies agreed that their organisations have implemented the best practice risk management framework, i.e. the three lines of defence model. A few chief executives voiced the importance of three lines of defence model in achieving sound governance in building societies:

> *I am a huge fan of the three-line defence model. It is the best one we have. It has got failings on it, but fundamentally, it makes sense to me. I am fundamental believer in having excellent governance [CEO-10].*

When the auditor was asked about the state of the risk management and internal control structures of building societies, the auditor stated that those structures in building societies have improved steadily over the years:

> *I think the risk management framework is generally pretty strong in what I essentially think is a fairly undiversified and conservatively run organisation. The same applies generally to the internal control environment and the quality internal audit. Therefore, both the risk management framework and internal control structures have improved significantly in the recent five years [AUD].*

Nonetheless, the regulator contended that the focus of risk management in most building societies tended be overly complex and comprehensive. Some building societies also had the propensity to concentrate on firm rather than macroeconomic levels of risk management:

> *The risk management framework in building societies is too comprehensive and too complex. Others don't have a framework yet. Building societies, they are thinking too much about the framework and not about the risks. It's all process and not contents. For me, it is important that the building societies look at the*

> *wider risks in the system and not just what are happening in front of their faces. Because at macro level, the socio-political and economic imperatives impact every building society as well. This is an area that has an awful lot of work ongoing, at the present time [REG].*

A CEO commented that regulators exert pressures and demand that building societies implement the so-called best practices model of governance and risk management structure:

> *When the regulator said well, we would like you to have a risk committee, my first concern is I am happy to do that. Just because they want me to change it, I have no choice but to change it. We need to please them. It takes us an enormous effort to make it work pretty well [CEO-8].*

The CEO further raised concerns that the governance structures promoted by regulators do not guarantee sound decision-making:

> *It is not just about the structure and processes of governance. Actually at the end of the of the day, bad decision making, actually causes as much trouble for building societies to fail in the financial crisis as poor governance. I am not sure necessarily myself, and the PRA would have agreed on that point, but it is what I have seen [CEO-8].*

These suggest that while building societies have attempted to improvise their risk management and internal control structures by following the 'best practice' guidance, additional improvements are still needed in terms of the way risks are being perceived, communicated and managed. Building societies should also focus on the substance over the form of good governance practices.

6.4.6 Financial Statements and Disclosure of Non-Financial Information in Annual Reports

Disclosures of financial and non-financial information are important for the building society sector to discharge *financial-social dual accountability* to customer-members, who rely on that information for their decision-making and judgements on their involvement with the business (Hyndman et al., 2002). Building societies are also required to file annual returns with the FCA and PRA to discharge their *compliance accountability*. Transparent disclosure of information is important for the sector to gain the trust and confidence of customers, regulators, credit rating agencies, financial analysts and members of the general public.

When interviewees were asked about the state of disclosure of financial and non-financial information in the annual reports, the majority of interviewees agreed that they did not encounter problems in the preparation of the annual reports. The purpose of reporting of financial and non-financial information in the annual reports is for *"regulatory returns and for the references and reviews of credit rating agencies*" [NED-4]. Members generally do not read and understand the information in the annual reports. A member mentioned that:

> *I got the voting forms come in every year. They asked the members to vote for them. I tend to scan through. I don't normally bother. Occasionally, I have done it. Normally, I don't be bother. I suppose 99.9 % of members don't even think about that. We just want our money safe and secure. As long as we get decent returns, we are fine with that [MEM-5].*

Another member likewise mentioned:

> *I receive the AGM pack of [SSS] building society. I normally cast them aside. I don't really vote mainly because I am not interested. I am fine as long as I am convinced that my saving is safe [MEM-7].*

The members' comments were echoed by directors, for example:

> *…most members are not interested. Most people are interested in how safe and secure their money is and they want to know that the building society is run by decent people [CEO-8].*

Nonetheless, there are minority members who displayed interests in the annual reports. It is suggested that these interested members are also likely to attend the AGMs and to hold the board accountable for their actions and decisions. For example, a director expressed:

> *We have 2 or 3 of what I would call governance-matter individuals who come to the AGM every year. They read the annual reports and they asked good and sharp questions. We answered all the questions and we are good about that [CEO-8]*.

When an NED was asked about enhanced transparency in their annual reports, the NEDs conceded that excessive disclosure of information in the annual reports increases the operational costs and provides limited value to the business:

> *I think disclosure from regulatory returns is fine. But there is a lot of work and costs in disclosing all these things. I am not sure how much those values are in that [NED-4]*.

In light of these, the annual reports of the building society sector were analysed to assess the overall state of information disclosed. Section 72 (1) of the *Building Societies Act 1986* requires directors of every building society to prepare:

(a) an income and expenditure account showing the income and expenditure for that year,

(b) a balance sheet showing the state of its affairs as at the end of that year,

(c) a statement of the source and application of the funds during that year [i.e. Statement of Changes in Equity].

An analysis of the 2014/2015 annual reports of the building society sector indicates that the financial statements of building societies are prepared in compliance with the *Building Societies Act 1986* and the *UK GAAP*. **Table 6-6** shows that all building societies prepare four major categories of financial statements such as an income statement, a balance sheet, a cash flow statement and a statement of total recognised gains and losses and additional financial information, such as financial performance indicators.

Furthermore, **Table 6-7** illustrates other information included in the annual reports. Twelve categories of information were identified and reported. Under Sections 74 and 75 of the *Building Societies Act 1986,* building societies shall prepare the annual business statement and directors' report. The auditors shall present their opinions to members regarding the financial statements, the annual business statement and the directors' report. Since it is mandatory for building societies to prepare such statements, both tables illustrate that all building societies complied with the *Building Societies Act 1986* and *UK GAAP*.

The building society sector also prepared information and reports on a voluntary basis. For instance, building societies are not required to adopt and 'comply or explain' with *The Code* and to prepare directors' remuneration reports which is required under Section 420 of the *Companies Act 2006*. As a best practice and encouragement by the BSA, PRA and FCA, a CEO argued that building societies "*always prepare and disclose information which is required by public listed companies but not mutual organisations*" [CEO-5]. These include information such as reports by the chairperson, CEO and CFO, statements of corporate governance, CSR and risk management, and employee-related and AGM information.

Categories	Building Society (in size order)	Financial performance indicators	Statement of comprehensive income/Income statement	Statement of financial position/Balance sheet	Cash flow statement	Statement of total recognised gains and losses
PG1	Nationwide	✓	✓	✓	✓	✓
	Yorkshire	✓	✓	✓	✓	✓
	Coventry	✓	✓	✓	✓	✓
	Skipton	✓	✓	✓	✓	✓
	Leeds	✓	✓	✓	✓	✓
	Principality	✓	✓	✓	✓	✓
	West Bromwich	✓	✓	✓	✓	✓
	Newcastle	✓	✓	✓	✓	✓
	Nottingham	✓	✓	✓	✓	✓
	Cumberland	✓	✓	✓	✓	✓
	Progressive	✓	✓	✓	✓	✓
	National Counties	✓	✓	✓	✓	✓
	Saffron	✓	✓	✓	✓	✓
	Cambridge	✓	✓	✓	✓	✓
	Monmouthshire	✓	✓	✓	✓	✓
PG2	Leek United	✓	✓	✓	✓	✓
	Furness	✓	✓	✓	✓	✓
	Newbury	✓	✓	✓	✓	✓
	Ipswich	✓	✓	✓	✓	✓
	Hinckley & Rugby	✓	✓	✓	✓	✓
	Darlington	✓	✓	✓	✓	✓
	Manchester	✓	✓	✓	✓	✓
	Market Harborough	✓	✓	✓	✓	✓
	Melton Mowbray	✓	✓	✓	✓	✓
	Marsden	✓	✓	✓	✓	✓
	Scottish	✓	✓	✓	✓	✓
	Tipton & Coseley	✓	✓	✓	✓	✓
	Hanley Economic	✓	✓	✓	✓	✓
	Dudley	✓	✓	✓	✓	✓
	Harpenden	✓	✓	✓	✓	✓
PG3	Vernon	✓	✓	✓	✓	✓
	Loughborough	✓	✓	✓	✓	✓
	Mansfield	✓	✓	✓	✓	✓
	Bath Investment	✓	✓	✓	✓	✓
	Stafford Railway	✓	✓	✓	✓	✓
	Teachers'	✓	✓	✓	✓	✓
	Swansea	✓	✓	✓	✓	✓
	Chorley & District	✓	✓	✓	✓	✓
	Buckinghamshire	✓	✓	✓	✓	✓
	Beverley	✓	✓	✓	✓	✓
	Holmesdale	✓	✓	✓	✓	✓
	Ecology	✓	✓	✓	✓	✓
	Earl Shilton	✓	✓	✓	✓	✓
	Penrith	✓	✓	✓	✓	✓

Table 6-6: Main types of financial information in building society's annual report (Source: Annual reports for the year ending 2014/2015, analysis by author)

Categories	Building Society (in size order)	Chaiman's statement	CEO's review	CFO statement	Directors' Report	Directors' remuneration report	Audit report	CSR statement	The Code	Risk management statement	Annual business statement	Employee related information	AGM information
	Nationwide	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Yorkshire	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Coventry	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Skipton	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Leeds	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Principality	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	West Bromwich	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
PG1	Newcastle	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Nottingham	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Cumberland	✓	X	X	✓	✓	✓	X	✓	✓	✓	✓	✓
	Progressive	X	X	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	National Counties	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Saffron	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Cambridge	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Monmouthshire	X	X	X	✓	✓	✓	✓	✓	✓	✓	✓	X
	Leek United	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Furness	✓	X	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Newbury	X	X	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Ipswich	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Hinckley & Rugby	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Darlington	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Manchester	✓	X	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
PG2	Market Harborough	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	X
	Melton Mowbray	X	X	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Marsden	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Scottish	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Tipton & Coseley	X	X	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Hanley Economic	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Dudley	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Harpenden	✓	X	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Vernon	X	X	X	✓	✓	✓	✓	✓	✓	✓	✓	X
	Loughborough	X	X	X	✓	✓	✓	X	✓	✓	✓	✓	✓
	Mansfield	X	X	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Bath Investment	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Stafford Railway	X	X	X	✓	✓	✓	✓	✓	✓	✓	✓	X
	Teachers'	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	X
	Swansea	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
PG3	Chorley & District	✓	X	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Buckinghamshire	✓	X	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Beverley	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Holmesdale	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Ecology	✓	✓	X	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Earl Shilton	X	X	X	✓	✓	✓	✓	✓	✓	✓	✓	X
	Penrith	X	X	X	✓	✓	✓	✓	✓	✓	✓	✓	X
	Total	**33**	**27**	**4**	**44**	**44**	**44**	**42**	**44**	**44**	**44**	**44**	**37**

Table 6-7: Other information (excluding financial statements) in building society's annual report (Source: Annual reports for the year ending 2014/2015, analysis by author)

It can be seen from **Table 6-7** that the disclosure of other information was inconsistent across the sector. For example, seven out of forty-four building societies did not report AGMs and CSR information to members. Similarly, thirty-three, twenty-seven and four building societies prepared reports by chairperson, CEO and CFO respectively. Large building societies, specifically those in the PG1 category, disclosed more information than the PG2 and PG3 building societies.

The annual reports also show that the extent of voluntary disclosures in some PG2 and PG3 building societies are limited to short reports and statements. For instance, the length of the statements of corporate governance and CSR in some building societies ranges from 2 to 17 pages, and from 1 paragraph to 11 pages respectively. It can be deduced that the big variation in terms of the disclosures provided by building societies is due to the size of those building societies. The regulator contended the state of disclosures in building societies' annual reports could still be strengthened:

> *If you looked in practice what building societies said in the annual reports, specifically the corporate governance statement, 'we had regard to The Code of Corporate Governance'. They didn't actually say we follow it. Building societies' board of directors are appointed by their members. You don't get the same influence if you have a group of shareholders who can put their own members on board. Building societies have to show greater and clearer accountability to the best code of corporate governance. Before the crisis they won't and they are improving. Unfortunately, today, not all of them follow all the rules within The Code of Corporate Governance. I think every building society should say we follow the corporate governance code to the letters [REG].*

The above indicates that building societies are discharging *financial-social dual accountability* to members and *compliance accountability* to regulators. However, improvements are still needed in voluntary disclosures to achieve *financial-social dual accountability*.

6.5 Employment and Staff Development

The 2008 financial crisis has caused the number of employees in the financial services sector to shrink. The British Bankers' Association (BBA) reported the main UK banks such as Lloyds Banking Group, HSBC, Barclays and RBS have shed around 18,500 staff. This put the total number of employment down from 435,000 in 2007 to 416,500 in 2008 and 292,600 by 2012 (BBA, 2014). Equally in the building society sector, the number of employees decreased from 51,578 in 2007 to 39,285 in 2010 and 40,220 in 2014. This is notably due to the merger of a number of banks and building societies during and after the 2008 credit crunch.

A CEO explained that building societies generally attract individuals who desire to develop their professional careers as well as being willing to commit their time for community-based activities:

> *We have very high employee engagement and we want people to come here because of the way we interact with our customers. If you come here, you have to be the sort of person who enjoys thinking like we do. If you want to come here and sell our stuff and get a kick from selling our stuff, don't bother. We are not the right organisation for you. If you want to come here, we will provide you with flexible employment, we will give you a career opportunity to try different things and have a good record of that. Summarize by diversifying and valuing our people. And lastly, we will be a force for good in our local communities and to the societies as whole [CEO-12].*

Another director saw individuals who worked in local and regional building societies as individuals who are not 'greedy', 'materialist', 'capitalist' or mainly seeking a secure job that facilitated learning:

> *I haven't met people who worked here who I would determine to be greedy. I haven't encountered any side of greedy culture to the organisation which can be destructive when greed drives the wrong behaviour [CEO-13]*

Likewise, a different CEO asserted that:

> *This building society attempts to attract certain kind of person who wants something more than turning up and taking the money. You will find people who are principled and they want to work with something than just take the money. They don't want to work in a political environment. They want to feel that they work in somewhere that is safe to raise concerns [CEO-10].*

However, a director commented that building societies are at times similar to a *"worker co-operative, where people working in it are just running and managing the organisation for themselves"* [CEO-9]. Another CEO acknowledged that his building society had situations where management got complacent and did not want to do anything. "*The board then gets to kick them at the ass and say-come on, let's get some stuff done*" [CEO-8].

In order to ensure that competent individuals are employed and to achieve *personnel accountability*, many initiatives have been undertaken by the sector to enhance staff well-being, personal and professional development. The annual reports reported that building societies provide training and professional development courses to employees, engage with employees to obtain employees' feedback and provide workplace pension schemes, holidays, bonuses and health care benefits. All building societies also recognise diversity, ethnicity and different sexual orientation. Consideration is given to applications for employment from a range of backgrounds and diversities. In return, employees are expected to follow the organisation's strategic plans and to provide a high service to customers.

A number of interviewees mentioned that there are different career options and personal development offered by different geographic areas and sizes of building societies. Large building societies such as Nationwide, Yorkshire Building Society and Coventry Building Society are widely spread across the UK. These organisations arguably provide greater career options to individuals and have a greater likelihood of attracting 'specific skilled individuals'.

Due to the regional focus and the less attractive reward schemes of small and medium-sized building societies, many directors claimed that those building societies experience the challenge of attracting individuals with IT, risk management and treasury credentials. An NED expressed that:

> *If you look at the shape of the building society sector, I would say if you are an employee or the senior manager of Nationwide, Skipton Building Society or Yorkshire Building Society, there is very distinct career path. They are very diversified and they have positions all over the country. Where you have the small and locally-based building societies like ours, which is in a small town, there aren't a lot of skills people in the catchment area that you are necessary looking at. At the moment, it is difficult to attract people at risk management and IT [NED-3].*

The above-mentioned interviewee suggested that to achieve *personnel accountability,* building societies provide personal and professional development to staff. Employees are also encouraged to engage and share any concerns with their superiors. Small and regional building societies, however, have to assess the idea of attracting high-calibre individuals for specific jobs against the costs of employing the individuals.

6.6 Summary of the Chapter

This chapter analysed and discussed the state of internal aspects of governance and accountability in UK building societies. The discussion in the chapter indicates that since the 2008 credit crunch, corporate governance and accountability have become a vital agenda in the building society sector. UK building societies have taken many initiatives to strengthen their governance arrangements by improving their board diversity, composition and skills. The interview data reflects that the customary appointment of close friends as NEDs which existed prior to 2008 has been reduced. Many building societies have been using professional search companies to search for NEDs. NEDs are considered more accountable, knowledgeable and provide constructive feedback to the board. All building societies also have remuneration committees in place to review and determine executives' remuneration. NEDs' fees were more thoroughly reviewed, determined and approved by the board of directors.

However, the study found that there were a number of critical issues experienced by UK building societies. Regional and local building societies had to search quite hard for individuals with expertise in treasury, financial services, risk management and information technology due to their regional locations and fees and salaries below the market rate. Some building societies are also found to hugely emphasise the form rather than the actual essence of sound governance. Governance practices are box ticking exercise without due regard to the actual substance of compliance. For instance, the study found that some building societies created board committee structures simply to meet the superficial requirements of the regulator. The best practice risk management framework—the three lines of defence model—was not implemented with the spirit of good accountability and governance. The analysis of the state of disclosure of information in the annual reports also revealed that all forty-four building societies complied with mandatory disclosures (such as reporting of financial statements and the directors' report). Disclosure of voluntary information such as the chairperson and CEO's reviews, the CSR statement and corporate governance statement were, however, inconsistent across the sector. Some building societies did not provide in-depth information in those reports and merely reported shallow information with short statements.

Governance practices for compliance purposes have value only if the underlying activities and procedures are relevant to the businesses. The risks of over-focusing on the form rather than the true substance of good governance practices are that building societies may invest huge resources in corporate governance systems such as the three lines of defence model, a risk committee or reporting of information which do not translate into improving business operations or enhancing accountability. These may consequently expose building societies to failures in governance, abuses of power and ultimately the collapse of the businesses. These areas still require more effort by building societies. The next chapter discusses the findings pertaining to the extent that intermediate governance structures assist in discharging accountabilities.

CHAPTER 7: Intermediate Governance Structures and Democratic Practices: An Analysis of the Views of Customer-Members, Directors and Regulator

7.1 Introduction

This chapter extends the discussion of the preceding chapter and discusses the extent to which the intermediate governance structures achieve financial-social dual accountability and facilitate democratic practices in UK building societies. The chapter presents key themes which emerged from interviews with customer-members, directors and a regulator. The interview data are substantiated with evidence from documents and non-participant observation. The chapter is structured into three main parts. Section 7.2 discusses customers' conceptualisation of mutuality. Section 7.3 reports on the current intermediate governance structures and the state of democratic practices in the building society sector. The concluding section is discussed in Section 7.4.

7.2 Conceptualisation of Mutuality Drawn from Customers

A mutual organisation has been defined by building societies as a business which is owned by and run for the benefit of customer-owner-members. When members were asked about what they understand about *mutuality*, the majority of members answered "*I don't know*" [MEM-3, MEM-4, MEM-8]. A building society's profit is distributed to its members as mutual dividends or is used to help people who require financial assistance to purchase a house. A member highlighted that:

> *Building societies look after their members better than the banks do. Because most building societies in this country are for their members…I tend to use the services of the smaller building societies, which are for members only. All the profits are going to the building societies at the end of the day. Not the shareholders [MEM-3].*

Members have the right to vote on the election or re-election of directors and auditors, on approval of the audited financial statement and to attend and speak at meetings. Each member has one vote regardless of the amount of money invested or the number of accounts they have (BSA, 2013c). The interview data indicated that almost all members are not interested in voting and understanding the day-to-day operations of building societies. For instance, a member expressed that:

> *I have the voting pack sent to me every year by different building societies. Sometimes, I read through them and casted my vote. But generally, I care less about them. I think as long as my money is protected by FSCS and I get decent return, I am fine [MEM-3].*

There were also a number of members interviewed who did not understand about their rights as customer-owner-members. A member explained that:

> *I become a customer of [zz] building society because I need different banking account. Coincidently, [zz] building society offers good deal for their savings and current account and they have a branch near to my house. So, I am not really bother about how building societies are run [MEM-4].*

Another member also explained:

> *I have been the customer of [tt] building society for two years. I think [tt] building society offers good rates in their savings compared to banks…I received their AGM packs, but I don't bother with it. I did not vote because I don't have time for that [MEM- 9].*

Apart from better interest rates, customers also enunciated that building societies provide good customer services. Employees are more attentive and engaging in building societies than banks:

> *One thing which is good about building societies is you can go into their branches and the staff and manager remember your name. They answer all your questions and they are good in doing that. I also have accounts with [UU] and [CC] banks. But I found that it is very difficult to get staff in branches to help. I think banks have so many ATMs in their branches that sometimes they forget the needs of customers who need to be talk to rather than machines [MEM-8].*

Some members mentioned that they expected building societies to be accountable to future customers and the local community rather than just the present members. Building societies were initially set up to provide assistance to individuals to own houses (Woodin et al., 2010, Dayson, 2002). Hence, building societies have a responsibility and accountability beyond current members:

> *I think building societies' accountability is to their current members. They have to show that they are offering good practices, and that they are not losing money. They should also have more money to be able to offer out as mortgages and to build local community. This is the initial idea of what a building society is [MEM-3].*

Another member corroborated this:

> *I like the fact the building societies seem to have a better ethos in terms of looking after their customers. I think apart from better deals, I like to know that my money is in a company based in UK. It can keep the money within the UK economy and hopefully is helping someone else in the country to own houses [MEM-1].*

The responses of members suggest that the majority of members associated the idea of mutuality with good and decent returns, good customer services, and the board of directors and management's accountability to present members, future members and the local community. The majority of customers do not exercise their ownership and control rights and do not attempt to understand the day-to-day operations of the business. The next section reports findings pertaining to types of intermediate governance structures applied by the building society sector in achieving *financial and social dual accountability* and in fostering democratic practices.

7.3 Intermediate Governance Structures and Democratic Practices

Intermediate or democratic governance structures are the mechanisms and structures to facilitate democratic practices and the achievement of *financial-social dual accountability* in mutual organisations (Ketilson and Brown, 2011, Pearce, 2003, Pellervo, 2000). As owners and customers of building societies, members have ownership and control rights to changes in building societies such as changes to the constitution, mergers with other societies or the decision to demutualise. Furthermore, the board of directors and the managers are elected by members to manage and run the business. Members therefore have the authority to remove and replace management if they are not delivering the required services and products (Cooperative Group, 2007, Birchall, 2013). The intermediate governance structures were discussed in Chapter 2, Section 2.5 and interviewees were asked to discuss them.

7.3.1 Member Panel and Member Forum

In order to obtain a greater level of participation and involvement from members, a number of building societies established member panels and member councils as part of their governance structure. A *member panel* is regarded as a type of *participatory democratic structure,* to call upon a group of members to make decisions or at the very least, express their feedback and opinions on the products or services rendered (Ketilson and Brown, 2011). A member panel is argued to represent all members. It is made up of individuals who are concerned about the governance of their building societies. Hence, the member panel is often informed about business conditions and strategic matters, ideas and feedback on new products and viewpoints and feedback of other members (BSA, 2010a).

There are two types of member panel structures in building societies. Large building societies (specifically PG1) have member panels consisting of a huge number of members who volunteered to review their building society's financial performance, provide feedback on operational details and suggest ways for better services and products. For instance, Coventry Building Society states on its website that the member council (or member panel) is made up of:

> *…a dozen members who volunteer to work with us to review our performance, provide feedback on our plans and help us develop our approach…at the latest meeting the Council was given an overview and update on the Society's performances…before moving onto the business of discussing the Society's Members First values and principles…In the afternoon, the Council talked about executive remuneration…this was followed by an item brought to the Council meeting by one of the members - a discussion around our community work and charitable partnerships (Coventry Building Society, 2016) .*

A member panel of small building societies (specifically PG2 and PG3) such as Hinckley & Rugby Building Society is made up of a small group of savers and mortgage borrowers who have volunteered their time to discuss products and services and business objectives as well as to provide insights and suggestions on the development of their building society. The panel meets a few times in a year at various locations and also attended by a chairman, NEDs, the CEO and senior managers (Hinckley & Rugby Building Society, 2016).

Besides a member panel, a number of building societies hold regular open forum events to members at different venues around the country. The board of directors and senior managers attend these events and local customers are invited to attend and provide suggestions to management. The researcher observed one of the member forums at [FF] building society. Executives and non-executives at that event gave a talk about [FF] building society's history and presented its financial performance. Following their talks, members were invited to provide feedback and share their concerns with other members and the board of directors.

When directors were asked the underlying reasons for organising a member panel and member forum, one of the directors commented that such approaches distinguish building societies from banks and preserve members' democracy:

> *Some of the banks will be able to get their principal shareholders into a single room and can be talking to a sufficiently large proportion of shareholders that carry the power to vote. We can never do that. That's why our engagement programme is so important for us to understand our members and to enable members to participate [CEO-5].*

Directors of regional and local building societies asserted that despite their increasing efforts to organise a member forum, there was a lack of member attendance and participation. This is supported with the researcher attendance at the member forum conducted by [FF] building society. There were less than 100 members attended the member forum out of a few hundred thousand of members. According to a chief executive, members' lack of participation increased the resources utilised by business:

> *So I have asked the branch staff and also local business meeting to say we do have the member forum where you can come along and you can talk about ways our building society could do a better job. They are very poorly attended. I used to run two a year and it's now ended to one a year and it tends to be the same three or four people that turned up. So we ended up spending more money and perhaps we are winding up more people [CEO-4].*

To overcome these problems, building societies employ retail branches to foster face-to-face interaction between members and branch employees. Building societies also communicated with members through members' magazines, newsletters, questionnaires and surveys and the use of virtual tools and technology. These provide building societies the ability to communicate with members in a timely, personal and efficient way (BSA, 2010a).

7.3.2 Retail Branch

The retail branch is a popular distribution network for building societies to communicate and interact with members. It is a medium that directors and management mobilise in order to obtain feedback and understand members' needs through employees. A CEO emphasised that:

> *We have to listen to our branch people because actually they are the nearer voice to the members, they hear and they report back on what they hear. There is good feedback with those being a formal structure, but they really know what our members are thinking and what our members are asking [CEO-3].*

Chief executives asserted that even though most members rarely approach them, they would visit retail branches to meet staff and to converse with customers:

> *I am more accessible than the chief executive of [GG] bank, who I am sure their customers could not phone up and talk to…Our position whereby, myself and my finance director always visit all our branches, greet our staff on what they should say to customers and also to talk to customers [CEO-1].*

The BSA representative commented likewise:

> *Directors go to the branches partly to meet the staff and partly to meet members. I heard one chief executive was very annoyed with his own staff, because he was in a branch and a member came over and asked 'who is that over there?' And he wasn't introduced as chief executive. When directors are out there with staff and members, they immediately interested in members [BSA].*

Members interviewed enunciated the significance of branches to acquire information and to express concerns about banking products and services. Employees in branches are approachable, accessible and friendly. They are also well trained to address customer concerns about online transactions, interest rates or financial advices on savings and mortgages products. A member expressed that employees in branches are *"much friendlier. They sometimes answer your questions better than banks would"* [MEM-3]. Another member commented similarly:

> *My wife and I have savings accounts with [KK] building society and [WW] bank. The impression I get, is that building societies are more local. I don't mean geographically local. But they are more on the ground. I don't know if you go to the [WW] bank on the high street, there's hardly a person, it is a very machine-based. The building society that I use, I felt like they are smaller, friendly and more approachable [MEM-1].*

Despite the benefits of retail branches to members and directors, an ex-director explained that branches are typically used by old customers who are "*in their 60s and 70s. These customers remember the local building societies' managers, the branch in the corner in the high street and they still make use in the branch" [EXDIR-1]*. However, young customers who are arguably more technology savvy, seem more interested in doing online banking rather than visiting branches:

> *If you think about the structural changes that occur in the UK society, young people are not interested in any of that stuff. It is going to be apps on the iPhone, and it's all about moving money from A to B. They would not become interested in local business [EXDIR-1].*

Another chief executive commented that the costs of maintaining branch networks are huge and the majority of member-customers scarcely use retail branches:

> *If you took a hard economic approach to it, we would probably close some of our branches because they are not being used enough. It increases our cost of maintaining them. There will come a point where mutuals will find it a challenge just having branches because it feels like the right thing to do [CEO-6].*

The CEO's remark raises a question of the future of branch networks to maintain the accountability relationship and to enhance proximity between building societies and customers. This is further supported by Casu (2015), who said that the number of branches in the financial services sector declined from 10,051 in 2006 to 8,837 in 2012. The branch network in the UK banking sector is expected to decrease to 7,000 branches by 2018 (The Telegraph, 3 March 2014). The decline of branch networks is due to changes in customer demographics. Customers, specifically young adults, are perceived to be more technologically savvy and are increasingly turning to online and mobile banking applications, rather than visiting branches and having face-to-face interactions. Many banks have thus migrated to online banking applications to suit the requirements of technology-savvy customers (The Telegraph, 3 March 2014).

Overall, members are satisfied with building societies' branch networks as the platform to address their concerns and to obtain financial services advice. Branch networks play a key part in understanding customers' needs and preserving proximity with customers (Bernard and Tetrault, 2012). They are also a channel to strengthen building societies' intermediate governance structures in promoting democracy and accountability. Nonetheless, retail branches are infrequently utilised by technology savvy customers and the costs of maintaining a branch network are rising. It is therefore questionable whether the future of branch networks will help to revive customers' overall banking experience and improve the accountability relationship between building societies' senior management and customers.

7.3.3 Social Media and New Technology

Building societies utilise technology to modernise their democratic process and to enhance the *financial-social dual accountability* to members. The BSA (2015b) reported that two-thirds of building societies use social media to communicate with members via Facebook and Twitter. For example, Darlington Building Society and Ipswich Building Society and their Chief Executive Officers (CEOs) use Twitter to announce new products, newsletters that might be of interest and to answer questions from customers.

Building societies also have information on their websites which describe customers' rights, types of product and interest rates, links to AGM materials and results and information on community activities. Some large building societies mobilise their websites as a medium to interact with members including online question-and-answer sessions. For instance, Leeds Building Society (2017) has a section on its website named 'TalkingPoint' for members to express opinions on matters that are vital to them and to communicate with other members to discuss improvement ideas for products and services. Nationwide also has an online member forum which enables members to suggest ways to improve services and to see other members' recommendations.

In addition, a few building societies have implemented 'in-branch technology' to enable customers to contact the administrative office via an in-branch video link. A director elaborated that:

> *Our use of in-branch technology is really important to offer advice. I can deploy technology and have an advisor available through the screen at every one of my branches. We invested in a network that if you are in a branch, this is the interview room. Somebody would pop on the screen and they might be downstairs and you might be in a branch in Colchester. You would see them and they would see you. On the other half of the screen, we would pop information there on how things work and shows you quotes, all sort of things. And we got a network technology to print that off in a printer wherever you are [CEO-11].*

Unlike banks such as HSBC, NatWest and RBS, which are closing their high street branches, some building societies are committed to keeping their branch networks intact and even expanding their branches. They believe in the significant role of the high street branch, in offering people the option of managing their money using technology in-branch, together with personal services. A BSA representative explained that the approach undertaken by building societies is to deliver a *mutual dividend* to customers and the local community:

> *Building societies are investing in their branches and expanding their branches at the time when the banks are universally withdrawn their branches. So when you think about what are the values, the values are about the members and*

> *about how you deliver the values to the members. It does sometimes call the mutual dividend [BSA].*

However, a majority of directors expressed their concerns on the ability of small and medium-sized building societies to invest in new technology and to cater to the needs of technological savvy customers who commonly opt for e-banking or mobile finance on their banking transactions. A CEO questioned whether small organisations (which most building societies are), "*can continue to invest at the level that is required as UK society becomes more digital and technology becomes more important*" [CEO-5]. The CEO further enunciated that:

> *There is a question about what will their position be not tomorrow, but in 5 or 10 years' time as we become a wholly digital society. I just think they might be at a tipping point where these small businesses have to decide whether they have got the ability to continue to operate and compete in that sort of environment [CEO-5].*

The regulator also commented that:

> *I think small businesses are facing challenges through new technology. The network capabilities such as Internet finance and mobile finance are becoming more prominent…I think there might be people who want traditional building society, just that now. But as network capability goes up, it will drive huge changes in individuals banking needs. Building societies need to be prepared to that and they need to think what would make a customer-owned business offers services that are relevant to people [REG].*

The increasing use of technology therefore posits challenges for the future od small and medium-sized building societies, which typically rely on branch networks and face-to-face interactions. These building societies may face an increasing cost mark-up and may need to continuously manage different distribution channels to meet the needs of their customers.

7.3.4 Annual General Meeting

Building Societies Act 1986 requires all building societies to carry out their AGM in the first four months of their financial year end (BSA, 1986). Schedule 2, paragraph 20 states that:

> every building society shall hold a meeting in the first four months of each financial year as its annual general meeting (in addition to any other meetings in that year) and shall specify the meeting as such in the notices calling it.

With respect to that, all building societies send their AGM packs to members prior to the meeting. The AGM pack enables members to vote on directors' remuneration and to elect and re-elect directors and auditors. However, the BSA (2010) reported that there was only an 18%, 19.4% and 18.4% voter turnout at AGMs in the years 2007, 2008 and 2009 respectively. In 2014, the turnout averaged 11.8% (BSA, 2015b). **Figure 7-1** also shows the decreasing trends in the AGM turnout at building society AGM between 2004 and 2014.

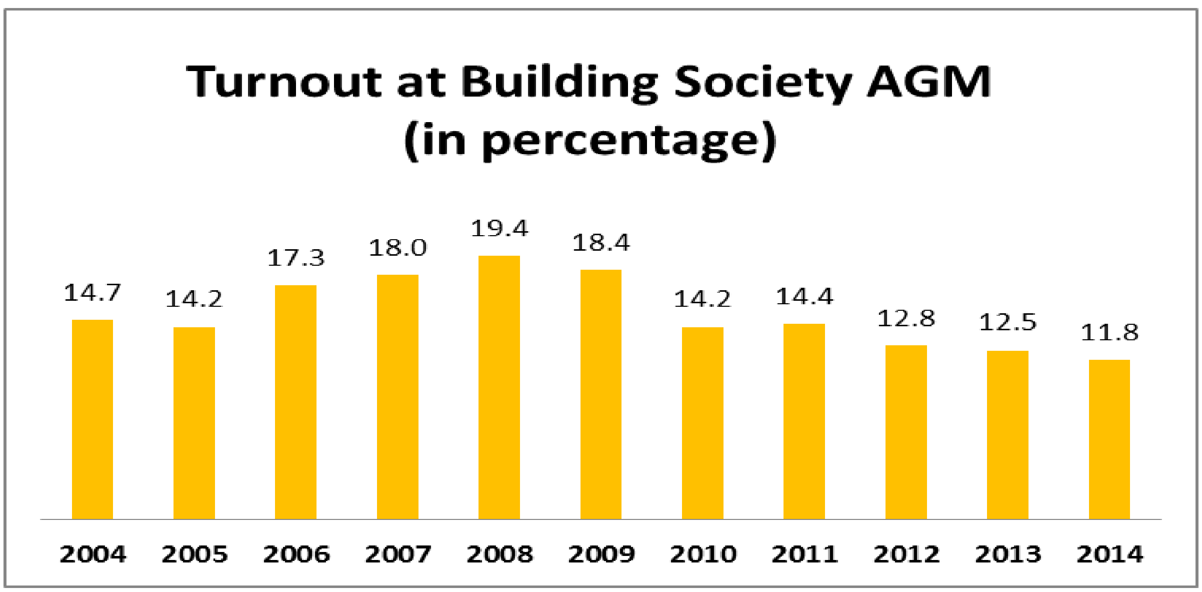

Figure 7-1: AGM turnout at building society AGMs between 2004 and 2014 (Source: The BSA (2016) AGM statistics, analysis by author)

Likewise, members' attendance was very small at the two AGMs attended and observed by the researcher. The first AGM was attended by 250 members out of about a few hundred thousand members. The second AGM was attended by fewer than 100 members out of about 500,000 members. The majority of directors contended that turnouts at AGMs were "*very low*" and "*disappointing*" [CEO- 4, CEO-11]. A CEO stated that:

> *We do put a lot of effort to try and engage members to come along. But you can see from last week's AGM, we sent out all those invitations and 100 were there. Our desire is that would be 500 plus people there [CEO-3]*.

An interviewee claimed that members attend the AGM when "there are proposals to merge with another organisation and during the 2008 financial crisis when members needed assurance about the soundness of their deposits" [BSA]. Another director commented that most members are satisfied with the way building societies are managed and they do not feel the need to turn out at an AGM:

> *When we looked at what happened at our AGM, we had 50 customers come along. They are not technically interested in governance. But, what they are interested in is what we are. A nice organisation, decent to its customers, well run, properly managed. That's what they like to see at the AGM. They are not interested in who is on what committee or how long any individual director has been there. They are not sitting there thinking, 'well, I got an issue here, and how long the auditor has been?' They don't care about all those things that governance people are obsessed about. It's a very rare person that does [CEO-8]*.

Members attributed the reasons for their lack of participation as: "*I merely regard building societies as service and mortgage providers* [MEM-3, MEM-4], "*I do not have time"* [MEM-1, MEM-9], "*I am not interested"* [MEM-3, MEM-5, MEM-8] and "*I do not believe my single vote would change anything"* [MEM-1, MEM-2, MEM-9]. On the other hand, a member who the researcher met at the AGM of [VV] building society argued that members should exercise their ownership and control rights. The directors and managers of building societies take into consideration feedback provided by their members:

> *We owned part of the company. If they said they want to expand and take over another building society, we will get a vote if we agree. We do have a say…Here, we are interested because this can be part of our company. The people are one of our people, our members. So they are quite happy to help you out. This building society really takes on board what their members asked. It's not possible to do everything all the time. They do listen to their members. People feel that they are worthwhile and they are being listened to. You all put a little into the company so you have a say on how it is run [MEM-6]*.

In order to encourage greater turnout at AGMs, numerous measures have been undertaken by building societies such as using technology to reach out to members who are using email and other web services as their primary means of communication. Nationwide states in its website that:

> *You don't have to actually attend the meeting to vote. We communicate with around 8 million eligible members through email and by post as it's really important that you have your say in ways that suit you (Nationwide, 2017).*

Some building societies also offer to make donations to charities for every vote they receive. Leeds Building Society reported on its website that:

> *We'll donate 10p for each paper voting form received or 20p if you vote online to national and local charities such as Depaul, Sense and Leeds Building Society Charitable Foundation. To vote online, you'll need your unique security code and password from your voting email (Leeds Building Society, 2017).*

A number of building societies even hired independent agencies such as audit firms to scrutinize the voting process and provide free lunches, live bands, bus stands and door gifts to increase members' attendance at the AGM. Even so, members rarely turn up at the AGM:

> *Customers are advised when the AGM is and we announce to people they are free to come and there is a buffet and wine. We also provide a shuttle bus from the train station. Last year, zero customers who were not already linked to the*

> *society by employment or past history turned up. So we changed the venue and nobody turned up other than people who were scheduled to turn up like auditors, directors and staff [NED-2].*

The analysis suggests that building societies undertake different measures to encourage members to vote and to attend the AGM. However, most members do not believe their votes result in changes in building society operations. Members mainly regarded building societies as products and service providers. Due to that, building societies experience the challenges of getting a high member turnout at the AGM.

7.3.5 Board of Directors

In the building society sector, the board of directors is expected to communicate and engage with members in order to better understand members' needs and represent them on the board (BSA, 2010b). All interviewees agreed that the board of directors visited branches to talk to staff and customer-members. Directors of building societies would attend roadshows and member forums to interact and communicate with customers. This is further seconded from the researcher's attendance at building society AGMs and member forum. NEDs were in attendance to engage with members and to answer customers' questions and probes with regards to a building society's operations. A chairperson commented that:

> *I go to branches, I sit in member forums and my non-executive colleagues do too. They go out into branches chatting to people, customers as well as staff [Chair-2].*

Furthermore, Saffron Building Society has an online form on its website that gives members the opportunity to contact board members other than through the traditional channel of writing to the Chief Executive or Chairman (Saffron Building Society, 2017). However, there were some directors who were sceptical as to the relevance of member engagement between

NEDs and members. The majority of members are not interested in interacting with NEDs and the engagement activities arguably increased the costs of the organisations:

> *What we asked the NEDs to do is to attend the AGM and invited them to member forums. So for example, in the 4 years I have been here, I have probably held about 6 or 7 member forums. So each time I get one, I said to the board I have got one coming up, who have not been on one before, would you like to come along and engage with the members? But unfortunately, it is let down by poor attendance not by the NEDs, but by members. So we ended up spending more money [CEO-4].*

Other directors emphasized likewise that it is "difficult for NEDs to engage with members. We had the AGM, roadshows, member forums and there were very few members who turned up" [NED-2] or the "same body of people turn up each time there are member engagement events" [CEO-2]. Even so, directors expressed that comments and suggestions received from members would be acted upon appropriately. Diverse measures were undertaken by those building societies to collate feedback from members, to be brought to the attention of board and senior management. Those measures include "engagement by staff and executives with members" [NED-2], "listening to staff in branches [CEO-3] and "sending out reports, giving members the chance to have opinion through our branches asking for feedback when somebody has visited and transacted" [CEO-13]. These demonstrate that building societies are undertaking different means to enhance their engagement with customers, despite the lack of interaction between NEDs and members.

7.3.6 Other Means of Engagement and Communication with Customer-Members

Member *questionnaires and surveys* are also widely used by building societies to seek feedback from members and assessment of customers' satisfaction with respect to products and services. Surveys are run annually or semi-annually in which they are posted together with an AGM pack or are available at retail branches (BSA, 2010a). According to directors, surveys by mail or telephone are useful to obtain feedback from customers and to understand what drives customer satisfaction:

> *We measure feedback from our members in terms of quality of our service how satisfied they are. Independently each month, we look at the satisfaction of our members and we used independent firms to measure that for us. And we talked to our members each year through that process. We have an online forum of members which covers the full age spectrum and profile of our membership, where we can test ideas and new ways of doing something, improving our communication and all of those sorts of things. When things go wrong, there are a lot of analyses of complaints and feedback so that we can understand what has happened [CEO-5].*

Another chief executive commented similarly:

> *If we do get complaints, they are captured and every single of them is put in front of me and the management team. So every month, we look through complaints then we understand where the problems lie, look for solutions, look for every cost analysis, any escalated complaints letter come to me, we get very few of those. And also we do surveys. Whenever a new member opens up a new account or closes an account, we will send them a survey form to fill in. I think we have about 15-20% of responses and invariably the results from those are very positive. Again what we asked for is the feedback about what would you do differently or what you think we could do better. And we read those as well [CEO-4].*

Nationwide reported on its website that the organisation commissioned an independent research company to contact 12,000 customers by telephone to ask about the quality of services they receive from retail branches and telephone staff. Nationwide also conducted an online survey with 5,000 of the users of its Internet banking service and website (Nationwide, 2016). Similarly, National Counties Building Society conducted an online survey with its customers to obtain feedback and suggestions about products and services. Its website reported that for every ten online surveys completed, a tree would be planted and members would stand a chance to win cash draw (National Counties Building Society, 2016).

Furthermore, to reduce the barriers to member participation, a number of directors allowed members to personally contact them. A director disclosed that:

> *Particularly during the credit crunch period when customers were worried about the safety and soundness of their deposits, members could phone me up and talk to me about the organisation financial position, our attitude to risks, and exposure to other banks in term of counter party deposit [CEO-1].*

Members are also kept abreast with building societies' activities, community activities and financial performance through newsletters, magazines, regular electronic publications and member roadshows. All building societies communicate with members through letters with respect to interest rate changes by explaining the context of the decision to amend the rate and reassure savers that their deposits are secured (BSA, 2010a). These approaches to member communication and engagement are to foster democracy in a customer-owned business. A CEO emphasised that:

> *We do a member roadshow, where we go to different parts of the community where we are represented and we present on certain topics and get their views back from those members. Very importantly, we do customer research about the service we provide. We have ten key categories about what we describe as service and we get customer feedback on that permanently those going well and the overall score and what we can do to improve. The feedback that we get is that they are pretty much happy with the way that we are trying to do things and with our strategies and they want us to carry on doing that. Now does that mean democracy exists for members' benefits? I think it probably is [CEO-12].*

Members found that they had no problems in accessing information when they required it. Building societies provide regular information updates and members are satisfied with the contacts they had with building societies. A member stated that:

> *Contact has always been good when you deal with building societies. They write real letters to me and not just emails and they have got telephone helpline if I need to do so. And then, they send general communication about what the company is doing [MEM-1].*

Another member mentioned that:

> *Everyone has different experience. I found that contacts with building societies have always been good. I don't have any complaint [MEM-3].*

Despite the increasing efforts made by building societies to enhance member democracy and improve engagement with members, the regulator questioned the board of directors' accountabilities in building societies:

> *One of the big challenges of their board is their lack of accountability. If you read their annual reports, they are trusted with their members' reserves. These are millions of pounds…Most of the building societies don't say to their members whether their reserves are earning above and in the right way of risks. Or how is the business moving forward…building societies, they do listen to their members and they are very good at member engagement events. But did they demonstrate that they invest in the members' money in wisest possible way and that's judge through the right level of profit that they generate at the end of the year, the right level of risks for that profit? I think that's more they can do in that area [REG].*

The analysis showcases that building societies have employed various means such as surveys, questionnaires, newsletters, magazines and regular electronic publications to facilitate democratic practice and discharge a *financial-social dual accountability* to members. Members are satisfied with the interactions they have with building societies and the regulator also agreed that member engagement remained a core agenda in the industry. However, the regulator demanded the board of directors' accountabilities and the internal governance practices to be further strengthened in terms of the ways risks are perceived, managed and implemented, and the process in which strategic decisions are formulated and undertaken.

7.4 Summary of the Chapter

This chapter analyses and discusses the extent to which intermediate governance structures assist building societies to achieve *financial-social dual accountability* to members and to foster democratic practices. The chapter found that building societies experience a number of challenges to effectively engage their customer-owner-members. Members are not interested in governance matters and the day-to-day operations of building societies. Members are largely value-for-money driven with regards to the products and services offered by building societies. Borrower-members expect lower interest rates for their mortgages and savers expect higher returns for their deposits. There were, however, some members who are strong supporters of customer-owned business and have more time to engage.

These findings are consistent with the assertions of Birchall and Simmons (2004), Spear (2004) and Birchall (2013) that most members in a customer-owned business have few interests in their membership organisations. Birchall (2011) cautioned that in the absence of effective member engagement, it is a challenge to ensure that the board of directors can act in the long-term interests of its owner-members. In order to build more meaningful relationship with members and to modernise the democratic processes, greater efforts and various intermediate governance mechanisms have been deployed by building societies. These include the usage of Internet and new 'in-branch technology' to facilitate members' turnout at AGMs and to improve engagement with members. Directors also visit retail branches and attend member forums and roadshows to communicate and engage with members in order to obtain feedback and suggestions. However, members feel removed from their building societies and less inclined to interact and engage.

Engagement with members therefore remains a long-term challenge for the building society sector. Building societies may need to continually demonstrate to members the benefits of being customer-owner-members of building societies, the quality and value-for-money of the products and services, and strengthen their internal governance practices by running proper risk management and internal control systems which will enhance the achievement of organisation’s *mutual accountability* and overall mission. The next chapter discusses the state of external governance structures in achieving compliance accountability in the building society sector.

CHAPTER 8: External Aspects of Governance and Accountability: An Analysis of the Views of Key Stakeholders

8.1 Introduction

While Chapters 6 and 7 discuss the internal and intermediate governance structures in achieving accountability, this chapter discusses the final empirical findings: the corporate social responsibility and accountability practices in the building society sector, as well as the state of external governance structures in achieving compliance accountability. The chapter presents key themes emerging from interviews with directors, an auditor and a regulator. The interview data are triangulated with evidence from documents and non-participant observation.

The chapter is structured into four main sections. While Section 8.2 explains the state of corporate social responsibility and accountability practices in building societies, Section 8.3 deliberates the role of the external auditor since the 2008 financial crisis. Section 8.4 discusses the extent to which external governance structures achieve compliance accountability, and Section 0 summarises the chapter and reflects upon the evidence presented.

8.2 Community Activities and Social Accountability

Milton Friedman claimed that the main responsibility of shareholder-owned companies or corporations is to maximize the returns of shareholders. Managers elected to run corporations on behalf of shareholders are expected to make as much profit as possible for shareholders;

and that a corporation does not have a social responsibility or accountability to the environment, community and societies (Friedman, 1970). The government is to use its legitimate taxing function to raise money to enhance the social welfare of taxpayers and to protect the environment (Avi-Yonah, 2008).

Unlike the ideas of Milton Friedman and the findings of O'Dwyer (1999) who found that CSR in most Irish commercial companies exhibited minor concerns to wider stakeholders apart from shareholders, the chief executives of building societies are highly aware of the benefits of CSR towards the community and societies. CSR is regarded as a commitment to the community or being part of the community. It is inherently espoused in the virtues of the business:

> *I have never even used the expression CSR since I have been here. It is not because we don't do things. We do it because we want to do them. We called it being part of community. Not corporate social responsibility [CEO-12].*

Employees are highly motivated to get involved in community activities and many building societies use the skills within their organisations to contribute to local causes:

> *If you went to any of our branches, employees get the autonomy to do the events that fit in the environment. It is one of these things that are in the DNA of our people. I am looking to encourage our people to do more in the community. That's both because people really enjoy doing it and want to do it. It makes them feel better and the community also loves it [CEO-10].*

The majority of CEOs also acknowledged that engaging in community activities enhanced business reputation, competitive advantage and created win-win relationships with customer-members:

> *We are a building society and we also think we have got a role to effectively build a better society. If the business starts to make more profit than we require, we think we could actually do something at society level such investing in the*

> *affordable of housing stock [or other community-related activities] which is representation for what we stand for. It leaves legacy for not just our members but for broader society. If we can become famous for doing things like that and that would reinforce our brand and make the society stronger, I think it will resonate with members [CEO-5].*

Another director recognised likewise that community activities help to contribute to its organisation profile and enhance engagement with members:

> *There's a very strong ethic about giving something back to the community that you are in. And again, that's the self-fulfilling value because people like to see local businesses that are fair and open and co-operative. And they want to be part of that. There is a definite spinoff to branding [CEO-14].*

Community activities in building societies take a number of forms such as charitable giving, donations, fund raising, volunteering in communities with environmental-related activities such as tree planting, water saving, cleaning and clearing of sites, managing waste of landside and reduction in carbon emissions. Building societies also established an affinity savings account where part of the interest is paid to charity rather than to members. For instance, Ipswich Building Society contributes 1% of the average account balance to established charities in Ipswich (Ipswich Building Society, 2016b). Furness Building Society makes a cash payment from its financial reserves to members' chosen charities based on the average balance held in the affinity group accounts (Furness Building Society, 2016).

In order to discharge *social responsibility and accountability* to community and societies, many building societies use social media, websites, newsletters, bulletins and annual reports to disseminate on their community programmes. Building societies also involve their members and employees when deciding on the community activities and charitable causes. Members and employees are asked to nominate and vote for the charitable causes and community-related activities. Charities are also encouraged to apply for donations or support from building societies. For instance, Nationwide reported in its website that it accepts:

> *…charities and community organisations [to] apply for support from [its] country-wide network of Nationwide volunteers in areas such as, but not limited to: marketing, public relations and IT support for campaigns; finance and employment sessions in schools; team volunteering challenges; trustees or governors; mentoring (Nationwide, 2016).*

While employees are highly supportive and participative in community activities, customer participation and involvement is often disappointing. A CEO expressed that:

> *I can't put words in members' mouths but members will look at it and said 'that's nice, but it's not for me. I like the fact they are giving back to community and that make them difference. I like to be part of an organisation that does that sort of things. But personally, I don't want to get involved in the activities' [CEO-7].*

The data suggest that directors are highly aware of the importance of building societies in 'building societies' at community and societal levels. Building societies are motivated to engage in community-related activities as being socially responsible and accountable is the core essence of a building society's principles and it aids in strengthening business performances. This is consistent with the assertions of Jones (1980) and Frederick (1994) that all businesses should voluntarily be socially responsible so as to encourage greater responsibility and ethical conduct.

8.3 The Function of External Audit

External audit has been regarded as a value-added function that lends credibility to a firm's published financial statement (Claessens, 2006). Sikka (2009, 2015), nonetheless, questioned the value of company audits, auditor independence and the quality of auditor works as a result of the 2008 financial crisis. Auditors provided a clean bill of health to a number of financial institutions' financial management and performances, yet many financial institutions such as Northern Rock, Bear Sterns and Lehman Brothers still failed during the 2008 credit crunch. Auditing services which are dependent on auditor fees are considered to blight the independence of auditors and the quality of their work as a result.

The politics residing in auditing practices was also under criticism during the financial crisis. Sikka (2009) claims the UK government enacted the *Financial Services and Markets Act 2000* to formalise the exchange of information between auditors and regulators and to promote market confidence in financial institutions. Auditors are expected to communicate with regulators in the course of their audit works if they become aware of an issue that would materially affect the function of regulators in protecting consumers' rights. The House of Lords alleged that financial institutions' auditors and regulators were guilty for "dereliction of duty" by not sharing information with each other on an informal basis before the crisis which partially led to the failure of a number of banks (Financial Times, 30 March 2011).

A number of financial mutuals and the Co-operative Bank were also issued with unqualified audit reports before they were rescued by large building societies and financial institutions. **Table 8-1** presents a list of distressed building societies which were issued with unqualified audit reports before the 2008 financial crisis. Auditors are expected to be responsible and accountable to customer-owner-members and members of general public by providing reasonable assurance that financial statements are free from material misstatements or errors (Solomon, 2013). However, all failed building societies received unqualified audit opinions on their financial performances, leading up to their takeover by other financial institutions.

Building Society	Asset Size for the year ended (£million)	Year End	Auditor	Date of Audit Report	Date of Transfer	Takeover by	Type of Audit opinion	Audit Fees (£'000)	Non-Audit Fee (£'000)
Manchester	792.3	31 December 2007	Grant Thornton	28 February 2008	Non-Applicable	Non-Applicable	Unqualified	83	22
Dunfermline	3,303	31 December 2007	Deloitte and Touché	20 February 2008	31 March 2009	Nationwide and UK Government	Unqualified	117	-
Norwich and Peterborough	3,729	31 December 2011	PwC	22 March 2011	01 November 2011	Yorkshire Building Society	Unqualified	161	480
Chelsea	13,413	31 December 2009	PwC	24 February 2010	01 April 2010	Yorkshire Building Society	Unqualified	168	1,048
Kent Reliance	2,257	30 September 2009	Ernst & Young	24 November 2009	01 February 2011	JC Flower to form One Savings Bank Plc	Unqualified	155	-
Derbyshire	7,094	31 December 2007	KPMG	12 March 2008	01 December 2008	Nationwide	Unqualified	100	200
Scarborough	2,852	31 April 2008	KPMG	20 June 2008	31 March 2009	Skipton Building Society	Unqualified	69	143
Cheshire	4,976	31 December 2007	KPMG	26 February 2008	15 December 2008	Nationwide	Unqualified	100	100

Table 8-1: List of distressed building societies which were issued with unqualified audit reports (Sources: Annual reports for the year ending 2014/2015, analysis by author)

When an audit partner was consulted about the role of external audit in facilitating good corporate governance and accountability, the auditor expressed that external auditors "*have no formal role in that respect. But informally, the auditors make observations, suggestions and recommendations to the building societies' clients" [AUD]*. Strategic decisions are in the hands of the board of directors and the function of auditor is to provide advice to board members (Cooperative News, 8 April 2014). The audit partner also asserted that limited changes occurred in auditing practices due to the 2008 financial crisis:

> *I don't think that the role of auditor changed as a result of the financial crisis…I think what the crisis did probably helped to contribute to the evolution of the long form audit report. The form of audit report now includes more details, what the risks are that we audited and how we audited them. That's more explanation on how we have done now in the audit report. But that's really a shift in how we report and the information that is in the account that complement what the board writes in front of the annual accounts [AUD].*

In fact, there is a continuing development and improvement in auditing practices and techniques which is policed by the FRC. The FRC has continued "*to press for improved standards in auditing across not just in the financial sector but across all segment of the economy"* [AUD]. The 2008 financial crisis mainly "*enhanced the gap in expectations between what an external audit really does and the fact that regulators, politicians, shareholders and members of the public expect auditors to be able to* l*ook into the future much further and much wider than we were able to look in projecting or predicting what would happen in the future and we can only look so far into the future"* [AUD].

8.4 States of External Governance Structures and Practices

External governance structures are the external parameters within which mutuals operate, such as the legislative and regulatory frameworks (Ketilson and Brown, 2011). The following sub-sections discuss interviewees' perspectives with respect to the supervisory roles of the PRA and FCA, and the key impacts of 2008 regulatory reforms toward the sector.

8.4.1 The Supervisory Roles of the FCA and PRA

The harsh financial climate in 2008 has diminished trust among members of the general public towards the banking industry. The FSCS (2015) reported that the financial services and banks in the UK are the second least trusted industries after the media. In order to enhance the confidence and trust of investors, consumers and members of the public towards the financial services sector, policy makers have reformed banking regulations. The supervisory roles and governance structures of regulatory bodies have also been restructured and strengthened. For instance, the FSA was abolished and replaced by the PRA and FCA under the *Financial Service Act 2012* (Casu and Gall, 2016).

The PRA supervises and regulates the prudential matters of building societies. An annual review is conducted by the PRA on building societies' business models, internal control and risk management frameworks, governance and management structures:

> *We constantly review them. We would visit them at least once a year and every year we write to one of the building societies in [an] area we see good practice and [an] area where we see they are not complying. And we expect them to address the areas that are non-compliant. And if we they don't, we have formal power to make them to if we want to [REG].*

On the other hand, the FCA supervises and regulates on conduct matters such as the processes by which complaints are handled and managed, and a review on products and services-related matters. The FCA conducts thematic reviews on most small and medium-sized building societies on an average of every three to four years. The conduct matters of large building societies such as Nationwide, Yorkshire Building Society and Coventry Building Society are reviewed by the FCA on a weekly and monthly basis due to their diverse product offerings.

When directors were questioned about the split functions of the PRA and FCA, all interviewees unanimously agreed that the roles of both regulatory authorities have been strengthened since the 2008 financial crisis. The PRA and FCA are conscientious in their supervision on banks, credit unions, building societies and other financial institutions. A CEO expressed that:

> *I think it is universal in the regulators' approach. They are just much more stringent now, whether you are a bank or building society. I don't think their attitudes towards mutuals have changed. I think their expectation towards every financial institution is they have got much higher hurdles now [CEO-5].*

Some directors are receptive towards the improvised supervisory approaches of the PRA and FCA:

> *Do I think the ways the regulators regulate are good approaches? If I were in the regulators' shoes, I would do the same. Because in financial services, whether you are a small building society or global bank, it is complex [CEO-13].*

There was also indignation among a number of interviewees on the competing objectives of the PRA and FCA:

> *The FCA and PRA have slightly competing agenda. For e.g. for the PRA to be sound and secured, you should charge your mortgage customers a nice high rates. So that you make lots of profit and be sound and secured. Charging your customers fair high rates may not necessarily ideal for the FCA and a good thing. In fact actually moving rates is one of those area where they tend to argue. So, there are conflicts in the agenda from time to time. We just sit there and sort of think maybe just tell us what you think. And they don't [CEO-8].*

The auditor contended that the split functions of the PRA and FCA create duplicate workloads and increase the costs for the banking sector and consumers. Directors arguably spend more time discussing business risks and governance issues with regulators:

> *I am not convinced that the split role of the PRA and FCA was helpful for the banking sector. I think there was the element of doubling up and possible duplication in divergence of aims and objectives which makes lives more complicated. I don't think overall it was wholly positive development for the sector and consumers [AUD].*

Building societies also hire more employees to prepare detailed and greater quantities of information to the PRA and FCA to discharge their *compliance accountability*. This, according to a chief executive, heightens the operational costs and posits long term business challenges to small and medium-sized (or regional) building societies:

> *It is becoming increasingly hard to have sustainable business and be small. You need to be in a certain size of balance sheet in order to have infrastructures that you are able to meet regulatory obligations. So since I have been here, we have got from a person in risk to having 3 people now. We have got quite a few more people in finance and part of that is to keep filling up forms to send to the regulators [CEO-9].*

The commentaries indicate that the 2008 credit crunch has transformed the supervisory roles and approaches of the PRA and FCA. Some directors are supportive of the new regulatory system. A number of directors were discontented over the competing objectives and roles of the PRA and FCA as they increase the regulatory costs and create duplication of workloads for building societies to discharge their *compliance accountability*.

8.4.2 Compliance with Banking and Mortgage Regulations

In order to promote sound corporate governance and accountability, policy makers and regulators have reformed the legislative and regulatory frameworks in the financial services sector since the financial crisis. The following sub-sections reflect directors' views about the implications of *Basel III*, *SM&CR* and the *bank levy* on building societies' *compliance accountability* processes.

Capital and Liquidity Requirements

In the light of the 2008 financial crisis, there have been arguments that the quality and quantity of capital issued by international financial institutions was not sufficient to absorb losses on the scale seen (BSA, 2010a). The Capital Requirement Directive (CRD), which is approved by the Basel Committee on Banking Supervision (BCBS), required the capital for financial institutions to be strengthened and increased. The criteria under CRD also apply to financial mutuals and co-operative banks around the world in which there are more stringent requirements for financial instruments to be classified as non-core Tier 1 capital.[26]

Large building societies such as Nationwide, Yorkshire Building Society, Coventry Building Society, West Bromwich Building Society and Principality Building Society raised their capital prior to 2010 through the issuance of Permanent Interest Bearing Shares (PIBS), subordinated debt known as Profit Participating Deferred Shares (PPDS) and from retail funding (Casu and Gall, 2016). However, the CRD 2 introduced more stringent requirements for financial instruments to be classified as core Tier 1 capital. This affected financial instruments such as PIBS and PPDS which were regarded as core Tier 1 instruments in 2010 (BSA, 2010a). In consequence, building societies have to find a new way to issue financial instruments which are classified as core Tier 1 capital.

Nationwide, for instance, has issued a type of financial instrument named Core Capital Deferred Shares (CCDS) in 2013. CCDS is a type of debt security which is sold to institutional investors, rather than individual customer-members. Institutional investors are paid a capped dividend annually. Nationwide (22 November 2013) stated in its prospectus that the key features of CCDS include:

[26] Under the Basel Accord, financial institutions' capital mainly consists of core Tier 1 capital and core Tier 2 capital. Tier 1 capital is a financial institution's core capital and is the most liquid capital in a financial institution. The purpose of Tier 1 capital is to measure a financial institution's financial health and is used when a bank must absorb losses without ceasing business operations. On the other hand, Tier 2 capital is a financial institution's supplementary capital and is less liquidate than Tier 1 capital.

- Holders of CCDS will not have proportionate voting rights at meetings of the members of the Society, and, like our retail members, will be subject to the "one member, one vote" requirement of the Building Societies Act 1986;
- The maximum discretionary return per CCDS per year is capped, in order to protect reserves against over-distribution;
- On a winding up, investors would be entitled to a share of any surplus assets alongside other qualifying investing members of the Society, such share to be capped as described in the terms of the CCDS;
- Distributions: Fully discretionary, non-cumulative and capped at £15 per CCDS per annum (such cap is adjusted for inflation by reference to the UK CPI each year), payable from Distributable Items for the Society's financial year (ending 4 April) in respect of which the Distribution is paid;
- The offer will be made available to certain institutional and professional investors in the United Kingdom and elsewhere outside the United States in reliance on Regulations under the US Securities Act of 1933.

A director contended that CCDS "*imposes upon management and the board a degree of profit imperative because a part of [an] organisation's profit has to distribute to pay the dividend to that capital instrument rather than to customer-members*" [CEO-11]. The board and management may be subjected to the influence of and pressures from institutional investors. Specifically, if the building society was in a difficult financial position, and to ensure that institutional investors do not withdraw their capital (under the assumption if institutional investors withdraw their investments, the organisation is not able to meet regulatory demand and it is likely to go into liquidation), the management of the building society may meet the interests of institutional investors over those of customer-members.

When one of the directors interviewed was consulted, the director agreed that his building society issued similar financial instruments like CCDS. However, the director contended that such a financial instrument "*is a tricky one" [CEO-12]*, and building societies have no other option but to issue the instrument in order to meet regulatory demand:

> *It was the regulators who introduced the new measure we have to comply with. The board believes that we have got more than enough capital. But because of the stipulated regulations, which we obliged to comply with, we have to raise more capital…we raised it, just to satisfy the bit over there [the regulator]. We don't actually think we need it. Unfortunately, there is a coupon we have to pay on it, as a detrimental impact on our profit, the amount of money we can give to our savers and mortgages customers. But at the same time, it is important that we are regarded as a safe and secure organisation. If this is the measure that regulator decreed as important measure, then we must comply with it. We didn't do it because we actually felt it was necessary or because we wanted to. We did it because we have to [CEO-12].*

However, no issue and sale of CCDS has taken place for small and medium-sized building societies. A risk director explained that "*if building societies intend to launch CCDS, they need to evaluate the fixed costs incurred, such as the fixed legal advisory costs would be significant. The organisation thus, needs to raise certain amounts of capital to make the issuance worthwhile. Nationwide is at a scale where it would be cost-efficient for the organisation to do that" [RiskDir-1]*. The majority of small and medium-sized building societies lack the scale and resources to develop and issue CCDS. Due to that, directors contended that regulators are concerned about the ability of small and medium-sized building societies to raise capital in the event of crisis:

> *So, our flaw is we can't raise new capital. Now, there is a mechanism by which we can raise more capital called CCDS and it is available to the very biggest*

players like Nationwide. By the time you make something like that work for our building society, it is awfully expensive and probably to a point where it is not a solution. So, we don't have an option. That is the big flaw for building societies. If you think about it from the regulator's point of view, if building societies get into trouble, they can't get themselves out of it with more capital. So, a bit like if they haven't got a life belt and probably best not to let them to get too close to the water [CEO-8].

The regulator interviewed also acknowledged that:

The weakness in the building societies is they can't get capital in a financial crisis because they only got their retained reserves. They need to demonstrate that they don't need capital. So they need to control their risks and the board needs to demonstrate that they are accountable [REG].

Regulators are also circumspect on the ways risks are perceived and undertaken by building societies. They placed restrictions on the types of products building societies could offer and this affected the strategic decisions undertaken by management of small and medium-sized building societies. A CEO criticised that:

The regulator is asking for more capital. But we do not have the scale to generate the returns to put into capital because it's constrained in competition…if I'm not allowed to sell certain products because of building society sourcebook [BSOCS] or the regulator doesn't want the building society doing that, I'm losing out on the ability to continue to be in business to meet my capital requirements. There's only one outcome there that at some point I've failed to meet my capital requirements, which means I have to find a new home for myself or be resolved to be put into administration by the regulator. There is a big cost in that [CEO-14].

The commentaries indicate that the rigorous capital and liquidity requirements cause building societies to seek new ways to issue financial instruments which could be classified as core Tier 1 capital. Nationwide developed and issued CCDS to meet the compliance accountability and capital requirements of regulators. Small and medium-sized building societies have not issued and sold CCDS due to their limited capital and the lack of skills and resources available to develop and sell the financial instrument. Regulators are thus concerned about the ability of small and medium-sized building societies to raise capital in the event of financial distress and they have imposed greater regulatory demands on them. This arguably curtails the business development of small and medium-sized building societies.

The Enforcement of the Senior Manager and Certification Regime (SM&CR)

The PCOBS criticised the lack of personal accountability in the banking industry in which no individual board member was prosecuted from the failures of failed financial institutions during the 2008 banking crisis (HM Treasury, 2013). The Senior Manager Certification Regime (SM&CR) was introduced to place clearer accountability on individuals working in the financial services industry and it becomes effective on 7 March 2016 (Deloitte and Touche, 31st July 2014, FCA, 2015). The PRA asserted that:

> *The SM&CR has made people very uncomfortable in the sector because it is placing clearer accountability on individuals. Now, one of the things we saw in the financial crisis is people on the board would say, 'it wasn't my fault'. The organisation actually blew up but nobody on the board was to blame…The SM&CR will make people more accountable. We think the good building societies already have this accountability. Some of the small ones will have to adjust [REG].*

The SM&CR requires financial institutions to set out clearly the responsibilities of all staff other than those not involved in the provision of firms' financial services activities (such as reception, security, catering, cleaning). In the event of failure of a firm or a breach of banking regulations, enforcement actions may be brought against staff and senior managers who are responsible for the business areas the staff operate within. A number of directors are supportive of the SM&CR. They stated that it is a good approach by the regulators and policy makers to enhance director's accountability. For instance, an ex-director claimed that:

Obviously I met the people at T [a bank that collapsed as result of the financial crisis]. What the NED was saying is, 'no we didn't do anything wrong. We didn't do anything wrong at all'. We based our judgment and information that presented to us and it wasn't our fault, it was the financial crisis. It was beyond our control. So they all said the same things. Instead of saying, you know what, I was in charge of audit and therefore the audit has responsibility for the external auditors, we should have been looking at the growth, we should have been looking at what happen, if this happens, we should be raising questions, we should have been saying is our lending too risky [EXDIR-2].

However, most CEOs perceived the requirements of the SM&CR is more relevant for large and complex financial institutions and less relevant for small building societies that have a simple product range and limited number of employees. This was expressed by the following CEO that:

SM&CR is less relevant for building societies because we are smaller and simple businesses. If our businesses failed, it's my fault or one of the three executive directors. That's where the capabilities and responsibilities lie. In big organisation, you need it because it is less clear [CEO-11].

Directors also argued that the SM&CR would affect the roles and responsibilities of directors, managers and employees in discharging their duties, responsibilities and accountabilities:

It will be interesting to see how SM&CR settled down. Up to now, there are great balance and level of understanding in NEDs between strategic and operational decision-making. There is a temptation that SM&CR might make NEDs become more operational to try to understand more and to make themselves feel their personal risk is less [CEO-13].

It may also affect the behaviours of employees in terms of the financial services advice offer to customers. This according to a CEO may create an adverse relationship between building societies and their customer-members:

Staff will think if there is one in a million chance of being a problem, they are going to change their behaviours. So instead of taking the risks and trying to explain these products to you as customers, they are going to give customers the leaflets about it, and leave them be. They don't want the risks of having to explain that things might go wrong. So, that's not the relationship I want with

> *customers and I don't think that serve customers well. I think actually we are in danger of creating culture that through SM&CR that are slightly at odds with really what we are trying to do. We want to engage with customers, we want to sit and talk and understand about their issues and help them through the model of financial services [CEO-8].*

Therefore, the interview data indicate that the implementation of the SM&CR causes unease among the majority of directors due to the personal accountability, liability and risks that individual director and employee have to shoulder. It may also affect the process by which financial advice is provided to customers (Hyndman et al., 2002).

The Enforcement of Bank Surcharges, and Other Banking and Mortgage Regulations

The UK government imposed a bank levy on financial institutions' debts in 2011. [27] The bank levy was to encourage banks to move into less risky funding or borrowing profiles as well as to recompense government for the damage that banks caused to the economy during the 2008 financial crisis (HM Treasury, 2011). The UK government alleviated the bank levy, which will phase out in 2021, and introduced a new 8 per cent surcharge on banks and building societies with profits above £25 million per year effective 2016.

The surcharge imposes an additional regulatory cost to the top six building societies: Nationwide, Yorkshire Building Society, Coventry Building Society, Skipton Building Society, Leeds Building Society and Principality Building Society. The surcharge is estimated to cost an additional £1.7 billion to building societies and they may have to forego helping more individuals to finance their mortgages (The Telegraph, 6 Sept 2015). A CEO

[27] The bank levy on financial institutions' debts excluded borrowing backed by UK government debts, ordinary deposits covered by the UK's deposit insurance scheme, the first £20bn of any bank's taxable debts and long-term debts where financial institutions have already paid half of the tax rate.

commented that the bank surcharge represented a missed opportunity by the government to support diversity in the financial services sector as promulgated in the coalition manifesto:

> *We have to pay the bank levy. We are not a bank. We didn't cause any of the grief. We continued to lend throughout the crisis and yet we are still charged with the bank levy and tax surcharge. And actually that net cost of our organisation will go up quite significantly rather than down. I think that is a missed opportunity by the government [CEO-5].*

The interview data also reflects that regulations for savings and mortgage borrowings under European law are not sensitive to financial mutuals in the UK. Banking regulations are 'one size fits all' and do not take into account the different types and sizes of financial institutions. A CEO asserted that:

> *So we have this pile of new regulations which basically come in from Europe and some are not very proportionate. I understand that we need some regulations about European banks and since the UK is in Europe, it is subject to some of the European laws. If the regulations don't really work in the UK, the regulators are going to subtly change this. So we are just about to adopt the European Liquidity Standard, European Mortgage Regulations and Mortgage Credit Directives, which has no use to British lenders or customers [CEO-8].*

A similar view was expressed by another CEO that:

> *We have a new liquidity process that has been brought into the UK during 2010 and 2012 by the UK regulators. And then in 2015, the EU have come along and said we want to impose new liquidity standards on all firms in EU. Well, you are about three years late. The UK is actually going ahead of the game and got in place stuff that was working. And now the European and Basel Committee are not undoing, but they are adding up layers which are late and not helpful. They might be helpful to very large banks, but they are not helpful to small building societies [CEO-4].*

When the regulator interviewed was asked about the 'disproportion of regulations' in the banking sector and that building societies are not on a level playing field with banks, the regulator claimed that banking regulations are universal for global financial institutions. Some rules and regulations may have "*disproportionate effects on smaller banks and* *building societies. So, this doesn't just make towards the building societies but it is also disproportionate to small banks" [REG].* However, directors argued the intrusiveness of regulations and overemphasis of governance by regulators increases the fixed costs of business:

> *The FSCS levies cost us £72,000 a month. All of these things, internal audit and small stuffs cause a lot of money. All of that keep ramping up [CEO-9].*

A number of CEOs further added that intrusiveness of regulations put small and medium-sized building societies at a competitive disadvantage with banks:

> *I think there is a danger to small banks and building societies. They will be sort of forgotten in the regulations. You get to a point sometimes where you look at the regulations and you think, 'you know what, this is going too hard. It just gets too hard to do it.' They got so many constraints on this and that and it becomes helpless and difficult. Our mortgage department, I have 12 people that do the same work as 8 people did before because of different regulations of one sort or another. So how would the building societies do in the long run? I think they will gradually and slowly decline [CEO-8].*

The commentaries indicate that building societies have had to cope with intrusive regulations and greater corporate governance arrangements since the 2008 financial crisis. Small and medium-sized building societies found it challenging to compete with big financial institutions as resources are expensive and hard to secure.

8.5 Summary of the Chapter

This chapter analysed and discussed the external aspects of governance and accountability practices in the building society sector. More specifically, the chapter examines the external parameters within which building societies operate, such as the corporate social responsibility and accountability practices, the function and development of an external audit and the reformation in the legislative and regulatory frameworks since the 2008 financial crisis.

The study found that building societies appreciate that their businesses and the interests of communities from which their members are drawn are interdependent. Building societies engage in social and charitable causes in which their members and staff have an affinity. Many building societies also allow their staff to volunteer their time and expertise in local charities and good causes such as tree planting and running literacy programmes in schools. Building societies are motivated to engage in community-related activities, as being socially responsible and accountable are the core essence of building societies' mutuality values.

Despite the increasing efforts of building societies to be accountable to members, staff and local community, the failure of banks and building societies during the 2008 credit crunch has caused the UK government to strengthen the regulatory and legislative frameworks in the financial services sector. A number of new regulations were developed and have come into effect such as CRD IV, which requires banks and building societies to hold more capital and the SM&CR, which required individual directors and employees to be more personally accountable for their duties and responsibilities.

The PRA and FCA are also pushing for more formalized and professional risk management, and for controlling and reporting in all UK financial institutions. These governance requirements by the PRA and FCA increase building societies' investment in skilled staff, tools and new governance systems. They also heighten building societies' fixed costs and workloads as employees spend greater time discussing risks and governance-related matters with regulators and preparing more documentation for regulatory compliance. Small and medium-sized building societies find it onerous to cope and compete in highly competitive and regulated environments, as resources are increasingly hard and expensive to secure.

Although Hyndman and McDonnell (2009) and Spear (2004) contend that regulations are an important mechanism to control agency problems in mutual organisations, this chapter found that extensive regulations could downplay the values create by mutual organisations to their members. The study thus maintains that building societies should ensure that the achievement of their *compliance accountability* do not detract them from the achievement of their *financial-social dual, personnel and social accountabilities to members, employees, community and members of the general public*. Overall, the findings and analysis of this chapter and the insights discussed in the chapter 7 and chapter 8, have raised some public policy issues. These issues are addressed and discussed in the concluding chapter.

CHAPTER 9: Theoretical Contribution: Mutual Accountability Framework

9.1 Introduction

While chapter 6, 7 and 8 reported the empirical findings, the purpose of this chapter is to discuss the extended mutual accountability framework which is developed based upon the empirical findings and academic literature. The mutual accountability framework discusses in this chapter is an extension to the skeletal conceptual framework presented in chapter 3. The framework is also considered as a normative conceptual framework which reflects multiple accountability relationships between customer-owned mutual organisations and their key stakeholders.

This chapter is structured into three sections. Section 9.2 discusses the internal aspects of governance and accountability in mutual organisations and Section 9.3 elaborates on the external accountability relationship between mutual organisations and their external stakeholders. Section 0 provides the concluding remarks of the chapter.

9.2 Internal Aspects of Governance and Accountability in Mutual Organisations

While the skeletal framework presented in **Figure 3-1** shows the expected key stakeholders in mutual organisations include employees, regulators, customer-members, community, society and environment; the empirical findings indicate that the internal group of stakeholders include the board of directors (or board of trustees), executive directors (EDs), non-executive directors (NEDs), board committees and sub-committees. The relationships between these groups are key features to building societies' (and all mutual organisations) governance.

9.2.1 Mutual Organisations and Organisations' Vision and Mission

This research found that building societies have in place the internal, intermediate and external governance structures in achieving the *overall accountability (or mutual accountability) and the organisation's objectives and vision*. The next sections discuss the internal and intermediate governance structures which prevail in building societies and these structures are also deemed relevant and applicable to other mutual organisations.

Board roles, responsibilities and composition

According to Hyndman *et al.* (2002), there are three levels of credit unions globally: the nascent, transitional and mature stage of credit unions. The nascent stage credit unions are wholly run by volunteers and obtain financial aid from local authorities and other bodies. The transitional phase credit unions inevitably hire paid employees but retain volunteer directors, and mature credit unions are generally operated and run by professional staff and directors.

Unlike the credit unions, all building societies are at 'mature phase' and are run and managed by professional directors and staff. The governance of building societies is similar to public listed companies, where the directors are members of different committees, such as audit, remuneration, risk and nomination committees. The directors are also the customer-members and are subject to election or re-election. Members also have the rights to make decisions and express their feedbacks and opinions on products and services rendered through various means of intermediate governance structures (such as member panel, member forum, retail branches).

While the governance system in building societies have continuously been reformed and strengthened (and at the very least similar to corporations and public listed companies), nonetheless, there are limited guides and codes of conduct pertaining to elected representatives or a board of directors' roles and responsibilities in the mutual sector. Even without the clear code of guidance, it is expected that mutuals are run and managed by competent individuals who are capable to carry out their duties in a competitive commercial environment and improve the organisation's performance (Ebrahim et al., 2014, Rezaee, 2008). Internal control systems and governance structures are expected to be in place to facilitate proper decision-making and segregation of duties in mutual organisations. Organisations are also expected to be run and managed in the best interests of members, communities, societies and the general public (Birchall, 2013a, Birchall, 2011).

As mutuals are initially incorporated by customers, and to ensure that board of directors may better represent customers, it is expected that mutual organisations have in place customers' representation structures (normally described as intermediate/democratic governance structures). Various best practice literature suggests the intermediate governance structures in mutuals and co-operative include representative and participative structures. *Representative structure* provides elected individuals or a board of directors the authority to make decisions on behalf of members, but also to ensure that the appointed representatives are accountable for their actions. Most large-scale organisations have the representative structure in place. For instance, the UK Co-operative Group has in place the representative structure in which there are eight corporate member representatives on the board. At the same time, individual member-customers are allowed to be elected onto area committees and regional boards based on the area in which the member resides (Cooperative Group, 2007). On the other hand, *participatory structures* normally call upon members to participate in the decision-making process and provide their views and opinions on the products and services offering. However, major decisions are in the hands of board of directors.

Those in favour of participative structure argue that participatory practices could promote collaboration and cooperation among different competing groups of stakeholders (Ketilson and Brown, 2011). However, it is not the contention of this research to determine which structures are better over the others. This is primarily because both representative and participative structures have their merits and demerits. It depends upon the complexity, membership diversity and size of the mutual organisations when the structures are determined. Based on the empirical findings, both of these structures exist side by side. They play an equally important role in establishing meaningful opportunities for members to participate in the decision-making process and in the governance and accountability of their mutual organisations. Hence, no one control structure is inherently superior and each structure emphasises certain values that may or may not be important to a particular organisation.

It is also expected that *independent non-executive directors (NEDs)* should scrutinise the performance of management in meeting agreed objectives and monitor the integrity of financial information, the internal control systems, and the risk management systems of organisations (Solomon, 2013, Mallin, 2011). Birchall (2011, 2013) specifically claimed the roles of NEDs are paramount in mutual organisations in terms of monitoring and supervising executive directors. As members have a very limited role in monitoring and controlling management, the roles of NEDs are to represent members' interests, lending their skills and to monitor and supervise management similar to public listed companies. NEDs are also responsible for determining appropriate levels of remuneration of executive directors and have a prime role in succession planning, in terms of hiring and removing executive directors (UK Corporate Governance Code, 2010).

Board Size

An important element in mutual organisations' governance is also the number of members on the board of directors. Solomon (2013) claimed that the board of directors should consider the way to promoting efficiency is by having a balance of both executive and non-executive directors, as both groups brings different skills to the board. Diversity in the skills of the directors with different personalities and educational and occupational backgrounds could enhance the effectiveness of the board. However, boards of directors should not appoint "clones" as this would threaten the independence and soundness of board members (Van den Berghe and Levrau, 2004). In mutual and co-operative literature in Canada, the best practices literature suggests that an effective board should comprise between five and fifteen board members. It has been argued that a board should not be too big, as it would risk the lack of participation from all members of the board. There is also the risk that the board which is too small may lack diverse viewpoints and independent ideas. Consequently, there may be a lack of usage of the committees due to a lack of board members (Ketilson and Brown, 2011).

The academic literature and best practice code do not suggest 'one size fit all' to the number of board members in the mutual sector. This study suggests that to achieve effective governance and accountability, mutual organisations should not merely focus on the *size of the board of directors*. Instead, mutual organisations should concentrate on diverse skills, expertise and perspectives that can help to drive effective decision-making in the organisation. Size of board should depend upon the complexity, size and nature of the businesses.

Directors training and development

Additionally, it is expected that elected representatives and directors should continuously expose themselves to education and evaluation in order to enhance their existing knowledge and skills (Rezaee, 2008). Directors should generally increase their skills and knowledge through attendance of professional workshops, conferences, seminars, in-house training and reference to books and magazines among other things (Ketilson and Brown, 2011). Performance evaluation should also be performed formally and regularly through self-evaluation, independent committee evaluation (e.g. risk committee, audit committee) or appointment of consulting firms (Rezaee, 2008). Proponents of directors' evaluations claimed that this practice helps to refresh board members' understanding of their roles and responsibilities, identifies areas for improvement and serves as a useful tool for nominating committees in their recruitment efforts (Ketilson and Brown, 2011). Specifically, in certain mutual sectors (such as credit unions), some of the elected representatives are elected among lay individuals or non-professional individuals. In order to ensure that the knowledge and skills of these individuals could be enhanced, it is expected that the 'lay board members' are continuously exposed to education and evaluations. The top-right hexagon in **Figure 9-1** depicts the governance and accountability mechanisms which aid to achieve mutual organisations' vision and missions and mutual accountability (in which the thesis argues to include financial-social dual accountability, personnel accountability, compliance accountability and social accountability).

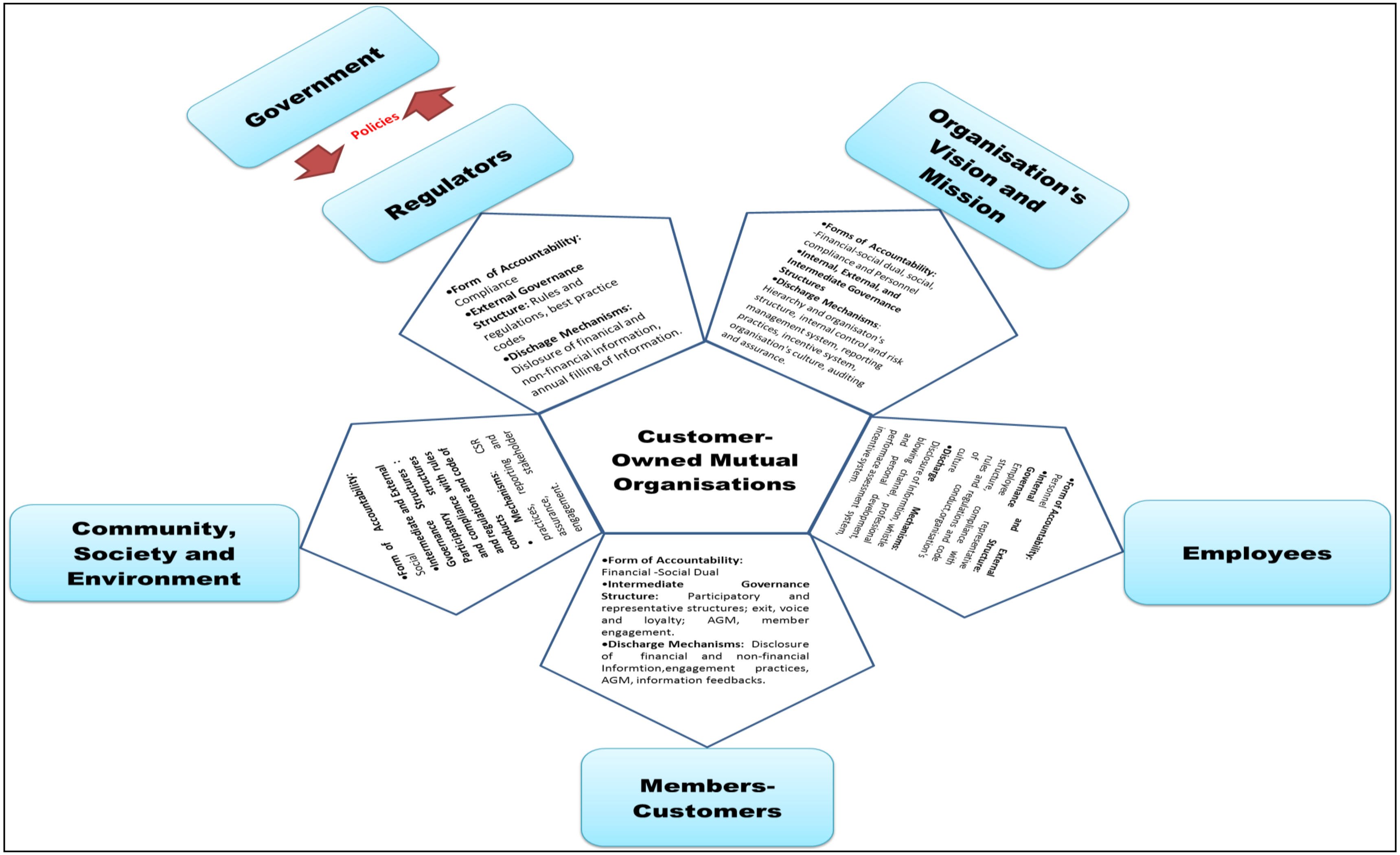

Figure 9-1: Mutual accountability framework and governance and accounting mechanisms (Source: Author)

9.2.2 Mutual Organisations and Employees

It has been found that building societies are run and managed by professional individuals from diverse background such as banking, accounting and surveying. In order to attract and maintain competence individuals in the industry, building societies provided personal and professional development courses, engage with employees to obtain employees' feedback and provide workplace pension schemes, holidays, bonuses and health care benefits. All building societies also recognise diversity, ethnicity and different sexual orientation. Consideration is given to applications for employment from a range of backgrounds and diversities.

With respect to this, all mutual organisations are expected to ensure the expectations of employees are satisfied and employees are well trained so that they are knowledgeable enough to provide new ideas, new projects and new innovations to compete with other businesses. Mutual organisation is expected to achieve *personnel accountability* by providing employees with minimum wage rates, a safe and healthy working environment, an equal opportunity working environment and there should be processes in place to foster whistle blowing. Alternatively, mutuals may have employee representatives' structure to share their professionals' and members' welfare (as some branch staff have greater contact with the customers). Employees are also expected to be held accountable for the jobs and work for which they are responsible. If employees fail in meeting their expected job performance, employees can be reprimanded and employees will be terminated. Internal performance appraisal is a common mechanism to gauge employee progress, development towards and accountability to the organisations' core vision (Ebrahim, 2003a, Fairbairn, 2003).

9.3 Mutual Organisations and External Stakeholders

The above sections have outlined the internal accountability relationship between mutual organisations and their internal stakeholders as well as the internal aspects of governance structures. The next sub-sections discuss three possible groups of external stakeholders—member-owner-customers, the community, society and environment, and regulators—which each of these individuals can be classified as being part of a specific stakeholders group with relatively similar interests and expectations regarding the organisations (although not all relationships are defined).

9.3.1 Mutual Organisations and Member-Customer-Owners

The empirical findings reflect that mutual organisations have dual *economic and social goals* to their customers. Individuals invest capital and time, and become members of such organisations for social purposes, financial purposes, or a mixture of both. In term of *financial objective*, customers support building societies mainly because the enterprises' help makes them better off, by fulfilling their needs and providing greater returns to them in terms of a better rate of products and services (Mook et al., 2007, Fairbairn, 2003). More specifically, some customers obtain loans from building societies mainly because the organisations provide better savings rates and mortgage rates than mainstream banking like Lloyds Bank, NatWest and Santander (Michie and Blay, 2004, Michie, 2005).

Apart from the 'economic goal', there are less opportunistic and more collective reasons which led some customers to support mutual organisations. The study found that members share *'common bonds'* among themselves. In some ways, members are aware that they are connected to their building societies and communities, and the building societies and communities have a connection to each other. Local pride, local identity and competitive prices (but not necessarily the lowest price) are important matters to customers. This is similar to the findings by Birchall and Simmons (2005) and Simmons and Birchall (2004) who also found that one of the reasons 75 per cent out of 448 members of the UK Co-operative Group participated in their co-operative's operational activities is primarily because they believed that their participation in the firms activities "benefits the [UK Co-Operative Group] group as a whole". Most of these member-participants considered that collectivist thinking of other members was vital. "Individualistic incentive was not necessarily unimportant, but it was secondary" (Birchall, 2013a, p.177).

With respect to this, mutual organisations generally have dual objectives or two types of accountabilities to customers. This research concludes that *financial-social dual accountability* as a form of accountability which is expected from customer-owners. Financial-social dual accountability is defined as an accountability in which the achievement of mutual organisations' financial and social objectives to customer-members arises side by side. This means that mutuals are expected not diverge away from their social purposes and mutual aids to their customer-members while they are in their pursuit of profits.

In order to discharge financial-social dual accountability, proper mechanisms should be in place to measure the quantitative performances, output and outcomes such as accounting measures (budgetary accounting, sales, profit, return on investment and any other formal accounting mechanisms that would measure and quantify the achievement of the financial performances and outcomes) and market measures (e.g. market value, share price, return on equity). This is primarily because the identity of customers is similar to investors in investor-owned firms. Mutual organisations are, therefore, expected to transparently provide financial and non-financial information to customers, engaging with customers and allowing customers to provide feedback to the business (Ebrahim, 2003a). This is to ensure that customers cum investors have the opportunity to continuously evaluate the firm's performance and to hold management accountable for its actions and decisions.

While mutual organisations may have instruments in place to quantify their financial accountability, however, they may experience challenges in calculating and measuring the achievement of the social dimension of the financial-social dual accountability. The study has found that it is difficult to compute and assess social performances in building societies. Some building societies utilised disclosures of non-financial information to enable these individuals to evaluate a firm's non-financial performances or engagement with customer-members to discharge their social accountability.

Therefore, the establishment of social indicators and benchmarks for computing social performance is still in its infancy in most hybrid organisations such as mutual organisations (Mook et al., 2003). Fairbairn (2003) argues that, it is paramount for mutual organisations to have in place mechanisms which would enable the organisations to convey the achievement of their social purposes and mutual aids. If customers and the general public perceive that mutual organisations achieve the organisations' inherent mission and mutual aids, they would continuously support and trust the organisations (Fairbairn, 2003, Fonteyne, 2007). A mutual organisation is arguably more successful when customers are able to trust it and when they perceive that it is an effective agent for themselves (Birchall, 2002, Birchall and Ketilson, 2009).

The study maintains that while mutual organisations are able to compute their financial performances and discharge their financial accountability through accounting measures, intermediate or democratic governance structures could facilitate the achievement of financial-social dual accountability. These include the representative and/or participative structures and mediums to receive feedback about products and provision of services from customers. The annual general meeting (AGM) is also considered an important means in which mutual organisations can discharge and facilitate the achievement of accountabilities to members (Ketilson and Brown, 2011, Cooperative Group, 2007, Leadbeater and Christie, 1999). Apart from the AGM, mutual organisations should employ a number of means to facilitate communication with their members. These include members' meetings (i.e. other than the AGM), focus groups, questionnaire surveys, road shows, site visits, newsletters, complaint letters and websites and retail branches among others (Leadbeater and Christie, 1999). Communication between directors, managers, staff and members is to build a relationship between elected representatives and members, promote democracy and arguably, strong communication to "facilitate and maintain members' loyalty and identification" with their mutual organisation (Ketilson and Brown, 2011, p. 20).The downward hexagon in **Figure 9-1** reflects the *financial and social dual accountability* expected by member-customers of mutual organisation and the accounting mechanisms in achieving the accountability.

9.3.2 Mutual Organisations and Community, Society and Environment

In the corporate social responsibility literature, there has been the argument that private firms do not have any responsibility to other stakeholders apart from shareholders. This perspective is based on Milton Friedman's notion that individuals elected to run the corporation on behalf of the owners are "to make as much money as possible" for the owners (Friedman, 1970, p.173). The corporation does not have to be socially and environmentally responsible and accountable, but the state is supposed to use its legitimate taxing function to raise money to fulfil these duties. The increases in a corporation's economic wealth are also perceived to be the increases in society's wealth (Avi-Yonah, 2008).

Nevertheless, Banerjee (2008) and Gray (2010) argue that corporations should think beyond financial accountability and pay attention to social and environmental issues, act ethically and demonstrate the highest level of integrity and transparency in all their operations. Corporations should contribute to the community in which they operate in terms of enhancing social welfare and providing community support through philanthropy or other social means (Carroll, 1991, Carroll and Shabana, 2010). This is chiefly because the state creates corporations by granting the royal charters for the incorporation of a corporation (see e.g. Banerjee, 2008, Bakan, 2005). When a corporation is created, an implicit contract is formed between corporation and state. The state has granted a corporation with particular privileges, such as a legal personality and rights to own properties. The corporation, in return, is to utilise the privileges granted to them to fulfil certain objectives that the state would like to achieve. This includes engaging in activities which would help to mitigate social and environmental harms that the corporation is responsible for, even when the corporation has no direct legal responsibilities or when the activities do not benefit the shareholders (Avi-Yonah, 2008).

In this study, it has been found that building societies are responsible and accountable to wider constituents, apart from their customer-owners. Most regional building societies are generally incorporated in local communities to support and help out individuals who are in need of their services. Being socially responsible and accountable to local communities and the environment are ingrained in the ethos of building societies. Building societies discharge their *social accountability* through CSR practices, disclosure of social responsibility information, and engagement with community and societies in order to understand desire community activities.

The thesis maintains that similar to private firms, it is critical for mutual organisation to be socially responsible and accountable to community, society and environment. The mechanisms which could be utilised by mutuals to achieve social accountability include sound governance system, engaging in CSR practices, disclosures and assurance of social responsibility information, and engagement with community and members to identify possible charitable causes and community related activities. The left hexagon in **Figure 9-1** reflects the accountability mechanisms which could be utilise to achieve and discharge *social accountability* to community and societies.

9.3.3 Mutual Organisations and Regulators

Similar to any business, all mutual organisations are subjected to varying degrees of regulations and they are expected to comply with all rules and regulations. Regulations are considered to ensure mutuals achieve effective governance and accountability (Hyndman and McDonnell, 2009). It has been found in this study that most members cum owners of building societies have a very limited role in monitoring and controlling the elected board of directors. Members generally withdraw from the membership if they are dissatisfied with the way building societies operate. The consequences of limited monitoring and control from members could lead elected representatives to have greater freedom of actions in running the organisation at their own discretion (Spear, 2004). In this regard, regulations are an important governance instrument to control the behaviours and actions of management and to enhance the confidence of multiple stakeholders (Hyndman and McDonnell, 2009). If individuals such as customers and members of the public believe that government is supervising the organisations effectively, they will perceive the chances of management opportunism to be reduced. This will ultimately increase the members' level of confidence, as well as other stakeholders, on the safety and soundness of mutual organisations (Fonteyne, 2007).

It is maintained in this thesis that external governance mechanisms, such as laws and codes of conduct, are the mechanisms to foster the achievement of *compliance accountability*. The discharge of compliance accountability entails mutuals to account for how rules are adhered to, through disclosure and submission of detailed information to regulatory authorities.

Mutual organisations in the UK are subjected to 'comply or explain' with the UK Code of Corporate Governance and comply with industry and trade regulations (e.g. the *Building Societies Act 1986* and the *Credit Union Act 1979*), accounting standards and regulations (e.g. IFRS, UK GAAP), competition laws, and European Union regulations (e.g. Basel III). Compliance with rules and regulations (or *compliance accountability*) requires mutuals to file annual returns and information to the FCA, PRA, Inland Revenue and other authority bodies. Compliance accountability is the most unambiguous type of accountability and can be quite invasive. It may potentially threaten to dominate and reorient the underlying operations and objectives of mutuals (Hyndman and McDonnell, 2009, O'Dwyer and Boomsma, 2015).

9.4 Summary of the Chapter

This chapter discusses the mutual accountability framework which developed from the empirical findings and academic literature. The mutual accountability framework discusses in this chapter is considered as a normative conceptual framework that are deemed relevant in understanding and evaluating the governance and accountability practices in mutual organisations.

CHAPTER 10: Summary, Reflections and Conclusion

10.1 Introduction

This chapter summarises and discusses the empirical findings of the thesis and provides a conclusion to the study. The chapter is structured into eight main sections. Following the introduction, Section 10.2 reflects on the key findings of the thesis. Section 10.3 and Section 10.4 provide reflections on the methodological issues and reflections on conducting this academic research respectively. Section 10.5 highlights the contributions of the thesis and Section 10.6 discusses the implications of the study. Section 10.7 delineates the limitations of the study and proposes recommendations for future research. Concluding remarks are discussed in Section 0.

10.2 Reflection on the Governance and Accountability Issues in UK Building Societies

This research concludes by considering the research objectives and aims of the thesis. First, the research seeks to examine the current governance systems in achieving accountability in UK building societies. More specifically, the thesis investigates the responsibilities of the board of directors, the processes by which members and other stakeholders are accounted for, the roles of regulators and auditors, and key governance and business challenges encountered by building societies since the 2008 financial crisis.

The findings reveal that the industry's internal, intermediate (or democratic) and external governance structures have positively transformed since the 2008 financial crisis with a positive impact on mutual accountability. Coercive pressure and the desire to be more accountable have led building societies to strengthen their internal governance systems. The majority of building societies have improved on the composition, diversity and skills of their board members with individuals who have knowledge in IT, financial services, risk management and treasury. All building societies are using formal means to recruit directors through advertisements, consulting firms, accounting firms and headhunters. The customary appointment of NEDs from close friends of executives, which perversely existed before 2008, has been reduced. NEDs are considered more independent, accountable and knowledgeable. Furthermore, the building society sector has strengthened its risk management models by establishing the best practices risk management framework—the three lines of defence model—in achieving sound governance. Directors' remunerations and NEDs' fees are also more thoroughly reviewed, determined and approved by the board of directors.

Member engagement also remains at the forefront of the governance agenda in building societies. Intermediate governance structure, which is a unique governance mechanism for mutual organisations in achieving democracy and mutual accountability, is mobilised by building societies in order to enhance interactions with members. Among these include the use of member forums, member councils, retail branch networks, newsletters and roadshows, among others. Members interviewed stated that they were satisfied with the communications and interactions they had with their building societies. However, similar to the findings of Birchall and Simmons (2004), Spear (2004) and Birchall (2013), most of the customer-members have limited interests in the day-to-day operations and governance matters of their mutual organisations. Most members are largely value-for-money driven, with regards to the products and services offered by building societies.

Despite building societies’ increasing efforts to enhance their mutual accountability and developing more meaningful relationships with the members, recent regulatory reforms in the banking sector have continued to pose challenges in the governance and long-term performances of regional building societies. Evaluations of the regulatory and legislative frameworks suggest that the improvements in banking regulations such as CRD IV and SM&CR do not distinguish between different types and sizes of financial institutions and they are ‘one size fits all’. The FCA and PRA also require more formalized and professional risk management frameworks, and greater reporting from all UK financial institutions. These, therefore, increase the costs and workload for many regional building societies, because managers and employees have to prepare more documentation for regulatory compliance and to discuss business risk and governance-related matters with regulators. Regional building societies specifically found it onerous to cope with and to remain competitive in what is already a highly competitive and regulated environment, as resources are increasingly hard and expensive to secure.

While the majority of building societies responded positively to the additional regulatory requirements to improve their accountability, a few building societies took it as a box ticking exercise without due regard to the actual substance of compliance. The study found that board committee structures in some regional building societies are created to meet superficial requirements of the regulators, and the best practice risk management framework—the three lines of defence model—was not implemented with the essence of sound governance. The disclosure of voluntary information in the annual reports of the building societies (such as reports by chairperson and CEO, the CSR and corporate governance statements) were also inconsistent across the sector. Some building societies did not provide in-depth information in the reports and mainly disclosed limited information with short statements. These are mostly due to size of building societies.

Moreover, the building societies are exposed to the challenges of finance technology in financial services. It can be seen that the demographic of building societies' customers is predominantly from the older generation and the majority of 'younger and technology-savvy' customers have opted for virtual banking. Regional building societies are experiencing greater hurdles in converting their distributions channels to finance technology.

An assessment into the current structures of the financial services industry shows that the 2008 financial crisis had prompted the UK government to promote diversity and competition in the banking sector. We witness an increasing number of banking licenses being issued to new financial institutions (The Telegraph, 9 August 2016). Long-established banks such as Natwest, HSBC, Lloyds, RBS and Santander have priced their savings and mortgage products more aggressively in response to that. Building societies are, however, exposed to undertake more risk lending and to force up their risk curve in order to operate and compete with banks. Overall, the reform in financial services sector post-2008 financial crisis has led building societies to be more accountable and of responsible to their members and other stakeholders.

10.3 Reflection on the Methodological Issues

This research adopts the methodological approach introduced by Richard Laughlin, middle-range thinking (MRT) (Broadbent and Laughlin, 2014, Laughlin, 2004, Laughlin, 1995). MRT maintains the hybridised ontological and epistemological assumptions of interpretivist and positivist. Laughlin (1995) contends that the approach to engage with social phenomenon cannot be operated with a minimal intrusion of subjectivity (as in positivist) or a very individualistic set of subjective processes (as in interpretivist). Instead, MRT argues the significance of structures around a subjective process of discovery. 'Skeletal' theory provides a scope to the qualitative researcher to explore the social world (Broadbent and Laughlin, 2014).

This study considers the governance and accountability practices are socially constructed and influenced by the key players. Knowledge and truth are obtained by studying and understanding key players' contexts, meanings, narratives and accounts about their governance and accountability processes (Willis, 2007, Hallebone and Priest, 2009). The mutual accountability framework serves as the conceptual framework of this research. The mutual accountability framework has been developed based on ideas from studies by Hyndman and McDonnell (2009), O'Dwyer (2005), O'Dwyer and Unerman (2007), O'Dwyer and Unerman (2008) and O'Dwyer and Boomsma (2015) and Najam (1996), who, based on nascent charities and NGOs' literature, have developed the theoretical framework of their research. The mutual accountability framework aims to explain and explore the governance and accountability matters in emerging literature in mutuals and building societies. The framework also affords scope and structure to the research in terms of themes and issues to be explored and investigated (Llewelyn, 2003). The framework defines all major accountability relationships between mutual organisations and their stakeholders and the accounting mechanisms used to achieve these accountabilities. Examining all the accountability relationships based on the framework aids in understanding the holistic governance and accountabilities issues in the building society sector (Najam, 1996).

Furthermore, the research interviewed directors of building societies. It is recognised that directors may give particular accounts on issues which may not be shared by other stakeholders, due to their social positions. Interviews were therefore conducted with other stakeholders: ex-directors, an auditor, a regulator and customers. The interview data are also triangulated with evidence from documentary analysis and non-participant observation. Although this research intended to interview a greater number of regulators and auditors, the researcher experienced difficulties in securing more interviews with these key actors. The analysis on all interview data shows that no major discrepancies exist in the accounts provided by different interviewees.

10.4 Personal Reflection in Conducting This Academic Research

I was initially skeptical of the relevance of the customer-owned ownership model of building societies. Professional reports, HM Treasury reports and newspapers indicated that building societies are similar to banks. They were subjected to board mismanagement, engaging in accounting fraud and failed during the 2008 financial crisis (see e.g. HM Treasury, 2009, 2014). I was therefore motivated by these reasons to examine the governance and accountability practices and issues in UK building societies. It has been found that building societies continuously strengthened their governance and accountability systems. The industry creates employment and social benefits and impacts to customers, communities and members of general public. I was indeed surprise by these findings as my prior conceptions about the building societies were that the sector was not democratically-owned and accountable to their members and other stakeholders, and directors and senior managers were accountable to themselves.

Moreover, conducting this academic research is challenging, yet rewarding. At the beginning of this doctoral study, it is challenging for me to understand the historical movement of building societies, as I have limited background and understanding on the context. The whole research process is rewarding when it changes and develops my intellectual thinking and personal skills.

This doctoral study has also taught me that carrying out academic research requires the desire to seek new knowledge, patience, perseverance, openness to criticisms and sacrifice of personal time. It is common for researchers to encounter rejections and criticisms from the scholarly and professional communities. I found that the research process is exhilarating and fruitful when I am open to new possibilities and knowledge, and believe in the ideas that I am advocating. Overall, this academic process has developed my intellectual thinking and personal perspectives about social phenomena and academia.

10.5 Contributions of the Thesis

This research makes a number of empirical and theoretical contributions to the literature, which are outlined in detail in this section.

10.5.1 Empirical Contributions

This thesis adds to the limited but much needed research in the governance and accountability of mutual organisations and building societies (see e.g. Shaw, 2006, Gray et al., 2014a, Solomon, 2013, Spear, 2004, Cornforth, 2004, Cornforth, 2002, Brennan and Solomon, 2008, Gray et al., 2014b). As far as the researcher is aware, no study has been conducted on governance and accountability issues in mutual organisations in the UK. There are a few government reports, white papers, and professional reports which have reported on the topic in failed financial institutions and insurance companies. This is, therefore, the first comprehensive research examining and analysing the practice of governance and accountability in building societies since the 2008 banking crisis. Such analysis contributes to the literature by providing empirical insights from a mutual organisation in an advanced economy country, which can be used for other comparative studies.

This research also provides another empirical contribution in terms of the views provided by—and issues discussed with—executives, non-executives, ex-directors, an auditor, a regulator and customers of building societies. A number of previous studies have focused on examining the effectiveness of the governance and accountability practices in credit unions from the perspectives of managers and/or regulators (see e.g. Hyndman et al., 2004, Hyndman and McKillop, 2004, Hyndman et al., 2002, Ketilson and Brown, 2011). To the knowledge of the researcher, no research has been conducted regarding the views of multiple stakeholders such as executives, non-executives, an auditor, a regulator and customer-members, when evaluating the holistic governance issues in mutual organisations. This is the gap in the literature which this study has comprehensively examined.

10.5.2 Theoretical Contribution

A number of scholars have used agency theory, stewardship theory and democratic theory to explain the governance and accountability issues in mutual organisations and co-operatives (see e.g. Adam and Armitage, 2004, Spear, 2004, Cornforth, 2004, Cornforth, 2002). However, these theories examine one dimension of the accountability relationship between the board of directors and customers cum members (Cornforth, 2002, 2004). This study revealed that all types of economic entities have responsibilities and accountabilities to a wider group of stakeholders who are directly and indirectly affected by the organisation’s actions and activities (O’Dwyer and Unerman, 2008, Gray et al., 2006). Accountability is a dynamic and multifaceted concept and consists of various forms (Stewart, 1984, Sinclair, 1995, O'Dwyer and Boomsma, 2015, Messner, 2009). Due to a lack of empirical works on mutual organisations, this research develops a normative mutual accountability framework in exploring and examining the governance and accountability issues in mutual organisations. The framework conceptualises multiple forms of accountabilities—financial-social dual, compliance, personnel and social accountabilities—the processes, rationales (i.e. for what, to whom, how and why) and how internal, intermediate and external governance structures foster the achievement of accountability (Ketilson and Brown, 2011, Pellervo, 2000). Thus, the framework is useful to study issues in context that are emerging but not well theorised, and also to provide a holistic overview on the governance and accountability disciplines in mutuals (O'Dwyer and Unerman, 2008, Najam, 1996).

10.6 Implications of the Study for Practitioners and Policymakers

This study sought the views of multiple stakeholders in the building society sector pertaining to its current governance and accountability practices. The findings of this research may therefore be of interest to directors, governmental agencies and regulators.

It is suggested to *policy makers and Members of Parliament* that the benefits of the existence of building societies outweigh their non-existence to consumers. The government should recognise the benefits created by mutuals and ensure that policies, rules and regulations which are developed are sensitive to financial mutuals and to different sizes of financial institutions. Disproportionate regulations reduce the potential benefits that building societies create for their members, as increasing efforts have to be invested for regulatory compliance (Hyndman and McDonnell, 2009, Birchall, 2013a).

Furthermore, it is suggested to the directors and practitioners in the building society sector that in any businesses, good leadership and management are the pinnacle of success within the organisation. The findings show that building societies which failed during the 2008 financial crisis were due to weak board of directors, business strategies, risk management and internal control systems. Although the current directors who were interviewed understand their roles, responsibilities and accountabilities, the majority of owner-members have a limited understanding of, interest in and control of the business. Directors of building societies may therefore have greater opportunities to manage the businesses for their personal interests. It is suggested that directors of building societies should ensure that decisions they make are in the interests and long-term benefit of members. Boards should undertake risks that are within the remit of their expertise and understanding. NEDs should also properly play out their roles in monitoring, controlling, challenging and providing constructive feedback to management as well as engaging with members in order to understand their needs and demands.

This study also suggest that building societies should continuously be transparent in their conduct by presenting truthful information to members, regulators, societies and members of the general public (Koppell, 2005), and have in place structures which facilitate members' evaluation of and enquiry into the performance and operations of the business. It is convenient for members to take their mutual organisation for granted and lose sight of the reason for their being, after a period of time (Fairbairn, 2003). In order to succeed, it is necessary for building societies to continuously develop and maintain their members' loyalty and trust against growing competition. This could be done by understanding the needs of members, delivering products which meet their expectation and being transparent to members in terms of business conduct and operations (Koppell, 2005, Fonteyne, 2007, Fairbairn, 2003). Fairbairn (2003) also suggests that building societies should continue to leverage their roots of mutuality by highlighting the difference between themselves and banks, assisting local communities and customers, and ensuring that customers consider the relevance of building societies operating in the financial services sector.

10.7 Limitations of the Study and Suggested Areas for Future Research

This study is subject to a number of limitations. Interviews with customers cum members have shown that members are not interested in the day-to-day operations of building societies. Most members are mainly interested in forming a customer and saving-and-mortgage-provider relationship with their building societies. Ineffective member engagement may cause the board of directors to be self-perpetuating (Birchall, 2013a). Future research may survey and seek a large number of members' perceptions on approaches that building societies could undertake to improve members' participation and to empirically examine the conceptual construct of Birchall and Simmon (2004) and Birchall (2013) on the factors that could enhance members to participate in their co-operatives and mutuals.

Furthermore, this study is context specific and mainly focuses on the governance and accountability issues in the UK building society industry. The findings of the study may not necessarily be applicable to another type, size or nature of mutual organisation, or to consumer co-operatives such as credit unions, friendly societies and the UK Co-operative Group. Future research may investigate different types and sizes of mutuals or co-operatives in developed or developing countries, as different mutual organisations and co-operatives have different historical movements, governance and accountability issues to be investigated (Michie, 2013, Gray et al., 2014a, Birchall, 2013a).

In addition, the study has found that there are differences in the organisational governance practice linked to size and geographical area. It is recommended that future studies use case study approach to compare and examine in detail the governance and accountability practices between small and large, and/or regional and national building societies. It is cautioned that this may subject to the accessibility of the data, as the researcher has experienced difficulties in gaining access to any building society to conduct a case study.

Of particular interest, the study also recommends that future research to examine how different forms of accountability manifest themselves in the building society sector and other mutual organisations. As building society and mutual sector has long-established-history, examination on the emergence, development and effects of different forms of accountability would enhance our understanding of how accountability processes operate in this important and influential context.

10.8 Summary of the Chapter

This thesis has examined the development of building societies and the extent of their current governance system in achieving accountability. The evidence shows that the state of building societies' governance and accountability practices have been strengthened since the 2008 banking crisis. Building societies are aware of the importance of the bilateral relationship between governance and accountability, in which governance affects the achievement of accountability and accountability bolsters governance. Many initiatives have been undertaken by the sector to improve their internal governance structures, such as the development of directors' skills and education, risk management and internal control structures, directors' remunerations and the level of disclosure and transparency. Members' engagement also remained significant for many building societies in which intermediate (or democratic) governance structures, such as retail branches, member forums, member panels and roadshows are in place to discharge financial-social dual accountabilities to members. Nevertheless, new capital and liquidity requirements under CRD IV and banking regulations such as BSOCS and SM&CR increase the workload and operational costs of regional building societies. These pose challenges for the governance and longer-term performance of these building societies.

In order to maintain confidence in the building society movement, improvement in governance seems essential. Indeed, such improvements could be viewed as necessary for the stability and growth of the sector. However, support and guidance by Members of Parliament, policy makers and the PRA and FCA are likely to encourage better growth, governance and accountability in the sector—and overall, a stronger legacy. This thesis urges future research to investigate the governance and accountability disciplines in different mutual and co-operative sectors in different countries, as the subject seems emerging, yet still very much under research.

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Appendices

Appendix 1: Invitation Letter

16 October 2017

Dear Sir/Madam,

<u>Invitation for PhD Research Participation</u>

My name is Sue Chern Ooi. I am a PhD student from Essex Business School, University of Essex. I would like to request the opportunity to carry out an interview with yourself on the subject of governance and accountability practices within mutual organisation, with specific focus on the building societies in the UK. I am conducting a series of interviews with key informants drawn from various building societies, government, regulatory bodies, and members with the hope to gather insights on governance and accountability issues that are not available via other sources.

The purpose of the interview would allow me to collect qualitative information for my PhD research that focuses on how governance, accountability and mutuality is constituted in the UK building society sector. This is a very significant area of research, especially given that prior to the 2007/2008 financial crisis, there was doubt and scepticism towards the building society sector. Nevertheless, most of the building societies weathered the credit crunch better than the shareholder-owned banks. The adverse risk approach and mutuality model of the building societies are claimed to have prevented the building societies from diversifying and expanding their operations into risky financial activities. Therefore, I believe that by discussing such matters with yourself and other managers, I will be able to obtain a comprehensive assessment of your views on the subjects. Without your participation, a crucial input to my PhD research would be missing with adverse consequences for its credibility.

I envisage taking about 60 minutes for an interview. All material gathered will be treated as confidential and references anonymised so that the sources are protected. If there are other restrictions, I am more than happy to discuss them with you.

I really appreciate it if you could spare me some time in order to share your knowledge and expertise. As you might expect, I am flexible to meet. However, I am planning to carry out all the interviews between August 2015 and October 2015.

Should you need any further information or clarification prior to making arrangements, please do not hesitate to contact me via email (scooi@essex.ac.uk), or my supervisor's email, Dr Pik Liew (pliew@essex.ac.uk).

Your contribution is vital to the success of this study and would be greatly appreciated. Thank you for taking the time to consider my request. I look forward to hearing from you.

Yours sincerely,

Sue Chern Ooi
PhD Candidate
Email: scooi@essex.ac.uk
Mobile no:

Appendix 2: Initiation Email

Dear XXX

Hope this email finds you well.

My name is Sue Chern Ooi, a PhD student from Essex Business School, University of Essex. I am writing to invite you to participate in my PhD research entitled "Corporate Governance, Accountability and Mutuality within a Financial Mutual : The UK Building Societies".

For your information, I have reviewed and analysed the building societies documents which are available online and other academic documents relating to them. As part of my PhD research now, it is important for me to seek some opinions and views on the corporate governance and accountability practices and matters within the UK Building Societies. This is a very significant area of research given that prior to the 2007/2008 financial crisis, there were doubts and skepticism towards the building societies sector. Nevertheless, in the wake of the credit crunch, this school of thoughts was challenged as most building societies survived the crunch better than the shareholder-owned banks.

Due to its increasing importance and little is known about the building societies, I would really appreciate it if you could spare me some time to share your views and knowledge regarding some of the governance and accountability practices and issues in this sector. The discussion shall be guided by an interview guide, and is expected to last for about 45 minutes to one hour. I can assure you that there is no right or wrong answers, and you are free not to answer questions that are not relevant.

Ethically, it is my responsibility to keep your name and your organisation anonymous. I assure you that all the information provided will be kept strictly confidential and secured, and would only be accessible by me or my supervisors. In return for your support, a copy of the information which we record about you will be provided on request.

I fully understand that you may have a very tight schedule and therefore, I am happy to meet you whenever you are available, anytime from Aug 2016 to September 2016. However, if you are not available, I shall be happy to meet you after this time frame. If you are happy to meet, please let me know the person whom I can liaise with, to arrange for our mutually convenient time and date.

Should you need any further information or clarification prior to making arrangements, please do not hesitate to contact me via email (scooi@essex.ac.uk), or my supervisor's email, Dr Pik Liew (pliew@essex.ac.uk).

Your contribution is vital to the success of this study and would be greatly appreciated. My apologies if this request causes any inconvenience

I look forward to hearing from you.

Warm regards,

Sue
PhD Candidate
University of Essex
Mobile no:

Appendix 3:Informed Consent Form

By signing this form I am attesting that I have read and understand the information below and I freely give my consent to participate in the research entitle **Governance, Accountability and Mutuality Within A Financial Mutual: The Case of UK Building Societies,** conducted by Sue Chern Ooi.

I understand that:

1. The aims, methods, anticipated benefits, and possible risks of the research study, have been explained to me.
2. My participation is voluntary and that I am free to withdraw and discontinue participation at any time without (or with) reasons.
3. The researcher will not identify me by name in any reports using information obtained from this interview, and that my confidentiality as a participant in this study will remain secure. Subsequent uses of records and data will be subject to standard data use policies which protect the anonymity of individuals.
4. Neither the names of my colleagues nor the names of any organization mentioned during this interview would be made public.
5. The findings of the research will be used for research purposes and may be reported in academic journal.
6. I have the right to allow the interview to be audio recorded and to request for the interview transcript, if necessary.

I agree that [*Please delete as appropriate]

7. I DO/ DO NOT* require an opportunity to check the factual accuracy of the research findings related to the organisation.
8. I EXPECT/DO NOT EXPECT* to receive a copy of the interview transcript

I hereby acknowledge that I have read and understand the explanation provided to me and voluntarily give permission to participate in this study.

Name of Participant	Date	Signature

Appendix 4: Template of Interview Guide		
Themes	**Questions**	**Insights Expected**
Demographic Details	1. What motivated you to run for the board of the building societies? (CEO/ED, Ex-ED, NED, BSA) 2. Why don't we get started with you telling me some background information about yourself as the member of the UKBS? (MB) ➢ What type of account do you hold? ➢ How long have you been a member of the UKBS?	• To conform the demographic details of the interviewees.
The role of the UKBS, conceptualization of mutuality and core principles of the UKBS (CEO/ED, NED BSA)	1. What does mutuality mean to you? How has it changed over the years? 2. How is value being created for members? 3. Do you think the idea building societies for societies are still applicable and relevant in the society? Why do you say so? 4. What are your organizational philosophies toward profit and commitment to communities/social responsibilities? 5. What motivates your organization to get involved in the social responsibilities activities?	• To understand the role the UKBS plays in the societies • To understand the way mutuality is being conceptualized and why it is being perceived in such way • To understand the underlying reason for social responsibilities in the building societies
Conceptions of governance	1. What do you understand of the term governance and	• To understand the nature of governance practices in the

Appendix 4: Template of Interview Guide		
Themes	Questions	Insights Expected
and accountability practices (CEO/ED, NED)	accountability? 2. How important is governance and accountability in your organisation? Why do you say so? 3. What aspect of governance is important in your organisation? 4. How would you characterize the relationship between the non-executives and the management (executive directors)? Why would you say so? (To probe further about issues of transparency and independence, if necessary) 5. What is the difference between corporate governance in the building societies and bank? 6. Does your organisation face any problem complying with the UK Code of Corporate Governance? 7. How are the NED selected and appointed in the building societies? 8. What are your views about the skills and capabilities of the NED in the building societies? How about in the past? 9. Do you think members govern/monitor/control the building societies? 10. What mechanisms are commonly used to discharge	building societies • To understand the implication of 2007/2008 financial crisis toward corporate governance in the building societies

Appendix 4: Template of Interview Guide		
Themes	Questions	Insights Expected
	accountability to members? 11. What are your views about NED serving more than 9 years on the BOD of the building societies? 12. Do you think the UKBS are doing enough to discharge accountability? 13. How important is disclosure of information by the UKBS? 14. In what ways has corporate governance and accountability in your organisation changed as a result of the 2008 financial crisis? 15. If given some flexibility, what would your organisation do differently? Why would you say so?	
The role of Non-Executive Directors (NED)	1. How do you play out your role as a NED? 2. In what ways do the non-executives work with the management? (Do they work together? If so, on what? Is this useful and productive?) 3. How is the clarity of roles and responsibilities or clear lines of accountability and responsibility between non-executives and management determined? 4. What are the purposes of member engagement?	• To understand the roles and accountabilities of the non-executives • To understand how the independent directors held the management accountable for their actions • To understand if the non-executives protect the interests of the members

Appendix 4: Template of Interview Guide		
Themes	Questions	Insights Expected
	5. What should be done to improve member engagement? 6. What do the non-executives do to protect the members' rights? 7. What are the steps taken to improve the skills and expertise of the NEDs? 8. In what ways do the non-executives and members communicate with one another? (Probes: kinds of communication, how frequent, to whom and from whom and why communication between non-executives and members are important.) 9. What improvements have the building societies made toward their corporate governance practices? 10. What challenges do you think building societies face in implementing better corporate governance? 11. What should be done to improve corporate governance in the BS?	• To understand governance practices from the perspective of the non-executives
The role of the UKBS and the conceptualization of mutuality(MB)	1. Why would you save or open an account with the UKBS? 2. What roles do the UK Building Societies (UKBS) play in our society?	• To understand the role the UKBS plays in the societies; • To understand how mutuality is being conceptualized and perceived by members

Appendix 4: Template of Interview Guide		
Themes	Questions	Insights Expected
	3. Have the roles of UKBS changed over the years? 4. In your own experience, what differences do you think exist between the UKBS as compared to other high street banks? Why would you say so? 5. Would you consider the UKBS to be profit-making financial institutions rather than mutual banks (value-oriented banks)? Why would you say so? 6. What does mutuality mean to you? 7. To what extent do you think mutuality is still in existence? Why would you say so?	
Members' Right (MB)	1. What would you consider to be your rights as a member? How do you influence the activities of the UKBS (or how do you exercise your rights)? 2. Would you expect any changes/impacts to occur in the UKBS after you have exercised your rights as a member? Yes/No. Why would you say so? 3. To what extent do you think your rights as a member are being protected? Do you think members are being treated equitably? Why would you say so? 4. How well do you think your rights as a member are protected by the law? How far are you satisfied? What	• To understand how members perceive and exercise their rights; • To understand the extent in which members are involved in the day to day operation of the building societies; • To understand the nature of democracy practice in the UKBS

Appendix 4: Template of Interview Guide		
Themes	**Questions**	**Insights Expected**
	should be done to improve it? 5. Have you ever been involved in the day to day operation and governance activities of the building societies? Why and why not?	
The role of the BOD (MB)	1. Do you consider the management of UKBS runs the organisation to the interests of the members? Why would you say so? 2. As a member, what do you expect from the BOD? Why would you say so? 3. Do you think the management of the UKBS are doing enough to discharge their accountabilities? Why would you say so? 4. Would you consider the non-executive directors to have represented your rights equitably? Why would you say so? 5. Do you engage with the directors of the building societies? If no, how do you get involved with your building societies?	• To understand how members perceive the role of the BOD and attempt to hold them accountable • To understand the extent in which members involved in the day to day operation of the building societies.

Appendix 4: Template of Interview Guide		
Themes	Questions	Insights Expected
Governance Practices (REG/AUD)	1. What aspects of corporate governance are important in the building societies? Why do you say so? 2. What are your views about the corporate governance performance of the building societies? a) Before the 2008 financial crisis b) After the 2008 financial crisis 3. What are your views about the _____of the building societies? a) Skills, knowledge and diversity of the board of directors b) Risk management framework 4. Do you think the building societies face any challenges in recruiting NED/employees with the right skills and capabilities? 5. What improvements have building societies made toward their corporate governance practices? 6. What other improvements should BS make toward their CG? 7. What are your views about the NED and Chairman serving more than 9 years on the board of the BS? 8. What challenges do you think building societies face in	• To understand regulator's views toward governance and accountability practices in the building societies and initiatives for further improvement.

Appendix 4: Template of Interview Guide		
Themes	**Questions**	**Insights Expected**
	implementing better corporate governance? 9. Building Societies ED commented that there are disproportionate regulations in place now (e.g. BSOCS and SMR). These regulations in fact put them in a position where they are not at a level playing field with banks. What are your views?	
General Governance and Accountabilities Issues (CEO/ED, NED, REG, AUD, Ex-ED, BSA)	1. Some of the building societies (e.g. Scarborough, Chelsea) failed during the financial crisis. What are your views about that? Do you consider their failure because of failure of governance? 2. The government seems to support the idea of mutual as a result of the 2008 financial crisis. Have there been any changes in the UKBS sector? 3. All the demutualised building societies failed during the financial crisis? What are your views about that? 4. Why do most building societies demutualised in the 1990s? In your view, what benefits does demutualisation bring? 5. Do you think with the current regulations in place, the building societies are at a level playing field with banks? 6. What challenges do you think building societies are	

Appendix 4: Template of Interview Guide		
Themes	Questions	Insights Expected
	experiencing? 7. What are your views about the future of the industry? 8. What are your views about the reasons the number of building societies has been diminishing over the years? 9. What should be done to maintain the legacy of the building societies?	
General Question	1. Is there anything else you wish to add? 2. Can I still be in touch with you in the event of follow up?	

MB: Member

NED: Non-Executive Director

CEO/ED: CEO/Executive Director

BSA: BSA representative

Ex-ED: Ex directors

REG: Regulator

AUD: Auditor