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COMMUNITY
OWNED
TRADING
ENTERPRISES:
THEIR
UNIQUENESS
AND
PERFORMANCE

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of Master of Business Studies at Massey University

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ABSTRACT

Community ownership of trading enterprises has not been so favoured as a concept during the latter part of the 20th century as successive New Zealand Governments pursued market forces policies. The face of the New Zealand public ownership business scene radically changed from the mid 1980's as telecommunications, railways, the ports, Coal Corp, energy ... were all restructured in pursuit of the market model. Why was the public or community ownership model apparently not supported?

The empirical evidence did not unequivocally uphold privatisation and the market model as being inherently more efficient as a structure. Notably also, community ownership was much enjoyed as a concept.

This research, therefore, looks at the concept of community ownership and seeks to define its uniqueness and identify its performance in operating trading enterprises. The electricity companies in New Zealand were the area selected.

The results moderately support the view that social/community goals are of more importance to community owned trading enterprises than their private ownership equivalents. Notably community ownership outperformed private enterprise as measured by ROE and ROA.

Thus the contention that community ownership as a concept had much to offer, and was not inherently less efficient, was not disproved by this research. Further research in other fields is worthy of pursuit.

THANKS!

You cannot complete a project such as this without a great deal of support. This then is my occasion to thank those who made the year of research that much easier, and this document more achievable.

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My father Bill Teahan completed another edit for me, 10 years after the first, and continued his practice of giving his family the benefit of his opinions!

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I am asked sometimes, why undertake such research? The inference seems to be that a senior management job at a reasonable sized organisation, dynamically changing and performing, and all else that life brings, should be enough. There is no simple explanation, but the answer is easy – the challenge, discipline and the project itself is enjoyable. It was never “a chore that had to be done”. And the quest for knowledge and growth is irresistible. An answer too, in part, lies in what my friend Jacob the philosopher says – what grows, never grows old.

The encouragement I receive from my wife Lynette is as much a cornerstone in this document as anything and everything achieved. AJ Cronin tells a story in his autobiography. The lesson is that substance is often not in appearance and status, but support.

Bernard Teahan
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SECTION 1

INTRODUCTION

This research began with a belief: That community ownership as a concept had much to offer, and that community ownership of trading enterprises was not inherently less efficient. And yet the evidence of events through the latter part of the 20th century pointed to the opposite.

Meggison *et al* in his 1994 research on the financial and operating performance of newly privatised firms, identified that

“... more than 80 countries have launched ambitious efforts to privatise their SOE’s. Since 1980 more than 2000 SOE’s have been privatised in developing countries, 6,800 worldwide.” (p. 404).

The New Zealand experience has not been dissimilar. Since the mid 1980’s New Zealand had extensively gone down the privatisation path. The face of the New Zealand public ownership business scene has radically changed during these years; telecommunications, railways, banking, energy, the Ports, Auckland airport, Coal Corp ...the list is extensive.

The market model was dominant in the pursuit of economic efficiency. And yet the changes that occurred in the New Zealand scene from 1984 onwards were based largely on faith. The empirical evidence to support such beliefs as a number of writers identified (Peters and Marshall, 1988; Kelsey, 1995; Hawke, 1988) did not unequivocally uphold privatisation and the market model as being inherently more efficient as a structure.

It was a further belief that those involved in community ownership of trading enterprises had inadequately defined and identified to their communities the points of differences between themselves and private ownership: What was unique? As private enterprise moved (or was forced) to a wider awareness of its impact on society, had the points of difference blurred to such an extent that there was confusion as to whether there were unique features? The concept of community ownership has often been associated with pious ideals and woolly thoughts. Was this apparent lack of definition part of the territory? If the belief was founded in fact, what was necessary to emphasise the need for crisp focus of direction?

Community ownership of trading enterprises has a long history in New Zealand. Banking had been provided by regional Trustee Savings Banks for 150 years, and yet through extensive changes in the 1990's only one, and that successfully, now survives, the Taranaki Savings Bank. Electricity had been generated and supplied by local authorities since the early 1900's. Licensing Trusts were established in the mid 1940's.

The community model was now clearly not in favour. The changes through this period clearly identified that the market model was dominant. Why was this so?

Community ownership as a concept was still well enjoyed. Consider, for example, the support for community ownership of the energy companies when in 1992 the Government was considering privatisation of the local authority based systems. As one official who was involved at that time

stated, when the community ownership concept was advanced, there was overwhelming support. It was a concept for that time and circumstance. As the Government moved down a market model path in the delivery of health services, communities rebelled and to save the hospital located in their town or area, a number developed a community trust system of ownership.

Thus the beliefs that started this research was contrary to by far the great majority of the dynamic change that had occurred in recent years so doubt existed. Are community owned trading enterprises less efficient? If so, by how much? Is the market model a more efficient provider of resources? If so, significantly, or moderately? Are there inherent faults in the concept of community ownership, for example, does the slow infiltration of politics (Spicer *et al*, 1996) lead to inefficiency and bureaucracy? Is there a uniqueness about community ownership and if so, are they clearly understood and expressed?

Many writers identified how important it was to balance the market model with its inherent emphasis on the individual, with the wider concept of community, with its emphasis on the 'we', the wider public good. Drucker in recent writings (1998) maintained that 'human beings need communities', and that 'the private sector – that is, business – cannot fill that need ...'.

Some researchers (for example, Boardman and Vining, 1989) suggest that where economic goals are mixed with social/community goals, inefficiency results and all objectives are less successfully achieved. The separation out of the business unit from community ownership has been exemplified in the establishment of the energy companies in 1992.

But is that necessary? Or does it just duplicate costs and create conflicts between different sets of 'actors' with different agendas? Are 'social and economic goals opposing', or are not 'economic mechanisms at the same time social processes'? (New Zealand Public Service Association, 1989.)

In pursuing the beliefs that was the basis of this research, it was evident that the key empirical research articles over the past 20 years provided a mixed answer. In some cases when comparing equivalent streams of private ownership companies with public ownership, the evidence supported that public ownership had performed better. On balance perhaps the evidence was more to the contrary, particularly in recent research. Kay and Thompson's key conclusion that it is the interaction of competition with ownership that promotes efficiency is particularly compelling (p. 24, 1986). The time spans for much of the research are short and it is reasonable to conclude that the next few years are more likely to deliver a more compelling result.

But there is very limited research that compares the performance of community owned organisations to that of private enterprise. A key question is whether community ownership delivers a closer sense of belonging than that of a more remote public or Government owned organisation. This sense of belonging is more likely to be closer to the sense of ownership that is inherent in private enterprise.

In pursuing research that compares the efficiency of community owned trading enterprises with their private enterprise counterparts, the impact of the nature of community ownership, the wider sense of the well being of the community rather than pursuit of individual objectives, was

important. Thus a key aspect of the research was to identify if the concept of community ownership was understood widely so that in debating what is in the best interest of the community in the specific field the community organisation may operate, that the widest possible choices are made, and all the options are understood and not excluded. Thus if a particular industry averages, say a return on equity of 15%, and a community organisation wishes to pursue a wider agenda of creating employment say, or pursuing economic development policies that will encourage firms to set up in their area of operation, and are prepared to accept a return on equity of say 10%, are there robust accounting and reporting mechanisms that quantify the impact and success or otherwise of those employment and economic development goals?

For if there is not a clear definition of the community goal to be pursued, and rigorous accounting and reporting criteria adopted therefore, any goal is going to be more difficult to be achieved, and not degenerate into warm wishes largely incapable of being judged (Negandhi and Ganguly, 1986). Alternatively, and perhaps additionally, in the absence of clearly focused social/community goals, do not economic goals take precedence (Kulkarni, 1979).

The concept of community ownership is widely enjoyed (for example, Peters and Marshall, 1988). Drucker (1998) maintains that community involvement can deliver the ideal effective citizenship where people can make a difference. Fukuyama's belief (1995) that there is no necessary trade-off for community and efficiency, and 'those that pay attention to community may indeed become the most efficient of all' are powerful statements that are worthy of research.

Thus in pursuing these lines of research, the stream that was selected of the electricity companies was tested to see what answers could be provided. It is important to recognise the limitations of these conclusions. The energy field selected in New Zealand is but one stream of data. The energy companies themselves were required by the 1992 legislation to be successful businesses. This requirement may have driven economic performance to the extent that social/community goals were not considered in an in depth understanding of the nature of community ownership. The data that was available was largely based upon the energy companies' performance and to a lesser extent, on the deliberations, selection of objectives, priorities, and performance and accountability mechanisms of the community trusts themselves. The community trusts are the end owner and hold in effect the assets of the energy company in trust for the community. Logically the community trusts' deliberations should be reflected in their companies' objectives. These limitations may have had some influence on the resultant selection of social/community objectives.

Some eight social/community objectives were noted as constant themes through the reports and public information generated by the energy companies. The key social/community goal that was pursued by the community trusts, significantly in advance of that of their private enterprise counterparts, was to keep tariffs as low as possible. In 1996 the community companies' tariffs were 5.69% less than that of their counterparts, in 1997 8.70%, and in 1998 6.64%. These lesser tariffs had a significant impact on profits foregone for the community companies and thus provided a 'hidden' dividend back to the community. In ROE terms, the impact in 1996 was 3.61%, in 1997 5.00%, and in 1998 3.54%

Another key objective of the community trusts was to deliver a rebate back to their community, generally through a reduction in their power accounts or tariff holidays. The nature of these community dividends is not dissimilar to the dividend a private enterprise company would provide to its shareholders. In comparing those two streams of dividends the public companies averaged a distribution percentage of tax paid profits to their shareholders of 78.5% over the 3 years 1996 to 1998. The community companies distributed 64.5% of tax paid profits. However, significantly, a number of the community companies pursued a low profit emphasis and when these are excluded the community companies' percentage of distribution increases to 83.2%. Thus a fair conclusion is that the community companies, while pursuing lower tariff regimes than their public company counterparts, also did not disadvantage their shareholders, the community, by lesser distributions of dividends. Further, the lower tariff regime provides a "hidden" dividend of significance.

The other five social/community objectives noted were not robustly pursued. The pursuit of economic growth in their regions, the support of community activities, good neighbour/environmental sensitivity programmes, and energy generation investment goals, identify that the community companies were either not more active in these areas than the public companies or the goals were of peripheral interest. Security of supply through a high level of capital expenditure that would improve the region's well-being and its ability to compete and attract investment, were not notably different between the two streams of data, although the community companies did expend more on capital expenditure. The community companies invested in the years between 1996 and 1998

11.1% of their fixed assets, compared to the public companies of 9.7%. However, a number of qualifications need to be made, and in particular the quality of the systems prior to the establishment of the energy companies in the early 1990's, the impact of density in rural and remote lines, and the impact of climatic conditions.

Thus with the sole exception of the low tariff regime objective, community energy companies have not actively pursued social/community objectives. Because there was a legislative requirement that they operate as successful businesses, interpretations may have been made by the community trusts that this limited the range of choice that was available to them. It may be also that the market philosophy that was, and is dominant, in the New Zealand environment again limited debate on the choices that may have been available. Thus further research into other industry sectors where community ownership is actively involved, would be desirable to strengthen the conclusions above. But the belief that community structured organisations often do not clearly identify their uniqueness is not disproved.

In analysing the economic performance of the community companies as compared to their public company counterparts, a number of conclusions can be made. Firstly the average return on equity for the three years 1996 to 1998 for the public companies was 9.29%. The community companies averaged 8.07%. The impact of the low tariff regime, is significant when adjustments are made to place an exactly similar tariff regime on the community companies that the public companies pursued. Return on equity would be improved in 1996 by 3.61%, in 1997 5.00%, and in 1998 3.54%. When the average of these (4.05%) is added to the recorded results in annual accounts and reports as noted above of

8.07%, the community companies achieved returns on equity of 12.12% significantly above those of their public company equivalents. The Return on Assets ratios (ROA) support a similar pattern. Thus it can be concluded that community companies are not less efficient.

CONCLUSION

This study sought to advance knowledge on the performance of community owned trading enterprises. Two hypotheses were proposed. The first of these was that social/community objectives are of significant importance. The research on the energy companies supports this contention moderately. The impact on financial performance of the key social/community goal pursued was very significant.

The second hypothesis related to performance as judged by key financial indicators. In this area, the community owned energy companies achieved higher ROE and ROA than their private ownership counterparts.

Section 2 following reviews the literature pertaining to this study. Section 3 develops the two hypotheses, section 4 the research methods, section 5 analyses the results of the research and section 6 summarises the conclusions. References and Tables complete this document.