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GOVERNANCE AND CO-OPERATIVES: THE SEARCH FOR A MODEL*
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Governance and Co-operatives: The Search for a Model

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I. INTRODUCTION – THE ORIGINS OF DIRECTOR RESPONSIBILITY

Corporate and co-operative governance issues have developed a high profile in recent years due to highly publicized business failures and, in turn, disappointment in governance associated with these failures. The key problems generally arise out of questionable accounting practices and controls or overly aggressive growth strategies, particularly those relying on debt, or in some cases both. Boards have a clear and overriding responsibility for accounting practices and controls through their audit committees, and over a company's business strategies through board responsibility to set long term direction for their company or co-operative.

Modern corporations and co-operatives can trace the essential roots of their structures and the underlying rationale for those structures back to:

1. The Joint Stock Companies Act U.K. of 1844;
2. The Rochdale Principles of 1844;
3. The Limited Liability Act U.K. of 1855.

The Joint Stock Companies Act (United Kingdom) of 1844 established some of the key elements of corporate law as we know it today. It did not however change the pre-existing laws under which shareholders generally had an unlimited liability in respect of the debts or obligations of a company in which they held shares. Nor did this Act impose any meaningful legal obligations on the directors of these companies. They essentially remained free of liability. *The Limited Liability Act* of 1855, as its name implies, brought into law the principle that the liability of shareholders was to be limited, generally to the amount of their investment. This created a situation where the shareholders had a limited liability, and thus less incentive to actively monitor and discipline the directors, and the directors had essentially no liability. This was an unsustainable situation and the legislative solution was a series of enactments, starting in 1862, which imposed increasing responsibilities on those who were, in fact, in the best position to assert influence or control over the activities of companies; the directors and officers. This trend continues today.

Viewed from a historical perspective, the demands we see today for greater corporate and director accountability are simply a continuation of the dynamics set in motion by the shift away from shareholder liability and director immunity. The thrust of legislative activity since 1862 has been aimed at insisting that the real controlling actors (directors and senior management) feel and are disciplined in respect of the consequences of their risk taking.

II. WHAT IS A BOARD?

Boards are designed to satisfy the requirements of the corporate and co-operative statutes which permit the formation of entities with limited liability. *The Cooperatives Act*

of Canada provides that co-operatives must have a board of directors and this board must “manage or supervise the management of the business and affairs of the co-operative.” The Act goes on to provide that “every director and officer must, in exercising the powers and performing the duties of office: (a) act honestly and in good faith with a view to the best interests of the co-operative; and (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances”. In other words, a board is a body created by law to discharge duties specified by law to the standard required by law.

It is important to note that the Act does not confer an authority on individual directors. Rather the authority is that of the directors as a group.

III. WHY DO BOARDS EXIST?

The short answer is, in addition to the reasons discussed above, that boards of directors exist for the sake of convenience and efficiency. It has long been understood that it is simply not possible for all of the shareholders of a large corporation or the members of a large co-operative to, as a group, manage or supervise the operations of an undertaking. Directors have, through a process of evolution in the law, been given the responsibility to represent and protect the interests of shareholders or members. The authority they exercise to discharge this responsibility has been delegated to them by shareholders or members through the election processes established by statute.

IV. CAN BOARDS ADD VALUE?

The answer these days seems to be “it depends”.

Boards must meet the minimum standards imposed by the relevant statute or the directors face personal legal liability. This in itself is an important responsibility which adds value. However, directors and boards which value excellence can and do strive to perform at a higher level. Good governance tools are essential for success on all levels.

Boards today face the same challenges that they have always faced in key areas;

1. Selection of a competent CEO and senior management;
2. Selecting an appropriate and productive vision and business strategy;
3. Protecting the interests of shareholders and members;
4. Monitoring and evaluating the performance of the organization and senior management.

If a board discharges its responsibilities skillfully in these four areas, it is clearly adding value. While there is generally broad agreement on the importance of these objectives, boards must pay very close attention to the practices which are used to meet or exceed those objectives. Thus boards must do more than pay lip service to these broad

principles. Boards must develop policies and practices that ensure that these objectives are met or surpassed in all significant aspects.

V. IS A CO-OPERATIVE BOARD DIFFERENT?

The answer is, in our opinion, a clear YES. *The Cooperatives Act* requires that “every co-operative must be organized and operated and must carry on business on a co-operative basis.”

The Act further specifies that a co-operative is deemed to be carrying on business on a co-operative basis if:

1. membership in the co-operative is open in a non-discriminatory manner to persons who can use its services and who are willing and able to accept the responsibilities of membership;
2. each member or delegate has only one vote;
3. no member or delegate may vote by proxy;
4. interest in any member loan and dividends on any membership share are limited to a maximum percentage fixed in the co-operatives articles;
5. to the extent feasible members provide the capital required by the co-operative;
6. surplus funds arising from the co-operative’s operations are used to develop its business, to provide or improve common services to members, to provide reserves for the payment of interest or dividends, for community welfare or the propagation of co-operative enterprises or as a distribution among its members as a patronage return; and
7. it educates its members, officers, employees and the public on the principles and techniques of co-operative enterprise.

The Act goes on to provide a mechanism by which individuals can apply to the court for certain remedies if a co-operative is not being operated on a co-operative basis consistent with the statutory requirements. If a co-operative is not acting on a co-operative basis, a court may direct that the co-operative be transformed into a share capital corporation under *The Business Corporations Act* or that it be dissolved. In other words, directors are obliged to exercise their authority in a manner that is consistent with co-operative principles as set forth in the statute. While the statutory reference above is to the federal *Cooperatives Act*, most provincial co-operative statutes have similar provisions. These principles must be kept in mind when formulating governance or other policies within a co-operative.

In addition, co-operatives generally adhere to *The Rochdale Principles*. These were most recently modified in 1995 and provide that:

1. Voluntary and Open Membership

Co-ops are voluntary organizations, open to all persons able to use their services and willing to accept the responsibility of membership, without gender, social, racial, political or religious discrimination.

2. Democratic Member Control

Co-ops are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-ops members have equal voting rights (one member, one vote) and co-ops at other levels are organized in a democratic manner.

3. Member Economic Participation

Members contribute equitably to, and democratically control, the capital of the co-op. At least part of the capital is usually common property of the co-op. They usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing the co-op, possibly by setting up reserves, part of which at least would be indivisible and/or benefiting members in proportion to their transactions with the co-op, and supporting other activities approved by the membership.

4. Autonomy and Independence

Co-ops are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments or raise capital from external sources, they do on terms that ensure democratic control by their members and maintain their co-operative autonomy.

5. Education, Training and Information

Co-ops provide education and training for their members, elected representatives, managers and employees, so they can contribute effectively to the development of their co-ops. They inform the general public, particularly young people and opinion leaders, about the nature and benefits of cooperation.

6. Cooperation Among Co-operatives

Co-ops serve their members most effectively and strengthen the co-operative movement most effectively by working together through local, national, regional and international structures.

7. Concern for the Community

While focusing on member needs, co-ops work for the sustainable development of their communities through policies accepted by their members.

One of the key differences in co-operative governance as compared to corporate governance is that each member of a co-operative generally has one vote. On the other hand, shareholders in a share capital corporation exercise their control on a one vote/one share basis. Also, co-operatives usually require that its directors be selected from among the membership. Corporations on the other hand are free to select any person for the position of director though the shareholders usually end up electing directors who have been nominated by a nominating committee composed of sitting directors, often on the recommendation of the chief executive officer. Another difference arises in the source of funding. Corporations are funded by investors who may contribute varying amounts of capital. Co-operatives are generally funded by earnings retained from members in proportion to the use that they make of the co-operatives' services. Finally, corporations are generally designed to produce a return on investment and co-operatives are, in broad terms, designed to reduce the costs of goods and services.

Many of the governance problems experienced by share capital corporations stem from circumstances that are unique to them. For example, much of the shoddy accounting in publicly traded companies has been driven by the desire of senior management to show increasing earnings every quarter or to cash in on stock options. In recent years some senior executives have earned enormous amounts through options and other compensation at the expense of shareholders. It is also common practice in share capital corporations for the chief executive officer to be the chairman of the board with control over nominations to the board. This, in effect, gives the CEO control over the board. This does not happen in co-operatives as directors are elected by the membership. In addition share capital corporations need mechanisms to monitor insider trading and to meet other stock exchange requirements.

All of these factors call for governance and control mechanisms in investor owned corporations which may not be applicable to co-operatives. Each of these dictate that co-operative governance principles and practices, as discussed below, will be different in important respects from those prevailing in investor owned corporations. However, there is also much common ground and accordingly many best practices in governance are equally applicable to both investor owned firms and co-operatives.

VI. STUDY OF GOVERNANCE: THE SEARCH FOR A MODEL

What Do We Mean by “Model”

In the literature dealing with governance, the word “model” is a confusing and often misleading term. A model is a framework or approach of some sort. In the field of

governance research, that framework may be formulated in theoretical, functional, institutional, or behavioral terms. However, to be useful, it must serve as a guide for members. That is, it must be prescriptive. The most prolific writer on the topic of governance, John Carver says that in his early days (1970's) of studying governance he finally grasped the problem. "In the scientific sense, there was no model for governance; ideas about the topic were strikingly devoid of conceptual coherence". By model, Carver means "a collection of principles and concepts that makes sense as a whole". In this context, he makes the observations that "principles of governance" might be better terminology than the word "model". However, as will be pointed out later, the word "principle" has different connotations to different writers. As well, Carver elaborates that a model must go much further than simply a collection of principles. They should be " a logical, deductive sequence built on postulates".

Looking at the idea of a governance model in the broadest sense, we might begin by identifying the players. Cyril Houle, author of *Governing Boards: Their Nature and Nurture*, suggests that all organizations over which boards govern are unique and distinctive in their purpose and work patterns but they all "share a common form and have basic similarities in how they operate". As organizations grow, he suggests, they usually move towards a tripartite system where a board establishes the policies and direction, a staff carries out the duties and an executive (CEO/ management) coordinates and directs that activity. In its broadest context this tripartite system might be considered a structural model of corporations, co-operatives and service organizations. In a related but slightly different vein, references are often made to the governance team as a trio consisting of owners, the board and management. Combining these two notions, the modern corporation or co-operative consists of four main players: owners, board, an executive and staff. In its broadest sense, this is the model. As we move further down this path and try to define further layers of this model, we find discussion around three main themes: *the who of governance (structure or division of work)*, *the why of governance (motive and behavior)* and *the "what to do" of governance (prescription and best practice)*.

Governance "Models" – Focus on Structure and Function

Mel Gill of the Institute On Governance defines "governance model" as a "distinctive set or cluster of governance structures, responsibilities (functions) and processes (practices) that are logically consistent with one another". The report "Governance DO'S AND DONT'S – Lessons from Case Studies on Twenty Canadian Non-Profits" is a case study approach which explores how certain factors such as ownership, size, complexity and financial circumstances influence the choice of the governance model employed. The governance models identified in the report are summarized in Appendix A.

One result of this report is that it provides a classification of boards by structure and it confirms that each of the seven hypothesized governance models are, indeed, in use in

the real world. As well, it finds that three quarters of the organizations in the case studies utilized more than one model for different segments of their responsibility. For example, a Policy Governance approach to human resources and an operations approach to advocacy may co-exist within the same board. Where a single approach was used, most often it was the Traditional governance model. It should be pointed out that all of these case studies were from the non-profit and governmental sector. None of these were commercial agricultural, financial or retail co-operatives that characterize a significant part of the membership of CCA. However, the results are consistent with the co-operative sector where the traditional model is also dominant choice. As well, the other models illustrate the several dimensions in which co-operative boards must deal. For example, co-operative board members must recognize their obligations to advance member concerns and interests on one hand while setting aside those concerns and interests as secondary to the fiduciary responsibilities they bear for the organization as a whole. This reality of being elected, at times, may drive whole boards or individual members to take what seems to be an inappropriate and often meddling interest in operations. In doing so, they may in part take on the appearance of an operations board.

Governance “Models” – Focus on Motive and Behavior

There has been significant research in the field of economics targeted at explaining why firms behave as they do beginning with the traditional “neo-classical” approaches of profit maximization to more recent approaches around agency theory and transactions costs (i.e. the “new institutional economics”). This approach builds on motive and rationale for corporate behavior. It is quite different from the structural approach above (who is involved and structure of workload) or the more prescriptive approaches below (what boards should do). Its strength is in shedding light on the tugs, pulls and tensions which characterize governance in different organizations. It is important to note that the word “model” in this case illustrates a different dimension of governance. Regardless of the type of board, an understanding of these behavioral models should only enhance understanding of the underlying motives of governance. A paper by Chris Cornforth titled “Making Sense of Co-operative Governance: Competing Models and Tensions” identifies six theories on organizational behavior and identifies an accompanying governance model for each theory. (See [Appendix C](#) for an outline of different behavioural models.) The important lesson from this behavioural approach is that different motives are present in co-operatives. These perfectly reasonable but different motives lead inevitably to tensions within co-operative governance. These tensions are discussed further in the section on the factors that influence governance models.

Governance “Models” – Focus on Prescription and Best Practices

The first issue of the CCA newsletter, *Governance Matters*, contains an excellent overview of the question of governance, particularly as it applies to co-operatives and credit unions. The editor states that the board has a clear role to “ensure that the

appropriate systems are in place to enable organizational *excellence and accountability*". Alternative wording as used by the Cadbury Committee Report are the words *direction and control*. In broader terms, the notion of excellence means leadership in developing a long-term strategic vision and stewardship in mobilizing and directing the resources of others (owners). Accountability means holding management accountable through proper measurement of performance and the reporting of these activities and results to the member owners and beyond. *Simply put, governance is a system, it is about direction and control and it is the responsibility of the board*. This system in its broadest sense might also be called a model. The editor, Debra Brown, suggests breaking this broad notion of a system or model into two categories. One is guideline-based models and the other is principle-based models. It is at this point that the word "principle" becomes problematic in that Brown classifies Carver's Policy Governance model as guideline-based while Carver would classify it as principle-based. Like most classification systems, the distinction is somewhat arbitrary. Both are prescriptive approaches. However, the Brown categorization based on the criterion of whether the approach is less or more prescriptive, we feel, is a useful classification system.

Guideline-Based Models (i.e. More Prescriptive)

These approaches are collections of standards or guidelines that are highly prescriptive. In some cases they are regulatory standards which must be met as conditions for listing on the respective stock exchanges. Examples where such lists of prescriptions can be found include the Toronto Stock Exchange and the London Stock Exchange as well as cases or case studies of companies practicing or meeting these standards. The Conference Board of Canada provides a set of ten basic governance standards and professional accounting groups such as the CCAF-FCVI Inc. (Canadian Comprehensive Auditing Foundation) have their own lists. The CCAF for example provides a set of six characteristics of effective governance. Brown argues that the Carver Policy Governance model fits into this category as well. Because of the prominence of the Carver model and the fact that it is a much more complete system or approach than any of these other examples, it is dealt with separately. Two examples of these other guideline-based or prescriptive models are given below:

The CCAF's Six Characteristics of Effective Governance

1. Board members with the knowledge, ability and commitment to fill their responsibilities;
2. Understanding the board's purpose and whose interest they represent;
3. Understanding the objectives and strategies of the organization;
4. Knowing and obtaining the information they require to exercise their responsibilities;

5. Once informed, being prepared to act to ensure that the organization's objectives are met and that performance is satisfactory;
6. Accountability to those they represent by reporting performance.

The Toronto Stock Exchange Committee on Corporate Governance
Recommendations:

1. Adopting a strategic planning process;
2. Identifying the principal risks and ensuring the implementation of appropriate systems to manage these risks;
3. Planning for succession, including appointing, training, and monitoring senior management;
4. Creating a communications policy for the corporation;
5. Ensuring the integrity of the corporation's internal control and management information system.

Principle-Based Models (i.e. Less prescriptive)

This approach is based on identifying the broad categories of governance and articulating the desired goal or end result for each of these categories. In this manner, boards are encouraged to find their own best approaches and "best practices" to achieve these general targets or principles. As mentioned earlier, the word principle becomes somewhat problematic because the word principle is used so extensively in a slightly different fashion by Carver. Brown mentions that the World Bank, OECD and the Conference Board of Canada are examples who have adopted this approach in their efforts to encourage better governance. The Conference Board model, for example, consists of six broad categories as a framework for grouping best practices. They are listed below. The categories are self-explanatory and, not surprisingly, parallel those more prescriptive statements above mentioned.

- Leadership & Stewardship
- Empowerment & Accountability
- Communication & Transparency
- Service & Fairness
- Accomplishment & Measurement
- Continuous Learning & Growth

CCA's newsletter, *Governance Matters*, is reviewing each of these principles in current and upcoming issues.

VII. THE POLICY GOVERNANCE OR CARVER MODEL

Primer on the Carver Model

In the most recent book by John Carver, *Corporate Boards That Create Value (2002)*, Policy Governance is defined as a “conceptual model for leadership by boards of directors – a universal paradigm composed of certain logically derived principles and concepts. The term is a registered service mark of John Carver”. Carver began developing this model in the 70’s and rose to guru status on governance with the publication in 1990 of the book *Boards That Make a Difference (Carver, 1990)*. In his introduction to the book *John Carver On Board Leadership (Carver 2001)* he states that “The Policy Governance model became the first – and arguably, still the only – theory of governance in the world”. These claims seem extravagant at first glance but we also see that Carver himself recognizes these to be “extraordinary claims”. He suggests that on closer examination of the actual functioning (i.e. poor functioning) of boards, the Policy Governance model takes on an air of common sense rather than radicalism. Carver tried to step back and identify universally applicable principles and “construct a comprehensive coherent framework of concepts and principles into an internally consistent paradigm”. His use of the word “model” is precise in that it implies a high degree of universality, internal consistency and integrity. The point of this brief discussion on the background to the Carver model is important for several reasons. First, it is important to recognize that the model has completely dominated governance discussions, particularly for non-profit boards, during the past decade or more. As well, many co-operatives have adopted or tried to adopt the Carver model. Second, the model is a system. It is not simply a collection of prescriptions or best practices. Third, it would be impossible to study the Carver model and his writings and not learn a lot about better governance. He is one of the clearest, most disciplined thinkers and writers on governance in the world today.

The purpose of the Carver model is to help boards provide strategic leadership to their organizations. It focuses on board job design and on the partnership of the board and management. The board functions on behalf of some identifiable ownership. An abridged summary (in some cases direct wording) of key principles drawn from *The Policy Governance Fieldbook (C. Oliver, General Editor, 1999)* is provided in Appendix B. These “principles” basically say that the board focuses on written values and perspectives that are called policies. These policies fall into four categories. ENDS policies focus on what is to be accomplished. EXECUTIVE LIMITATIONS policies describe the ethics and prudence boundaries within which the CEO must act. GOVERNANCE PROCESS policies clarify the board’s own work and rules. This includes how it relates and communicates to “ownership”. BOARD STAFF LINKAGE policies describe the delegation and accountability linkage through the CEO. Once these last three are put in place they should be relatively stable allowing the board to focus on ENDS policies. The chair of the board and the CEO are two distinct and separate roles. Each reports to the full board.

Evaluation of the Carver Model

This evaluation is not a detailed evaluation of the elements of the model. The model is comprehensive in that it takes a systems approach. It requires a high degree of understanding and discipline to implement and once implemented requires continuity of that understanding and discipline. This is more easily said than done. The *Policy Governance Fieldbook* states that the popularity of the model and the extent and success of its implementation is impossible to answer because no one has taken such a survey. We do know, however, that in the co-operative world the model has received a lot of interest and that the reception has been mixed.

Carver in his most recent book, states “The reaction to Policy Governance has been curiously mixed”. As a comprehensive working approach based on a rational foundation or a governance “model” (in the Carver use of the word), the Carver model was unique when it first came out and likely is still unique. There is an inherent paradox in the Carver literature and in this subject in general. Boards are described by Carver, and in much of the literature overall, to be a fairly dysfunctional lot. With recent corporate scandals it would be difficult to disagree. Yet board members are asked to understand and implement Carver’s rather complex model which is often very different from their current culture and they are asked to change their behavior radically. In this situation, progress might be expected to be slow encountering a high degree of resistance.

There is little question that Carver has performed a great service to the governance world in the depth and passion of his writing and work on this topic. His model has received a lot of attention in the public and voluntary sectors but very limited attention and adoption in the private sector. Within the private/commercial sector, user-owner entities (co-operatives and credit unions) have been much more receptive and open to the model than has been the case with investor-owned-firms. One simple explanation is that the Carver model demands complete recognition of and separation of the roles of CEO and chair of the board. These boundaries are already clear and accepted by most co-operatives and credit unions. This is not the case among investor-owned firms where these positions are often combined positions. A bias towards retaining fluidity of structural choice by this mélange of CEOs, board chairs, presidents and aspiring senior management of such firms would be natural if not expected.

Mel Gill of the Institute on Governance, as earlier discussed, has tried to come to grips with this question of models or structure in the public and voluntary sectors. He states that various organizations have tried to implement the Carver model with varying degrees of success. Many have expressed frustration, he states, with the complexity of the model, its degree of difficulty in implementation, the time and training involved, the distance between board and organization and erosion of board control and accountability. Gill respectfully states “Carver assures his model is generally applicable

and will benefit any organization in which it is properly implemented”. This wording seems to imply a certain sympathy, if not concurrence, with the Carver view.

The Carver Policy Governance model has been attractive to many boards, particularly in the “non-profit” sector. Its merit is that it is a systems approach that offers clarity and transparency by forcing boards to acknowledge and deal with fundamental questions within a prescribed framework. These questions are:

- Who are our owners?
- How are we accountable (in accomplishing the mission while avoiding unacceptable situations) to them?
- How do we provide leadership to our owners?
- As a diverse group of individuals with individual values, what are our values as a group?
- What is the role of the board versus staff?
- How do we make our workload manageable?

Experience in implementing the Carver system has been mixed. Criticisms include comments that the system is too abstract, too complex or requires too much group discipline and separates the board too much from operations. Although the *Policy Governance Fieldbook* looks at several case studies and observes that “The model requires a degree of group discipline that most boards find extremely challenging”, evaluation of real-life implementation experience is limited.

It has been implemented successfully by many co-operatives, partially adopted or rejected by others and ignored by many. At this time, there is a strong need to evaluate this experience as it relates to different segmented groups of the co-operative world. These include agricultural producer co-operatives, consumer retail co-operatives and credit unions. This research has not been done. The leadership demonstrated by the CCA in beginning a newsletter on governance and focusing attention on governance are important first steps. A next logical step is canvassing and evaluation of experience of such companies regarding their experience with Policy Governance.

VIII. FACTORS THAT INFLUENCE GOVERNANCE MODELS

With regard to factors influencing the choice of board structure, the Institute on Governance study concludes that the Carver notion that *one size fits all* “has drawn attention away from alternative models more suitable to many voluntary organizations”. Size is an important factor in this choice. The choice of approaches other than Policy Governance seems especially compelling for smaller organizations where relationships between board, staff, volunteers and consumers may need to be more collaborative. The study concludes that size and complexity will automatically lead organizations to adopt the “Traditional”, “Policy Governance” or “Corporate Models”. These models differ in several important aspects: the focus of the board; the role and

boundaries among the board, Chair, CEO and other positions; the use of committees, and the measurement of performance. The important point for board members to recognize is that structure is only one element of a governance model or approach. There is also culture and prescription. In other words, boards can choose or at least influence:

- Structure of governance
- Culture regarding board function
- Prescriptive rules regarding the detail of board focus

The historical development of an organization has often shaped structure and culture. By the word “culture”, we mean the values (stated or unstated) of the board as a group and the embodiment of these values in the practices and processes of the board. For example, some boards have a culture which permits critical questioning of management.

In the final analysis, using the D. Brown terminology, boards will choose a framework, or if you prefer model, that draws upon prescription, either of their own choosing or from someone else. Choices at the moment include:

- Prescription by general catchments (Brown principle-based approach)
- Prescription by specific directive list (Brown guideline-based approach)
- Prescription by a fully integrated directive list (Carver approach - guideline-based)

Note: The Carver approach, because it is a fully integrated approach, goes beyond directives in that it addresses structure and culture directly or indirectly.

In the search for the best approach to co-operative governance we find there are excellent boards that are approaching governance from each of these. Successful boards, by definition, have developed their own fully integrated, successful models.

An interesting study by Chris Cornforth observes that much of the prescriptive-based literature for co-operatives does not come to grips with the conflicting demands and pressures that board members face. He outlines a number of key theories that explain organization behavior and also highlights key paradoxes and conflicts that characterize governance. The theories and the associated “models” are summarized in [Appendix C](#). While this approach to corporate models is not very productive in a prescriptive sense, it illustrates clearly some of the paradoxes and the very real tensions that are faced by boards. These include:

- Tension over board member selection. Different models imply different competencies - lay representation versus professional expertise versus key contacts.

- Tension over control versus support of management. Different models suggest monitoring management re conformance to owner interests versus working with management to drive performance to new levels.
- Tension over boundaries between board and management.
- Tension related to multiple stakeholders.

Recognition of these paradoxes and acceptance of these tensions is an important job of the board. Each co-operative or credit union faces different circumstances and will face different tensions. A framework or model for governance of co-operatives should recognize and embrace these tensions, paradoxes and gray areas. A failure to do so will result in problems and poorer performance whatever the governance model.

IX. ESSENTIAL ELEMENTS OF CO-OPERATIVE GOVERNANCE

A co-operative governance structure must be designed so that it:

- Meets the requirements of the legislation under which the co-operative operates;
- Protects the economic and other interests of its member owners to at least the minimum standard established by that legislation;
- Avoids or at least minimizes to the extent possible the risk of business failure. A co-operative governance model can also be a valuable set of tools to help the co-operative to achieve excellence it is designed for that purpose;
- Supports and determines the business and other objectives of the co-operative.

X. THE CHALLENGES TO GOOD GOVERNANCE

Good co-operative governance principles can shape and influence the governance structure of a co-operative, enhance its capacity to achieve its objectives and improve the effectiveness of the steps by which it achieves its business objectives.

In order to function effectively, a co-operative must be structured so that its directors and senior executives receive accurate, complete and timely information on all factors which may affect its success. In a corporation, boards of directors typically receive all of their information on the business from or through the chief executive officer. Co-operatives are often structured so that the board of directors receives its information through both the chief executive officer and another individual directly accountable to the board who is usually the corporate secretary or the executive in charge of member relations. In this structure, the entire member relations function may be outside of the scope of the chief executive officer's responsibilities. This allows those boards of directors to receive information through two separate channels, both of which are

directly accountable to the board of directors. CEO's usually resist this structure while many board members feel it is essential. This is a natural difference or tension and should not be avoided or discarded simply because there is tension.

While the CEO and management must report fully to the board, directors have a corresponding responsibility to review and understand the information which they are given and to interpret it rationally. If boards react negatively to every piece of bad news they receive they discourage honest reporting. If they accept excuses for non-performance uncritically they reward excuse-making.

Directors of corporate boards are often selected on the basis of their specific knowledge or expertise in a given industry or their personal connections and contacts within that industry or in the financial community. The theory is that the selection of highly credentialed individuals for directorships will bring information and the benefit of contacts to the deliberations of the board. Co-operative directors are almost always selected from among the membership of the co-operative. Most co-operative directors have not had extensive experience in serving on other boards of a similar nature nor have they through their employment worked closely at a high level with boards of directors or even management. Accordingly, co-operative directors stand to benefit immensely from solid director development programs. Co-operative directors will not be able to evaluate, or when necessary, challenge a chief executive officer effectively unless and until they are, individually and as a group, in a position of comparative equality with the chief executive officer in terms of their understanding of the matters at hand. The challenge to co-operatives is firstly to encourage its most capable members to stand for election to the board and secondly to devote the resources to train those directors once they are in place. A democratic structure and a member relations program which attracts the interest of members and gives them a meaningful role in the life of the co-operative is an indispensable part of a contemporary co-operative governance model because it will increase the pool of members interested in seeking election to the board. Solid director training from both internal and external resources is also an indispensable part of a program to enhance the value of being a director. These steps can also make a powerful contribution to a co-operatives' business success.

XI. TOWARD A CONTEMPORARY CO-OPERATIVE GOVERNANCE MODEL

An ideal model for co-operative governance must reflect co-operative principles. It should also be recognized that this model will always be in development and must be flexible/general enough to reflect the circumstances of individual co-operatives. It is the sum of its parts - not individually but how those parts work together. We believe that such a model might best be composed of seven general parts or components. We believe they are so important to good co-operative governance that they merit

individual treatment and highlighting. This very high level approach or model is as follows:

- Structure of work and responsibility - At a very high level it must be determined what is to be done, for whom and who does it. This includes defining board, CEO, committee, and corporate secretary roles.
- Governance Framework - This framework sets out the rules and culture of governance within the co-operative.
- Setting priorities - Within this framework what are the “big ticket” items that should be done and how is this determined?
- Evaluation – Competent and comprehensive evaluation of the performance of the co-operative, the CEO (and senior management by the CEO) and the board itself.
- Information Support – How does the board ensure it has the right amount and quality of information at the right time?
- Member Relations - How does the board relate to the membership? What processes and procedures are in place for members?
- Director Selection – How can a co-operative encourage its most capable member with the expertise needed at the board to come forward?
- Director Training - Once elected, whatever the capability and expertise of the individual, how best can this individual be trained to upgrade capability and competency?

Within this approach we believe that a good co-operative governance model would encompass many of the elements which are outlined below.

Perhaps the most important responsibility of a board is that of selecting a chief executive officer. A thorough selection process involves an analysis of the circumstances which the co-operative will face during the tenure of the chief executive officer and an analysis of the likely ability of the candidates to successfully address those circumstances. The challenges of accurately reading both the future and human nature are such that boards also have to be willing to deselect at an early stage before too much damage is done if they have made a mistake. The unique characteristics of co-operatives should be taken into account in this process. A co-operative chief executive officer should have a basic respect for and understanding of those characteristics and of the co-operatives membership. This includes a respect for the boards’ right to deal with that membership on a more direct basis through a corporate secretary or similar position.

It is essential that directors receive accurate information in a timely way on the key elements of the business so that they can determine whether its business objectives are being met satisfactorily. Directors must hear both the good news and the bad news in a complete and honest fashion. As we know, this does not always happen. Human nature being what it is, there is no sure way that this can be done. However, directors can diligently question senior management on reports that come forward and can take steps

to ensure that management reports on a regular and consistent basis, on the factors which indicate success or a lack of success. Those factors will vary from business to business. Financial co-operatives in particular must ensure that they receive all of the information necessary to ensure compliance with applicable regulations.

Directors should insist on receiving adequate information on matters to be discussed at board meetings well in advance of those meetings. Only in the rarest of cases should a new issue be walked onto the floor of a board meeting for approval by the board without prior notice.

When strategic alternatives need to be considered by the board, directors should be prepared to press for the development of two or more strategies to achieve their vision. If only one strategic choice is presented, the board of directors is not able to exercise its judgment on behalf of the membership. It runs the risk of simply being a rubber stamp for management.

A board of directors should insist that resources be made available for a good director development program. It is essential that co-operative directors supplement their perspective through channels which are not under the control of management.

Training programs should take into account the need for a broad range of expertise on the board as a whole and the needs of individual directors. It should focus on both the unique aspects of co-operative business and practical, general business skills such as reading financial statements. Directors should determine their needs in this area annually, perhaps as part of its board appraisal process.

It is vital that co-operatives have a solid member relations program. This not only connects the board to the essential reasons for which the co-operative exists, it also facilitates the involvement in the affairs of the co-operative by a high proportion of members. It is useful to consider member relations activities to be, in part, the early stages of a director development program and also a part of the business development function.

Directors should feel comfortable meeting regularly without senior management present. This allows individual directors to communicate openly about any matters that may be concerning them. Such discussions, however, must be undertaken responsibly.

Directors should insist on solid evaluation procedures for the chief executive officer and through him or her, for the senior management group. In addition, directors should adopt a solid evaluation procedure for the board as a whole, its committees and individual directors. Structured properly, this can be a good source of feedback for individual directors and can be used to fine-tune a director training program.

Directors must ensure that the co-operative does not “get led astray” by a vocal activist minority. A solid member relations program can help to prevent this. At the same time,

they need to be mindful of the fact that a vocal activist minority just might be right on a particular point.

The board should consider adopting mechanisms that would allow employees at all levels to draw matters of concern to the attention of the board or its committees. Because of the potential repercussions for individuals, there should be a mechanism for doing this anonymously. On the other hand, directors must recognize that such feedback could be driven by poor motives or may be badly informed. Nonetheless, it is clear that in some cases, frontline employees can tell that something is wrong but they do not, or cannot, convey the message upward. A mechanism to allow that to happen may be beneficial.

Directors must ensure that its auditors are truly independent and that the reports of auditors to the board's audit committee are not compromised by the fact that the auditors may have given business advice to senior management or to the board through their consulting practice. It may be useful to consider empowering the audit committee to hire and fire independent auditors and to approve any significant non-audit relationship with the independent auditors.

Directors should insist on having independent access to legal, accounting and other advisors on matters that concern them. Such access must be used responsibly. It may be acceptable to require that such access be approved by the audit or governance committee.

Finally, directors must ensure that governance policies and practices strengthen and clarify the roles of the Board, CEO and senior management and strengthen and improve the relationships among them.

XII. CONCLUSION

Governance must be seen as an entire system. Co-operative governance is a means by which a board of directors, consisting of a number of individuals, selected by the owner members of the co-operative and acting on the influences and information which they receive, form a unified strategy for the co-operative and provide direction to a chief executive officer on the manner and means in which that strategy is to be achieved. Good governance improves the likelihood that the board of directors will achieve these objectives.

APPENDIX A: Governance Models – Focus on Structure and Function

The governance models as identified by the Institute On Governance study are as follows:

Operational – The board does the work of the organization. Boards in the ‘founding’ stage and service clubs with no staff are examples. (Note that even in the most sophisticated and advanced stages of governance, boards will justifiably and non-justifiably drill down into specific issues and take on characteristics of an operational board).

Collective – Board and staff are a single team making decisions about governance and carrying out the work of the organization.

Management – The Board manages operations, perhaps with a staff coordinator.

Traditional – The Board governs and oversees operations through committees but delegates the management functions to the CEO. Committees are used to process information for the Board and sometimes do the work of the Board. The CEO may have a primary reporting relation to the board through the Chair.

Policy Governance (Carver) – summarized in detail in Appendix B and discussed more fully in the body of the paper. The Board governs through policies in four specific areas. Committee use is very limited and the CEO reports to the full board.

Corporate – The CEO is a non-voting member of the Board, carries substantial influence over policy making, is viewed as a full partner with the board and has a relatively free hand at managing to achieve objectives established by the Board. Committees are used for monitoring/auditing performance of the board, CEO and organization. Board members are selected for community profile, capacity to open doors for the organization and may be used for selected tasks in their area of expertise.

Constitutional Representational – Used by public elected officials, federations and other constituency elected boards whose primary interests are to balance the interests of their constituents against the best interests of the overall organization. They may have prescribed functions and responsibilities around areas such as grievance and public consultation.

APPENDIX B: Carver “Policy Governance” Key Principles

The Board Acts As Trustees on Behalf of Owners – The Board must clearly identify the “ownership” and look after their interests. This also requires communication with the “owners”.

The Board Speaks with One Voice or Not at All – A Board decision must be upheld by all members. No member has the authority to speak for the board unless specifically authorized to do so by the whole board. The board’s policies are the board’s voice.

Board Decisions Should Be Policy Decisions – The board’s voice is expressed in its policies and decision making is always an amendment of, or an addition to, existing policy.

The Board Should Formulate Policy by Determining the Broadest Values Before Progressing to Narrower Ones – This is an important aspect of the “how to” part of the Carver model. This concept says that decisions come in various sizes and that they are nested. Directors make the broadest decisions stopping where the board is willing to delegate the rest of the nested decisions. They must allow this party to use any reasonable interpretation of its words. This party is usually the CEO but it could also be the board chair or a committee.

A Board Should Define and Delegate Rather Than React and Ratify – The board must not be led by staff members or its own committees by reacting to and ratifying their ideas. Rather it must define the results they want accomplished. These are called Ends policies. Also, it must delegate those responsibilities to the CEO through Executive Limitations policies that define acceptable boundaries. This leaves the CEO to take any reasonable interpretation of these policies to accomplish the Ends.

Ends Determination is the Pivotal Duty of Governance – This is the biggest job of the board – to determine the benefits to be produced, the people to be served and the cost of meeting these goals. ***The Board Can Best Control Staff Means by Limiting, Not Prescribing*** – This is the notion of empowerment allowing the CEO to determine how to achieve the Ends policies within the limits of ethics, law and prudence set by the Executive Limitations policies.

A Board Must Explicitly Design Its Own Products and Processes – The board must decide what it means by governance and decide how it will govern. All board members must understand the board role in defining the future (Ends) and ensure that this future is achieved in a legal, ethical and prudent manner.

A Board Must Form an Empowering and Safe Linkage with Management – This concept centers on role clarity between the board and the staff. This clarity is achieved by board

commitment to focusing on policies allowing staff to achieve the Ends as long as the Executive Limitations are not violated.

CEO Performance Must be Monitored Rigorously but Only Against Policy Criteria – The staff knows the rules and standards by which they will be judged because the board has stated this in its policies.

APPENDIX C: Governance Models – Focus on Motive and Behaviour

Representational Theory – A Democratic Model – This theory suggests that the ideas of democracy and democratic government are central to the development of culture and practices in the governance of co-operatives. This includes open elections based on one person one vote and the separation of policy making by members from implementation of those policies by staff. This perspective suggests that representation of member interest is the key driver in the job and responsibility of a board member. In this context, any member can come forward as a candidate for the board. Expertise is not a key requirement as it may be in other models. This implies that for this model, greater emphasis and resources may be needed in the areas of training.

Agency Theory – A Compliance Model – This theory assumes that the owners of organizations and the management of these organizations have different interests. Governance arrangements are a means by which management (the agents) is encouraged and forced to act in the best interest of the owners..

Stewardship Theory – A Partnership Model – Contrary to agency theory, this model assumes that managers want to act as effective stewards of resources on behalf of owners. The board supports management, works with management and focuses on long term strategic interests.

Resource Dependency Theory – A Co-optation Model – In this case the main role of the board is to maintain good relationships with key non-owner external stakeholders.

Stakeholder Theory – A Stakeholder Model – This theory suggests that organizations should be responsible to a range of groups besides the owners.

Managerial Hegemony Theory – A Rubber Stamp Model – This theory relates to the premise that control of organizations has really passed from owners to a new professional managerial class. The board becomes little more than a rubber stamp.

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