CHALLENGING GOVERNANCE ORTHODOXIES

Address by Alexandra Wilson to the International Governance Symposium

17 June 2021

I have joined you today to bring a practitioner's perspective to the question of fit governance practices for co-operatives. An active co-operator since 1974, I have played multiple volunteer and professional roles in a variety of co-operatives including consumer co-operatives providing housing, credit and funeral services; a large insurance and investment management co-operative; and co-operative associations at the local, national and international level. These involvements have exposed me to co-operatives that are just starting out and those that are long-established; very small co-operatives and very large co-operatives, and co-operatives operating in different economic sectors.

My purpose today is to challenge the following governance sacred cows, or orthodoxies, respecting the role and composition of the board of directors in a co-operative:

- The board sets the ends; management decides the means.
- Boards govern best by setting policies and holding management to account for results.
- Strategy is the board's province, operations management's province.
- Smaller boards are more effective.
- Directors should be recruited for their hard skills.
- Term limits promote diversity.
- Staggered terms promote continuity.

I call these "orthodoxies" because they are received ideas that reflect conventional or normal ways of doing things, for co-operatives and non-co-operatives alike. Their fitness for co-operatives requires close examination, beginning with the role of the board.

THE ROLE OF THE BOARD

To begin, let's ask why co-operatives have boards. The answer may seem so obvious as to render the question unnecessary: unless a co-operative is very small, the members (i.e., the users) cannot operate it without paid help and cannot govern it, which includes supervising the paid help, without vesting some responsibilities in a sub-group of members. In other words, some responsibilities, and the powers to carry them out, must be delegated. The first delegation is to a board of directors, which then delegates some of its duties to a manager. This dual delegation gives rise to the question what is the board's role and what is management's?

The usual answer would draw a fixed line between board and management, assigning governance to the first and operations to the second. Putting it differently, we could say that the line demarcating the separate duties of board and management sits at the division between the ends the organization seeks and the means by which it seeks them. This division finds expression in the following two norms:

- The board sets policy and management operates the enterprise within the boundaries those policies establish.
- The board decides strategy and management implements the strategy.

But here there is a problem. The distinction between means and ends isn't always clear and, even if it is clear, a board can't always stick to the ends and delegate the means. This is more obvious in a smaller co-operative or one just starting out, but it holds true in large and mature co-operatives as well.

To make this case, I will take a housing co-operative as an example of a small co-operative. Because they live in the co-operative, the members have a much closer relationship to the board and management than they would in, say, a credit union or a retail co-operative. Paradoxically, the distinction between what each one does is much less clear to the members than it would be if they had a more distant relationship with their co-operative.

For instance, the members of the housing co-op will understand and accept that the board has delegated to staff the task of deciding who is eligible to pay a reduced rent based on their income. This, not because they agree that this is an operational rather than a strategic question, but because they can see right away the advantage of their neighbours not being privy to their personal information. However, if the board tries to explain a decision not to resurface the parking lot, which is full of potholes, by saying that, as an operational matter, the decision was left to staff, the members will see the board as shirking its duties. They rightly believe that the board, as their elected representatives, is accountable for the co-op's operations, regardless of which duties may have been delegated and to whom.

One might say at this point that to fulfil its accountability to the members while delegating duties to staff, the board can set policies to guide staff in making operational decisions. However, to try to govern wholly by policy is to try to govern by code or formula, i.e., to anticipate the questions that will arise and to answer them in advance. But codes and formulas are inevitably limited in scope, and they are fixed, at least until changed: they cannot anticipate all circumstances. This is perhaps why boards tend not to refer often to policies and demonstrate little ability to recall them, especially, in my experience, in larger co-operatives. So, policies have their place, but they have less efficacy than we imagine.

Drawing a hard line between the duties of the board and those of management is equally problematic for co-operatives in the start-up stage. Seldom does a new venture have enough capital to hire people to do all the necessary work; what staff the start-up can afford will need the active help of members of the board to get the enterprise safely off the ground. Who does what will be a function of who among the paid and unpaid participants has the requisite time and skills. There can therefore be no fixed formula to guide the division of duties.

Probably no one will dispute this. But surely in a larger, securely established co-operative, one can draw a firmer line between governance and management. Can one? Let's assume that the co-operative has followed the strategy adoption/strategy execution paradigm to draw the line between governance and management.

First, it is famously difficult to distinguish between strategy and tactics, but let's try. Take these definitions, found on the Internet: "Strategy is the overarching plan or set of goals. ... Tactics are the specific actions or steps you undertake to accomplish your strategy." That seems clear, but anyone who has framed up either a strategic plan or an operating plan knows that a strategy in one context is but a tactic in another. This year's strategic goals will guide this year's tactics but are but tactics themselves when viewed in the context of the five-year plan.

Another difficulty is that strategy must be securely rooted in a strong knowledge of the enterprise and the environment in which it operates. How, if a board does not have a reasonable understanding of the business, can it elaborate a useful strategy for it? The answer is it can't. Luckily, most boards don't really formulate strategy. In practice, managements elaborate strategies and then test them with their boards, which may endorse them without change, adopt them only after making major changes, or tinker with them and then adopt them.

How can a board arrive at a sufficient understanding of the business or, if the co-operative is an association, of its affairs, to enable it at least to endorse a strategy and ideally to collaborate in its development? By taking a strong interest in the entity's business and affairs. This needn't imply meddling, but it does imply asking questions, as many as the board needs to ask to enhance its understanding of the business and to test management's advice. Management teams that prefer not to be grilled will complain that the board is getting too "operational." Or, more likely, they'll observe that those directors most prone to asking questions are straying from their governance role into management. Members of the board whose own understanding of the organization's business and affairs is weak may agree.

However, a strong management team will welcome directors' questions, take pride in being able to answer them persuasively and be thankful when the give and take of discussion leads to new insights and helpful corrections to management's plans and priorities. Even so, a board well versed in operations cannot set strategy independently. Nor should it. After the start-up stage, its real job is to question and to debate with management until a sound strategy is found. The board must then continue questioning management as the strategy is executed, results become visible, and the environment takes its actual rather than its anticipated shape.

There are other reasons, legal and regulatory, why a board, even after delegating significant responsibilities to management, cannot remove itself entirely from the operational realm. First, under corporate statutes, including those governing co-operatives, the fundamental duty of any board of directors is to “manage or supervise the management” of the business and affairs of the organization. To be effective, oversight requires considerably more than receiving reports when the year is out, and the results are in. It isn’t enough to identify which goals were met and which were not; the board must understand how the successes and failures came about. Moreover, it must be present as the year unfolds, satisfying itself that results are emerging as expected and challenging management when they are not.

Second, statute law may vest the board with specific duties that are unmistakeably operational. For instance, both Canada’s Bank Act and the Insurance Companies Act require the audit committee to discuss with the internal auditor the effectiveness of the internal control procedures established for the company. Few would disagree that, in the division between strategy and tactics, internal controls fall squarely under tactics.

Finally, without any regard for the thinking that says that boards are responsible for strategy, not operations, regulators are increasingly relying on boards to ensure that the companies they govern are properly run and take no undue risks. They seek to locate accountability for the operation of the regulated entity within its board and will not accept as a defence that the duty to manage has been delegated to staff. In this behaviour, it would seem that the regulators have joined those who believe that the board is an organization’s strongest defence against failure. Is this not perhaps wishful thinking? Let me explain.

The most important duty of a board is to hire and supervise the senior-most staff member, whatever their title. Once the manager is in place, the board’s hands are off the wheel. It may decide on the destination and even approve the route, but management is driving the car. The board’s job is to make sure that the car stays on the road and that the driver gets the organization to its destination, making route changes and other adjustments as necessary, while respecting the rules of the road.

In the eyes of regulators, the board is not a passenger, and the CEO is not a chauffeur. Rather, regulators’ heightened and growing expectations would seem to cast boards in the role of co-pilot. There is just one problem: if we are in the car at all, we are sitting in the back seat. Our only recourse if the current driver proves unfit is to stop the car, at least briefly, and replace the driver with another. For very good reasons, that isn’t something most boards want to do often; before they do, they may resort to back-seat driving for a time in their need to get the car to the destination.

It is precisely because management is at the wheel and the board is not that most co-operative failures, indeed business failures generally, originate in the decisions of the people who run the business and not those who oversee them. Holding the board responsible does nothing to pinpoint where the business mistakes were made.

Finally, insisting on a hard line between management and governance overlooks the role of management in ensuring an entity’s effective governance. The responsibility, in other words, runs in both directions. No one here would be surprised to hear that, in investor-owned corporations, management plays a part in finding suitable persons to join the board of directors. In co-operatives, we tend to see this as a heresy that flies in the face of democratic control. It doesn't. Real democratic control requires that a board be effective. Management in a co-operative can help by nudging some people to run for the board and discouraging others. In a small co-operative, such as a housing or daycare co-operative, this can be crucial in mending weak governance. Even in a large co-operative, management can and should give the board advice on how to do its job.

Here are a few conclusions one might draw from these observations:

The proper division of responsibility and degree of delegation within a co-operative will be strongly influenced by the co-operative's size and stage of development. In this sense, there is no best practice.

- The need to delegate duties arises mainly out of size and, secondarily, out of the requirement for specialized expertise. So, for instance, in a very small housing or worker co-operative, the board can and should comprise the entire membership.
- The real line between the board's duties and those of management is jagged, malleable, and permeable, rather than straight and fixed. It will reflect the co-operative's specific circumstances rather than a strict or precise compartmentalization of powers. As circumstances change, the line can bend and be reformed without breaking. And, regardless of where it lies, circumstances may require exceptions: the board may sometimes have to step in and do management's work and vice versa.

This is not to say that boards should not establish clear expectations of their co-operative's management. They should. And unless circumstances dictate otherwise, they must also avoid doing what the co-operative's managers are paid to do.

THE COMPOSITION OF THE BOARD

Turning now to the composition of the board, let us consider the question of board size. For a number of years, the trend has been towards smaller boards, presumably on the grounds of streamlined decision-making and economic efficiency, though too many boards make the decision to shrink on the grounds that boards are smaller these days. But, in fact, there is no optimal size for boards generally.

The right size for an individual co-operative depends on its size, type, and stage of development. Start-ups need working boards, as I was suggesting earlier; this argues for smaller, though not necessarily small, boards populated only with those who either are prepared to roll up their sleeves or can bring the co-operative business or credibility with an important public, such as a funder or regulator.

Association boards need to be representative, which, depending on the circumstances, may require them to be rather large. For instance, the board of our apex body, Co-operatives and Mutuals Canada, needs to balance Canada's two official language groups, include a diversity of types of co-operatives and reflect a geographic mix. The same is true of The Co-operators, as a joint undertaking of more than 40 co-operatives serving a broad policyholder base in ten provinces and three territories. Both organizations also want good gender representation, and they want to reflect, to the extent that numbers allow, the demographic diversity of the Canadian population. To meet all these requirements, they will need large boards. This should go without saying but, for those preoccupied with best practices, it does not.

The size of the board must take account of the size of the membership the co-operative draws its leaders from. For example, it is hard to fill a larger board in a housing co-operative with people who have the time, the willingness, and the ability to contribute effectively. A board of seven may be just right, but a board of ten continually hard to keep filled.

In larger co-operatives, including credit unions, a bigger board will offer greater room for diversity. Many co-operatives have been slow to respond to calls for gender parity because they don't want to displace their current directors. Faced with the same problem when they were required by law to fill at least 40 per cent of their board seats with women, many European businesses, including co-operatives, met the new rule without difficulty by adding seats to their board.

As long as the co-operative isn't small, a larger board also aids in recruiting good talent. When The Co-operators had a twenty-person board (the board is now 22), the then CEO complained to me privately that it was too large. I retorted that, with a board that large, he could count on having at least ten good directors at one time, which was enough to get the job done. I was exaggerating for effect: perhaps we had 14 good directors. My point is that, no matter the size of a given board, one can never count on every member contributing effectively, so, when one designs the board, one should apply a small multiplier to the size that otherwise suggests itself. One way to do that is to specify in the by-laws some flexibility in the size of the board.

What about director qualifications? Here, the current trend, both within and without the world of co-operatives, is towards recruiting directors for their hard skills. While that is an improvement on whom one plays golf with, it falls short. For one thing, it reflects a view of the board's responsibility that is at odds with the desire to maintain a firm distinction between governance and management. Perhaps cynically, I sometimes think that boards want to add experts to their ranks so that the other board members will not be obliged to learn enough about a technical subject to be able to assure themselves that management has the area in hand.

More important, the skills matrix approach overlooks the greater importance in contributing to a director's effectiveness of what I will call soft qualities, such as courage, candour, judgement, insight, diligence, persistence, discernment, rigour, persuasiveness, an independent mind, and the ability to work with others. By narrowing the selection of qualified candidates, the matrix approach may even lengthen the odds of getting the necessary soft skills.

Just as problematic, by introducing more filters into the selection of directors, recruitment for skills works against gender parity and slows progress towards greater demographic diversity. Nomination committees, by placing too much emphasis on professional skills and reducing competition, can have the same effect.

On that theme, in a bid for greater diversity, term limits have become common place. But do they really promote diversity? In theory they do, by freeing spots on the bench. In practice, they can work against achieving diversity in the senior ranks of the movement: women and members of other under-represented groups, who tend to ascend more slowly to positions of power, often "time out" on their primary board and so step down early or cannot reoffer for the boards their primary board led them to.

Term limits do have a place, but their place is not everywhere. They are vital in housing co-operatives, for instance, where board members can become entrenched and hard to displace without conflict, leading to dissension and ineffective or even corrupt governance. Remember, however, that term limits are essentially management's friend: they allow a manager facing pressure from their board to wait out the directors they perceive as difficult. That can be a good thing or a bad thing.

Staggered terms are another popular measure, normally rationalized on the grounds of continuity. Though a useful counterbalance to term limits, there seem to me to be two knocks against them. First, they are devilishly difficult to manage, absent a professional corporate governance staff, especially if the board has other structural features, such as regional representation. Second, they make boards revolution proof, which may be the reason they were first introduced. While continuity is normally desirable, sometimes we need a revolution, for instance, to replace a corrupt or ineffective board, to achieve gender parity on a reasonable timetable, or to induce a leap forward in diversity and inclusion.

THE FIT CHOICES FOR CO-OPERATIVES

What does all this tell us? In designing their governance structures and processes, co-operatives need to

- **Think** instead of simply copying the practices of other co-operatives.
- **Distinguish** between trends—what increasingly others are doing—and actual best practices.
- Make **conscious** choices.
- Recognize that the choices they make require **trade-offs** between competing needs and goals.

- Regularly **review** and rethink the co-operative's governance structures and processes.

- 30 -