The Cooperative Boards of Directors

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Every individual should understand the role of the board of directors. While there are differences across the business forms, the board of directors is an important part of the governance of investor owned corporations, cooperative corporations and not for profit corporations. Understanding the functions and role of the board of directors will help you better understand those specific business forms. Additionally, many individuals are asked to run for or serve on a board of directors sometime in their career. Any prospective board member should understand the important legal and fiduciary responsibilities as well as the commitment of time, skill and resources. While there are many unique aspects of the cooperative board of directors, understanding the role and responsibilities of the board in a cooperative firm also provides insights into the role of directors in other firms or not for profit entities.

The cooperative board of directors has the primary legal authority for the firm. Except for a few major decisions, which are specified in the Articles on Incorporation or Bylaws to require a vote of the membership, the board has top level decision control to oversee the corporation and ratify important decisions. In practice, the board delegates much of the authority for operational decisions to the manager. In an effectively governed cooperative the board oversees the manager and makes strategic and policy decisions while the manager supervised employees and makes operational decisions. The board hires, directs and evaluates the general manager or CEO. We typically say that the board has one employee: the CEO and the CEO manages all of the other employees. The board works with the CEO to develop and update the cooperative’s mission and to set strategic goals. The board makes long run decisions on capital structure. It is the board of directors that actually signs a long-term loan agreement. The board also makes annual decisions in distributing profits in cash and retained patronage and whether to retire previously issued equity. Through those decisions they determine the cooperative’s level of equity. The board also approves legal, accounting, insurance and banking relationships and oversees the annual audit. The board establishes policies. The board chairman presides over the cooperative’s annual membership meeting.

As stated the board of directors is the governing body of the cooperative and has wide ranging authority as specified in the Articles of Incorporations and Bylaws. A board member has authority only when acting within a duly authorized board meeting. At any other time, a board member has no more authority or stature than any other cooperative meeting. The only exception to that rule would be when the board appoints a subcommittee of the board to undertake a particular task. A subcommittee of the board would have authority to conduct investigation or other activities outside of the board meeting provided that they pertained to the committee’s specific charge. Board members have a responsibility to communicate cooperative issues to the membership and to convey members concern to the board. That communication role, while important, does not imply that they have any individual authority to make decisions or promises.

Board members are elected by the membership to oversee the cooperatives activities and to safeguard the member’s investments. Because of this expectation, and their role as the top level governing body, serving on the board of directors comes with legal responsibilities. From a legal perspective the board of directors has three fundamental duties:

**Duty of Care** which is taking the care and exercising the judgment that any reasonable and prudent person would exhibit in the process of making informed decisions, including acting in good faith consistent with what you as a member of the board truly believe is in the best interest of the organization. The law recognizes and accepts that board members may not always be correct in their choices or decisions, but it holds them accountable for being attentive, diligent, and thoughtful in considering and acting on a policy, course of action, or other decision. Active preparation for and participation in board meetings where important decisions are to be made is an integral element of the duty of care. A board that did ask for a feasibility study prior to making a decision with major financial implications, or a board member that did attend meetings or did not review the meeting packet prior to making a decision, might be viewed as violating the duty of care.

**Duty of Loyalty** which calls upon the board and its members to consider and act in good faith to advance the interests of the organization. In other words, board members will not authorize or engage in transactions except those in which the best possible outcomes or terms for the organization can be achieved. This standard constrains a board member from participating in board discussions and decisions when they as an individual have a conflict of interest (i.e., their personal interests conflict with organizational interests, or they serve multiple organizations whose interest conflict). A board member who participated in a discussion on the cooperative purchasing a tract of land that they, or their family members owned, would likely be viewed as violating the duty of loyalty. When a possible conflict of interest arises the board member should inform the board of the possible conflict, and if the board concurs that it is a conflict of interest, the board member should recluse him/herself from the discussions. The minutes would reflect that the board member left the room during the discussion and voting and returned after the decision was reached.

**Duty of Obedience** which requires obedience to the organization's mission, bylaws, and policies, as well as honoring the terms and conditions of other standards of appropriate behavior such as laws, rules, and regulations. Many cooperatives have a code of conduct for directors which includes items such as being in compliance with the cooperatives credit policy. A director who did not keep their account with the cooperative current might find themselves in violation of the code of conduct and in danger of violating the duty of obedience. The “Fiduciary Responsibility” of Boards

Boards and board members often are reminded that they have a "fiduciary responsibility" to the cooperative and, ultimately, to the membership. At its core, "fiduciary responsibility" is the responsibility to treat the resources of the organization as a trust, and the responsible board will ensure that these resources are utilized in a reasonable, appropriate and legally accountable manner. While the phrase often is used to refer especially to financial resources, it applies to the stewardship of all of the assets and resources of the organization. In general the appropriate exercise of fiduciary responsibility includes developing and implementing an ongoing system to monitor and assess the financial condition and performance of the cooperative, establish a system for budgeting the cooperatives financial resources, adopt a set of policies to govern the acquisition and use of financial resources including a formal risk management plan and implement a formal external review process, such as an independent audit to assess the cooperatives, fiscal condition and performance including the effectiveness of its internal controls.

In addition to those responsibilities the board has general responsibilities to both the membership and the manager. The board obviously has the responsibility of making decisions that are in the long-run interest of the cooperative. In that process they have the responsibility to convey member concerns to the board and manager. While a board member may have elected to represent a particular geographic district or type of producer, their duty is present the concerns of their district to the board as a whole. However, when making decisions their primary concern must be whether the action is in the best interest for the cooperative as a whole. Board members have a duty to keep sensitive information confidential. As the same time they should objectively communicate non-confidential information to members. A board member may also need to explain the logic and rationale for a decision made by the board. While it is important for a board to actively debate issues and provide dissenting opinions, when a decision is reached the board member should support the majority decision and provide a unified voice to the membership. Cooperative members often view board members as their elected representative and expect them to reflect their personal views on a decision. While the board is elected by the membership their primary responsibility is to protect the viability of the cooperative. In the long run that responsibility aligns with every member’s interest, but in some decisions protecting the cooperative may come at a short run sacrifice by the member.

The cooperative board also has responsibilities to the manager or CEO. The board should work with the manager in developing strategic plans and visions that will help guide operational decisions. The board should also spell out goals for the manger, objectively evaluate their performance and actively manage their compensation and incentives. The director’s most important responsibility with the board is develop a good teamwork relationship. In performing as a team it is essential that the board understand their role and not intrude into employee and operational issues. Because of their backgrounds in running their own farming operations, many board members tend to be operational focuses. They often unintentionally shift away from their oversight and strategic role and move into second guessing management decisions.

**Board Structure**

Board structure varies across cooperatives. Most cooperative statues require a minimum number of directors, with five being the most common minimum. If one were to poll cooperative board members, most would likely say that a board size from 7-10 is ideal. As board size increases, the logistics of board meetings become more complex and discussion time is increased. On the other hand, a larger board has more ability to create sub-committees to work on specific issues. Cooperatives tend to have an odd number of members on the board to avoid the possibility of a tie vote. Cooperative boards tend to try and work toward a consensus opinion. The board chair traditionally does not vote unless the vote is needed to break a tie. The odd numbered board size does therefore not completely solve the problem of tie votes unless the chair is comfortable being the tie breaking vote. Larger cooperatives and those operating over larger geographic regions tend to have larger boards. Board size also tends to increase after a merger. Many merged cooperatives begin with the members of both former organizations on the board of the merge firm and implement a plan to decrease the board size over time.

Most cooperative elect directors for three year terms, although shorter and longer terms do exist A cooperative generally starts with staggered board terms so that only a portion of the directors are up for re-election each year. Some cooperative impose term limits, with 3 or 4 terms being a common maximum. Other cooperatives have age limits beyond which a director cannot be nominated for election. These structures create an automatic rotation which some view as creating a healthy turnover on the board. On the other hand, term limits and mandatory retirement can force experienced directors off of the board. In many cases it takes a new director 1-2 years to come up to speed on the cooperative’s operations and activities. Excessively turnover reduces the effectiveness of the board. Some cooperatives use non-voting associate (junior) board members. The associate board structure gives potential board members the opportunity to sit in on meetings and even join in discussions. While there is no guarantee that the membership will elect a former associate member, they are often viewed favorably by the membership due to their experience and demonstrated commitment.

Many cooperative boards are considering the election of non-member, outside, expert directors. The 1986 Farm Credit Act required that all associated associations and banks have at least one non-member director on their boards. Other cooperatives have had a long experience with outside directors. Almost all boards that have them find outside directors make a significant contribution. They are typically chosen for expertise in areas member directors do not have, such marketing, finance, plant operations, management information systems, etc. They are typically elected by member-directors, rather than members. About half of the states make a specific exception to the typical requirement of an all-member board, permitting the appointment of non-member directors. In these states, the outside directors can have the same powers and rights other directors, although many statutes typically limit their numbers to one-fifth of the total directors on the board. The tradition of low or only symbolic compensation of cooperative directors can make it difficult to recruit outside directors.

**Board Decision Making**

Effective board of director meetings and efficient decision making is both a science and an art. The board chair usually works with the CEO in determining the meeting agenda. An annual calendar may be used to cover specific topics throughout the year. The board chair has a key role in board effectiveness In addition to helping to set the agenda the chair leads the discussion and tries to ensure that every board member has a chance to express their perspective. A good board chair encourages board members not to take a stance on an issue until both the advantages and disadvantages have been discussed. When possible, the chair may want to schedule an issue as a discussion item at one meeting and bring it up as an action item for a vote at the next meeting. That helps to prevent the board from making rash decisions due to the passions of the moment.

It is likely and even desirable that the board will have disagreement on a decision. A good board has diversity not only in composition but also in thought process. However, after amble debate the board must reach a decision. When a decision is made, the board has spoken and the board members should respect the majority decision. The board should expect that the CEO and the membership to respect a 5-4 vote exactly like a 9-0 vote. Board members should support the decision of the board outside the board room and attempt to speak with one voice. Even when a board member disagreed with the majority decision they should avoid sabotaging the board by suggesting to members that a decision was incorrect. Because of the value of acting as a unified board, many boards tries to reach unanimous decisions whenever possible. As one board member remarked, while it is important the we explore and discuss an issue from all sides, we try and reach a consensus opinion. If we can’t come to a consensus on an important decision, that might be a indication that we haven’t talked through it enough.”

There are times that a director may want to record a dissenting vote even when it is clear that it will not change the majority decision. A board member may have a strong opinion on an issue and hope that a dissenting vote will encourage the other members to carefully consider their decision. In the rare instances when a director feels that the board is operating illegally or unethically, a director should cast a dissenting vote and have it reflected in the minutes. In some cases, a dissenting director is not held liable for legal issues resulting from a majority decision which results in an illegal action. The court’s created this structure with the hope that a dissenting director could help prevent a corporation from inappropriate actions. It should be emphasized that instances of inappropriate or illegal board decisions are very rare in cooperative firms. The more practical consideration is whether a director feels so strongly about an issue that they are willing to risk creating disharmony within the board.

**Board Compensation**

The time and responsibilities required of directors has increased, there has been a tendency to increase director compensation. However, there are still many small cooperatives that still do not pay any remuneration. In almost all cases, directors are reimbursed expenses associated with their cooperative duties. Historically, cooperatives have merely paid a per diem for each day of cooperative business. For the larger cooperatives this generally varies between $150 and $300 per day (Weick, Anderson, Henehan, 1997). However, there is an increasing tendency to also pay an annual retainer for time the a director spends on cooperative business that is difficult to specify, i.e communicating with members, keeping abreast of industry issues, preparing for board meetings, etc. The amount of the annual retainer varies. In almost all cooperative directors receive less compensation than do IOF directors for similar responsibilities.

**Board Member Recruitment**

Despite the importance of the board of directors, many cooperatives do not invest enough effort in identifying and recruiting potential members. Board member recruitment is complicated by the fact that the selection of the board is a member responsibility. This suggest that the directors should have a hands-off approach to the recruitment and nomination process. Unfortunately most members have a poor understanding of the operations of a board of directors or on how well directors perform. Members may nominate or re-elect individuals with good political skills sometimes to the detriment of those with strong business skills. Ideally, both the current board and the CEO should be involved in identifying potential board members while leaving the specifics of the process to the nomination committee. As cooperative’s evolve and grow the cooperative may need directors with specific financial, operational or even political expertise. The fact that cooperative boards are restricted to members of the cooperatives limits the opportunity to recruit board members with specific skills. The more limited pool of potential members makes it essential that the cooperative work to identify and encourage the best possible candidates.

Most cooperatives use a nominating committee which is often composed of formal board members. The charge of the nominating committee is to identify a pool of qualified candidates for each open position. This is often difficult both because nominating committees often are not active enough and because producers may be unwilling to run against another farmer, or particularly against and incumbent director. There are alternative systems for informing the membership about potential board candidates. Some cooperatives merely list the candidates at the annual meeting. Others have potential candidates introduce themselves and make a few comments. Some cooperative allow members to nominate themselves or other members by mail, or on-line. They then circulate information about the slate of candidates prior to the annual meeting. Some progressive cooperatives even conduct the voting on-line prior to the annual meeting and simply announce the new board members at the annual event.

Smaller cooperatives tend to elect directors at-large while larger and more complex organizations are more likely to have geographic districts. Some cooperative have formal or informal systems to keep a balance across specific farming systems or cooperative services. For example a cooperative might want to keep a balance between irrigated and dryland producers or between grain producers and livestock producers. One of the problems of electing by district or other criteria is that it might not yield the best possible directors. If for some reason a cooperative has several good directors in one district it may not be logical to elect a less qualified director just to keep the geographic balance. Directors selected on the basic of district or farming type may also have more tendencies to focus decision making solely through the lens of that membership group. However, as cooperatives get larger members sometimes feel less connection with the cooperative. The district system may help the board stay connected with members across the trade territory.

**Board Member Qualifications**

In general, there are few specific qualifications to be eligible to be nominated for a cooperative board of directors. Any member of the cooperative that is in compliance with the cooperative’s policies and meets the criteria of the board’s code of conduct is eligible to be elected. A common clause in the code of conduct is that a board member cannot be operating a business in competition with the cooperative. For example, there is no reason that a farmer that also operates a custom fertilizer application business could not be a member of a cooperative. However it would not be appropriate for him/her to serve on the board and make decisions impacting the cooperative’s fertilizer application activities. A minority of cooperatives require candidates to complete a cooperative board education program prior to being nominated. Most cooperatives do not want to interfere with the members’ right to select board members and encourage new board members to attend educational programs.

While there are relatively few official or legal qualifications for serving on a cooperative board, other than being a member of the cooperative and meeting any qualifications spelled out in the bylaws or policy. There are a great number of desirable qualifications. A board member should be of unquestionable character. They should have the trust of other members, the existing directors and management. They should also have a realistic vision of the industry and the cooperative. A potential director needs good business judgment. They should also be a team player but at the same time have the ability to add independent assessments. Finally, a person considered for a director should have no personal agenda as a director, either for themselves or for a specific subset of members who supported them. That is not to say that the director cannot communicate the perspectives of a membership constituents to the board, but they should base their decisions on what is good for the cooperative as a whole.

**Director Education**

For the board of directors to play its appropriate role in cooperative decision making, there is a need to educate and train directors. This is especially true of newly elected directors. A new director is used to considering decisions of the cooperative as a customer. They are now in a different role with the primary responsibility of protecting the viability of the cooperative. Educational programs can help them understand how to “take off their farmer hat and put on their board member hat”. Available training sessions cover such topics the legal responsibilities and liabilities of directors, the distinctions between board and manager responsibilities, understanding financial statements, cooperative equity programs, components of sound marketing strategies, etc. Most cooperatives conduct their own internal orientation programs to familiarize their directors of internal operations. More formal and multi-cooperative director training program are offered by state cooperative councils, universities, cooperative banks, and cooperative trade organizations.