

Co-operative Governance Fit to Build Resilience in the Face of Complexity



Statement on the Co-operative Identity

DEFINITION OF A CO-OPERATIVE

A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

CO-OPERATIVE VALUES:

Co-operatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity. In the tradition of their founders, co-operative members believe in the ethical values of honesty, openness, social responsibility and caring for others.

CO-OPERATIVE PRINCIPLES:

The co-operative principles are guidelines by which co-operatives put their values into practice.

1. VOLUNTARY AND OPEN MEMBERSHIP

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

2. DEMOCRATIC MEMBER CONTROL

Co-operatives are democratic organisations 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-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner.

3. MEMBER ECONOMIC PARTICIPATION

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members 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 their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.

4. AUTONOMY AND INDEPENDENCE

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

5. EDUCATION, TRAINING AND INFORMATION

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

6. CO-OPERATION AMONG CO-OPERATIVES

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

7. CONCERN FOR COMMUNITY

Co-operatives work for the sustainable development of their communities through policies approved by their members.

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Foreword

The co-operative movement boasts a shared identity and unity of purpose as the only organisational model with internationally recognised definition, values, principles, and a social movement behind it. Nevertheless, the co-operative model of enterprise is versatile and flexible. It can be adapted to any sector of economic activity and takes the form of small and locally restrained businesses, as well as multi-national conglomerates. Co-operative enterprises serve, first and foremost, member needs – globally: 1 billion individuals.

Governance is a key component of the co-operative difference. The co-operative values and principles call for an open, voluntary, and democratic process of decision-making, and co-operative governance is an essential tool in applying those values and principles. In an increasingly regulated, complex, and inter-dependent global economy, where market pressures are high, a current reference on the basic tenets of co-operative governance is required.

This exercise aims to help establish the tenets of co-operative governance and tease out its delimitations. As co-operatives innovate in their sectors of activity and in their typologies, the Alliance gathers leading thought from around the world and across sectors to reflect on the balance between rigidity and flexibility we must achieve in our governance strategies and practices in order to continue building a better world.

We trust that this document will catalyse further dialogue and inspiration.

PAULINE GREEN
PRESIDENT
INTERNATIONAL CO-OPERATIVE ALLIANCE

1

INTRODUCTION: Co-operative Governance Fit to Build Resilience in the Face of Complexity

SONJA NOVKOVIC AND KAREN MINER

1. INTRODUCTION: Co-operative Governance Fit to Build Resilience in the Face of Complexity

SONJA NOVKOVIC AND KAREN MINER

A think piece, such as this one on governance in co-operatives, is designed to be thought-provoking and invite debates and discussions, agreements and disagreements, new ideas and reassurances. Our intent is to initiate rich conversations and motivate co-operative members and leadership to re-examine the wide-ranging systems of governance they are a part of. Are these systems conducive to multi-layered participatory frameworks? Are channels of communication open throughout the organization and into the community?

Starting from the Blueprint's vision for elevated participation within the co-operative movement (see p. 135), we also look at the economic trends that call for networked governance. Global society is facing new trends in which co-operatives are seen to be the enterprises of the future. How can co-operative governance match those trends and expectations?

Our introduction is built on those premises: looking to increased complexity in the socio-economic milieu that demands structures which build resilience, coupled with vibrancy of new networked social movements and co-produced technology, we highlight the characteristics of co-operative governance fit for the demands of the emerging socio-economic systems. Our introductory remarks present the building blocks of such co-operative governance systems, followed by a group of contributors who present a select sample of experiences in co-operatives, allowing us just a glimpse into the diverse world of co-operatives today. This document is opening the space for what we hope will be rich ongoing conversations and evolution into the next decade and beyond.

Co-operative governance

The word governance has its root in the Latin verb "Gubernare" which derives from the Greek "Kybernan", meaning "to lead, to steer, to be the head of, to set rules, to be in charge of the power". Governance is related to vision, decision-making processes, power dynamics and accountability practices. The ultimate goal of governance is to effectively fulfill an organization's goals in a way consistent with the organization's purpose.

Co-operatives are member owned and democratically controlled organizations. Their governance has to meet co-operative's objectives, protect member interests and maintain member control. Co-operatives are also values based businesses whose governance and management principles and practices need to reflect and safeguard their values.

Governance of co-operatives is very diverse as it reflects an evolutionary path determined by a co-operative movement dating back hundreds of years, combined with different legal environments, industry standards in sectors in which co-operatives operate, the size and type of membership, life cycle and maturity. In terms of co-operative governance effectiveness, small co-operatives seem to be doing better than large; worker and producer co-operatives better than the consumer-owned¹.

¹ Birchall (2014a) *The Governance of Large Co-operative Businesses* Manchester: Co-operatives UK (also republished by New Zealand Co-operatives Association)

What can they learn from each other, and can we find some common ground for co-operative governance?

Governance practice, particularly in large co-operatives, is often marked by the ‘state of the art’ in hierarchical corporate governance. The corporate governance model protects owners’ personal interests (focused on financial return), and is typically designed as a top-down control mechanism. There seems to be a great deal of pressure for co-operatives to adopt hierarchical command and control systems and adhere to corporate governance ‘best practices’, against the inherent ability of co-operatives to tap into tools and structures fitting of democratic, member-owned and controlled organizations.

In light of numerous governance failures in large corporations, co-operatives included, Turnbull argues that hierarchical² command and control systems fail because of “the tendency of centralised power to corrupt; the difficulty in managing complexity; and the suppression of ‘natural’ – human – checks and balances.”³ He goes on to argue that **large organizations need to break complexity down into manageable units and decompose decision-making into a network of independent control centres – in other words, polycentric, or network governance.**

Where are co-operatives on this, and how can they deliver on a decomposed governance structure fit for democratic organizations?

There are three fundamental properties inherent in co-operatives as peoples’ organizations: humanism (people-centred approach); joint (distributed) ownership and control, and democracy (self-governance).

Regardless of the expected diversity in the world of co-operatives, we suggest there are three fundamental properties inherent in *co-operatives as peoples’ organisations* --democratic and values based-- that give them an edge over the competing models in the ability to devise complex governance systems for resilient enterprises.

1. Humanism (people-centred approach). Humanistic understanding⁴ of management and the firm assumes people are intrinsically motivated social beings, balancing their personal and group interests in accordance with general moral principles. Organizations, in this view, embrace a balance of objectives, including financial, and tend to involve key stakeholders (see Box 1.1) in their decision-making process.

2. Joint (distributed) ownership and control. Joint ownership is a hallmark of co-operative organizations, and it is coupled with member control⁵. Although typically operating under private property regimes, co-operatives distribute ownership rights equally among their members and hold a part of their assets in non-divisible reserves⁶.

3. Democracy (self-governance). Self-governance is the underlying engine of autonomous co-operative enterprises, with democratic decision-making by their members as its vital component.

These three properties, when operationalized, form the building blocks of co-operative governance advantage in the context of increased complexity.

“Large organizations need to break complexity down into manageable units and decompose decision-making into a network of independent control centres – in other words, polycentric, or network governance.”

2 Vincent and Elinor Ostrom call these ‘monocentric’ governance constructs, in contrast to ‘polycentric’ self-governance mechanisms which more effectively govern common goods. B. Allen 2014. A role for cooperatives in governance of the commons, in Novkovic S. and T. Webb *Co-operatives in a post growth era*. Zed books:242-263.

3 Turnbull, S. 2002 *A new way to govern. Organizations and society after Enron*. A NEF pocketbook: 47

4 Pirson M.& S.Turnbull 2011 Toward a more humanistic governance model. *Journal of business ethics* 99,1: 101-114 (103).

5 This is in contrast to employee share ownership schemes, where ownership is distributed but employees do not control the company, except in rare cases where they own majority shares

6 In some cases, such as land ownership, co-operative members may have usufruct rights – they can freely use the asset and its products, but cannot sell (dispose of) the land.

BOX 1.1. STAKEHOLDERS IN THE CO-OPERATIVE CONTEXT

The term *stakeholders* was first defined as **“those groups without whose support the organization would cease to exist”** (Stanford Research Institute 1963).

The definition has since been expanded¹ to include: “any group or individual who can affect or is affected by the achievement of the organization’s objectives” and are typically understood in the corporate literature to include shareholders, employees, customers, suppliers, government, society and more.

The term stakeholder often implies a trade-off and a conflictual relationship between independent self-interested groups, each with a ‘stake’ in the organization. **In contrast, the humanist approach to co-operative governance and management adopted here implies that co-operative stakeholders are motivated by *solidarity*, and a *shared objective* they can realize through a co-operative enterprise.** They each bring a different perspective to the table, but their interests align to work towards co-operative viability and adherence to co-operative values.

Co-operative members are *key stakeholders* in the model of governance presented in this chapter. Although one can argue that members do not need a ‘stakeholder’ label, we talk about members as *key stakeholders* because without them the co-operative would cease to exist (see the Stanford Research Institute definition), and democratic member engagement in all facets of governance is crucially important to the health of the co-operative.

We continue to use the term ‘stakeholder’ because engagement of multiple (key) stakeholders/constituents is an important aspect of the humanistic and polycentric governance frameworks. We make a case that members and other stakeholders ought to contribute to the governance and management processes in co-operatives. Among them, **employees (members or not) occupy a special place as insiders with a clear interest in co-operative’s long term viability, as well as in its organizational culture and implementation of co-operative values and principles.**

The term **multi-stakeholder co-operative** (see the Girard chapter) is used to describe a co-operative with *multiple types of members* (key stakeholders) engaged with the co-operative in different capacities. Any combination of types of stakeholders could be members and may include such constituents as workers, producers, consumers, suppliers, volunteers, among others. These co-operatives are also called solidarity co-operatives.

¹ E. Freeman, 1984. *Strategic Management: A stakeholder approach*. Pitman: 46

The fundamental properties of co-operative governance

1. HUMANISM

“In contrast to governance [...] based on agency theory, humanistic governance theories such as trusteeship and stewardship theory, include the other-regarding positive aspects of human nature, while not being oblivious to self-interest” (Pirson & Turnbull 2011: 103).

At the heart of much corporate governance practice is the principal-agent theory⁷ which builds on assumptions that people are rational economic beings in pursuit of self-interest and they respond predominantly to monetary incentives. Managers of organizations represent the absent owner (principal), but do not necessarily behave in the best interest of the owners since they possess the information necessary to make decisions (while owners do not), and they use this advantage to maximize their own benefits. Agency theory is positioning management and owners in adversarial roles. Its recommendations for governance structures draw on those opposing interests:

- manager cannot be trusted to protect owner’s interest and should therefore be compensated for performance in terms of share options to align his/her motivations with owner’s goals to increase share value;
- Chief Executive Officer (CEO) must be monitored closely;
- Board of directors must be independent from management and perform a supervisory (monitoring) function; and,
- CEO serving as Chair of the board (CEO duality) should be avoided.

In opposition to this view, the humanistic paradigm suggests that people are intrinsically motivated to ‘do the right thing’ and do not respond to extrinsic incentives to the extent proposed by the agency theory. Incentives or sanctions are counter-productive; managers can be trusted to do what is best for the organization, as they align their goals with the organization’s objectives. This understanding of human behaviour calls for governance structures that facilitate management autonomy and discretion; it supports CEO chairing the board and suggests that board directors should serve in an advisory role. Generous, but fixed, remuneration ensures that intrinsic motivations are not crowded out by a focus on compensation tied to financial incentives⁸. Table 1 summarizes the two contrasting views and assumptions behind agency theory and humanist theory of governance.

⁷ In this section we draw on extensive research on corporate governance, captured by J. Davis, D. Shoorman and L. Donaldson 1997. Toward a stewardship theory of management. *The Academy of Management Review*. 22.1:20-47; J. Grundel 2008. Are Managers Agents or Stewards of Their Principals? Logic, Critique, and Reconciliation of Two Conflicting Theories of Corporate Governance. *Journal für Betriebswirtschaft*. 58:141-166.; S. Turnbull 1997a. Case study. Innovations in corporate governance: The Mondragon experience. *Corporate Governance an International Review*. 3.3:167-180; S. Turnbull 1997b. Corporate governance: Its scope, concerns and theories. *Corporate Governance an International Review*. 5.4: 180-205. S. Turnbull 2007. *A sustainable future for corporate governance theory and practice*. SSRN; and Pirson & Turnbull 2011. Agency theory is attributed to Jensen M. and W. Meckling 1976. Theory of the firm: Managerial behavior, agency cost and ownership structure. *Journal of Financial Economics*. 3:305-360.

⁸ For example, evidence shows that many volunteer blood donors stop donating when financial remuneration is introduced in the system. Human relations are built on reciprocity—giving, with an expectation that others will also give as needed—rather than on financial gain. Benkler 2011 *The wealth of networks*. http://www.benkler.org/Benkler_Wealth_Of_Networks.pdf

TABLE 1.1 CONTRASTING AGENCY THEORY AND HUMANIST THEORY OF CORPORATE GOVERNANCE

	Agency Theory	Humanism /Stewardship Theory
theoretical basis	neoclassical economics	organizational psychology and sociology
performance criterion	shareholder value	interest in the company/ stakeholder value
owner-manager relationship	goal conflict	goal alignment
model of man	individual opportunism	pro-collective behaviour
managerial motivation	extrinsic (financial, status)	intrinsic ('doing the right thing')
general approach to uncertainty about managerial behaviour	distrust and uncertainty avoidance	trust and uncertainty acceptance
representative design recommendations	<ul style="list-style-type: none"> • monitoring the CEO as primary board role • independence of directors management and board sharing decision rights • financial incentives (stock options) 	<ul style="list-style-type: none"> • advisory role for the board • large discretion for management decisions • fixed salary • in co-operatives, demanding co-operative business management and governance expertise of the CEO*

* Trust between the board and the CEO is built upon the proven co-operative leadership track record of the CEO. It is a mistake for co-operatives to separate co-operative knowledge (as Board expertise) and the business knowledge (as CEO expertise). Instead, the two have to be inseparable and jointly viewed as critical competencies for governance and management. Source: Based on Grundei 2008 p143

Why is a humanistic approach the best fit for co-operative governance structures and control mechanism?

If they assume human behaviour to be consistent with agency theory, co-operatives may implement controls and governance structures that reinforce this behaviour as a ‘self-fulfilling prophecy’⁹. Instead, we argue, they need to design governance systems to induce stewardship and multi-stakeholder engagement. Co-operative members and leaders need to take into account complexity, uncertainty and human psychology¹⁰ as well when shaping their governance structures and control mechanisms.

Governance systems - rules, practices and processes by which an organization is directed and controlled - are self-imposed rules in co-operatives. In other words, members, through a democratic process, devise their own rules and regulations to ensure their goals are met over the long term, to prevent oligarchy and abuse of power, and to ensure stewardship over jointly owned assets¹¹. This is an evolutionary and dynamic process of adaptation to changes in external or internal conditions.

The humanistic perspective suggests organizational commitment to total value creation, rather than just shareholder value, and includes equitable distribution of rewards to all key stakeholders¹².

9 Grundei 2008 states this in general terms. For co-operatives, the issue is even more compelling.
 10 Research in psychology shows that people are not fully rational, or fully informed; they make decisions based on rules of thumb (bounded rationality, Simon 1957 *Models of Man: Social and Rational*. John Wiley and Sons). Personal judgement is often skewed and it can be based on distorted perceptions.
 11 Co-operative systems design needs to ensure a long term perspective beyond one generation of members. Bancel J-L. and O. Boned 2014. Heirs and annuitants of co-operative banks – three principles for securing the long-term future of co-operative governance. in *The International Journal of Co-operative Management*. 7.1:90-93.
 12 Pirson &Turnbull 2011.

2. JOINT (DISTRIBUTED) OWNERSHIP AND CONTROL

The foundation of an economic model as we know it is its form of resource ownership. Owners of an enterprise pursue their goals and objectives, and they put in place a governance system to ensure these objectives are met.

Small family businesses will typically make in-house decisions and run the business by themselves, monitoring their employees very closely. Family members are the owners, decision-makers, and executors. In contrast, in publically traded corporations owners are absent shareholders who hire professional managers to run the business on a daily basis on their behalf. Governance systems in this case need to ensure oversight to align managers who control the business with the goals (typically the return on the investment) of the owners. Ownership may be dispersed, or concentrated - it depends on the number of shares held by any one investor. Ownership may change hands easily since shares are traded in the capital market.

In contrast, co-operatives are jointly owned by their members-users (or producers), who also democratically control the enterprise. Control rights are distributed equally in primary co-operatives on a one-person-one-vote principle, and equitably (as decided by members) in second-tier co-operatives. In consumer co-operatives the majority of members are absent from the daily running of the business, but elected officials, as well as managers are most often members.

Typically, joint ownership is reflected in the self-imposed constraints on the withdrawal of a member's share, as well as on the reinvestment of a part of the surplus into indivisible reserves. On top of these constraints, co-operative shares cannot be sold on the open market¹³, and co-operative assets are often transferred to the community if a co-operative shuts down. This joint ownership, or a sense of a co-op belonging to 'us', is of critical importance in understanding co-operatives as a common asset, and devising appropriate democratic governance systems that fit with these characteristics of the enterprise.

The predominant neoclassical economic model assumes that human beings are rational self-interested individuals. Under this assumption, an asset owned in common will be subjected to overuse because each person looks to maximize their own benefit – the infamous 'tragedy of the commons'¹⁴. However, the evidence shows that assets held in common can be used sustainably by a community with self-devised and self-monitored rules of engagement, i.e. democratic governance systems devised and agreed to by those affected by an asset's use¹⁵. Members of co-operatives have been developing such rules since their very beginnings at Rochdale, and have embodied them in the co-operative values and principles. Governance architecture that allows members to exercise their right to control a co-operative in all its functions is at the heart of co-operative governance. For example, worker co-operatives, where members - insiders with access to information - engage in decision-making on a daily basis, do not face separation of ownership from control to the extent outside user-members do. To ensure equality among members, and prevent oligarchy, they often design flat systems of polycentric governance, with multiple small groups making independent decisions, and engaging in devising the rules (See for example chapters by McNamara and Cannell on Union Cab and Suma worker co-operatives, respectively).

“Governance architecture that allows members to exercise their right to control a co-operative in all its functions is at the heart of co-operative governance.”

¹³ Capital is de-incentivised in co-operatives, to ensure they are user-benefit organizations. Investment capital is typically restricted and it does not carry ownership and control rights.

¹⁴ G. Hardin 1968. The Tragedy of the Commons. *Science*. 162, 3859: 1243-1248.

¹⁵ E. Ostrom 1990. *Governing the Commons: The Evolution of Institutions for Collective Action*. Cambridge University Press.

BOX 1.2. THE THIRD INDUSTRIAL REVOLUTION AND THE SHARING ECONOMY

The third industrial revolution is caused by the convergence of the new collaborative communications technology and an imminent shift from fossil fuels to renewable energy, distributed in a dispersed system of micro-power plants connected in a decentralized network¹. The movement was initiated with the demand for reduced CO₂ emissions, reduction of dependence on fossil-fuels, and a push for a green economy. The new technology is itself co-produced as open source software protected under the creative commons licence, and shared via the Internet.

At the heart of the new sharing economy movement are social relations between peers. It is enabled by excess capacity of owned goods on the one hand (e.g. empty car seats or idle computer time) and an increase in demand for access and (re)use, rather than personal ownership of goods². Collaborative consumption includes examples of this trend such as carpooling, couch surfing, peer-to peer sharing of music, digital media and vacation housing.

Co-operative ownership is omnipresent in this new economy, recognised by Rifkin³ as the organizational form fit for governance of the commons. From distributed green energy co-operatives to carshare, co-operative ownership, unlike efforts of individual entrepreneurs, reduces the risk of commodification of the firm, and it attracts people with predominantly intrinsic motivations; it ensures joint benefits beyond the use of an asset and secures fair income distribution and equality. However, governance systems for such wide networked horizontal systems of ownership and use also have to be distributed and wide reaching to maintain participatory democracy - not to alienate members, but also to prevent power shifting, corruption and mission drift.

1 Jeremy Rifkin 2011 *The third industrial revolution* Palgrave McMillan

2 Yochai Benkler 2004 "Sharing Nicely": On Shareable Goods and the Emergence of Sharing as a Modality of Economic Production, *Yale Law Journal* 114: 273-358.

3 Jeremy Rifkin 2014 *The zero marginal cost society*, Palgrave McMillan p 211

Control rights that remain distributed, rather than concentrated, are an important component in networks as evidenced by demands of co-produced technology and the emerging collaborative systems. Independent producers/users/members (green energy co-operatives are an example) maintain joint control over the common resource. See Box 1.2.

3. DEMOCRACY (SELF-GOVERNANCE)

Democracy literally means 'power of the people'. In co-operatives, democratic member control is the key feature of co-operative organizations. It is built into co-operative values and principles, as well as co-operative law, but it is certainly not a unified concept as it manifests itself in different forms, thus yielding different levels of member participation.

Self-governance in co-operative organizations implies that governance rules are decided by the members, revisited on a regular basis, and are familiar to all members. In a situation in which the membership is not involved in governance matters, the risk of having a minority controlling the resources, taking decisions and wielding illegitimate power is high. It is for this reason that self-imposed rules need to deploy mechanisms for checks and balances as well. Enhancing democratic participation also means creating loyal relationships between the co-operative and the members, based on trust and transparent communication.

For effective co-operative governance, how do we engage members in decision-making in a meaningful way and ensure their control over the enterprise and its objectives?

If we had to list what “participation” means to a member, this list would include some of the following actions: becoming a member, participating economically through goods and services provided, taking part in meetings and general assemblies in order to discuss and deliberate, voting, contributing to committees, and standing for election to various councils/ boards.

Participation needs to penetrate the organizational culture deeply, both through participatory management and governance practices, engaging members and employees in decisions, and through connections with the larger co-operative community.

Insiders - employees – have the key role to play in strengthening democracy through deliberation, participation, and ultimately delivery of co-operative objectives, regardless of the co-operative type.

Insiders are much more motivated to engage in all forms of participation, as their contribution to the co-operative is non-alienable, i.e. they cannot work in two places at the same time. In worker co-operatives, and in multi-stakeholder co-operative forms, employee status goes hand-in-hand with membership and results in highly engaged members. Similarly, producer (worker) owners such as in agricultural co-operatives tend to result in high levels of engagement as co-operative membership is critical to a member's economic wellbeing.

Consumer loyalty, on the other hand, is much more fragile since a member's connection to the co-operative is often tenuous in the face of many alternative options of where to buy a product or a service. As consumer co-operatives grow, it is a challenge to maintain an engaged membership. Typically, a professional management team engages the members as customers, focuses on meeting customer preferences in terms of products and services, and concerns itself with being competitive in the marketplace. Opportunities for member control are limited to voting in Board of Directors elections and attendance at general meetings. Additional opportunities for member engagement (without implied control rights) take the form of customer surveys, focus groups, and loyalty programs.

Employees in all types of co-operatives form an important constituent group. Organizations practicing economic democracy, co-operatives and other¹⁶, ensure that employees have a voice in decision-making. Arguments in support of employee empowerment include ample evidence that employee participation in decision-making increases efficiency, productivity and overall organizations' effectiveness¹⁷. Employees who are empowered to make decisions that are affecting their well-being identify with the organization more readily and are more likely to align their personal goals and values with the organization's. But more importantly, when workers make decisions that impact their work life – from pay and benefits to work hours and working conditions, they are the source of innovation and the key element of adaptive resilience to the changing economic conditions.

Democratic decision-making in co-operatives presents an opportunity to engage employees in meaningful ways - as members, and/or in other ways as decision-makers (workers councils, seats on boards, etc.).

¹⁶ World Blu is one example of a global network of companies committed to workplace democracy. They certify and produce a list of democratic organizations. <http://www.worldblu.com/>

¹⁷ David Erdal. 2011. Beyond the corporation: Humanity working. Random House

BOX 1.3. MANY FORMS OF DEMOCRACY

Examples of relevant forms of democracy for co-operatives:

A **direct** democracy or pure democracy is a type of democracy where the people govern directly (a referendum).

A **representative democracy** is an indirect democracy where authority is held by the people's representatives.

Participatory democracy strives to create opportunities for all members of a population to make meaningful contributions to decision-making, and seeks to broaden the range of people who have access to such opportunities.

Consensus democracy is the application of consensus decision-making. It takes into account a broad range of opinions, including minority views.

Deliberative democracy is compatible with both representative democracy and direct democracy. Also called discursive democracy, it is a form of democracy in which deliberation (not mere voting) is central to decision-making. It adopts elements of both consensus decision-making and majority rule.

Associative democracy places the emphasis on freedom through voluntary and democratically self-governing associations.

Industrial democracy involves workers in decision making, sharing responsibility and authority in the workplace.

Sociocracy or **dynamic governance** is a democratic system of governance based on **consent** decision making, circle organization, and double-linked representation.

The advantage for co-operatives over other types of business is that employees can be offered membership, and therefore forge a deeper and more meaningful relationship that goes beyond work and that penetrates the entire organization.

In contrast with both the Employee Stock Ownership Plans (ESOPs) where employees are part owners but typically have no voice, and privately owned business implementing workplace democracy where workers are not owners, co-operatives can offer both the ownership and the control to their employee-members and elevate participation to higher level.

Co-operatives are built on relationships, and need to ensure that members have opportunities to exercise their democratic rights. Deliberation and decision-making can follow different rationales. Some co-operatives opt for democratic procedures based on consensual decisions, others apply proportional representation, or rely on majoritarian systems (see Box 1.3.).

Member voice is secured through governance architecture -multiple boards, or councils, for example-but members in a co-operative need to have opportunities to understand and participate in decisions through associational processes as well. An example of extensive engagement in decision-making is dynamic governance, or sociocracy, built on consent as the decision-making rule.¹⁸ Some ideas for member engagement include associational life not related to patronage (i.e. to the customer relationship), but affecting other aspects of a person's social life. Examples of these extended relationships include various social groups organized by co-operative members in Japan (see contribution by Masuda et al. in this volume), co-operative incubators offering gathering places and access to

¹⁸ John Buck and Sharon Villines. 2007. *We the People: Consenting to a Deeper Democracy*. SOCIOCRACY.INFO

information¹⁹, and community centres such as Cooperativa Obrera's in Bahia Blanca, Argentina²⁰. These forums bring user-members closer to the co-operative as its reach overlaps with other aspects of their social life.

Co-operative governance system design

Co-operative governance systems vary greatly due to path dependence (past decisions), legal, and other specific factors affecting the evolution of decision-making processes. However, these factors should not cloud our thinking as we imagine the best possible system for co-operative governance. In this section, we suggest that all co-operatives should assess the opportunities to elevate their governance through the use of network governance with multiple centres of decision-making and opportunities for engagement of members and other constituent groups. We believe that these elements are linked to the common properties of co-operatives as peoples' enterprises.

NETWORK GOVERNANCE

Generally speaking, hierarchical governance reflected in unitary board structures is inadequate because it concentrates power; it does not facilitate access to information; and is unable to deal with complexity²¹. Complexity needs to be broken down into manageable units, simplifying the responsibilities and duties of directors, executives and employees. The central issue with the unitary board structure is the inability to access full information due to uncertainty, coupled with human fallibility (information overload, expertise limitations, bounded rationality, and skewed judgement with oligarchic tendencies). This applies to the application of unitary board structures in any organizational form, including co-operatives.

We all operate within complex systems. Thus, the type of knowledge and expertise required will differ from one problem to the next, and it will change across issues and over time²². Arguments in favour of expert boards therefore place excessive expectations of a small number of directors who cannot hope to have an adequate scope of expertise. Furthermore, the expert, unitary board structure typically does not make provisions for decentralised nodes of decision-making that are more readily adaptable to a changing environment. Complexity requires access to multiple sources of information that can come from and be dealt with best by a more diverse network of key stakeholders - employees, consumers and suppliers.

These are some of the elements of co-operative networked governance²³ design:

- **Small independent basic** units that can function alone, but also form a part of the larger network, such as federations, industry networks, or solidarity networks;
- Decisions are made at the level closest to the basic unit (**subsidiarity principle**);
- **Multiple centres of control (polycentricity)** in a nested structure;
- Participation of **multiple stakeholders/constituents** with control over their domain of expertise (e.g. workers councils).

19 Impact HUBs are gathering places for social innovation. They often include co-operatives, but are not co-operatives themselves. They certainly offer a model worth exploring for increased engagement of co-operatives with the larger community.

20 Mariano Glas 2015. The co-operative social audit in Cooperativa Obrera, in *Co-operatives for Sustainable Communities: Tools to Measure Co-operative Impact and Performance*. L. Brown, C. Carini, J. Gordon Nembhard, L. Hammond Ketilson, E. Hicks, J. McNamara, S. Novkovic, D. Rixon, and R. Simmons (eds.) University of Saskatchewan Press.

21 S. Turnbull 2002

22 R. Stocki 2014 argues that expertise is domain specific. This implies that it is not possible to secure full expertise in unitary boards (Common meritocracy challenge: How members of the Mexican co-operative "Pascual" tack between oligarchy and democracy. *The International Journal of Co-operative Management*. 7,1:9-21)

23 Based on Ostrom 1999 Revisiting the commons. *Science* 284, 5412: 278-282; Carlsson & Sandsrom 2008 Network governance of the commons. *International Journal of the Commons*. 2, 1: 33-54; Marshall G. 2008. Nesting, subsidiarity, and community-based environmental governance beyond the local level. *International Journal of the Commons* 2,1: 75 -97
Pirson & Turnbull 2011.

Small independent units secure autonomous decision-making and the ability to adjust to changing circumstances on the ground - this may be a production improvement, a system improvement, or a simple observation that the working environment is changing. Small units also facilitate direct democracy.

Subsidiarity principle assumes decision-making at the lowest possible level in the organization. If basic units have the means and capacity to act on their own, the next tier in the network need not be involved. The subsequent tiers in the organization provide complementary services to basic units, rather than substitute for their decisions and responsibilities.

Multiple control centres (polycentricity) in co-operatives need to protect joint assets, secure democratic voice, and enhance stewardship/humanism within all layers of the organization. These centres/boards include independent conflict resolution mechanisms; small group coordination; general member meetings; representation in nested organizational systems; feedback systems through double links (see sociocracy / dynamic governance- Box 1.3.); and access to various types of expertise²⁴ (co-operative management and co-operative strategy expertise; technical expertise; business operations; risk; and so on).

Multiple stakeholders are a valuable source of information with access to many of the expert fields required for effective decision-making in a co-operative. Co-operative values, purpose and nature are conducive to engagement of multiple constituents as they strive to benefit members and communities.

Although some stakeholder participation and engagement may be developed without a membership status, in a network built on stewardship and solidarity, consultations with members are ongoing. The multi-stakeholder co-operative form would most easily enable substantial engagement of a broad group of stakeholders in the co-operative governance, as all key stakeholders /patrons (consumers, workers, suppliers)²⁵ are potential members. This creates an advantage in networked governance design for the co-operative form of organization over a single member type co-operative²⁶.

For some co-operatives, especially with single membership type, it will possibly not feel natural to consider the implementation of the above elements of networked governance. In small co-operatives where trust is high and members are closely connected to each other and to other constituents, they may not need to. However, even in small consumer co-operatives, employees ought to have decision-making powers on matters that impact their personal growth and the work environment; they are the frontline in co-operative's dealing with other stakeholders and the harbinger of co-operative health.

Can network governance elevate participation to a new level?

To reiterate, the proposed co-operative governance design is based on the three inherent properties (humanism, democracy, and joint ownership and control) and the implementation of some or all of the suggested network governance elements. We assert that these elements can relate to any co-operatives (not just small, worker, or multi-stakeholder co-

²⁴ P. Couchman 2015 – personal communication.

²⁵ Only two major stakeholder groups are members in some cases (e.g. EROSKI with consumer and worker members), while other may include more than two distinct member types (e.g. multi-stakeholder co-operatives in Quebec with consumers, workers and supporting members).

Outside investors, where engaged, have a limited term interest in co-operatives. They should therefore not be treated as other (user) stakeholders. This view is further supported by the principle of autonomy and independence, and a secondary role for capital in user-owned co-operative enterprises. This does not mean that investors cannot contribute to decision-making, but this engagement is typically limited and controlled.

²⁶ MSC form can also present a challenge if its design structure positions various constituents in competition for limited resources, rather than collaboration, building synergies and growth based on their complementary strengths.

operatives): small independent basic units; subsidiarity principle; multiple centres of control (polycentricity); and engagement of multiple stakeholders/constituents.

Combined, these properties and elements are powerful forces that can elevate participation to a new level and deliver a “potent combination of empowerment, autonomy, and efficiency”.²⁷ In the words of the Blueprint for a Co-operative Decade, “[t]he individual member has a role to play in a co-operative which goes beyond the basic economic relationship of customer, worker or producer. Collectively members own their co-operative, and through democratic arrangements they participate in its governance. Individually they have a right to information, a voice, and representation.” To achieve great governance, the co-operative sector must evolve. This introduction chapter and the contributions in the chapters that follow provide fodder for the necessary, ongoing discussions required by individual co-operatives, networks, and the global alliance in order to achieve a governance design that encourages stewardship by protecting democratic control of the commons.

27 Turnbull 2002:22

2

The design of effective democratic governance structures for large co-operatives

JOHNSTON BIRCHALL

 EDITOR'S CORNER

Linkages between this chapter and inherent co-operative governance properties: humanism, joint ownership and control, and democracy.

The introduction to this chapter presents arguments built on the assumptions of agency theory of governance. Birchall draws on his previous work to further develop elements of “member governance¹”, a concept more closely aligned with our vision of the fundamental properties of co-operative governance.

The author positions co-operative governance around three elements (slices of a cake) - **involvement, representation and expertise**; a compelling approach, complementary to our own. The first two ‘slices of the cake’ form elements of democratic decision-making; the third belongs to our design section where we draw on network governance to improve access to information by inclusion of multiple constituents to break down complexity.

Birchall discusses various ways in which elected directors access expertise in large co-operatives. **Democratic decision-making** is the key concern in this elaboration. Among the approaches are two tier boards with sufficient powers given to elected directors.

Connecting this chapter to network governance design concepts: small independent basic units, subsidiarity principle, polycentricity, and multiple stakeholders.

To ensure representation, co-operatives resort to network governance with **multiple centres of decision-making** and voice related to patronage. Birchall highlights some examples of this governance design for heterogeneous members and complex environments.

Subsidiarity: Recognising the diversity of approaches, the author indicates that most large co-operatives with a strong member-centred focus develop complex network structures with appropriate distribution of authority between the levels in the organization.

Multiple Stakeholders: Birchall outlines four governance complications of which two directly relate to multiple member types. The author points out that in heterogeneous-member (multiple stakeholder) environments a co-operative needs to create forums for the voicing of different interests; in other words, enable multiple-constituent engagement in governance.

Birchall closes with the observation: “Co-operatives that do have a strong member-centred focus also have more complex structures through which members can express their voice”, indicating that in practice, co-operative governance design often takes on network properties.

¹ Birchall 2014a The Governance of Large Co-operative Businesses Manchester: Co-operatives UK (republished by New Zealand Co-operatives Association): 17.

2. The design of effective democratic governance structures for large co-operatives

JOHNSTON BIRCHALL

Introduction: why size is a problem for democratic governance

It is generally assumed that the larger the co-operative the more difficult will be its governance. What is it about size that leads us to this assumption? There are (at least) five problems that grow with size. The first problem is *the larger the co-operative the more limited are the ownership rights of the members*. There are many members each of whom only owns one share, the value of which is usually fixed at a low level. They cannot share in the growing value of the business through revaluation of shares, as these are not traded. Sometimes the profits will be returned to them in the form of a dividend, but this is based on the use they make of the business not on their investment. Sometimes there is no return at all, and all the profits go to build up reserves. The less the members feel they own the co-operative, the less likely they are to support it and to take part in governance. The co-operative becomes in practice a kind of non-profit whose board of directors act more like trustees than elected representatives.

“The less the members feel they own the co-operative, the less likely they are to support it and to take part in governance.”

The second problem is *the larger the co-operative the greater the complexity of the business*. Governance systems designed for small, community-based businesses are now being applied to very large national and sometimes international conglomerates. Their complexity partly derives from having subsidiaries and joint ventures that can only be governed indirectly by their members. This is made worse by the trend towards internationalisation, so that the members who continue to live only in the country of the co-operative's origin cannot easily oversee the whole business. Both the UK Co-operative Group and OVAG failures are actually a failure effectively to govern subsidiaries, made worse in the latter case because the subsidiary was operating in other countries¹.

Third, there is a collective action problem. *The larger the co-operative, the more likely the members are to free-ride on the participation of others*. When there are many members, and the contribution of each member is likely to have a minimal effect, the rational response is to let others do the work. This is true also of widely-held companies that have many small shareholders, but if there are large shareholders such as pension funds and mutual investment funds they will find it more rational to take part and bear some of the costs of governance.

Fourth, there is a problem of managerial capture. *The larger the co-operative, the more difficult it is for the governors to control the managers*. Principal-agent theory says that boards of directors are the principals and the managers are their agents. It predicts that, if they are not stopped, managers will further their own interests rather than those of the board and the shareholders. They will tend to extract more rewards from the business than the board needs to pay to ensure effective management. They will tend to build empires for themselves, avoid risks by building up unnecessarily large reserves, and so on. What stops them is not just good governance but government regulation combined with profes-

¹ See Birchall J (2013a) *Finance in an Age of Austerity: the power of customer-owned banks* Cheltenham: Edward Elgar (in paperback 2014)

sional ethics. Co-operatives, by their nature, cannot offer share options to managers and so their interests are likely to be poorly aligned with those of the owner-members.

Finally, there is a problem of lack of focus. *The larger the co-operative, the more difficult it is for it to keep focused on the needs of the members.* Here the argument is that, while investor-owned companies have one overriding goal – to maximise value for shareholders – large co-operatives struggle to find meaning. Their boards lose the focus on members and begin to see the co-operative as having broader obligations. For instance, consumer co-operatives begin to see their goal as to give value to customers in general or to a variety of ‘stakeholders’. They have a double or even triple ‘bottom line’, and so will be harder to govern than their investor-owned competitors.

These problems may afflict all large co-operatives, but they are more severe in consumer than in producer co-operatives. In discussion of governance, it is useful to make a simple distinction between these two types. A producer co-operative is owned by people who need it in order to be productive, either as individuals in a worker co-op or as business people whose own businesses depend on services the co-operative provides. The category includes: farmer co-operatives; employee-owned co-operatives; retailer-owned wholesale co-operatives; professional partnerships constituted as co-operatives; shared service co-operatives (designed to support small businesses); farmer-owned banks, and so on. A consumer co-operative is owned by people who need it in order to provide for their consumption needs. The category includes: retail consumer co-operatives; mutual insurance companies; co-operative banks and credit unions; health co-operatives; utility co-operatives, and co-operatives that provide for any other kind of consumption good.²

“The problems of governing large co-operatives are felt at some time by all co-operatives regardless of their type, and effective governance must always be a priority.”

Member-centred governance is easier in a producer co-operative. Its members need it in order to make their own living, they can usually keep it focused on their needs, and have enough of an incentive to ensure representative governance. A very large consumer co-operative may struggle to make membership meaningful. There are often millions of members, their attachment to the co-operative may be weak, and they can usually switch to another provider.³ The co-operative may find it difficult to persuade members to participate, and may lose its focus. In the study of the top 60 co-ops, analysis of their websites showed that the three largest retail consumer co-operatives emphasise different ‘owners’; Co-op Swiss focuses primarily on customers, Migros on the community, and SOK on members.⁴ However, the problems of governing large co-operatives are felt at some time by all co-operatives regardless of their type, and effective governance must always be a priority.

Cutting the cake: the three elements of good governance

There are three elements that all have to be present in some degree for there to be effective governance. In my report on the governance of the 60 largest co-operatives, I used a simple metaphor of a cake that is cut into three pieces. These pieces are member involvement, representation and expertise. None of the co-operatives cut the cake in exactly the same way. Some assume that representatives will have the necessary expertise so they cut a very large slice for representation. Some do the opposite, using the nominations process to ensure that only people with expertise are elected to the board, in which case they cut a very large slice for expertise, neglecting the representative function. Some of

² There is a more elaborate treatment of this subject in ch.1 of Birchall, J (2011) *People-centred Businesses: Co-operatives, Mutuals and the Idea of Membership* London: Palgrave Macmillan

³ The ‘exit costs’ are sometimes higher, though, for instance if one has a pension with a mutual or a contract with a utility co-op that is a monopoly supplier

⁴ Birchall (2014a)

these also cut the cake so that member involvement is a very thin slice indeed! The obvious conclusion is that in designing co-operative governance we should make a deliberate attempt to balance the three elements.

There is another tempting metaphor that we might use, of a cake mix. The three elements are seen as ingredients that are weighted out in the right quantities, whipped up together and then baked to create the perfect governance cake. However, this metaphor is misleading. It suggests that member involvement, representation and expertise can be mixed up together and this is wrong. They should be kept separate and given their due weight in the design of the co-operative governance structure. Of course, members of the board are themselves involved members, representatives and (we would hope) reasonably expert as well. In practice, the three elements are all present to some extent whenever a board meets. Yet we should keep to the simpler metaphor of three pieces of a cake, because it helps us think more clearly, particularly when designing or attempting to redesign a governance structure. Now we can discuss the three elements in turn and learn some lessons from the study of the 60 largest co-operatives.

1. MEMBER INVOLVEMENT

In very large (consumer) co-operatives, the most important contribution that members make to governance is to vote in a representative body to govern on their behalf. They do this in at least three different ways. In some co-operatives, they have one vote each and cast this for candidates nominated for them by the board. This can be the most democratic method, but not if the board insists that their nominated candidate is always endorsed without any choice of other candidates. There is also the problem for a very large number of members in judging who is worthy of their vote. A second alternative is to have a large (100-400 member) delegate assembly. Here, the members elect delegates who then elect the board. This could encourage more competition for places, and more accountability. However, sometimes this method can lead to factionalism among the delegates, who, if there is a low turnout among members willing to vote, can be unrepresentative. It is important that the delegate assembly has an open ethos, because it forms the AGM and so ordinary members are typically not allowed to take part. A third option is to have a smaller member council (40-100 members). Here, the members elect a small representative body who act more like a nominations committee to a much smaller board of directors. They can be made up of the chairs or presidents of regions, or be elected from the regions. They either elect the board or advise the members about who to vote for.

There is an urgent need to gather examples of good practice in the 'orchestration' of member involvement. When a co-operative reaches a certain size (not very large!) the members need commitment from the board and managers to keep them involved. Otherwise they are disenfranchised, and lose interest. If their interest is important to the business model – for instance, relying on the loyalty of farmers choosing to market their crops through the co-operative – then this impacts on performance. However, if the business model does not really need their input (for instance, in large mutual insurers and consumer co-operatives that operate more like non-profits with a trustee board) the board and top managers have to be committed to promoting member involvement. This can be through a sense of moral obligation, or through belief in the co-operative business advantage, or both.

It is easier to get member involvement in producer co-operatives than in consumer co-operatives.⁵ People whose own businesses or livelihoods depend on the co-operative are more likely to be incentivised to participate. Why should members participate in large con-

⁵ This point is discussed in more depth in Ch.10 of Birchall, J (2013a)

sumer co-operatives, co-operative banks and insurance mutuals? The free rider problem, and the lack of personal incentives to participate, are acute.

Fortunately, people are more complex, and more interesting, than the conventional economists would have us believe and so it is possible to orchestrate member involvement, at least among an interested minority.

2. REPRESENTATION

All co-operatives have to find a way of representing their members in their governance, otherwise the purposes of the business will become out of line with what the members need and expect. Other things being equal, the larger the co-operative, the more likely it will be to 'deform', either into a business run for the benefit of the managers, or a non-profit in which the board of directors act more like trustees. If the interests of the members are similar, it will be easier to govern on their behalf. However, the larger the co-operative, the more likely it will be that the interests of members will diverge. This is not always the case; for instance, single purpose farmer co-operatives in grains or dairying can become very big while their many thousands of farmer-members all need roughly the same services. CHS, the giant American grain co-operative is a good example; it has 77,000 farmers in membership but they are all in the same kind of farming. The same is true of large dairy co-operatives. However, if co-operatives serve both small and large farmers, or regions where farming faces different technical challenges, their governance structure will have to take the strain of different needs and expectations. Consumer co-operatives that have retained their traditional two-tier structure of primary societies and a secondary tier have a fairly easy set of choices over governance; the Finnish secondary co-operative SOK is a good example, reproducing the same kind of governance structure at the national level as its members have in the regions.

In producer co-operatives, one way to make sure divergent interests do not arise is to tie members closely into the business through contracts. Their conditions can be demanding. Rewe (Germany) ties its members in through a goods-purchase agreement and a service level contract. Leclerc (France) has a minimum contract term and penalties for premature withdrawal. They can do this because the relationship is so important to the members. In consumer co-operatives, where the business is not central to the lives of the members, this alignment of interests is more difficult to achieve. Insurance mutuals can do it for life insurance coverage and pensions because their contracts are long term, but for the annual assurance business all they can do is offer bonuses for loyalty.

Co-operatives have to find a way to enable different interests to be represented, whether it is through regional groupings, or electoral colleges for different types of member. Because the interests of members shift over time, it is important to keep these governance structures under regular review. For instance, every five years the giant American dairy co-operative, Land o' Lakes, evaluates the boundaries of its regions and the number of directors elected from each region so that the number of directors reflects the proportion of patronage income coming from each region.

There are at least four complications that make the task of representation even more complicated.

Complication 1 – when co-operatives have different types of member

If, through amalgamations and takeovers, co-operatives begin to serve two or more distinct types of member, they will have to design their governance structure very carefully. They will also have to align incentive structures so that the members feel they are being

fairly rewarded. Danish Crown, for instance, has separate electoral districts for pig farmers and cattle farmers. Land o' Lakes does the same for dairy farmers and a broader group of farmers who benefit from its farm supply business.

Most co-operatives cut down on the potential **costs of governance** by having only one type of member, but some are deliberately designed to have more than one. The retail co-operative, Eroski, is based in Spain and now France, and it was designed to have both employee and customer members. Its governance structure has been carefully designed to have an equal number of representatives for each, but with a consumer-chairperson having a casting vote. The Korean co-operative, iCoop, has both consumers and farmers in membership but it is comparatively small and it will be interesting to see how its governance structure develops as it gets bigger.

Complication 2 – when co-operatives have both individuals and other co-operatives in membership

In some cases the growth process has led to one complex hybrid organisation owned by both primary co-operatives and individual members. There are three of these among the top ten farmer co-operatives: CHS, Land o Lakes, and Dairy Farmers of America, all based in the USA. The UK Co-operative Group has the problem of two very different types of member: individuals who join through its stores, and regional co-operative societies that use its wholesale and distribution services. Credit Agricole (France) has the added complication of a minority of investor-owners.⁶ If the ownership structure cannot be simplified, it should be made even more complex, by the co-operative providing forums for the voicing of different interests, which then come together at a higher level of decision-making after they have (one hopes) reconciled their differences. If conflicts remain, governance is likely to be costly, and the only way to avoid this is to find a way of insulating the board from the conflict.

“If the ownership structure cannot be simplified, it should be made even more complex, by the co-operative providing forums for the voicing of different interests,”

Complication 3 – when market-based and representative relationships conflict

Often, primary co-operatives buy services from a secondary co-operative of which they are also members. This creates two types of relationship, one based on market transactions and the other on ownership. In the UK, during the 1980s and 1990s the CWS (precursor to the Co-operative Group) was owned by regional co-operatives but their relationship to it was often antagonistic because they felt it was not helping them to compete effectively with multiple chains on price. In Canada, the demutualisation of the big wheat pools came about partly because primary co-operatives found they could get a better price from partnerships with investor-owned food companies (even when they are members of a secondary co-operative, primary co-operatives may choose to take their business elsewhere). On the other hand, the European co-operative banks and North American credit union systems act in solidarity, with a group structure that emphasises their mutuality.⁷ It is important to see exchange relationships between co-operatives as being different from market transactions.

Complication 4 – when co-operatives become transnational

Very large co-operatives based in one country often cannot resist expanding into neighbouring countries. It can help to spread costs, and bring large profits back to the business. However, it can also be risky – the Austrian co-operative banking group, OVAG, lost so much money during the banking crisis that it had to be bailed out and then partially nationalised by the government. It was not its home market that brought it down, but the

⁶ See Birchall, J (2013b) *Good governance in minority investor-owned co-operatives: a review of international practice* Manchester: Co-operatives UK

⁷ See Birchall, J (2013c) *Resilience in a Downturn: the power of financial co-operatives* Geneva: International Labour Office

losses made in its subsidiaries in Central and Eastern Europe. With hindsight, we can see this as a governance failure as well as a failure of business strategy; if its board had asked the members whether they wanted to expand into other countries they would probably have said no!

However, there are sometimes good reasons for becoming transnational. Farmer co-operatives in Europe have had to do it in order to remain competitive within a very consolidated food industry. Arla Foods now operates in Sweden, Denmark, Germany, Luxembourg, Belgium and the UK, and it has developed a tiered structure of regional, national-level and group-level boards that has enabled its governance to keep pace with the expansion.⁸ Crucial to this has been its policy of insisting that the farmers who supply it in each country become owner-members.

3. EXPERTISE

Often, co-operative boards think they have the expertise needed to run their business without bringing in independent directors. Sometimes they are right. Unfortunately, if they are wrong, they only find out when a weakness in the skill and knowledge set of the board has been exposed, and it may then be too late to undo the damage. This is what happened in the Co-operative Group. In the study of the 60 largest co-operatives, around half have appointed independent directors and others are considering this, but the boards of some of the biggest businesses see no need for it. In its old governance structure (superseded in November, 2014), the Co-operative Group had the option but did not use it except in its subsidiary boards.⁹ The Co-operative Bank had two independents but this did not save it from a massive governance failure that was exposed when the Bank's losses finally became known.

In considering this third piece of the governance 'cake', again we find differences between producer and consumer co-operatives. Farmer co-operatives have directors who are immersed in the business (some of them running more than one farm and having considerable business skills). Employee-owned businesses have directors who also know a lot about the product and the market they are in. Co-operatives of professional people and shared service co-operatives owned by small businesses have a wide range of business skills to draw on. Most of them see no need for independent non-member directors.

Primary consumer co-operatives that only have individual member-representatives on the board struggle to meet the demands of a rapidly changing and sophisticated market. They can either appoint independents to fill their skills gap, or use a powerful nominations committee to ensure the 'right people' get elected. The problem with the first option is that independents generally expect to be paid far more than the member-directors and so there can be some envy and loss of motivation. The answer may be to try to bridge the gap and pay all board members more generously for their time. This would also have the benefit of encouraging people who currently cannot afford the time to put themselves up for election. The second option, of using a powerful nominations process, is clearly being used by some very large consumer co-operatives (such as Co-op Swiss) to ensure an expert board results. Secondary consumer co-operatives do not have such a big problem, as their board members are generally the chairs or CEOs of member co-operatives and so they are already expert. However, in the case of the Co-operative Group which has a mixed membership, board members representing regional societies did not perform much better than those representing the Group's own customers. It still lacked that crucial ingredient – independent and critical thinking.

⁸ See Birchall, J (2014a) for details

⁹ Birchall, J (2014b) 'Innovation in the governance of large co-operative businesses: the alarming case of UK Co-operative group' in *International Journal of Co-operative Management* 7.1, August, 22-28

The underlying need is for board members who can challenge the consensus, especially when a risky business strategy is being pursued. Independents may make better challengers, but it is also the job of the member-representatives to call managers to account. The important issue here is whether the board members have access to independent information and advice that enables them to challenge the assumptions of powerful and charismatic CEOs. They also need effective – and mandatory – training that makes them realise when they need to ask for such advice.

“The underlying need is for board members who can challenge the consensus, especially when a risky business strategy is being pursued.”

Another way of ensuring effective scrutiny and challenge is to design a two-tier structure in which a larger group of member representatives oversees the work of a smaller board of directors. In the top 60 co-operatives there are a variety of groupings that serve this function. The variety is bewildering because they use different names for the same kinds of groups, they can vary in size from 30 to 400 people, and they can be voted in directly by the members or by even larger representative bodies that themselves represent regions or different types of member. What they have in common is that they have enough powers to be able to influence the election of board members and call them to account. They have members on the nominations committee or can directly nominate a certain number of board member positions, they appoint the auditors and accept (or decline to accept) annual reports, and so on. The jury is out on whether the new structure of Co-operative Group will give sufficient powers to its 100 member representative council effectively to carry out these tasks of scrutiny and challenge.¹⁰

Some lessons from the study of very large co-operatives

The study of the top 60 co-operatives shows an amazing variety in their governance structures, most of which seem to work. One lesson is that there is no simple blueprint for good governance. In redesigning their structures, co-operatives should look at what others are doing, but they need to be careful about adopting someone else’s structure in its entirety. Structures are designed, but then they evolve in all sorts of interesting ways as the organisation grows and becomes more complex. Much of the evolution is – like natural evolution – due to adaptations that have been found to work, and so the search for good governance demands a long-term commitment. It also demands flexibility in building on what works, and courage in getting rid of what does not work.

Another lesson is that we should not be frightened of complication. Governance structures can be too simple. Look at the structure of big co-operative groups such as Mondragon Corporation or Desjardins Group; they are multi-layered and have a carefully thought out distribution of authority between the levels. On the other hand, some very large co-operatives can have a simple, more conventional structure. In the ‘Governance of large co-operatives’ study, several co-operatives were described that operate through a holding company so that the members are also shareholders. They are conventionally governed through a small elected board of directors. Those co-operatives in the top 60 that are closest to being investor-owned (operating through a holding company, treating members as shareholders) are much more likely to have a simple governance structure with a strong central board and little opportunity for member participation. Co-operatives that do have a strong member-centred focus also have more complex structures through which members can express their voice. Governance is far too important to be left to chance.

¹⁰ See Barber, H, Mayo, E and Birchall, J (2014) *Myners Plus: How to make a success of governance proposals developed by the Myners Review for The Co-operative Group*, Manchester: Co-operatives UK

3

Governing Resilient Co-operatives: Agricultural Co-operatives in Scotland

RICHARD SIMMONS, BOB YUILL, JIM BOOTH

Linkages between this chapter and inherent co-operative governance properties: humanism, joint ownership and control, democracy.

This article sets the stage through its discussion of how co-operatives must respond to complexity through building resilient systems and ensuring sustainability; for co-operatives, this requires approaches that embrace conservatism, adaptation, and exploration.

Humanism and Democracy: The chapter lines up with the humanistic approach to governance and management. The authors believe that a concentration of power in apex bodies or view of governance as being about control and certainty to be “wholly inadequate to sustainably govern the co-operative”. Instead, the authors take a position that the Board’s role is to develop strategy and provide support to management, but governance is a “broad and deep alliance” of all key stakeholders engaged in a co-op. Managers and directors are trained to understand the co-operative business, to pursue co-operative strategy and to engage membership in this process. Engagement is about “deep member relationships” rather than “shallow transactions”.

Strong positions are taken on the importance of member participation in decision making with a tie to the type of decision being made. In particular, ‘wicked problems’, due to their complexity, require involvement at three levels: participation (full membership); governance structures (Boards and other formal bodies); and management. At the same time, some operational problems don’t require extensive participation and should be made by either management or the board. The above discussion is supportive of our positioning of a humanistic (people-centred) and democratic (participatory) approach to governance.

The chapter highlights reliance on members in building the co-op strategy. A mechanism to gather information from members (and other key stakeholders) on an ongoing basis is necessary for effective co-operative governance. Giving members voice “can provide vital intelligence and act as a counterweight to the dominance of overly-narrow command-and control or managerialised approaches”.

Joint ownership and member control: That co-operatives are businesses belonging to a community is an assumption woven throughout this chapter. It describes SAOS, a second tier agricultural co-operative, whose role is to ensure that a network of co-operatives remain viable to provide long term benefits to multiple generations of members and their families.

Connecting this chapter to network governance design concepts: small independent basic units; subsidiarity principle; polycentricity; multiple stakeholders.

Multiple Stakeholders: The authors share our view that governance in co-operatives is about deep engagement of members and key stakeholders - “effective governance entails recognising and managing the multiplicity of interactions throughout the whole co-operative, and between the co-operative and its business environment”.

Polycentric (compound) boards and subsidiarity: The chapter discusses the role of the Board of the second-tier co-operative in providing strategic direction to the co-operative, its members and the wider community. Each member co-operative engages its farmer members in their governance.

A second tier co-operative is a nested network by design. This feature adds strength to co-operative governance and provides an extension of access to required expertise framed by co-operative identity. Access to information and expertise building through training and networking is realised through cross-pollination of knowledge among the leadership of various co-operatives in the network: their directors, managers, and members. Governance training is covered in detail by the authors as the quality of the board, coupled with their strategic capability, is argued as the most important factor in the success of a co-op.

3. Governing Resilient Co-operatives: Agricultural Co-operatives in Scotland

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Introduction

This Chapter draws on the ongoing experience of the Scottish Agricultural Organisation Society Ltd (SAOS)¹ working with its agricultural co-operative members concerning their governance, strategic planning, membership and management. It considers the dynamic and ongoing nature of governance, the factors that provide threats and opportunities for resilience, and the strengths and weaknesses of co-operatives in dealing with these issues. The discussion addresses governance as a broad and deep alliance between all the people who should be making decisions and shaping the outcomes of their co-operative(s) and who, at the same time, are working to contend with complex systems including increasingly rapid changes that are affecting food production, processing and distribution. This alliance is about developing governance structures and practices that pay attention to everyone who has a role and a stake in shaping their co-operative, its functions and performance, not just the people acting as directors or who are senior managers. The Chapter sets out some of the key issues for co-operative governance, before outlining how SAOS's learning on these issues has evolved, and how a set of tools and resources has been developed to support agricultural co-operatives in Scotland.

Responding to Change: Building Resilience and Sustainability

It has been claimed that **society has recently emerged into a state of permanent crisis, in which a 'mix of urgency, high stakes and uncertainty' have become the norm** ².

In this new operating environment, there is a need for co-operatives to be resilient enough to cope. The emerging objective of SAOS and its co-operative members is to build sufficient resilience to deal with our uncertain future. That is, resilience that encompasses individuals, their family, their community and their business. It is about how each of these can work together in support and planning, so that their co-operatives are able to deal adequately with inevitable shocks emanating from this uncertain future.

Throughout agriculture and downstream food business there is inexorable change being forced by significant 'change drivers':

- Commodity price volatility (largely due to speculation and globalisation of food trade)
- Growing food demand (from rising population and increasing wealth particularly in India and China)
- Climate change and resource scarcity (Stanford University climate scientists warn that the likely rate of change over the next century will be at least 10 times quicker than any climate shift in the past 65 million years³)
- Incredible technologies (genetic modification, drones, big data, robotisation)

¹ For details see www.saos.coop

² Heifetz, R., A. Grashow & M. Linsky (2009) Leadership in a (Permanent) Crisis, *Harvard Business Review*, July/August: 3.

³ Diffenbaugh, N. & Field, C. (2013) Changes in Ecologically Critical Terrestrial Climate Conditions, *Science* 341: 486-492

- Retail competition (heavy discounting of staple foods to drive footfall)
- Corporatisation (shift away from family farms, increasing vertical integration)

These six change drivers have created a new and shifting paradigm for agriculture. However, such shifts also prefigure a degree of uncertainty about the particular form of resilience that is required. Organisational resilience can be defined as both:

- a capacity to tolerate disruptions and absorb shocks so that no change is considered to be necessary
- a capacity to adapt to disruptions through change in structure, processes and functions

Resilience therefore appears to rest on the ability for successful resistance in some instances, and the ability for successful adaptation in others. These definitions may seem contradictory, but they each represent different approaches to problem-solving.

THE NATURE OF CO-OPERATIVE RESILIENCE: CONSERVATISM, ADAPTATION AND EXPLORATION

“Co-operatives’ capacity to tolerate disruptions and absorb shocks may be hailed as a strength.”

Co-operatives’ capacity to tolerate disruptions and absorb shocks may be hailed as a strength. For example, in sectors such as financial services it is claimed that their more conservative, member-led business approach has exposed co-operatives to less risk and enabled them to survive recent crises more effectively⁴ (Birchall, 2013). Conservatism may be understood as a disposition to preserve or restore what is established or traditional and to limit change. Indeed, SAOS’s experience is that when change is happening around them, co-operatives are often found trying to rebuild some aspect of their past as the simplest way to deal with their unpredictable future.

Conservatism implies closing organisational boundaries to the environment in an attempt to ‘ride out the storm’ of external change. This may be appropriate for a short time, or in relation to certain developments (e.g. unproven innovations in crop technology or animal husbandry). But, what if this approach also inhibits necessary change. In other words, if it is used to withstand forces that ought to lead to change and ought not be resisted? Research has shown, for example, that large organizations that positively reinforce this way of thinking can nevertheless maintain themselves, (albeit in an underperforming system state) for extended periods of time⁵. Mamouni-Limnios et al 2014⁶ therefore argue that, on its own, conservatism is not enough for sustainable resilience. Sustainable resilience requires the organisational wisdom to know when such an approach is appropriate, and when to recognize that it is part of the problem rather than the solution⁷. Organisational research suggests such wisdom lies in balancing more than one approach to change⁸.

Conservatism represents one form of ‘strategic defence’. A second, in which organisations tend to remain more open to their environment in determining their strategy, has been termed ‘dynamic conservatism’ (or ‘changing to stay the same’⁹). Many co-operatives employ strategies of ‘dynamic conservatism’. ‘Strategic retreat’, for example, involves a return to the original mission and core business. This may be important, particularly if the co-operative has experienced a degree of ‘mission creep’ over the years. An example in

4 Birchall, J. (2013) *Finance in an Age of Austerity*, Cheltenham: Edward Elgar

5 Derissen, S., M. Quass, & S. Baumgartner (2011) The relationship between resilience and sustainability of ecological-economic systems. *Ecological Economics*. 70(6), 1121–1128

6 Mamouni-Limnios, E., T. Mazzarol, A. Ghadouani & S. Schilizzi (2014) The Resilience Architecture Framework: Four organizational archetypes. *European Management Journal*. 32: 104–116

7 Grint, K. (2009) *Leadership and Resilience Research Report*, ESRC, Available at http://www.esrc.ac.uk/_images/Grint_Summary_30_Oct_09_tcm8-2436.pdf

8 March, J. (1991) Exploration and exploitation in organizational learning. *Organization Science*. 2(1): 71–87; March, J. & T. Weil (2005) *On Leadership*, Malden, MA: Blackwell Publishing

9 Ansell, C., A. Boin & M. Farjoun (2015) Dynamic Conservatism: How Institutions Change to Remain the Same. in M. Kraatz (ed.) *Institutions and Ideals: Philip Selznick’s Legacy for Organizational Studies, Research in the Sociology of Organizations*. Vol. 44:89 – 119. Emerald Group

Scotland is ANM Ltd, who have re-focussed on their core business of auctioneering and livestock marketing. Another form of dynamic conservatism is 'self-cannibalization', or the strategic introduction of new products/services in full knowledge that this will reduce demand for the co-operative's existing products/services. This may provide an important pre-emptive strategy to avoid being overtaken by external change. An example in Scotland is the machinery/Business Rings¹⁰ who are introducing new services e.g. labour training and services that are now overtaking the core business of machinery sharing.

While conservatism and dynamic conservatism represent different forms of 'strategic defence', there is a third response to change - 'Exploration' - that implies 'strategic offence'¹¹. Exploration involves scanning the external environment for new opportunities, engaging in strategies of experimentation and repositioning. It exhorts co-operatives to 'embrace the disequilibrium that will provide just enough pressure on members to accept the necessary changes, and maximize their opportunities to participate in change by supporting organizational experiments'¹². While agricultural co-operatives may be justifiably concerned about the long-term effects of certain innovations largely driven by corporations seeking profit by producing 'fixes' for what previously had been unknown problems (such as hormone bovine somatotropin to increase milk production, or manufactured crop genes that provide resistance to glyphosate herbicide, or rumen antibiotics to increase the 'efficiency' of beef animals), this does not mean they are Luddite about new technologies. The best co-operatives are adapting and embracing new technologies and techniques. They are finding new markets and market niches, often with an ethical dimension that promotes their products within a sustainable framework. The very best are nurturing talent and training skills and techniques that are sufficiently robust to take advantage of change.

In sum, while *conservatism* implies closing organisational boundaries to the environment and positively reinforcing existing strategies, *dynamic conservatism* involves running like mad to reconfigure internal processes (even if the evidence of this may be less obvious from outside the co-operative), and *exploration* implies embracing changes led by the external environment.

Agricultural co-operatives, to be successful, are in the business of de-risking and building long term resilience for their members. This means having agility; multiple moving parts that can take over if another one fails – thereby providing confidence to farmers to maintain an equilibrium with the change happening all around them. Over time, the ability to exhibit sustainable resilience requires a balance to be struck between the above strategies, and thus between the views of different stakeholders about the best way forward. This is a fundamental task of co-operative governance, and helps to explain why the pursuit of 'good governance' is a dynamic and never-ending task.

THE DYNAMIC AND ONGOING NATURE OF 'GOVERNANCE'

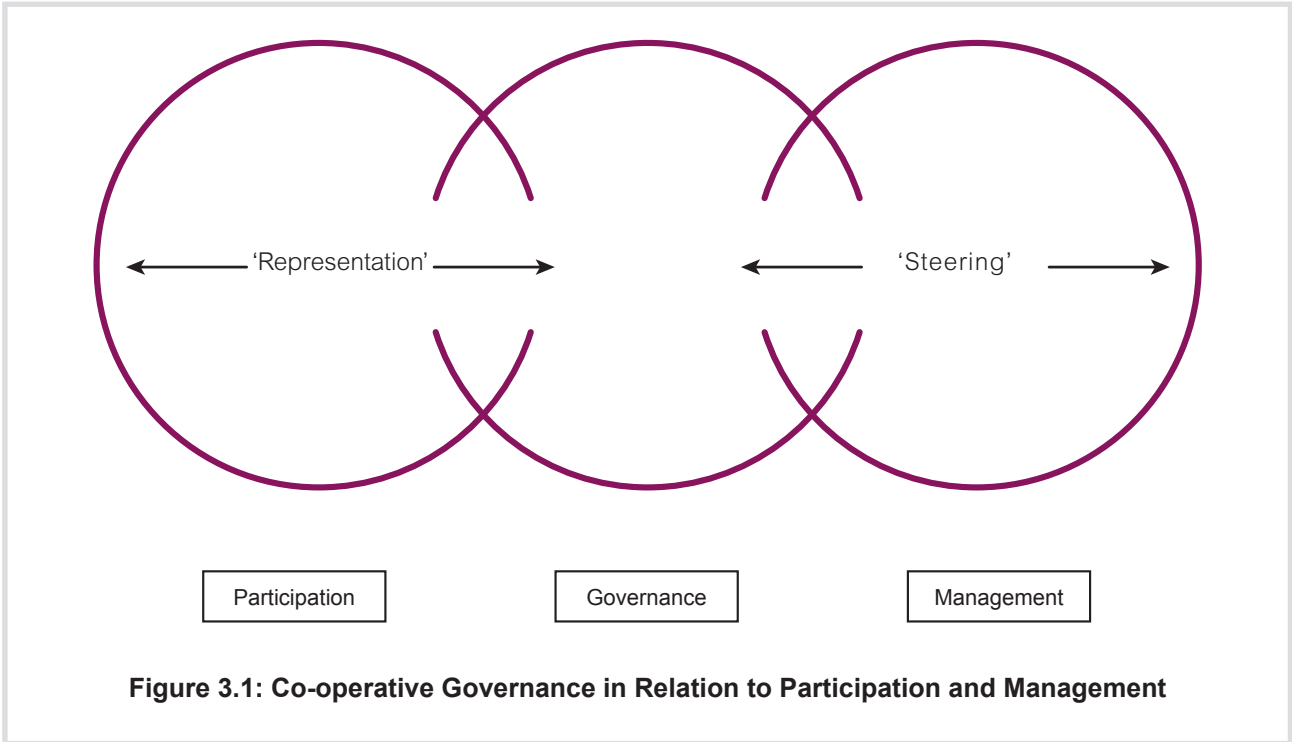
Broadly speaking, co-operative governance provides a sphere (the Board) in which representatives from the sphere of member/stakeholder participation can engage with representatives from the sphere of management to provide appropriate steering and co-ordination for the co-operative¹³. These three spheres and their interaction are represented visually in Figure 3.1.

¹⁰ Machinery/Business Rings match a shortage of machinery and labour capacity on one farm with a surplus on another, and may also provide members with economies of scale on farm inputs and services. All agri-businesses are eligible to join and each pays an annual subscription in order to access the services. Scotland's first Machinery Ring was established in 1987. Rings throughout Scotland now serve more than 7000 farmers and other rural businesses.

¹¹ Mamouni-Limnios et al, 2014

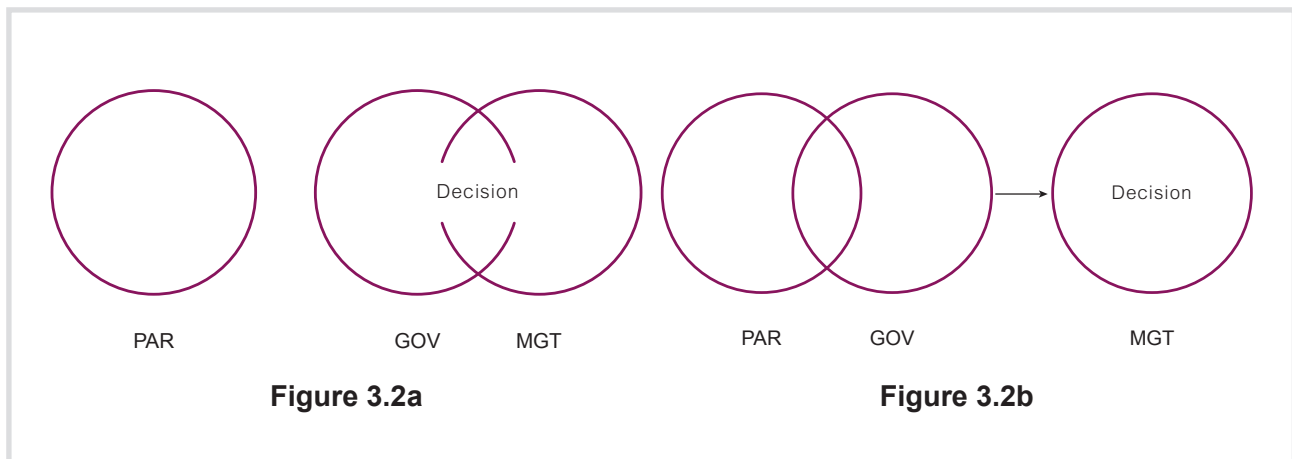
¹² Grint, 2009

¹³ Simmons, R., M. Powell, J. Birchall & S. Doherty (2007) 'Citizen Governance': opportunities for inclusivity in policy and policy making?' *Policy and Politics*, 35 (3), pp. 455-475



The relationship between these different spheres at different times requires further scrutiny. Keith Grint (2009), a leading management theorist, outlines several possibilities. First, he suggests that in the face of a ‘critical’ problem or real-and-present danger (where there is little time for consultation and debate), a reasonable expectation might be that the Board and Senior Management will adopt a ‘command and control’ approach, acting clearly and decisively on behalf of members, without consulting or including them. This creates the relationship shown in Figure 3.2a. Alternatively, he suggests that in the face of ‘tame’ problems (that may be complex but are ultimately solvable using technical expertise), the expectation might be that members and their representatives will stand out of the way and allow a ‘managerial’ approach to the problem, simply informing the other stakeholders of what they have done (creating the relationship shown in Figure 3.2b).

Yet, as discussed, many problems in agricultural co-operatives’ operating environment are neither critical nor tame; they are ‘wicked’ problems. Wicked problems are complex, rather than merely complicated, and often intractable (such as climate change). Uncertainty reigns and there are generally no stopping points at which the problem can be considered



‘solved’¹⁴. In such situations, Grint (2009) suggests that a more inclusive and connected form of problem solving (such as that depicted in Figure 3.1) is advantageous. For agricultural co-operatives to be successful in meeting the various challenges they currently face, this means going beyond the Board and Management, to a broad and deep alliance between all the people who should be making decisions and shaping the outcomes of their co-operative.

CO-OPERATIVE STRENGTHS AND WEAKNESSES IN DEALING WITH CURRENT ISSUES

Grint (2009) bemoans that the requirements of more inclusive and collaborative governance are ‘extraordinarily difficult to fulfil for many organisations, because they require an egalitarian body to make collective decisions’. However, this is built-in to co-operatives through their member participation structures. In this sense, SAOS believes that ignoring the special characteristics of co-operative enterprise and viewing it as just another form of business is a mistake. The opportunity for co-operatives is to use the inherent advantages of their unique business model to deal effectively with change in their operating environment, thereby driving forward their ambitions for development.

Strong, resilient and successful co-operatives are built on a clear, well-defined purpose supported by a sound business model, which is sustained by building member loyalty, identity and commitments through delivering value to members in ways that build both economic and social capital. Indeed, SAOS believes that over the long term the only business structure with the scope, depth and guiding principles able to adequately deal with the uncertainty which envelops our food systems are co-operatives. The opportunity is to embed a culture of sustainable resilience, not to primarily compete with corporations, but quite simply to do what is right; right for families, for community and for the natural environment. This does not simply mean going back in time to recreate some aspect of their past; it means using a full range of appropriate strategies to progress. In turn, this means deciding between offence and defence, and between different degrees of openness to input from stakeholders.

Co-operatives therefore have to adapt and build governance systems that are adequate to the task ahead. What has become clear to SAOS is that co-operatives cannot be guaranteed to be successful simply because of their co-operative structure. They can drift and become enticed to emulate investor-owned businesses. In particular, there may be the well-known problems in which co-operatives become addicted to either the exclusive, ‘command-and-control’ approach depicted in Figure 3.2a, or the heavily ‘managerialised’ approach depicted in Figure 3.2b). In either case, democracy drifts, member loyalty weakens, and a key co-operative advantage is lost.

Finding ways to listen, engage and respond to member perspectives within co-operative governance is key¹⁵. Member ‘voice’ can provide vital intelligence and act as a counterweight to the dominance of overly-narrow command-and control or managerialised approaches - yet co-operatives vary in how attuned they are to the concerns that matter most to members. On one level, the technical level of service provided by co-operatives is highly important. Beyond this, however, a view is emerging at SAOS that co-operatives might prioritise ‘deeper’ member relationships rather than ‘shallow transactions’. This means customizing new strategies and promoting new behaviours that respond appropriately to members’ concerns; where members feel unable to engage effectively, they are likely to feel disconnected and withdrawn.

“SAOS believes that ignoring the special characteristics of co-operative enterprise and viewing it as just another form of business is a mistake.”

14 Rittel, H. & M. Webber (1973) Dilemmas in a general theory of planning. *Policy Sciences*, 4: 155–69

15 Birchall J. & R. Simmons (2004) The Involvement of Members in the Governance of Large-Scale Co-operative and Mutual Businesses: a formative evaluation of the Co-operative Group. *Review of Social Economy*. 62(4), pp. 487-515

To avoid the above governance traps and maximise their inherent advantages, agricultural co-operatives often require support. Such support should be knowledgeable and tailored exclusively for these co-operatives' needs and requirements - based on a deep understanding of the power of co-operative values and principles. As detailed below, it is exactly this kind of support that SAOS, a second-tier co-operative, seeks to provide to its members.

Co-operative Governance and SAOS: Supporting Agricultural Co-operatives in Scotland

HOW SAOS'S LEARNING HAS EVOLVED

The prompt to serious action by SAOS was delivered in 2002 when Scotland lost one of its century-old and largest co-operatives - North Eastern Farmers Ltd (NEF), with a membership of 7,300 and net assets in 1997 of nearly £8 million, all lost within a five year period. A very weak NEF was purchased by a competitor private business and the co-operative's members didn't know why things had gone so wrong, so quickly. It was clear to the agricultural co-operative community that this should never happen again, but it was unclear at the time what could be done, or developed, as a prevention strategy. SAOS undertook to figure out what had happened and develop solutions that would have prevented the failure.

Certainly there were outstanding features that were compounded by management feebleness such as weak selling, production inefficiencies leading to overpriced product, which in-turn seriously reduced members' loyalty. There were legacy issues from previous overbearing management that had stripped away member control rights and had developed a culture of deference to management throughout the organisation - compounded by a general lack of understanding by members of how their business operated, its strategic purpose and intent. Perhaps most poignantly, the membership did not have the confidence or knowledge of their democratic power to take (back) control.

The learning point for SAOS and its co-operative community was that effective governance entails recognising and managing the multiplicity of interactions throughout the whole co-operative, and between the co-operative and its business environment. Importantly, governance becomes weakened by an over-reliance on those at the 'apex' (Board and/or Management) to find solutions. Governance is weakened by the belief that it itself is about control and certainty. In an uncertain and ever-changing paradigm there is little that can be controlled and there is no certainty. In essence, while those at the apex of any organisation have important strategic and specialist knowledge, on its own, an insular, 'command and control' style apex is wholly inadequate to sustainably govern the co-operative.

TAKING THINGS FORWARD

Taking the learning from the dramatic failure of NEF into subsequent discussions with members has prompted a suite of new initiatives to support better governance in Scotland's agricultural co-operatives. It is, perhaps, fair to note that none of this would be possible without Scotland's Agricultural Co-ops supporting their own federal development co-operative - SAOS. It is unlikely that any of Scotland's co-operatives on their own, even the largest (which are small by international comparisons) could, or would, dedicate sufficient resources to provide a comprehensive governance programme. However, with modest government funding and member fee income, SAOS has been able to develop a 'holistic' governance programme designed to deliver its objective - to have resilient co-operative members able

to grow and prosper within our uncertain future. Since 2002, the Program has developed towards its current format, for which comprehensive delivery began during 2014.

The components of this programme are detailed below. First, the Corporate Governance Code for Agricultural Co-operatives is discussed. SAOS's role in director and staff development training is then detailed. Next, there is discussion of the Managers' and Chairmen's Forums. Finally, there is consideration of two initiatives to bring members closer to the governance of their co-operative: measuring 'member loyalty' and examining the 'member value proposition'.

The Corporate Governance Code for Agricultural Co-operatives¹⁶

SAOS developed the 'Corporate Governance Code for Agricultural Co-operatives' in partnership with Co-ops UK. This is the first comprehensive code (in the UK) to reflect the distinctive characteristics of agricultural co-operatives. The Code is a guide to the key elements of effective board practice and designed to assist boards in carrying out their governance role to provide a measure of accountability and assurance to members. The code recognises that boards must operate in line with the International Co-operative Alliance Statement of Co-operative Identity and actively engage and maintain close relations with members and encourage active member participation in its governance practices.

The Code sets out the high-level principles of governance applicable to all co-operatives¹⁷. Each high-level principle has one or more supporting principle. These supporting principles give illustrations of what might constitute good governance compliance with the high-level principles. The Code requires co-operatives to provide statements in their annual reports disclosing the extent to which the Code was followed during the reporting period. They may make any statements they see fit concerning their approach to governance and the Code.

It is recognised that different co-operatives may choose to apply the provisions of the Code in different ways and that 'one size does not fit all'. However, all co-operatives must disclose whether they have complied with the Code provisions and, where they have not done so, give an explanation of the action they have taken instead. Such explanations should state what alternative measures the co-operative is taking to deliver on the principles set out in the Code and mitigate any additional risk. SAOS is able to provide external assurance to co-operatives on their level of compliance with the Code.

Building Knowledge and Learning from Experience

Developing the Code and monitoring compliance is a step forward. However, in itself it is insufficient. SAOS has developed its meaning of co-operative governance to include the broad base of individuals, their families, community, businesses and networks who are all involved in building their futures together – with the overall objective to become increasingly and sustainably resilient to prosper in uncertain times. It is important that everyone who has a role and a stake in the co-operative is able and willing to act appropriately to support this objective. Accordingly, SAOS has a programme of support activities: the Director Development Programme; training opportunities for staff to build 'next generation

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¹⁶ <http://www.saos.coop/wp-content/uploads/2014/02/Agricultural-Code-Feb14-Final.pdf>

¹⁷ These principles relate to: Members; Voting Opportunities and the Annual General Meeting; The Role of the Board; The Role of Directors; Board Size; Board Balance and Independence; Co-option of External (Non-member) Directors; The Chair; The Chief Executive; The Secretary; Election, Renewal of the Board and Succession Planning; Induction, Information and Ongoing Professional Development; Independent Professional Advice; Board Performance Evaluation; Committees of the Board; The Nomination Committee; The Remuneration Committee; The Audit Committee; The Auditor's Report to the Board; and The Annual Report.

BOX 3.1. DIRECTOR DEVELOPMENT MODULES

1) Effective Co-operative Governance

Prior to 1990, certainly in the UK, the term Corporate Governance was largely unknown. Then a series of high-profile scandals, including the collapse of 'Polly Peck International' and Bank of Credit and Commerce International (BCCI) amidst claims of mismanagement and fraud, prompted the 1991/2 UK Cadbury Committee on Corporate Governance. Nine separate reports have followed on corporate governance between 1992 and 2009, including the Walker review in 2009 in response to the financial crisis. However, no amount of Corporate Governance legislation, or reports, or codes will ever prevent gross stupidity and/or rampant greed among corporate directors. So rather than exclusively teach governance procedures and processes, which are set out in Governance Codes, the workshop concentrates on aspects that are fundamental to co-operatives. The first of these is the importance of member control rights over Revenue Streams, Contracts and Property, all of which are essential to members' understanding of their co-operatives strategy. This might be referred to as transparency, but it is more than that, it is about understanding and knowledge; all of which **provides cohesiveness amongst members and loyalty to their co-operative – sufficient levels of loyalty and knowledge to challenge the board and management when change is required.** If there are a couple of key learning points for directors to take away they are: firstly, there must be no deference – the poison that can seep into governance – by the Members to their Board, by the Board to their Chairman, by the Chairman to their Manager. Secondly, co-operative governance must never be 'frightened' of its membership, **it is the membership who will have the solutions to difficult issues, who have the diversity of thought and diversity of experience** – a co-operative that doesn't really know its members, who they are and what they want, is lost.

2) Developing Strategic Capability

The main responsibility of the board is to establish the co-operative's purpose and vision, to set clear business objectives and to develop a strategy for their achievement. Co-operatives who don't think strategically and develop strategic plans will inevitably fail. Directors need to understand what business their co-operative is in, how it adds value and competes in the market. This long-term planning is essential for future success. Thinking strategically means looking to the future – facing up to uncertainty. **Developing competitive strategy in co-operatives is different to other forms of business, because the development of effective co-operative strategy must involve members.** The involvement of members needs to be tangible, it needs to be concrete. It is essential that the co-operative's strategies align with members own strategies. Strategy development therefore cannot be carried out by the board behind closed doors.

3) Marketing, Member Relations and Communication

Agricultural co-operatives often market products such as grain to customers, while, at the same time, they deliver services including grain drying, storage and logistics to members. Because a co-operative's reputation is based on how well their services meet or exceed member needs and expectations, it is essential that directors and managers have a key understanding of the characteristics of services, how members evaluate them, and their quality can be managed and improved. A good experience of service quality leads to positive images and word of mouth messaging and greater loyalty.

A combination of *service quality improvement* based on understanding what members need backed by *communication planning* provides a strong basis to improve member relationships and loyalty. Communication plays a role in how co-operatives influence and educate their members. The multitude of tools and media makes it challenging and it is essential to gain an understanding how they can be best employed. The ability to understand the effects of any message and the numbers of people engaged

and listened to are also important. These measures can be used to assess the existing communications used by a co-operative and consider how they can be developed and improved.

4) Co-operative Finance

Agricultural co-operatives are often capital intensive businesses. With the continuing development of new technologies driving novel food processing and consumer products the requirement for new capital is never ending. A difficulty for agricultural co-operatives is that farmers also require capital for the development of their own farm business, and so there is tension between the capital requirements of the farm and of their co-operative. Combined with requiring a knowledge of regulatory frameworks for co-operatives, interpreting and acting on financial data plus finding innovative ways to finance co-operatives and their joint ventures, the challenge for directors is to provide consistent and astute financial governance.

5) Managing people

Co-operative and co-operative networks rely heavily on knowledge that requires appropriately skilled enablers to establish relationships. Directing and managing a successful co-operative requires a particular type of social intelligence - the capacity to effectively negotiate complex relationships and environments, or simpler put - the ability to get along well with others, and to get folks to co-operate with you.

6) Collaboration and Supply Chain Management

Agricultural co-operatives necessarily work within what can be complex supply chain systems. Co-operatives can influence these supply chains positively, by consistent application of their rooted co-operative values. Collaboration within food and drink supply chains generate additional value for all participants by developing transparency and trust, and by reducing uncertainty and risk. Directors have to be aware of the commercial advantage and value attainable through business collaboration and supply chain integration; their co-operative cannot be successful within a 'world of its own'.

managers'; a Managers' Forum; a Chairmen's Forum; and an extensive focus on members to develop the 'member value proposition' and build loyalty.

A. DIRECTOR DEVELOPMENT PROGRAMME

There are many factors which contribute to the success of a co-operative but arguably the single most important is the quality of the board, and their strategic capability to govern effectively. Directors carry the responsibility for ensuring their co-operative's succeed in a market environment that is rapidly changing and in which commercial risks are increasing. To be effective, they require a clear understanding of their role both individually and collectively, and knowledge of good board practice. It is therefore imperative that directors develop skills and knowledge to meet the challenge of change. SAOS has developed and delivered a Director Development programme over the last 12-years, recently adding a sixth module – 'Collaboration and Supply Chain Management' – to the existing five:

- Effective Co-operative Governance
- Developing Strategic Capability
- Marketing, Member Relations and Communication
- Co-operative Finance
- Managing People

The thinking behind these modules is illustrated in Box 3.1. The expectation is that any new co-op director (including the Managing Director or other senior manager) would undertake to complete the programme within the first two years of office. In addition,

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BOX 3.2. THE CO-OPERATIVE MANAGEMENT IN PRACTICE (CMIP) PROGRAMME

CMiP topics include:

- Understanding the role of co-ops in a turbulent world
- Understanding the co-operative business model, the 'co-operative advantage' and co-operative principles
- Competitive strategy and the role of great managers
- How co-operatives help members manage risk and build resilience
- The co-operative life-cycle model - what are the typical challenges co-operatives face?
 - How do you measure success in a co-operative?
 - Member recruitment
 - The allocation of surplus
 - Why co-operatives fail
- Effective co-operative governance – what is best practice?
- Building Member commitment and loyalty – how to make this a success
- Co-operative growth – what are the barriers and issues?
- Financing co-operatives – what are the main routes of funding and their differences?

long-serving directors and managers are encouraged to attend modules every 3-4 years as part of continuous professional development.

B. TRAINING AND DEVELOPMENT FOR OTHER STAFF: THE CMIP PROGRAMME

A review of SAOS's Training Services in 2014 showed our focus was largely on farmer directors and senior managers. As a result, SAOS extended their Training Services provision to include staff at all levels in the organisation so they become co-operative advocates and effectively an extension of the co-operative promotion team. New services include the 'Co-op Management in Practice' (C-MiP) programme, largely aimed at 'Next Generation Managers/Leaders' and trainee co-op staff. C-MiP is especially for those individuals ambitious to develop their co-op career and aspiring to be tomorrow's senior managers. As well as building understanding of the distinctive nature of successful co-operative businesses, the program covers the role of managers and the qualities demonstrated by the most effective among them through a highly interactive, two-day residential course. As well as increasing their skills, knowledge, and understanding, participants share ideas and experiences as a means of acquiring and developing new approaches for leading and managing the co-operatives of the future. Box 3.2. shows the topics included.

As a further focus on the 'Next Generation', SAOS also convene development groups of younger farmers who, by building knowledge and understanding of their co-operative, will act as ambassadors for the co-operative amongst their peer group and may stand for election to the board in future. An award is presented each year at SAOS' annual Conference to recognise a young person who has made an exceptional contribution, either as a co-operative employee or as a co-operative farmer member, and shows both vision and a commitment to co-operation.

C. MANAGERS' AND CHAIRMEN'S FORUMS

Over the years of running the Director Development Programme, SAOS has learned the value in directors and managers from different agricultural co-operatives coming together to net-

work, share knowledge and experiences and search for best practice. As an extension of this, SAOS has helped to establish two regular forums, for Managers and Chairmen respectively.

A forum for *Co-op Managers* was established four years ago for General Managers/CEOs. The founding principle was that the co-operative managers take ownership of their forum and decide on meeting topics, agenda, meeting times, venues, etc. Confidentiality and trust is very important so meetings are run under 'Chatham House Rules'. At the outset, none of the co-operative managers really knew each other well or regularly exchanged information. This quickly changed resulting in strong, trusting relations. Individuals will frequently consult fellow managers and regularly visit each other on their own initiative. There is no doubt these Managers' Forums have made a real impact on managers. Examples of meeting topics include: the Manager–Chairman relationship; credit insurance and bad debt management; employment legislation and tribunals; funding capital projects; effective member communication; information and communication technology; breach of contracts; banking terms and conditions; biomass grain driers; strategic alliances and insurance terms. SAOS facilitates the meetings, producing a summary of learning from each meeting to ensure they are outcome-based.

Following the successful model of Managers' Forums, in 2014 a new forum was established exclusively for the *Chairmen of SAOS*' 20 largest co-operatives to meet regularly (2 to 3 times per year). The forum recognizes that the Chairman's role is different to other directors, with additional roles and responsibilities requiring more time than any other Director to understand the whole 'ambience' of the co-operative. It recognizes the chairman's cardinal role in ensuring the effectiveness of the Board, in providing the primary link with senior management, and thereby in ensuring the co-operative Board delivers on its obligations to members, staff, creditors, and the wider community.

D. MEMBER INITIATIVES

Every co-operative manifestly exists for its members, who share the benefits of trading with their co-operative as well as the risks. The greatest development challenge for SAOS and its members is the development of tools that empower and measure the connectedness of members to their co-operative and the value members place on their co-operative. As part of this, SAOS has two ongoing work streams that are proving successful in implementation:

- Measuring the Member Value Proposition

SAOS is attempting to develop a methodology to allow co-operatives to measure the benefit of membership, enabling them to report annual value to members. This follows the example of CBH Group (www.cbh.com.au), a large grain co-operative, which ensures each of their members receives an individual annual value statement. On a single sheet, this statement shows how the co-operative has added value to the industry and to the local geographical zone in which the farmer member is based, as well as the value returned directly to that farmer's business. Satisfaction with this statement helps build loyalty and member retention. Dissatisfaction allows members to challenge the co-operative to deliver value in way(s) that are better suited to their needs. Recognising that farmers always have an alternative option in who they trade with, the aim of this methodology is to provide the co-operative with a better understanding of how the co-operative creates value as a route to understanding members' needs and identifying any deficiencies. SAOS believes this work is significantly important as it will not only provide evidence of the value of co-operation but also motivate everybody involved to improve co-operative performance.

“Every co-operative manifestly exists for its members, who share the benefits of trading with their co-operative as well as the risks.”

- Measuring Member Loyalty

Member loyalty is the 'acid test' of the relevance and fitness of any Co-operative. A loyalty strategy is the business of everyone connected to the co-operative; it cannot be developed in isolation by a single group within a co-operative. SAOS has distilled the measurement of loyalty into four fundamental statements within the membership survey, to which members are able to 'Strongly agree'; 'Agree'; 'Somewhat agree'; 'Disagree'; or 'Strongly disagree':

- A. *"I can always rely on (my Co-operative) to provide a quality Service".*
- B. *"(My Co-operative) sets the standard for excellence in its field".*
- C. *"(My Co-operative) knows how to listen to me and meet my needs quickly".*
- D. *"I am proud to be a member / customer of (My Co-operative)".*

Feedback on these four simple statements allows boards and management to quickly interpret the results in conjunction with earlier surveys, other communications with members (such as meetings or focus groups), and benchmarking with other co-operatives. SAOS subsequently supports co-operatives to identify any weaknesses that are identified and make clear recommendations for action¹⁸.

Conclusion

SAOS's thinking on co-operative governance and how best to support it is developing all the time. It recognises that in order to face up to the big issues for agricultural co-operatives, it needs to build effective governance strategies. Conservatism has its place in governing resilient co-operatives, but perhaps has traditionally been the default response to change in the sector. SAOS is a proponent of bolstering resilience through adaptation in the forms of dynamic conservatism and exploration. This is particularly important given the wicked problems currently impacting their operating environment require different sets of skills and new forms of engagement in agricultural co-operatives. These evolving governance strategies reduce the relevance of previous emphases on managerialism and command-and-control decision-making systems; instead, more inclusive, connected forms of problem-solving are highlighted.

In supporting agricultural co-operatives to deliver on the objective to 'build sufficient resilience to deal with our uncertain future', SAOS has developed its meaning of co-operative governance to include the broad base of individuals, their families, community, businesses and networks who are all involved in building their futures together. This means ensuring that co-operative governance permeates the entire organization, facilitating member control at the centre of the co-operative, and delivering member value. SAOS' holistic approach sets standards; builds skills and capacities; allows space for sharing knowledge and experience and provides feedback on both high-level governance principles, and key aspects of member loyalty and satisfaction. Learning from this approach tells us to remember two things. First, each component must not be regarded in isolation, rather as one part of a whole governance framework to support the above objective. Second, that the need to strike a balance between different approaches and different stakeholders means that the pursuit of 'good co-operative governance' is a dynamic and never-ending task.

¹⁸ Yuill, B. (2015) Developing and Measuring the Effectiveness of Strategy: Loyalty, the Essence of Successful Co-operatives in L. Brown, C. Carini, J. Gordon Nembhard, L. Hammond Ketilson, E. Hicks, J. McNamara, S. Novkovic, D. Rixon, and R. Simons (eds.) Co-operatives for Sustainable Communities: Tools to Measure Co-operative Impact and Performance. University of Saskatchewan Press.

4

Creating Competitive Advantage in Agricultural Co-operatives through Improving Governance Systems and Enhancing Member and Community Engagement

YOSHIAKI MASUDA, TETSUJI SENDA, KENGO NISHII



EDITOR'S CORNER

Linkages between this chapter and inherent co-operative governance properties: humanism, joint ownership and control, and democracy.

Humanism: A people-centred approach to governance is central to the governance reforms discussed in this chapter, which connects engagement of both members and the broader community to positive business performance.

Democracy: The authors state that “the reform of formal governance alone cannot improve relationships with members”. This is particularly true in a co-operative where flexibility to make changes (e.g. to membership categories) is constrained. JA Group co-operatives face institutional obstacles to multi-stakeholder member participation. Current legislation reduces membership category flexibility, thus farmer members are patrons with a voice, while consumers are associate members without voting rights. As associate membership far exceeds the number of regular members, maintaining a democratic structure that gives ‘voice’ to members and is aligned with co-operative values and principles is problematic. Participation of all patrons is elevated by extending the relationship between the co-operative and its strategic stakeholders through community engagement opportunities and multiple boards. Voice is enabled by informal decision-making and social engagement through associations closely connected to the local co-operative.

Joint Ownership and Control: Further to the points above, this paper highlights the risks associated with a membership structure that does not match member participation (particularly economic participation in this case). As membership has shifted from full-time farmers to part-time farmers along with the majority of the membership held by non-voting associate members, ownership and control of the co-operative is not represented proportionally by the members that use it most. The authors indicate that governance reform (at the level of membership categories and associated rights) is desirable but unlikely. Thus, how does a co-operative craft an appropriate ownership and control structure given these dynamics?

Connecting this chapter to network governance design concepts: small independent basic units; subsidiarity principle; polycentricity; multiple stakeholders.

As a complex system spanning rural to national, participation in JA Group governance is positioned by the authors from both a formal and informal perspective.

Multiple Stakeholders: The current member categories – regular members (farmers) and associate members (consumers) – represent multiple constituents, but not in a balanced sense as member rights are not equal (e.g. voice). However, the JA Group casts a wide net for ‘governance’ by considering the role of participation for its members as well as other stakeholders, in recognition that strategic stakeholders extend beyond formal member categories for many co-operatives.

Polycentricity: JAs exhibit a nested, multi-layered governance structure from the rural to the national level. Formal (Councils, Boards) and informal (social groups) structures encourage participation. They are strengthening connections to the co-operative through involvement of multiple stakeholders (members and non-members) at the grass roots level of community-based activity groups. The activities are a critical method of staying connected to community, facilitating the flow of information between the co-operative and its stakeholders, and building loyalty which supports the growth of the business.

Small Independent Units and Subsidiarity: The JA Group is a federation style co-operative operating a complex business with multiple levels and lines of business. By virtue of the complex structure, network governance structures are more readily apparent. This chapter does not cover the JA Group’s structure in detail, but does illustrate subsidiarity through the branch-level activities that address participation and engagement at the grass roots. Steering committees constituted by representatives of the rural communities associated with JA and independent community organizing centred on JA membership and patronage is an indication of co-operative strategy built from the ground up.

4. Creating Competitive Advantage in Agricultural Co-operatives through Improving Governance Systems and Enhancing Member and Community Engagement

YOSHIAKI MASUDA, TETSUJI SENDA, KENGO NISHII

ABSTRACT

The agricultural co-operatives group is facing the challenge of reacting to structural changes in both the agriculture sector and business conditions in Japan. In response, they have deployed a strategy to improve member participation. This includes improving the governance system of co-operatives, improving the election systems to enhance women's participation, setting up steering committees at the branch level, and revitalizing member organizations and rural communities through engagement in "branch-level activities". Research findings reveal that business performance and activities engaging members in branches are closely correlated. To improve competitive advantage, co-operatives must restructure member and community engagement and effectively communicate their missions and ideas to members in order to help them be conscious drivers of co-operative success.

Introduction

Agricultural Co-operatives Group in Japan (JA Group) is a complex group of agricultural co-operatives in Japan¹. It has about 700 member primary co-operatives (JAs), totaling 9,000 branch offices including central branches, nearly 10 million co-operative members, and more than 200,000 workers. JAs are multi-business entities that offer deposits, loans, insurance, marketing, supply, and agricultural guidance services. Their federations are formed by the type of business. The Norinchukin Bank, the central bank of JA Group and the leading financial institution for the fishery and forestry industry, and Zenkyoren, the National Mutual Insurance Federation of Agricultural Co-operatives, are rated alongside Japan's largest banks and insurance companies by the value of their assets.

JA faces structural changes in the composition of members caused by the decline of agriculture and generational change of farmers. JA members are divided (by Agricultural Co-operative Law) into "regular" members who are farmers and "associate" members who are non-farmers, with only the former group enjoying voting rights despite being in the minority.

In the past ten years the JA Group has been advocating the change from co-operatives just for farmers to those of rural residents (including farmers as the main category of members), holding onto the idea of "rural co-operatives based on agriculture". The JA

¹ The term JA has been in use since 1992 for Japan's agricultural multi-purpose co-operatives with credit services. JA Group consists of primary co-ops and federations.

Group insists that JAs should continue as rural co-operatives; multi-member and multi-purpose co-operatives that have contributed to local communities through their infrastructure and strong relationship-based social capital.

The government (MAFF: Ministry of Agriculture, Forestry and Fisheries) on the other hand prefers to regulate “agricultural” co-operatives as tools for the promotion of agriculture in the national economy. Accordingly, they did not permit governance rights to associate members, and are trying to introduce a minimum number of board of directors who are certified full-time members, as well as implementing a usage limitation for associate members at per the law amendment in 2015².

Besides the above issues, JAs also face governance problems common in large co-operatives. Their average size increased from 3,000 members in 1992 to 13,800 members in 2012 and territorial reach also widened, resulting in several prefecture-level JAs.

Despite difficulties with legal requirements, JAs have to improve their governance system from one favoring farmers (especially the part-time farmer category), to a system more appropriate to diversified, multiple member-type co-operatives. JA Group has improved its governance system gradually over the past 20 years as well as revived its relationships with members by strengthening member and community engagement.

This chapter introduces a new approach taken by the JA Group to create competitive advantage through restructuring relationships with members to improve governance systems and enhance members’ organizations and activities. First, we explain the institutional character of JAs and the changes to membership and businesses over the past 20 years. Second, we review formal governance system improvements in this period. Third, we describe certain branch-level co-operative activities by JAs including governance improvements and member involvement. Also, we report our finding that business performance at the branch level is correlated with co-operative activities aimed at engaging members and community. The challenges facing the JA Group and the results of this research offer suggestions to co-operatives in other countries wanting to revive their co-operative identity and thereby enhance their competitiveness.

Institutional environment of agricultural co-operatives in Japan

Agricultural co-operatives were first created when the Industrial Co-operative Law of 1900 was enacted by the Japanese government. This Law allowed co-operatives to offer credit, marketing, and supply services with no limitations on members according to their professions (Kurimoto 2004³). When the Agricultural Organizations Law of 1943 was enacted in wartime, co-operatives in rural areas were merged with Nokai, another farmers union, to become Nogyo Kai, whose purpose was to support agriculture in the wartime economy. For the first time in Japan’s co-operative history, Nogyo Kai demarcated members by profession, as the law treated farmer membership as mandatory, while non-farmers as optional members.

² In May 2014, the Agriculture Working Group of the Council for the Regulatory Reform of the Japanese government issued a number of recommendations including abolishing ZENCHU (the Central Union of Agricultural Co-operatives), converting ZEN-NOH (the National Federation of Agricultural Co-operative Associations) into a joint stock corporation, and limiting the usage of associate members to under a half of the usage of regular members. Although JA group denounced this attack, it accepted changes including legal positioning of ZENCHU and its auditing authority in February 2015.

Japan’s government insists that JA must be exclusively farmer co-operatives and serve as an instrument of agricultural policies, whereas JA wants to include local non-farmer residents into membership and remain autonomous. These developments are therefore not driven by co-operative governance, but mainly by policy changes.

³ Kurimoto, A. (2004). “Agricultural Cooperatives in Japan: An Institutional Approach.” *Journal of Rural Cooperation*, 32(2):111–128.

The Agricultural Co-operative Law, which was enacted by the General Headquarters of the Occupation Army, aimed to help owner-farmers create farmland reform after World War II. Therefore, the Law limited full membership to farmers, with non-farmers positioned as associate members (see Table 4.1). This limitation of joining co-operatives by profession was the same in fishery and forestry co-operatives under the control of MAFF. In contrast, there was no membership-type limitation in consumer co-operatives and small business co-operatives based on the Small and Medium-Sized Enterprise Co-operatives Act. Further, the use of agricultural co-operatives by non-members was limited to one quarter of members' use by volume in savings businesses and one fifth in other businesses.

TABLE 4.1 MEMBERSHIP OF JA

membership	attribute	rights of use	capital subscription	rights of participation	numbers of members
regular membership	farmers	full use	needed	full	4.61
associate membership	non-farmers	full use (mainly deposit and loan)	needed	almost none	5.36

Diversification of businesses and users

STRUCTURAL CHANGES TO AGRICULTURAL CO-OPERATIVES AND MEMBER COMPOSITION

Taking members and properties over from *Nogyokai*, new agricultural co-operatives were established in 1948. While regular members of agricultural co-operatives amounted to about 6 million households in the 1950s, there were only 0.5 million associate members. As Japan's economy grew in the 1960s and 1970s, rural regions close to metropolitan areas became urbanized and the use of credit by non-farmer members increased rapidly. The number of associate members also increased in suburban areas. Since the 1980s, this increase in numbers of associate members has occurred nationwide to the point where they outnumbered regular members in 2011.

On the other hand, the number of regular members has declined in recent years due to structural changes in the agriculture industry in Japan. After WWII, agricultural workers in the country were comprised of those born between the late 1920s and the early 1940s. Following their retirement from farming in 2000s, the working agricultural population in Japan is declining rapidly. Regular members have become diversified into a disproportionately high number of part-time farmers (including retirees) compared to full time farmers⁴.

DIVERSIFICATION AND SHIFTING OF BUSINESSES: FROM AGRICULTURAL TO CREDIT AND LIVELIHOOD BUSINESSES

JAs have long been multi-purpose co-operatives (also known as "general agricultural co-operatives"). For example, insurance services were introduced in the 1950s and grew rapidly from there. Retail businesses including supermarkets and gasoline/LP gas suppliers (so-called "livelihood supply businesses") quickly followed. Further, the enacting of

⁴ Although 4.61 million regular members remain, the number of full-time farmers was only 0.42 million in 2013, according to MAFF statistics.

the Long-Term Care Insurance Act in 2000 allowed many JAs to operate elderly nursing care and funeral service businesses.

The proportion of livelihood businesses (credit, insurance, livelihood supply, elder-care and other services) has grown over time compared with agricultural businesses (marketing, production materials supply, and agricultural guidance). Only regular members are nowadays using all JA businesses, while associate members, which are rising in relative terms, are using only the credit, insurance, and supplying businesses of JAs. Consequently, the business structure of JAs has changed significantly over time (Table 4.2 and Fig.4.1).

TABLE 4.2 MULTI-BUSINESSES AND MULTI-USERS IN JA

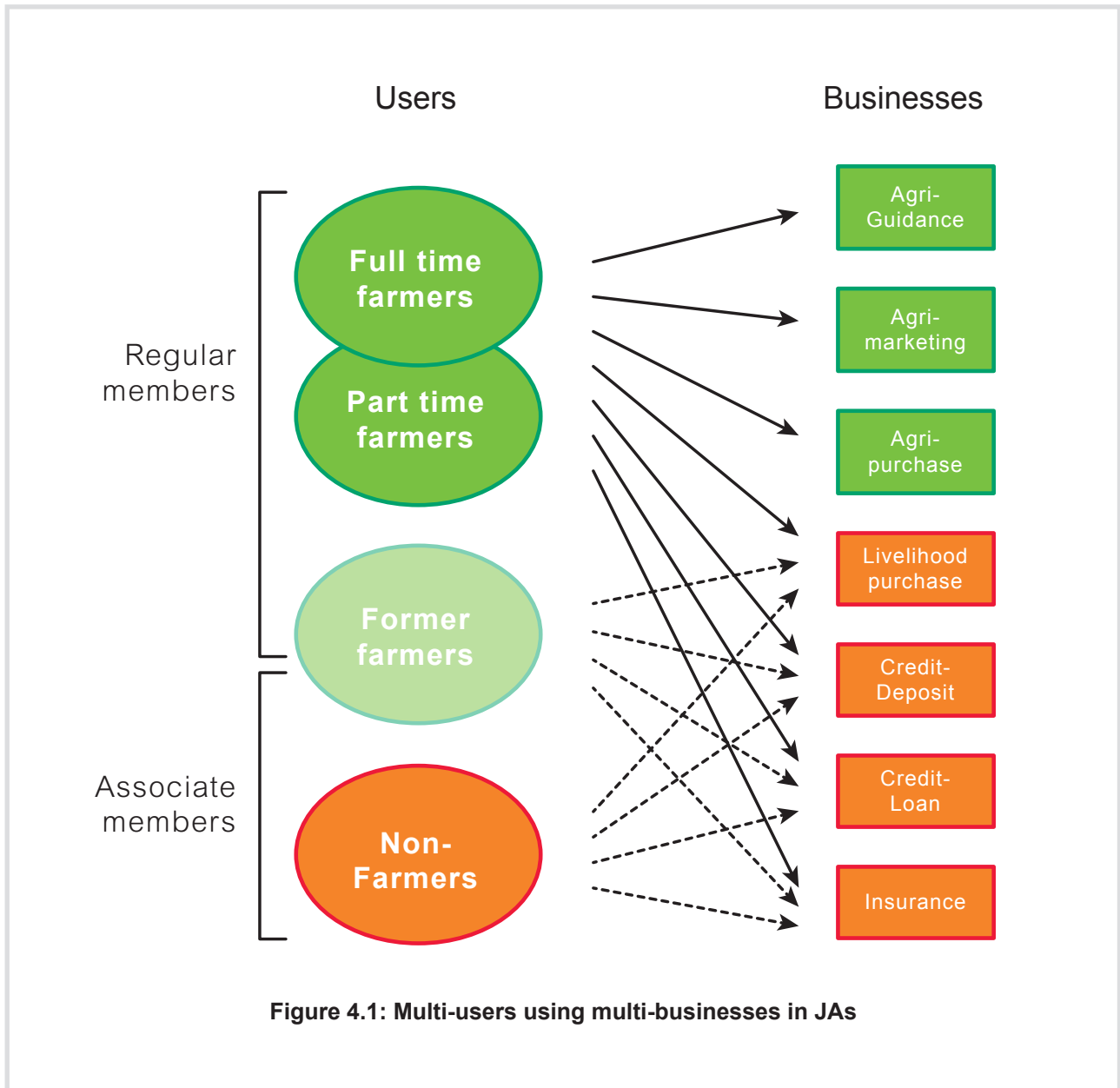
	Business	User	Average Gross Profit per JA (2012 Business year)	
			(mil. Yen)	(%)
Credit	deposit and loan	regular member	1,074	41
		associate member		
Insurance	life and non-life	regular member	677	26
	mutual insurance	associate member		
Supplying	Agri-production materials and	regular member	464	18
	livelihood commodity	associate member		
Marketing	Marketing of agri-products	regular member	191	7
Guidance	Agricultural and lifestyle guidance	regular member	-31	-1
Total	-	-	2619	100

Rebuilding member relationships

“JA Group is facing the twin challenges of governance improvements and member and community engagement.”

JA Group is facing the twin challenges of governance improvements and member and community engagement. Farmer members can reflect their needs and opinions to their JA by formal governance route like the general representative members council. Farmers typically also have close relationships with JA and among themselves, as their organizations, the so called “Seisan Bukai” organized by crops, are geared toward crop production and marketing. Therefore, they can become involved in decision making processes of JAs to achieve their purpose efficiently.

Associate members are merely customers, having no voting rights at the representative council, and tending to use JAs’ financial businesses selectively (e.g., banks or insurance companies). If the majority of JA members are merely customers, the characteristics of JAs as co-operatives will weaken over time and may be lost altogether because they cannot engage more fully with JA through formal governance channels or identify with its broader purpose as a co-operative. So, the competitive advantage of JA as a co-operative with close ties to its members will also be diminished, as deposit, loan, and



insurance businesses of JA are facing intensive competition with local commercial banks and insurance companies. Against this background, JA Group is aiming to restructure its relationships with members, especially non-farmers, in two ways. One is the improvement of formal governance and the other is through co-operative branch-level activities.

REFORMING FORMAL GOVERNANCE

The main governance route of each JA consists of the General Representative Members Council (GRMC) and board of directors system. Representative members are usually elected by members on a small agricultural settlement basis. They are usually elected by regular members' through informal decision making processes, even though a voting system exists. The number of GRMC members is 500 at a regular-sized JA, representing on average over 10,000 regular members.

Board members are elected by GRMC every three years. The average board size is 20 to 30 directors. The president and executive directors including president, vice-president

and full-time executives are elected to the board at the first meeting of the board. The term length for a director is commonly three years⁵.

Although the principal governance issue for JA is to entitle formal rights to associate members, Agricultural Co-operatives Act does not allow it. At present, associate members cannot be elected to the GRMC, so they cannot select board members, nor vote. It is obviously inadequate that associate members do not have formal voting rights because they own shares and use JA in the same way as the regular members. Given the limitations within the law, it is therefore necessary for JAs to improve participation of associate members in various ways.

The second issue is the election system of representatives and board members. Most GRMC members were elected at the hamlet level in rural areas, with heads of households usually elected as representatives. It was difficult for women to be involved in JA governance as representatives or board members, although they can assume important roles in farm management and farm work and be eligible for regular membership.

JA Group has long attempted to increase memberships in farming households in order to improve participation of family members other than heads of households, especially women and youth. In 2000, following the Basic Act for a Gender-Equal Society enacted in Japan, the JA Group set the goal to raise the proportion of women as regular members to 25%, as representatives to 10%, and as board members to two persons per board. Nevertheless, as of 2014, the proportion of women as regular members was just 20.6% and as representatives just 7.6%, while the total number of women board members was 1277. Only 72 JAs, or 10%, had met all three objectives. To help improve this situation, many JAs have female quotas for board members and some also have quotas for young farmers or large farms.

ENHANCEMENT OF MEMBER AND COMMUNITY ENGAGEMENT – FOCUSING ON LOCAL BRANCHES

The competitive advantage of co-operatives cannot be realized only by pursuing sales volume. A co-operative must also build relationships with members if it wants them to be engaged users and not only customers.

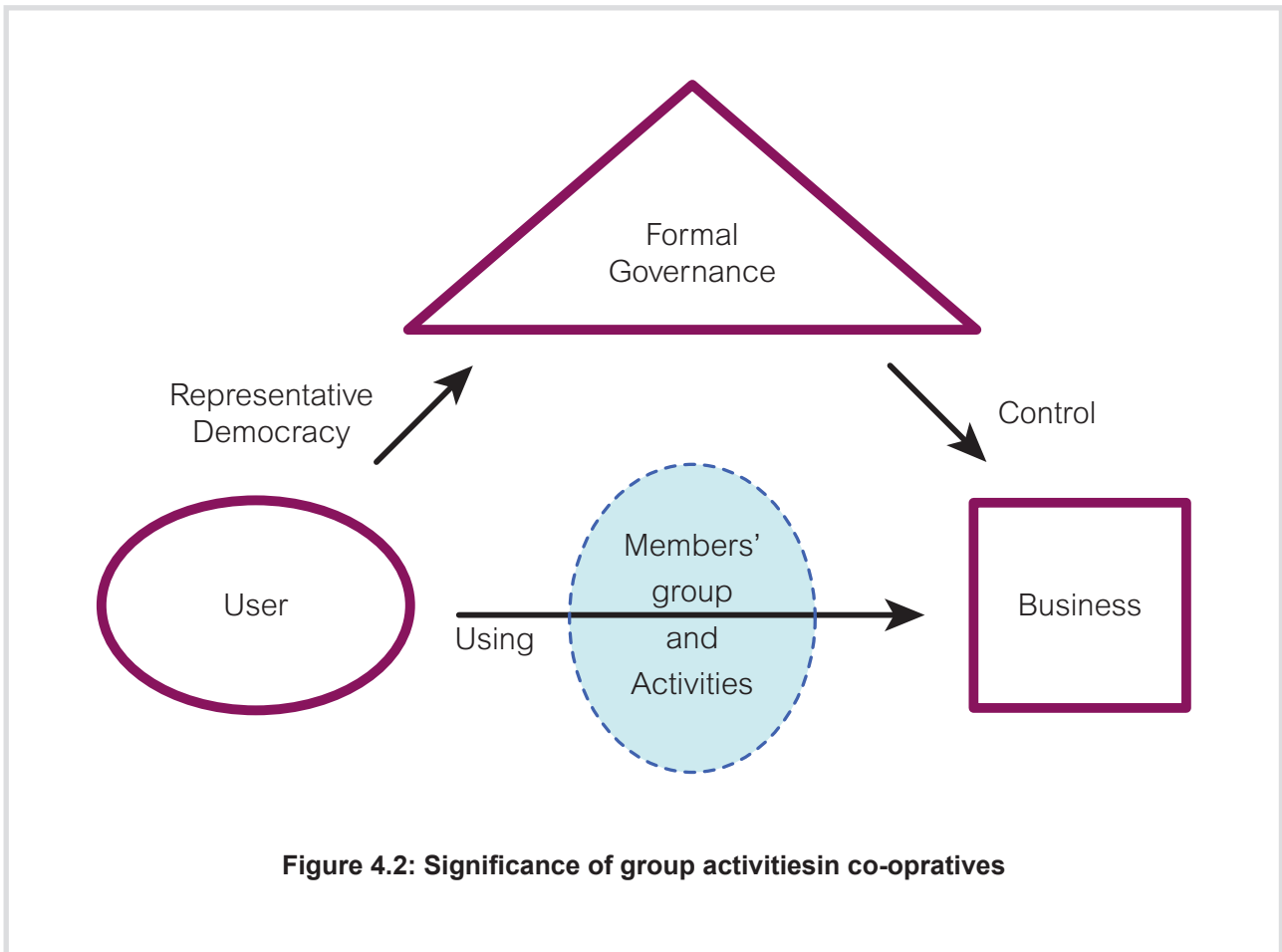
“The reform of formal governance alone cannot improve relationships with members.”

Although formal governance systems ensuring member control are characteristic of co-operatives, the reform of formal governance alone cannot improve relationships with members. Without rebuilding organizations and providing activities for members and other customers, co-operatives cannot expect to grow or even remain viable. Forming member organizations and forging relationships between members and community residents through branch activities may provide competitive advantage for co-operatives (Fig.4.2).

The national convention of JAs in 2012 formulated the slogans “co-operatives join the next generation” and “facing the issues of members and rural society” in order to focus on JA branches. Since then, branches of JAs have begun to serve as hubs of member organizations and voluntary activities under the so-called branch-level co-operative activities campaign.

“Branch level co-operatives’ activity” encompasses engagement of members, non-member residents and workers at JA branch level, which typically consists of: 1) a branch steering committee, 2) a branch activity program, 3) a branch newsletter and 4) a branch festival. As JAs have on average 13 branches per co-op, branch level activity can pro-

⁵ The term of executive board members is same as other board members and representatives. But usually, they stay two or three terms. According to our national level research, 67% of executive members come from a career as JA workers, while 8% are federation workers. Masuda Y. ed. (2013), “Whose is JA?”, in Japanese, Tokyo.



vide chances for members and community to participate in co-operative governance and activities and also provide co-operative education opportunities.

Many JAs organize branch-level steering committees constituted by GRMC members and representatives of rural communities associated with JA, to exchange opinions and plan and carry out members' activities in branches⁶. Some examples of the community are: Nouka Kumiai, a farmers and farmland owners' organization formed on a hamlet basis (this is sometimes called the basic organization of JA); lodge of Joseibu, women's associations formed mainly by farm-household women; Fresh Mis, an association for young women; and Nenkin Tomonokai for pensioner seniors. The committee consists of 10 to 30 persons, general manager of a branch usually engages as a secretary of the meeting.

Such committees function as mini-boards at the branch level of JAs, increasing members' self-awareness as co-operative members and inspiring their co-operative activities. They have demonstrated successful results, as many more members can realize participation in JA governance.

As JA became large, the chance to participate in its governance is limited for members. For example, although the number of members including associate members is 14,000 per JA, it has on average only 25 board members who represent about 560 members on average. If 16 branches have 20 committee members each, 320 persons can participate in JA governance. Furthermore, committee members represent many more members of their local groups.

⁶ JA Fukuokashi, in Kyushu, has developed branch activities including branch Steering Committee, action program, branch newsletter, for over 10 years. The JA experienced a rise in business performance in this period along with an increase in branch activities. Thus, this has become a typical model of the campaign in JA group.

In addition, it is important that the committee functions as a part of JA governance system (e.g. reporting co-operatives business achievements to members and handling questions and answers) but also as an autonomous and active organization at the branch level. It forms branch action programs, organizes and conducts festivals, sports events, tours etc. at the branch level, usually with branch staff (workers) support. So, they can “realize” participation in JA governance through their real activities. Branch Steering Committee and its activities present a very important opportunity to educate members about co-operatives, and to increase awareness of membership.

JA Fukuokashi and some leading JAs tried to vitalize the committee by planning and conducting branch activities. In a case of JA Hyogorokko, the branch committee (named the “Fureai committee”) designs and organizes branch activities such as festivals. Although nearly all committee members are regular JA members, representatives of the groups responsible for the specific activities are often associate members.

However, those local associations mentioned above have weakened over time due to demographic changes. The basic organization is losing influence because of the decreasing number of farmers, and women’s associations are also shrinking as farm household numbers are declining and associate members usually do not participate. Not surprisingly, only seniors’ organizations are on the rise. At the same time, the associate members are sometimes left without organizational connections with JA, although their numbers are increasing. Thus, there is urgency to forge relationships with associate members, besides the need to revitalize existing member organizations. Branch steering committee and branch co-operatives activities will contribute to those issues.

BOX 4.1. JA FUKUOKASHI

JA Fukuokashi is located in Fukuoka, the largest city in Kyushu. Its number of regular and associated members in 2014 was 6,879 and 29,310, respectively. Thus, associate members outnumber regular members four to one. Its deposits are 334 billion yen (almost 2.7 billion USD). Its sales volume of agricultural products is 4.0 billion yen (33 mil. USD) including direct sales at 10 Farmers markets (farm-products outlets). It also has elderly nursing care centers that offer in-home care services, ambulatory care services, and short-term care services. Further, JA Fukuoka Co., Ltd., a subsidiary company, runs funeral, real estate, and travel businesses.

Owing to the weakness of Nouka Kumiai, its basic organization for farmer members, in 2004 it planned to revitalize all member organizations, focusing on branches as the hubs of co-operative activities. At the branch level, it created a committee for branch activities that consisted of representatives of member organizations, which has since conducted various events and activities at the branch level. Branch letters handwritten by staff were, for example, delivered to members and non-members living in the local area.

JA Fukuokashi also has member organizations for different membership segments. Its women’s association, for instance, provides and runs dancing, cooking, travel, and crafts classes, while the Fresh Mis group holds study sessions on topics such as parenting, food, and health. The young farmer’s association runs agricultural experience events at elementary schools and social welfare facilities. Nenkin Tomonokai organizes golf tournaments and travel events. Further, at the branch level, various activities are conducted, such as agricultural experience classes for children, harvest festivals, open area markets, kitchen garden classes, karaoke, calligraphy, hula dance, ceramic art, choirs, and summer festivals.

BOX 4.2. JA HYOGOROKKO

JA Hyogorokko is located in the southeast of Hyogo prefecture and it covers a wide area of Kobe and seven surrounding cities. It has 99,306 members, including 31,159 regular and 67,617 associate members. As Kobe is a large city with a population of over three million, competition with other banks and insurance companies is fierce. Nevertheless, this JA's deposits are increasing rapidly because of use by associate members.

JA Hyogorokko has 55 branches that offer not only credit and insurance services, but also agricultural, asset maintenance, welfare, and funeral businesses in addition to various activities by members and community residents at each branch. One of these activities is its "activity circles." The JA promotes the formation of activity circles called the Rokuchan Circle. The requirements of the circle are as follows: circles must have at least five members, more than half of which are JA members; meetings are held at least six times a year, and they use JA facilities; there must be no overlaps with the activities of women's associations, and they must be nonprofit. A Circles' activities include flower arranging, learning the Taisho harp, playing Japanese chess, and exercise sessions. Many non-farmer participants join circles and become motivated to join the JA. In addition, branch festivals, classes for tax matters, agricultural experience classes, cooking classes, and sports/travel events are held at branches. The branch committee named the "Fureai committee" designs and organizes these activities. Although nearly all committee members are regular JA members, representatives of activity groups are often associate members, too. Hence, branch activities are organized without distinction between farmers and non-farmers, since they perform a social function.

It is worth noting that the JA provides so-called "life consulting staff" to support those activities. Although these workers are normally sales staff from credit and insurance businesses, they also encourage members and users to join circle activities and to start new circles. In this respect, the JA believes that it must promote learning and communication between members and community residents for the sake of improving their overall quality of life. By driving businesses and activities in parallel, JA Hyogorokko has increased the participation of business users in various circles and grown its business volume concurrently.

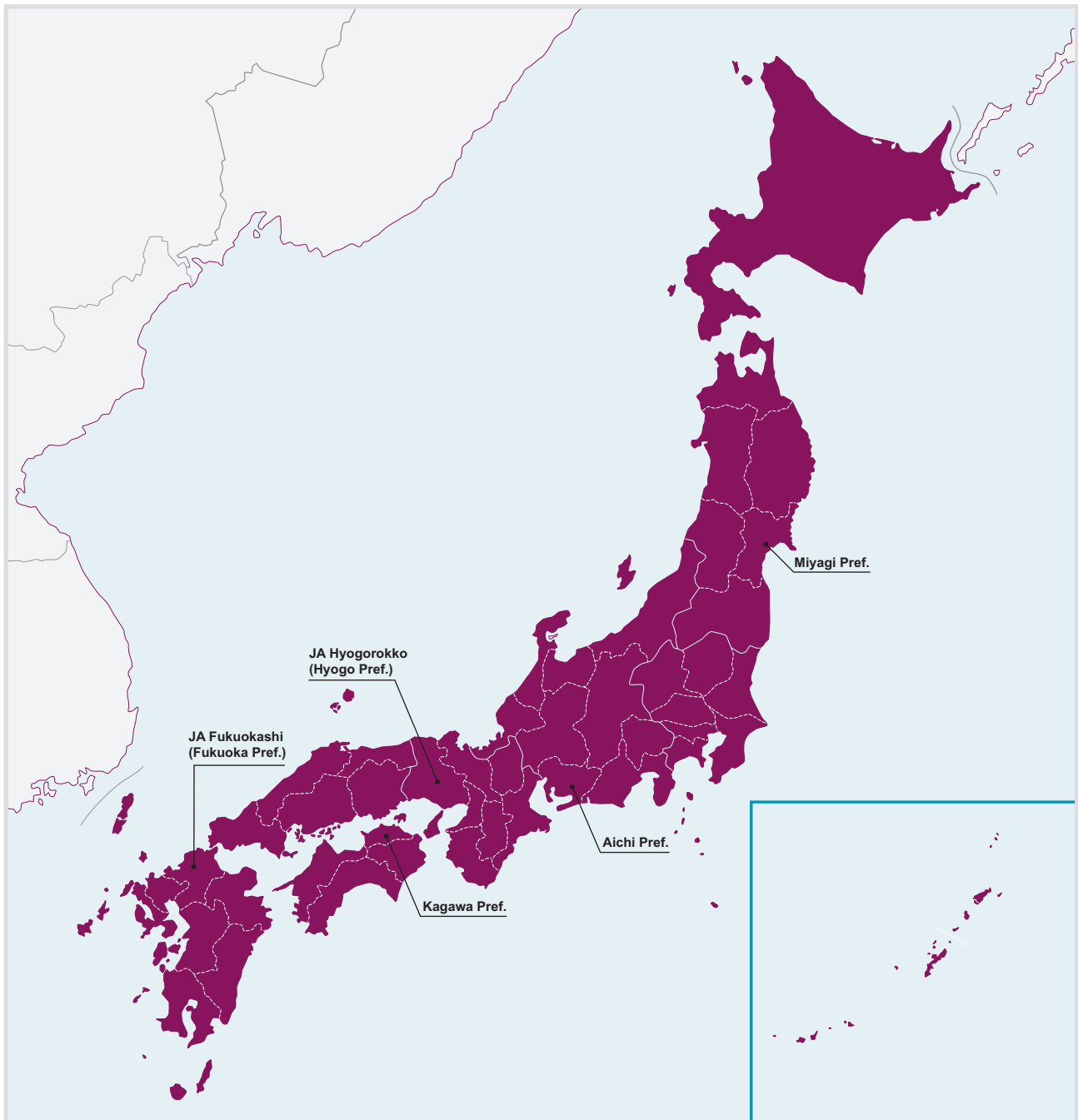
Correlation between the business performance of branches and member activities

We conducted research to quantify the relationship between community activities and business performance from 2009 to 2011⁷. In total, 109 JA branches in Miyagi prefecture were surveyed in 2009, 153 branches in Kagawa prefecture in 2010, and 137 branches in Aichi prefecture in 2010.

The results of our study indicate there is a positive relationship between the performance of businesses at JA branch such as deposits, loans, and long-term insurance and the number of community-activity organizations at JA branch **level**.

Furthermore, the analysis results for Aichi prefecture showed that a 1% increase in the number of community-activity organizations directed at JA members resulted in a 0.2–0.4% increase in deposit balances. The same results for Aichi prefecture also showed that the holding of branch festivals had a positive impact on business performance. The above results quantitatively demonstrate a positive correlation between community activities held at a JA branch and business performance at that branch.

⁷ "Research on effects of community activities to the business performance in JA branches", Agricultural Development and Training Center, Kyoto, 2010,2011,2013, in Japanese.



Therefore, although the results do not prove a causal relationship, a strong correlation of the business performance of co-operatives with their level of community activities is an indication that their members' rich associational life facilitated by the co-operative reflects on the vibrancy of the organization.

Conclusion

Today, co-operatives are increasingly facing issues in terms of how to restructure their relationships with members and society. Some co-operative members are merely “customers” and they do not share their co-operative’s aims and relationships, nor do they use co-operatives with intent. To improve competitive advantage, co-operatives need to communicate their missions and ideas to members and their communities in order to make them conscious users of co-operatives. It is not enough to have democratic rep-

representative governance systems in co-operatives. Members and the community must be directly engaged to increase the level of participation in the co-operatives while reinforcing achievement of the co-operative's purpose. Representative democracy in formal governance structure alone does little to engage members in the co-operative life on an ongoing basis.

Agricultural Co-operative Law is separating farmer and non-farmer members, and preventing associate members from voting since its purpose is mainly to enhance agriculture. The Law should be amended to remove these restrictions following the example of revisions made to the Basic Law of Agriculture to Basic Law on Food, Agriculture and Rural Areas in 1999, which expands its purpose from "agriculture" to "rural areas". Under the existing legal limitations, JAs have revitalized their member associations and rural communities through engagement in social activities at the branch-level. Such approaches in Japan can offer examples to large co-operatives in other countries whose members may feel disenfranchised. Our findings that the performance of co-operatives positively correlates with the levels of community activities are further indication that associative activities of co-operative members and community at the local (branch) level may form the building blocks of the co-operative advantage.

5

Worker Co-operatives In Focus

5a. Governance in Mondragon

FREDERICK FREUNDLICH

5b. Co-operation as Conversation:
Suma Wholefoods UK

BOB CANNELL

SUMA MEMBER

5c. Union Cab of Madison,
Wisconsin, USA

JOHN McNAMARA

The next three case studies feature examples of worker co-operative structures: Mondragon (Spain), Suma (UK), and Union Cab (USA). These co-operatives differ in terms of their size, location, and products/services yet they are similar in that the workers are the members, owners, managers, and governors. Each co-operative has constructed management and governance structures to suit its needs.

Linkages between this chapter and inherent co-operative governance properties: humanism, joint ownership and control, and democracy.

Humanism, joint ownership and control, and democracy are all strong forces in each of these co-operatives. What is it about the worker co-operative form that results in these properties being intuitive?

Humanism: On a spectrum of command and control on the one end, through to self-management on the other, worker co-operatives as companies of peers typically avoid command and control structures. When they employ hierarchy to facilitate the production processes, managers are accountable to the workers and operate in the participatory management framework, built on trust. Often, managers (or coordinators) develop their skills in the co-operative and are internally selected, rather than hired outsiders, but this varies. While they exhibit some important differences, in all three cases an attempt is made to preserve human dignity and ensure fair and equitable treatment of members and stakeholders.

- In a clear separation of managerial functions from strategic and governance functions, **Mondragon** does not allow the CEO on the Board and typically avoids senior management on Board as well. Participatory management is practiced in all co-operatives in the network; pay differential is limited and determined by Social Councils.
- **Suma** utilizes a flat management structure where all workers operate in a company of equals. This results in management and governance structures that are intertwined and fluid – it can be difficult to separate one from the other. Suma members practice 'consensual management', where team leaders do not have authority based on their status. Wages are equal regardless of the job performed, and they are presently double the industry average. High productivity and low turnover suggest that SUMA is a workplace of choice due to the strength of relationships, the quality of employment, and the potential for personal development in the co-operative.
- **Union Cab** implemented a highly participatory, policy-driven governance framework with numerous opportunities for member engagement in management, the Board, councils, and committees. Conflict resolution belongs to the peer-mediation bodies, rather than being left to management. Pay determination is shared among the peer group, and a living wage policy is adopted.

Joint ownership and control: Ownership and control is central with each member having a clear stake in the co-operatives success. Worker co-operative members are involved in participatory management, peer evaluation, governance design, determination of equitable pay structures, distribution of surplus, and all the elements of responsibility and accountability in the organization. Multi-part governance structures are developed to deal with increased complexity, but remain focused on flat power structures, management accountability to workers, and workplace autonomy. Conflict resolution mechanisms devised by the members are critically important in worker co-operatives. All three worker co-operatives include solidarity structures (e.g. equal pay; a living wage; job security and tenure).

Democracy: Member participation in worker co-operatives is very high compared to other types of co-operatives, and it is not restricted to general membership meetings. Democratic decision making is at the heart of these enterprises run by the insiders. Joint control translates into member voice at all levels of the organization, from work teams through coordination teams/work councils, to the board of directors. All three worker co-operatives in our sample hold general member meetings more often than just once a year. Channels of communication are complex, varied, and penetrate all segments of the organization. Those channels include informal means of communication, so enabling space and methods that facilitate this are very important.

Connecting this chapter to network governance design concepts: small independent basic units, subsidiarity principle, polycentricity, and multiple stakeholders.

Worker co-operatives typically ensure that complexity is broken down into **small manageable units** for communication, organization and governance. As they grow, worker co-operatives organize teams and coordinators, and delegate representatives to **multiple centres of decision-making**. Mondragon is an example of extraordinary growth by spinoffs, where each primary co-operative typically does not exceed 500 workers.

Worker empowerment leads to decision-making throughout the organization, so the **subsidiarity** principle is practiced. This is evident in particular in the Mondragon network with each individual co-operative as an autonomous unit within a democratic governance structure. Participatory management techniques are applied (Mondragon), or coordinator duties rotated among members (SUMA and Union Cab). Appropriate expertise is also used at the level where it is needed, enabling adaptive changes in all corners of the organization.

Development of strategy is also interesting in the three cases. SUMA and Union Cab feed off their close connection to consumers through their ethical orientation and/or the service industry demands, while Mondragon's co-operatives function in highly competitive global markets, so strategy is more formally structured. Regardless, all three co-operatives rely on member input in developing and executing their strategy and all three designed polycentric governance structures ('compound boards', or 'parallel decision-making' bodies with feedback loops).

Multiple stakeholders: Mondragon's network includes multi-stakeholder co-operatives (MSC). This is primarily due to the network's commitment to ensuring labour sovereignty and maintaining the employee member category in all their co-operatives. Governance of MSCs is complex, but the solidarity ethic prevails in their governance design. The remaining two co-operatives are single-membership type. Both include close communication with their consumers, with feedback systems and strategies to address consumer concerns and needs in place.

5. Worker Co-operatives In Focus

5a. Governance in Mondragon

FREDERICK FREUNDLICH

The Mondragon co-operative experience is one of the largest and most successful in the world. It involves over 100 co-operative organizations in diverse business sectors and a work force that today surpasses 74,000 people. Aside from its sheer size, Mondragon sparks widespread interest for a variety of other reasons and two of the central ones are, first, that its 100 co-operative organizations are tightly joined together in a group (more on this below), and second, that the vast majority of these co-operatives are *worker co-*

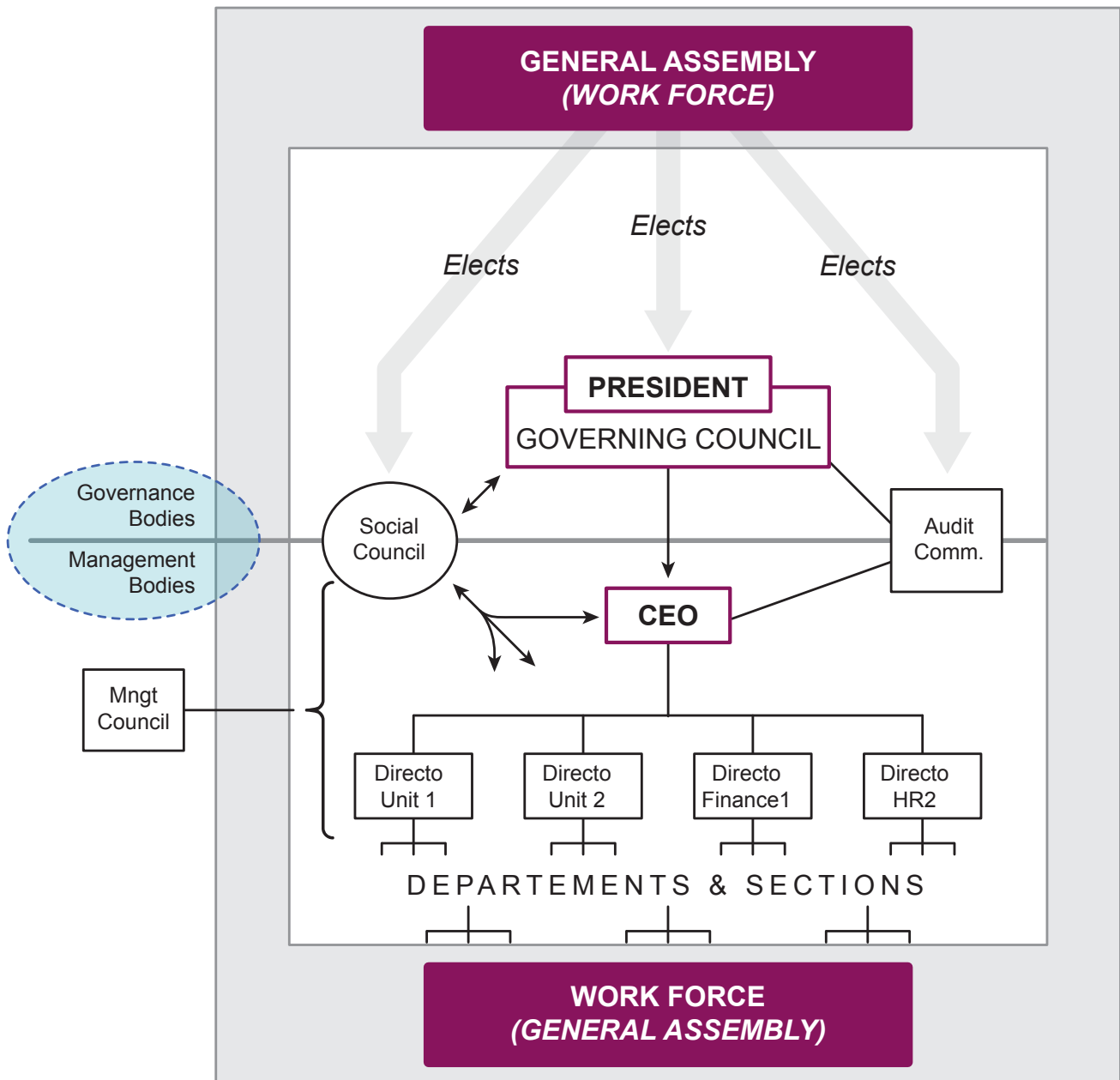


Figure 5.1: The Structure of a Mondragon Co-operative Enterprise

operatives as opposed to user co-operatives, the latter being generally much more widely known in the co-operative world and the general public. In a worker co-operative, the people who work in the firm are its member-owners. A few Mondragon co-operatives are quite large, with well over a thousand worker-members, but most are smaller with about 350 worker-members on average. Here, we will summarize briefly how governance works in Mondragon, both at the level of the individual Mondragon co-operative and at the level of the Mondragon group.

A MONDRAGON CO-OPERATIVE.

The legal-organizational structure of the typical firm in Mondragon directly embodies the democratic principles upon which worker co-operatives are based. This structure is shown below in Figure 5.1.

The most outstanding characteristic of this figure concerns the General Assembly (GA) of worker-members, which appears twice. It appears once at the “bottom” of the organizational chart, where worker-members report to managers in day-to-day operations. In complex organizations, with detailed divisions of labor, as is the case in Mondragon companies, some amount of hierarchy of this kind is considered inevitable¹. We also see, however, that the General Assembly appears at the top of the chart. The General Assembly of worker-members is the highest authority in the company. Management is ultimately accountable to the membership. This is the essence of democracy – popular sovereignty – applied to governance of the enterprise, and is one of the principal features that distinguishes worker co-operative firms from conventional ones.

BOX 5.1.

The overwhelming majority of co-operatives in the Mondragon group are worker-co-operatives, but several important co-operatives are not, notably the co-operative bank, Laboral Kutxa, and the supermarket-consumer goods chain, Eroski, the group’s largest co-operative. Laboral Kutxa is a hybrid, second-tier co-operative, that is, in structural and governance terms, partly a worker co-operative, partly a credit union and partly a co-operative governed by other co-operatives. Its General Assembly is made up of its worker-members, representatives of other Mondragon co-operatives and depositor-members. Eroski is a hybrid consumer co-operative/worker co-operative. In legal terms it is a consumer co-operative, but it has special by-laws stipulating that half its governance bodies correspond to worker-members, half to consumer-members. For a variety of reasons, then, in these, and in a number of other co-operatives, it was decided that a variety of constituencies should be represented in governance bodies, not only workers. A key to Mondragon co-operatives, though, is that, in principle, workers should have worker-membership status and corresponding governance rights, even if other constituencies also have their own membership status, and even if these other members have majority control over firm governance.

Consider briefly a few basic elements of this structure in Mondragon. By law, the General Assembly must meet at least once a year, though it often meets twice, once informally. An Extraordinary Assembly can be called at any time. GA decisions are made on the principle of one-member-one vote and they address company-wide concerns, including closing the books on the previous year, approving or rejecting the Annual Business Plan

¹ Democratic governance and broad participation in management are cornerstones of Mondragon policy and practice; they are, in fact, two of Mondragon’s ten basic principles. No matter how well they are carried out, however, they do not eliminate hierarchy. Mondragon companies are not concerned about hierarchy per se, but rather about its nature – whether it is more rigid, steep, bureaucratic and authoritarian or more flexible, flat, responsive and participatory.

for the upcoming year (or a five-year Strategy), making changes in company by-laws or basic policies and other major issues. It also elects the company's Board of Directors (often translated into English as "Governing Council"), which selects a Chairperson of the Board (called "Presidente") from among its members. Board members serve for four-year terms. The Board is the organization's senior governance body between Assembly meetings, representing the GA when it is not formally in session. Its role is to ensure that decisions of the General Assembly are carried out, to develop basic policy and strategy in conjunction with other bodies (at times for approval on its own, at times for presentation to the GA for a vote) and to monitor the performance of the company, generally in terms of the objectives of its annual plan. It is made up of approximately 9 – 12 members, depending on the size of the co-operative, and meets once or twice a month, or more frequently if necessary.

A key governance function of a Mondragon co-operative board of directors is to monitor and hold accountable the company's senior management. The Board itself appoints the company's chief executive and must approve his or her choices for the firm's highest level managers. The CEO and this group of senior managers together form the co-operative's "Management Council", the body responsible for day-to-day, month-to-month operations of the firm. The CEO is not permitted to serve on the Board, to avoid a concentration of power, and though the CEO generally attends Board meetings, it is at the Board's invitation, and s/he has no vote in Board decisions. For the same reason, members of the Management Council generally do not run for Board seats, but it is not prohibited and does happen in smaller co-operatives.

Mondragon co-operatives almost always have another governance body, the Social Council (SC). This body is not required by co-operative law, but it is recommended for Mondragon co-operatives with over 50 members, which covers all but a handful of firms in the Mondragon network. The Social Council is also elected on a one-member-one-vote basis, its members serve two-year terms, and co-operative members may *not* refuse to serve if elected. Though it is also an elected body, its functions are different from those of the Board (or Governing Council).

The co-operatives came to the conclusion in the early years of the group's existence that when an organization reaches a certain size, its complexity and division of labor are such that it is difficult for the Board to handle all representative functions.

Communication and shared decision making among frontline workers, the board and senior management become problematic under these circumstances. The co-ops further thought that, in this situation, its frontline workers have considerably less access to information and decision-making bodies, and less operational authority than managers, and hence, their perspective needs to be more effectively and consistently represented through a formal, structural body. As a result, the Social Council structure was created and, to ensure its members are in tune with frontline members' issues, it is not elected by the General Assembly as a whole, but rather by department or work area, approximately one representative for every 25-30 members. Officially, its meetings are presided over by the Board Chairperson, but in practice they are generally coordinated by a SC Vice President elected by Social Council members at the outset of each two-year session. The SC meets at least once a month and serves to promote communication among manage-

ment, the Board and frontline worker-members, to ensure frontline members² perspective is taken into account in major decisions, to serve as an initial forum in the grievance process, and to make proposals to the General Assembly on worklife issues such as the work calendar, hours, pay adjustments, working conditions and the like³. The above has been a summary of an individual co-operative firm in Mondragon. Turn now to the Mondragon group as a whole.

THE MONDRAGON CORPORATION.

Perhaps the most unique and successful feature of the Mondragon co-operative experience is what is known in local parlance as “interco-operation”. The meaning of the term goes well beyond loose intentions to work together; it entails close and multi-faceted collaboration that is achieved through the formal integration of firms and other co-operative institutions into a tight network. The network has been a crucial part of the Mondragon experience since its very early years, beginning in 1959 with the first co-operatives’ joint creation of their own co-operative bank, then called Caja Laboral Popular, today, Laboral Kutxa.

Since that time, the network has developed in dramatic ways, but its essential purpose remains the same: to help the individual co-operatives accomplish things together that would be difficult or impossible to accomplish alone. More specifically, this collaboration takes shape in three different ways: (1) the creation of common institutions and policies from which all network members benefit, institutions and policy that are tailored to their needs as co-operatives and hence provide them with services the conventional market either does not provide well to co-operatives or does not provide at all; (2) firm-to-firm collaboration in pursuit of business synergies and economies of scale; and, (3) coordination of business activities and an overall strategic orientation.

“Perhaps the most unique and successful feature of the Mondragon co-operative experience is what is known in local parlance as “interco-operation”.”

BOX 5.2. LABORAL KUTXA (FORMERLY CAJA LABORAL POPULAR)

The bank’s role has evolved quite significantly over the years. In the early decades, its mission was to serve as a co-operative development finance organization, that is, to promote co-operative growth by providing venture capital and ordinary loans to the Mondragon co-ops, as well as, and importantly, technical/business assistance through its “Business Division” (*la División Empresarial*). These were both crucially important roles. Further, its General Assembly served as the seat of the Mondragon group’s overall governance until the mid-1980s. As the co-operatives became larger and more sophisticated, and as the Bank of Spain’s regulatory framework changed, the bank’s role shifted. A separate organization was created for venture capital investments, “Mondragon Investments”. Caja Laboral was obligated by the Bank of Spain to shift a substantial majority portion of its loan portfolio out of Mondragon co-operatives. Technical assistance and consulting were re-located in Mondragon’s Area/Division organizations or in the consulting co-operative, LKS. Laboral Kutxa is one of Mondragon’s larger firms and it continues to make important financial contributions to Mondragon’s development, but its role is somewhat less central. It is no longer a motor of development finance and the seat of governance; rather, it is a sizeable, co-operative company focused on the retail banking business.

2 There are non-member workers in Mondragon co-operatives, which group policy limits to 15% of a co-operative’s work force. They do not have a vote for SC members and do not have formal representation. Full treatment cannot be given to this complex and problematic issue in this space (see references in last four footnotes), but suffice it to say here that, first, their wages and working conditions are governed by the regional collective bargaining agreement and, second, in practice, a significant problem for non-worker members typically is also a significant problem for worker-members, or becomes one, and, as a result, ends up being addressed by the SC.

3 Figure 4.1 includes an “Audit Committee”, a body formally responsible for overseeing a co-operative’s books and other issues. As the co-operatives have become more sophisticated about accounting and finance over the decades, and external audits became mandatory, this body has declined in importance.

“In 2014, the Mondragon network consisted of 103 co-operatives firms, as well as ten support organizations, eight foundations, one health-insurance-and-pensions mutual and 122 subsidiaries in different parts of the world.”

In 2014, the Mondragon network consisted of 103 co-operative firms, as well as ten support organizations, eight foundations, one health-insurance-and-pensions mutual and 122 subsidiaries in different parts of the world. As mentioned, Mondragon companies have joined together to create network structures since their earliest years, but, not surprisingly, these have evolved over time. The overall structure in use today is pictured in the Figure 5.2 below. All the co-operative enterprises and affiliated organizations are gathered under one umbrella, the Mondragon Corporation. The individual companies are distributed among four main business Areas – Financial, Industrial, Retail & Allied and Knowledge – and, within the Industrial Area, into 12 divisions. The Mondragon Corporation as a whole has governance and management bodies that roughly mirror those that exist at the level of an individual co-operative firm – senior management bodies appointed by and accountable to representative, democratic governance bodies. More specifically, at the level of Mondragon overall, management functions are carried out by the General Council, led by its President. The GC is a twelve-member body comprised of the President, Vice Presidents/Directors of the Finance and Retail Areas, the Vice Presidents/Directors of the six largest divisions within the Industrial Area, as well as the General Counsel/Corporate Secretary and the heads of two of the Corporation’s Central Departments (Finance and Social Affairs). Mondragon officials and documents emphasize that the function of the General Council is most definitely *not* centralized operational control, but rather, as mentioned above, the ongoing search for greater economies of scale, technological and business synergies, and the provision of technical and management services, in particular, greatly strengthened strategic coordination and development.

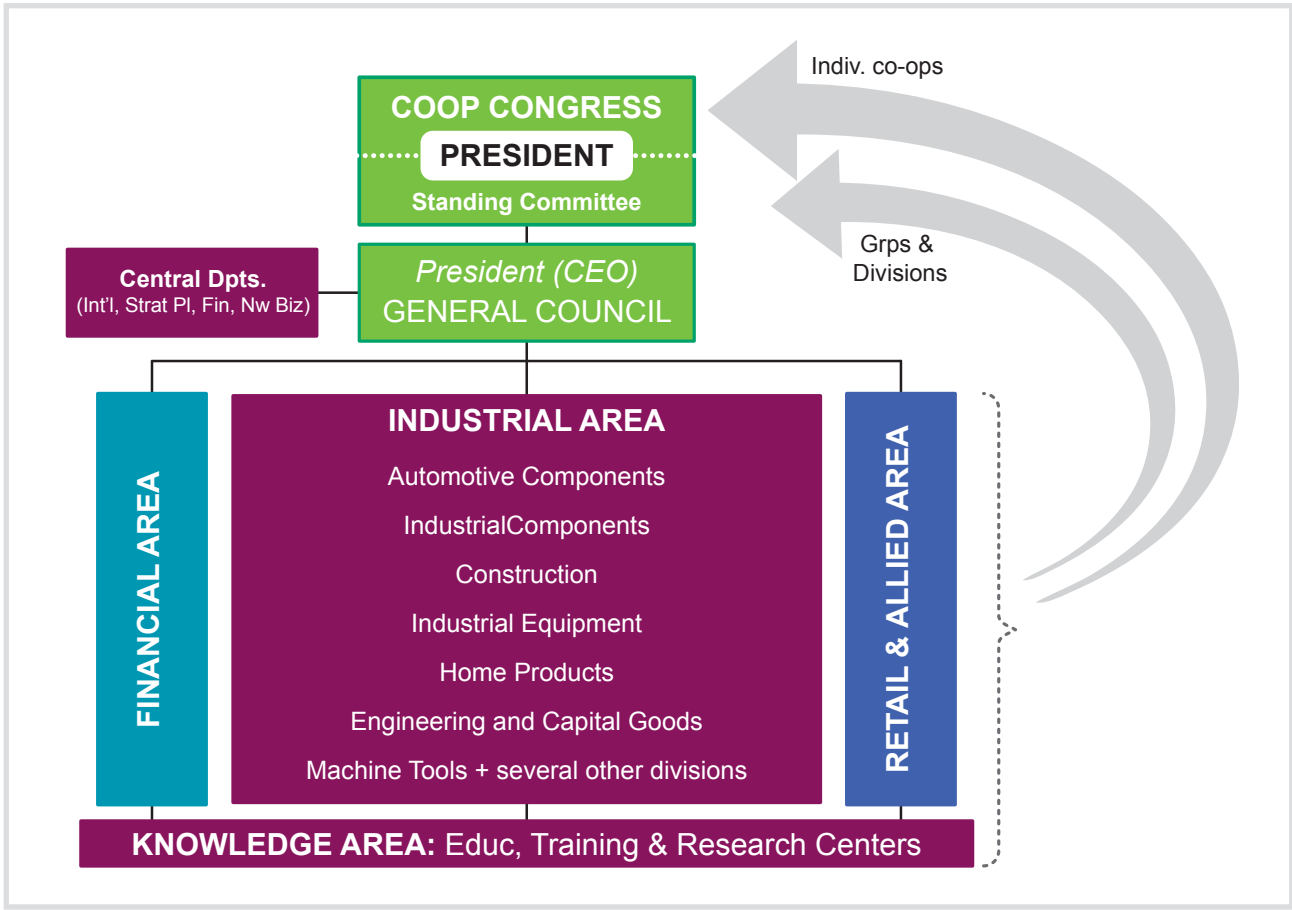


Figure 5.2: Organizational Structure of the Mondragon Corporation

The central management bodies in Mondragon are accountable to two representative, democratic governance structures, the Mondragon Co-operative Congress and its Standing Committee. The Congress is made up of 650 people representing all the co-operatives in the network. Each co-operative sends a number of representatives in indirect proportion to its size – larger co-operatives have more representatives, but cannot dominate. The Congress debates and establishes basic rules and policy that must be followed by all the co-operatives in the Corporation. The Standing Committee is essentially an internal board of directors and it consists of 21 people elected from among previously elected boards of the Areas and Divisions. The Standing Committee appoints the senior management official, the President of the General Council, and must approve the President's choices for the senior managers who will be members of the General Council, that is, the Area and Division Vice Presidents/Directors⁴ and the Directors of the Central Departments.

While the Mondragon Corporation structure may appear as complex and multi-layered as that of a conventional conglomerate, essential co-operative principles are still in place. Each individual co-operative is, legally, an autonomous unit with democratic governance structures. Each joined Mondragon and agreed to abide by its policies through a vote of its General Assembly of worker-members, and can vote to leave at any time.⁵ That said, there is a natural tension between central bodies and their prerogatives on the one hand, and the autonomy of the individual co-operative enterprises and other co-operative principles on the other, tensions that are negotiated in the day-to-day work of the Corporation and its co-operatives and also taken up in debates of the Congress and other senior bodies. Many would argue that the tension is generally resolved adequately, balancing business and co-operative priorities reasonably well under the circumstances of intense international competition with conventional multinationals.

This is where the Mondragon network organization stands today. It has become a multi-billion dollar group of international enterprises, with a unique and complex internal structure. The network rests on a foundation of democratic structures and co-operative business practices, all of which are subject to frequent discussion and regular review and reform. Dilemmas and challenges abound, however, particularly as regards co-operatives' subsidiaries among Eroski retail stores and the industrial co-operatives' overseas operations. These are too complex to be explored in this space, but discussions can be found in Azkarraga et al., 2012⁶; Cheney, 1999⁷; Freundlich et al., 2013⁸ and Malleson, 2013⁹.

“While the Mondragon Corporation structure may appear as complex and multi-layered as that of a conventional conglomerate, essential co-operative principles are still in place.”

4 These choices must also be approved by the Boards of the Areas and Divisions in question since the person's job is both to be a member of the General Council (a Vice President of the Corporation) and to coordinate the strategic management of the Area or Division.

5 The decisions by the co-opERATIVES Irizar and Ampo to leave the Mondragon sectoral/congressional structure in 2008 while remaining members of other key Mondragon institutions are examples.

6 Azkarraga, J., Cheney, G. and Udaondo, A., (2012). “Workers Participation in a Globalized Market: Reflections on and from Mondragon,” in Atzeni, M. (ed.), *Alternative Work Organizations*, London, Palgrave Macmillan: 76-102.

7 Cheney, G. (1999). *Values at Work: Employee Participation Meets Market Pressure at Mondragon*, Ithaca, NY: Cornell University Press.

8 Freundlich, F., Arando, S., Gago, M., Jones, D. and Kato, T., (2013). “Institutional Innovation in Mondragon: Context, Shape and Consequences,” in Klein, J. L. (ed.), *Pour Une Nouvelle Mondialisation: Le Défi d'innover (Towards a New Globalization: The Challenge of Innovation)*, Montreal, Presses de l'Université du Québec (Social Innovation Series).

9 Malleson, T. (2013). “What does Mondragon Teach Us about Workplace Democracy?” in Kato, T. (ed.), *Sharing Ownership, Profits and Decision Making in the 21st Century. Advances in the Economic Analysis of Participatory and Labor-Managed Firms*. Volume 14, Bingley, UK, Emerald Group: 127-157.

5b. Co-operation as Conversation: Suma Wholefoods UK

BOB CANNELL, SUMA MEMBER

Suma is a large worker co-operative in Yorkshire in the North of England. Since it was founded by a worker buyout of a private business forty years ago, Suma, has grown into a £43 million turnover, 150 worker member, food products distributor with customers in 40 countries.

Suma is undoubtedly successful as a worker co-operative and as a business. Last year's accounts show a net profit rate of 3.7%, the highest amongst its privately owned competitors. Annual growth for the past decade has been double digit (much of it in export markets), likewise, growth in the number of member workers.

Suma was one of the pioneers of the healthy eating, wholefoods revolution of the 1970s as a sub-culture reaction to the increasing domination of food markets by heavily processed, industrially manufactured foodstuffs. Much of this counter culture was organised as co-operatives, largely worker co-operatives in contrast to the long established consumer co-operative grocery store chains. Suma, as a wholesaler, supplied the new wholefood and health food shops, acted as a distributor for small food production businesses and developed ethical, wholefood alternatives to the mainstream supermarket food and household products.

Like many 1970s UK worker co-operatives, Suma grew from an anarchist tradition rather than the labourist origins of traditional co-operatives. The seven founding members rejected hierarchical management practices and the concept of a division of labour between workers and managers, and organised the business on formally egalitarian lines. Much of this thinking is still in practice today.

MANAGEMENT IS A FUNCTION NOT A STATUS

Suma has no Chief Executive or Managing Director, Chairman or President. Suma members practice 'consensual management'. Team leaders are titled 'function coordinators' and have little of the status authority expected. **'Management is a function, not a status'** is a key Suma principle.

Visitors to Suma remark on the feeling of high social and operational energy in the workplace. Workers move around in corridors and work areas quickly and talk to each other constantly. The canteen is the social centre of the business, serving free meals and snacks, packed and noisy at mealtimes and with a steady flow of workers coming and going, chatting and interacting freely.

It is impossible for a visitor or a new recruit to spot the centres of organisation and management in this environment. There are no 'suits' on the premises except for salespeople preparing for sales visits to corporate customers. There are no closed offices except for small meeting rooms scattered around the building. There are no executive parking spaces. Visitors often say 'But there must be someone in charge of all this activity somewhere in this building. Where are they?'

There are formal governance (of the co-operative) and management (of the business) processes.

Suma is governed by a set of Co-operative Society Rules which on paper are very similar to those used by the UK consumer society co-operatives. Suma members meet in general

meetings (GM) four times per year, and the GM is the sovereign body of the co-op. There is an elected management committee of six members acting as the board of directors with the authority to run the business in between GMs. There is the normal shadow board of appointed managers, in Suma's case titled Function Area Coordinators, to avoid the 'M' word, who meet weekly and daily to organise the short term operations.

None of these mechanisms operate in the same way as they do in more conventional co-operatives. Members are quite independent. For example, members occasionally vote for a proposal that makes sense at the business level and then refuse to abide by those decisions at the individual or team level. The management committee has occasionally used its nominal executive authority to force through developments only to find that the membership, as individuals, withdraw co-operation from the project and it fails. Coordinators complain about their lack of personal authority to make people do what they are supposed to be doing 'on the rota' (the weekly schedule of tasks).

There is a feeling that 'normal' recipes for good governance and management don't fit Suma and maybe don't fit other worker co-operatives.

Due to the experience and personality of individuals and their personal networks inside the organisation, Suma cannot be perfectly flat in terms of status. Some individuals clearly have more influence and more personal freedom to act than others, usually, more recently arrived. Attempts have been made to map these informal power relationships.

A Social Network Analysis map, which maps the formal communications pathways between participants in an organisation, gave the opposite to the expected result. In a hierarchical organisation the most powerful people are in the centre with the highest number of pathways, and the powerless are on the periphery. In Suma the outliers were clearly the most personally powerful members whereas those in the centre with the largest number of interactions were less influential in the co-operative as a whole.

Despite these puzzling phenomena, operational management functions extremely effectively in Suma, anecdotally much better than in other comparative worker co-ops. Planning and coordinating work and resources for the next few days and weeks is relatively easy and very effective. Failed deliveries (not on the day agreed) are almost unknown at Suma, while the industry average is around ten per cent of all deliveries. Order fulfillment rates are very high with a low level of mistakes and out of stocks. The extremely low staff turnover and low sickness absence rates show this is not being achieved by burning out workers. In recent years sales predictions and planning has become very accurate, which enables a greater confidence and preparedness to risk novel projects.

Things didn't used to be like this. Suma was a normal mass of inadequately coordinated functions creating conflict and errors. Getting one functional area sorted was undermined by another 'falling apart'. But there was a change some ten to twelve years ago when 'everything seemed to come together'. This was not due to any recognizable improvement in leadership by the Management Committee or Coordinators.

Underlying the formal governance and management processes at Suma are a mass of unmeasured and informal communications. Suma is an ongoing conversation being participated in by workers primarily, but also by suppliers and customers. When this conversation is healthy, the huge number of details to be managed are dealt with effectively and informally outside formal processes, in passing in the corridor or at tea break or over lunch or in conversation by phone and other media. Unlike many other organisations where hierarchy suppresses, excludes or otherwise interferes with informal conversation, it flows freely in Suma.

“There is a feeling that 'normal' recipes for good governance and management don't fit Suma and maybe don't fit other worker co-operatives.”

“Underlying the formal governance and management processes at Suma are a mass of unmeasured and informal communications.”

Twelve years ago all Suma workers got their own email accounts; mobile phones became omnipresent. It is possible that the glue that brought together all the parts that previously clashed is the greater communication made possible by these new media which are heavily used and only lightly moderated.

Over the years Suma members have planned and delivered some big business critical projects, such as two relocations, when the business had grown to be much bigger than a group of friends. The technical aspects of these were delivered better than planned.

Suma members have also managed business-critical crises including a devastating flood and an almost equally damaging but less conspicuous whole system IT failure. Both were dealt with quicker and more effectively than a normal business could manage, with the damage to the business minimised. Yet there is no traditional strategic management, after a few failed attempts to introduce it. Commonly recognised strategic management techniques simply do not work at Suma. The executive authority required to action them does not exist. Members reject them.

ABOUT THE MEMBERS

Suma members mostly stay in the co-operative indefinitely. One reason for the statistically insignificant turnover (less than 2% annually) is high relative wages and job security. 30 years ago a General Meeting decided to increase wages annually by at least the rate of inflation and drive the business to sustain that annual increase. Eleven years ago the members decided to make it a net 5% annual increase. This has resulted in exceptional remuneration for a distribution business and required a more efficient and effective business operation to provide it.

Wages are double the industry average with, in addition, in recent years a profits bonus distribution equal to a further two months wages. If the wages premium (the premium in excess of average market rate wages, the minimum necessary to staff the business) is considered to be distributed profit, Suma's annual return on member shareholder capital invested in the business is well in excess of 100%.

Wage rates are equal for all workers. From students helping out in the warehouse during the summer holiday season to veterans with decades of experience of global commodities trading, the net wage rate is equal. Suma is allegedly the 'largest equal wage employer in Europe'. This policy is at odds with almost all current business management thinking. Incentives in Suma are in the quality of the employment relationship and the potential for personal development inside the co-operative, rather than financial. Observers ask 'How does Suma acquire specialist and expensive business skills?' Utilising enthusiast activists in co-operative team-working and conserving experience inside the business to replace the need for highly paid specialists, is one solution. Time limited contracting with external consultants is another.

Wage parity has enabled Suma to maintain an exceptionally high degree of job-rotation and multi-skilling. Suma members will normally share their working week between two of the three work areas (office, warehouse, driving). By order of the GM, the Personnel team monitor and manage multi-skilling by members, encouraging individuals to take up new roles to preserve their skills portfolio.

Members can have dizzying career paths within the co-operative. Enthusiastic creative new members are elected management committee members or team leaders almost as soon as they sign the members register. One inexperienced young member with modern qualifications in logistics found himself in charge of a fleet of twenty delivery trucks and

an international supply chain because he could be supported by co-workers with decades of practical experience.

Member recruitment and induction focusses on the principle of self-management. The process takes nine months from initial job offer to acceptance as a new member by ballot of the membership. Suma members are expected by their colleagues to operate with individual initiative within collective responsibility. There is a constant tension between getting the day's work done and making improvements to make work better. Indeed the worst sin at Suma is for a member to allow a known error to affect a customer. Such behaviour is seen as un-co-operative and disappointing to the rest of the membership. Most dispute resolution activity at Suma does not concern conflicts between employer and employee (as in normal businesses); it is between colleagues unhappy at the quality of a team mate's work.

5c. Union Cab of Madison, Wisconsin, USA

JOHN McNAMARA

Union Cab began operations on October 29, 1979 after close to a decade of bitter labour struggles between the drivers of Checker Cab and its owner. After the owner closed his doors in 1978, the workers decided to take matters into their own hands and set about establishing their own taxi company. In deference to their struggles and to express solidarity with the larger worker movement, they chose the name Union Cab and organized as a co-operative under Wisconsin State Statutes Chapter 185¹⁰. Unlike many taxicab co-operatives, Union owns the vehicles and equipment, and the drivers are employees of the company instead of independent contractors. In addition, all workers must join the co-operative upon passing probation. This means that, in addition to the drivers, dispatch staff, mechanics, administration staff, and management, all join the co-operative and have an equal voice in the co-operative. Although Union Cab has one class of membership, its members working conditions, pay structures and expectations are very diverse. This structure can create conflict between the needs and desires of different internal stakeholders in terms of pay, benefits, and work.

Today, Union provides employment for over 250 workers making it one of the largest worker co-operatives in the United States. The taxi industry provides structural difficulties to membership engagement. Like most cab companies, Union operates twenty-four hours a day, seven days a week including weekends and holidays. This means that even at the peak times of the day when all cabs are on the road, only about 40% of the membership is at work and the overwhelming majority of those working are spread out geographically across sixty square miles. This can create different ideas of how to manage the business from the perspective of drivers who engage the front-end service, to office support staff who connect with the community through a different vantage point. At times, this has led to large disagreements over the direction of the co-operative and the best means of governance.

In 1995, the same year as the adoption of the Statement on the Co-operative Identity¹¹, Union found a similar need to further define its identity in light of a period of growth and a new generation of leaders who came of age after the initial founding of the company. The membership adopted a set of core values that focused on membership responsibility,

“Union provides employment for over 250 workers making it one of the largest worker co-operatives in the United States.”

¹⁰ Chamberlin 1989

¹¹ International Co-operative Alliance 1995.

open and honest communication, safety, a living wage and customer service. A seventh core value was added in 2004 as part of a discussion regarding the effects of the co-operative's operations on the environment.

For most of its life, Union Cab used a traditional hierarchical management structure. The nine member elected board hired a General Manager who then hired a management team. After several social audits found a growing dissatisfaction with traditional management models, the membership engaged a two part process to democratize their governance. The first step involved removing managers from the disciplinary system and establishing a set of peer councils to review collisions, behavior, and offer mediation and support. The next step further developed a unique management structure (see figure 5.3.) based on committees, teams, and councils.

Committees, appointed by the Board of Directors, develop and review policy. Teams, appointed by the Steering Team, implement policy and develop procedures and issue directives to staff. Councils, nominated by the Human Resource Team or Vice-President and approved by the Board of Directors, resolve conflicts among the membership.

The membership elects a nine-member board of directors as well as three alternate directors. The directors set policy, approve the annual budget and strategic plan, approve appointments to the councils, hire a business manager, and oversee the Steering Team.

Committees carry out governance functions (education, elections), review policies, review finances and assist with the annual audit, and create the strategic plan. The board appoints self-nominated members to overlapping two-year terms.

Councils, on the other hand, provide peer review.

- The Mediation Council whose members receive special training provides third-party mediation to members having a dispute.
- The Behavior Review Council (BRC) consists of seven members appointed to overlapping four-year terms who investigate worker complaints and decide on the appropriate action.
- The Accident Review Council (ARC) consists of five members serving three-year terms who review each collision by a driver.
- The Workers' Council consists of members appointed to hear an appeal of either the BRC or HRC.
- The Human Resource Council consists of the President, Vice-President, Business Manager and Human Resource Manager to investigate and resolve complaints involving protected characteristic discrimination or sexual harassment.

The business manager facilitates the Steering Team, which coordinates the activities of the teams, managers, and key staff, and manages the operations of the co-operative. The Steering Team also approves passing new employees of probation and offering membership as well as hiring for management positions. Each member of the Steering Team sits on a management team as well (e.g. member support, marketing, etc.). Each management team, including the Steering Team has at least two seats for "at-large" members (one for day shift and one for night shift). Other seats on the teams are determined by job description (for example, the Taxi Office Supervisor serves on the Operations Team and the Accounts Receivable Supervisor serves on the Finance Team). The Business Manager serves on all teams to provide consistency and communication throughout the system. The size of each team varies with Operations being the largest at twelve members and Marketing the smallest at four. Teams meet on an as needed basis so some teams such as marketing might meet semi-monthly, while Operations might meet weekly. Decisions of all

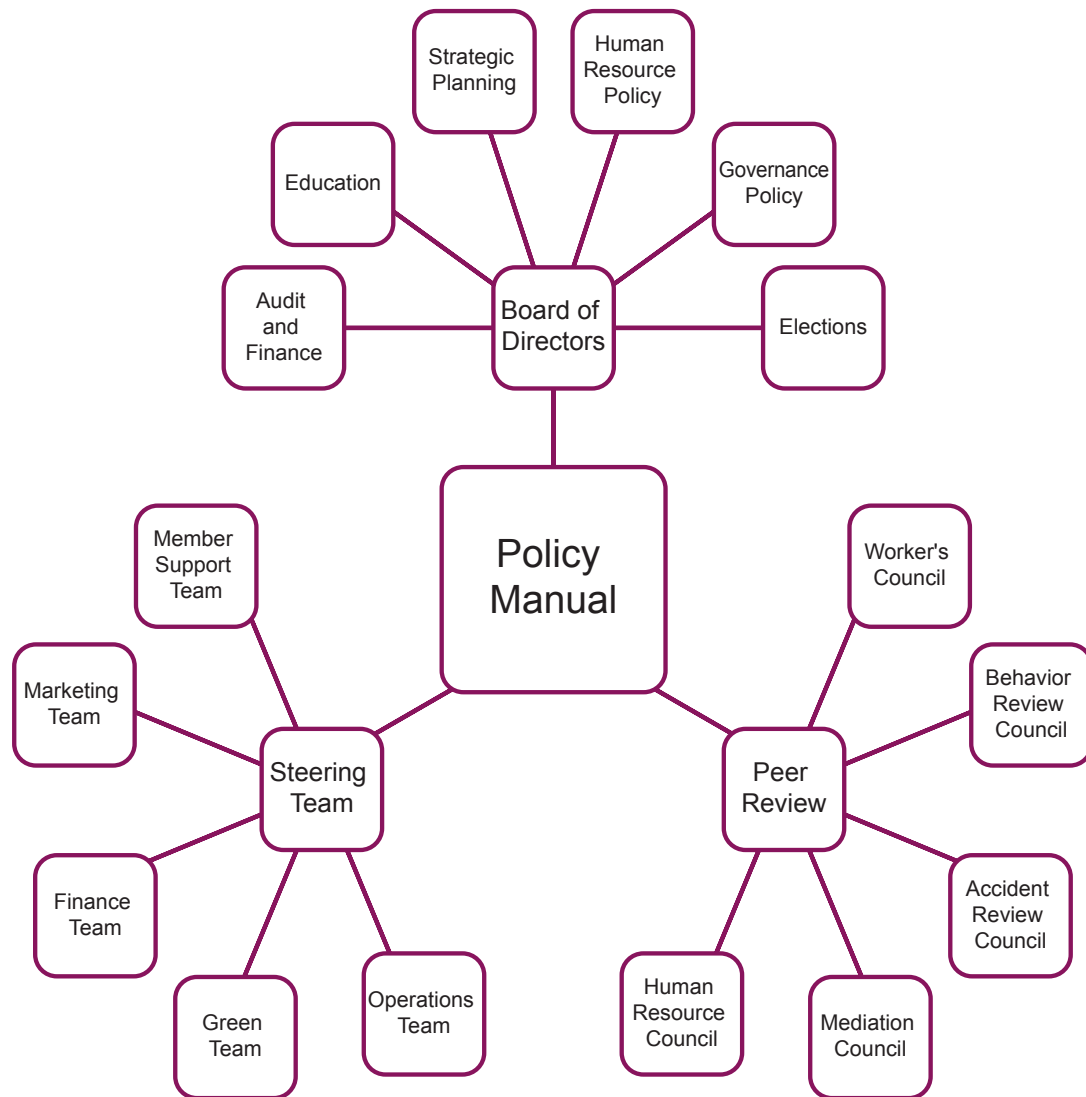


Figure 5.3: Union Cab Organizational Chart (source Union Cab of Madison Co-operative, 2014)

the teams operate on a modified consensus basis in which it requires two members of the team to block a decision while providing their reasons for doing so.

Effectively, no one individual has the power of a traditional “boss” in a hierarchical-style management system. While the business manager is responsible to the Board of Directors and coordinates the Steering Team, the position does not have authority over members of the team. The “Policy Manual” has become the effective “boss” of Union Cab, and changes to it go through a lengthy process of discussion and decision-making that give all concerned members a voice. This process brings the different stakeholders of Union Cab to the same table to make decisions. This creates a higher level of buy-in by the people required to carry out the decision. Further, for issues that may need board approval, the management team then speaks with a clear united voice in providing advice to the board. The interlocking teams allow information to disseminate to the different departments, and the at-large members of the teams help create a conduit of information between the members regardless of the space/time displacement of workers.

“No one individual has the power of a traditional “boss” in a hierarchical-style management system,,

In terms of accountability, the members and workers have the self-responsibility to manage themselves. For example, the Operations Team began reviewing customer complaints instead of a single manager. The team would examine each complaint without knowing the name of the member or the customer, but they would know if the member had similar complaints and the twelve month history of complaints in their file. After review and debate in a public forum, the team then chooses a course of action from the following choices:

- 1.No validity (remove the member's identifying information)
- 2.Leave the member's identification for tracking, but no further action
- 3.Assign a team member to speak with the member
- 4.Assign training to the member
- 5.Assign the Operations Manager to issue a Letter of Direction
- 6.Draft a Worker Complaint to the Behavior Review Commission

After the first year of this process, customer complaints dropped by over fifty percent. Further, members came to gain a greater understanding of how the general public engages the co-operative. Finally, members began to trust the disciplinary system as the process became more democratized and transparent.

The new system of governance can seem complicated to an outsider and even to some members. To assist members, the Peer Review policy also creates a support mechanism in the form of "stewards". The name is a connection to the labour union movement and the role of the steward is to assist members in navigating the councils, helping members to engage the teams, and even present policy ideas to the committees. In some cases, stewards work in tandem to help members have a facilitated discussion outside of the mediation council. This process allows each party in the dispute to meet with their advocate as opposed to the neutral third party of mediation. Stewards self-nominate and achieve status once they acquire a threshold of member signatures on their nomination form. The Vice-President reviews the nominations and confirms their appointment.

The new governance and accountability structure is a process and continues to evolve. After the replacement of the General Manager position by the business manager, the HRC was tasked with making appointments to the BRC and ARC, which are then confirmed by the board. Likewise, there are efforts to expand the number of at-large members on the teams and even allow those members to be elected by their peers instead of by current members of the team. The "team system" began in earnest with the councils on January 1, 2011 and followed by the "team system" and business manager on May 1, 2012. The board of directors receives reports from the Steering Team, Committees of the Board, and Councils providing a rich analysis of the functioning of the co-operative. To facilitate communication, the president meets with the Steering Team and the Business Manager attends all board meetings..

The old hierarchy engaged the board and the General Manager in decision-making with engagement of members based on the goodwill of the GM or will of the members paying attention. The new hierarchy develops leadership, embraces open communication and transparency and brings upwards of eighty to ninety members into decision-making roles while also allowing members to take part in the discussions as they wish. This process moved a lot of workers out of a mindset of being an employee and into that of an owner and a member with collective responsibility for the success of the organization.

“The new hierarchy develops leadership, embraces open communication and transparency and brings upwards of eighty to ninety members into decision-making roles while also allowing members to take part in the discussions as they wish.”

6

Governance of European Co-operative Banks: Overview, Issues and Recommendations

HANS GROENEVELD

Linkages between this chapter and inherent co-operative governance properties: humanism, joint ownership and control, and democracy.

The chapter discusses governance of European co-operative banks. The author takes the co-operative specific approach to governance and states “the countervailing power of members vis-à-vis banking professionals and/or executives should not only be legally and/or statutorily anchored, but must be vividly present at all levels of governance”. For this to be effective, the perceived meaningfulness of membership along with member engagement and involvement are highlighted as crucial factors.

The impact of **joint ownership and member control** is evident in co-operative banks in that “It is impossible for current cohorts of members to convert a local co-operative bank into a joint-stock bank and to redistribute the built-up reserves.” Jointly owned capital provides one mode of capitalisation of the co-op banks. Further, Groeneveld proposes that the non-co-operative part of the business, where it exists, be restricted to ensure the stabilizing aspect¹ of co-operative banking is materialized. Governance challenges emerge when business activities stray from the core business and when non-member investment interests (typically seeking higher returns) are counter to member interests. The author indicates that “the reliance on external funding or equity could lead to an erosion of the co-operative profile and an estrangement between local co-operative banks and the central institutions with its group subsidiaries.”

Democracy: Local co-operative banks apply the one-member one-vote rule to elect non-executive directors to the board by direct voting. Most local co-operative banks also form second tier structures to benefit from network scale economies. Central governance bodies function with a representative democracy, with representatives of locally elected board members influencing the policy and strategic course of the entire network. Co-operative ownership and decision-making is bottom-up, as opposed to top-down structures found in investor owned banks.

Connecting this chapter to network governance design concepts: small independent basic units, subsidiarity principle, polycentricity, and multiple stakeholders.

Local independent co-operative banks are the **basic unit of decision-making** within a large and complex network. European co-operative banks sometimes function on the principle of subsidiarity, but most are tightly linked in a network with much of the decision-making being removed from the individual bank. As a result, the autonomy of local banks may be questioned. This is particularly true for product and pricing decisions; however, the author specifies that some strategies on the application of co-operative identity remain in local hands. This area of discussion has overlap with the Chapter by Mangan which points to the tension between co-operative principles #4 and #6 relating to the need to balance autonomy of local co-operatives with the benefits of a network (association, federation).

Co-operative banking groups subscribe to **polycentric** governance design. The strategy of the local unit needs to align with the strategy of the overall network, indicating solidarity relationships. This is assured through “a bottom-up manner [of operation] (starting point is the member base) which creates a framework of checks and balances between local co-operative banks and the central structure [...]”.

Governance expertise is a topic that emerges in a few chapters within this report. This author positions the influence of various types of expertise as beneficial for effective governance, and points to a diversity of backgrounds (not just banking and technical) as an asset that has “proven useful for good governance”. However, directors must be equipped to exercise their duties, and the author points to the emergence of education programs to “boost the level of professionalization and sophistication of directors”.

¹ Co-operative banks engage in less risky investment; they are not publically traded; they invest in the real economy.

6. Governance of European Co-operative Banks: Overview, Issues and Recommendations

HANS GROENEVELD ¹

Introduction and summary

This article focuses on governance issues of the European co-operative banks, which constitute the largest category within the family of banking co-operatives worldwide. The insights and considerations also apply to other banking co-operatives like credit unions, building societies and co-operative banks set-up by other co-operatives. In recent years, it has been empirically confirmed that European co-operative banking contributes to enhancing the diversity of the financial system. Co-operative banking groups are considered 'different animals in the European banking zoo', largely due to their specific member-based governance².

To maintain or strengthen the co-operative nature and profile, I have distilled four recommendations related to co-operative governance. These suggestions are based on my own interpretation of recent events and regulatory developments. First, the countervailing power of members vis-à-vis banking professionals and/or executives should not only be legally and/or statutorily anchored, but must be vividly present at all levels of governance. The preparedness of members to exert this countervailing power in the governance largely depends on their commitment, engagement and involvement, which are all related to many different aspects of co-operative banks (e.g. performance, distribution concepts, virtualization of banking services, innovativeness, positioning, consolidation, etc.) and the perceived meaningfulness of membership. The importance of a vibrant and noticeable countervailing power by members for the viability and specific orientation of co-operative banks is not dealt with in a separate section but is mentioned either implicitly or explicitly in many parts of this article.

The second recommendation is to restrict the non-co-operative part of the business (i.e. the size of subsidiaries and international activities together) to 30-40 percent of all operations of the co-operative banking group.³ This rule of thumb is primarily based on the observation that recent sizeable losses and/or write downs at some co-operative banking groups were located at group-level entities and/or subsidiaries in non-retail or non-domestic activities⁴. These events entailed reputational damage and risks for the affiliated co-operative banks. In this respect, activities outside the co-operative part should be mainly related to retail banking.

The third suggestion is that pros and cons of the introduction, presence or expansion of external investors and/or third-party shareholders must be carefully assessed and clearly

¹ Professor Financial Services Co-operatives at TIAS School for Business and Society of Tilburg University and Deputy Director Co-operative and Governance Affairs at Rabobank, the Netherlands (j.m.groeneveld@tias.edu). The views in this article are personal and do not necessarily reflect those of Rabobank.

² Goglio, S., and Y. Alexopoulos (2014, Eds.), Special Issue on Co-operative Banks, *Journal of Entrepreneurial and Organisational Diversity*, Vol. 3, Issue 1, Trento, Italy.

³ This could be defined in terms of total assets, total employment or gross revenues.

⁴ Birchall, J. (2013), *Resilience in a downturn: The power of financial co-operatives*, International Labour Office, International Labour Organization, Geneva

explained to member representatives. It is my opinion that the dependency on wholesale funding and equity providers of a co-operative banking group should remain as limited as possible or necessary, even if this would imply lower growth compared to other banks.⁵ In some recent cases, the presence of external funding or capital providers has led to complications in the functioning of the member-based governance.⁶

“Co-operative banks should not ask for favours, but policy makers should take their features into account when designing and implementing policy measures.”

The fourth suggestion is linked to a series of new rules and guidelines that international and national regulators and supervisors have introduced that directly and indirectly affect the governance of banks, both commercial and co-operative⁷. These regulatory developments urge co-operative banks to explain their specific governance features in a convincing, credible and transparent way to the regulators and supervisors. It would be detrimental for co-operative banks and would hurt the entire financial sector if these characteristics would – deliberately or unconsciously – be ignored or misunderstood. Co-operative banks should not ask for favours, but policy makers should take their features into account when designing and implementing policy measures. Co-operative banks exhibit positive effects for diversity, competition and stability in the European financial sector as will be explained in the section devoted to the beneficial effects of co-operative governance.

Stakeholder and Shareholder Value Banks

The banking sector incorporates a rich array of banks with diverse business models and ownership structures. Public, state, savings, co-operative, mutual and private banks co-exist in a diversified market. In policy reports and research publications, a particular distinction is made between Stakeholder Value (STV) banks (of which co-operative banks are a major component) and Shareholder Value (SHV) banks (of which listed banks are a major component). The distinction is ultimately about the banks' bottom line objectives and the extent to which profit maximisation is the central focus of their business models. SHV banks can be categorised as 'dual-bottom line' institutions, i.e. they aim at both financial/economic goals and social objectives.

SHV banks have shareholders which are the owners of the bank and the ultimate risk-takers. In this model, the bank management is supposed to act primarily in the interests of the shareholders through maximising the value of the business as reflected in the rate of return on equity and the market capitalization value. The products and services SHV banks provide are a means to generate income for their investors, within the limits of the law and accepted social, financial and sustainable standards. SHV banks are governed by shareholders on a 'one share, one vote' principle, which is equivalent to economic decision-making power in proportion to wealth⁸. SHV banks also tend to have a single, centralised board that operates top-down through an appointed CEO with wide latitude to define the company's operating strategy, policies and structures from the centre⁹.

In contrast, in STV banks there are many stakeholders, and most especially the members (as owners and customers) in co-operative banks. In the STV approach, while profitability is one of the objectives of the bank, it is not exclusive or even the primary objective. It is

5 It is difficult to define a precise threshold for this requirement. Basically, this requirement is closely linked to the desirable loan-to-deposit ratio as well as the appropriate level of the leverage ratio featuring in current supervisory policy discussions.

6 This was the situation at Rabobank where Member Certificates were transformed into listed Rabobank Certificates. Moreover, the Italian Popular Banks were forced by decree to change from co-operative banks to public listed companies due to the fact that they have external shareholders without voting rights and members who do not have an effective role in the governance.

7 European Banking Authority (2011), Guidelines on Internal Governance (GL 44), London, 27 September 2011.; Basel Committee on Banking Supervision (2014), Corporate governance principles for banks, consultative document, October, 2014.

8 Nadeau, E.G. (2012), *The Cooperative Solution: How the United States can tame recessions, reduce inequality, and protect the environment*, Madison, USA.

9 Oliver Wyman (2014), Organizing for Effectiveness and Growth in Co-operative Financial Services: A focus on the Americas, Financial Services, Report prepared for the International Summit on Co-operatives in Québec, Canada.

more an issue of balancing different interests of the various stakeholders in the company via local or central governance bodies. In practice, this means that a STV bank will not pursue profit maximization to the same degree, or with the same intensity, as SHV banks. For STV banks, profitability is a means to safeguard continuity and growth on the one hand and to be able to meet social or societal goals on the other. STV banks are not subject to the pressure from investors for immediate returns, and can consequently apply a longer-term perspective.

Types of banking co-operatives

Taking a global view, four categories of banking co-operatives can be distinguished¹⁰. They share a number of common characteristics and values, among which: social com-

BOX 6.1. DISCIPLINING STV AND SHV BANKS

Dissatisfied members have a powerful option to discipline management or executive board members of local co-operative banks and/or their central institutions in the form of withdrawing funds and business¹. Exit or voting with their feet by members diminishes the volume of deposits available to the business, and can consequently be a more powerful discipline on management than the sale of shares in a SHV bank. Although customers of SHV banks have similar options at their disposal to signal their discontent by, for instance, withdrawing deposits, the crucial distinction is that they are not owners of the bank. The exit route by members (who are also customers) is a particularly powerful disciplinary tool in the case of co-operative banks, as it removes resources from the bank, whereas the sale of shares in an SHV bank does not.

Withdrawing deposits thus exerts a powerful discipline on co-operative banks and constitutes, in some sense, a more direct threat to managers. This is because when a depositor withdraws funds, the funding capacity of the co-operative bank is immediately reduced. By contrast, the sale of an equity stake in a SHV bank does not in itself influence the capacity of the bank, though the share price might fall, which would have the effect of raising the cost of capital and might also create a confidence problem for the bank. Thus, if equity stakeholders in SHV banks sell their ownership stake on the stock market, this does not remove assets from the control of the management of the banks, whereas the withdrawal of members' deposits at co-operative banks does.

¹ Groeneveld, J.M., and D. T. Llewellyn (2012), 'Corporate Governance in Co-operative Banks', in *Raiffeisen's Footprint: The Co-operative Way of Banking*, J. Mooij and W.W. Boonstra (Eds.), VU University Press, Amsterdam, The Netherlands, pp. 19-36.

mitment, local community focus and democratic governance according to the 'one member, one vote' principle. In terms of total assets, European co-operative banks are the largest category, followed by the global credit union movement. The main differences between the two are that in the credit unions customers have to be members, whereas the co-operative banks are also able to serve non-members.

European co-operative banks have long been an integral and well-established part of the European financial system. Co-operative banks operate with a full banking license and serve many non-members nowadays. In the early days, membership was compulsory in order to be eligible to obtain a loan from a local co-operative bank. Many co-operative

¹⁰ Groeneveld, J.M. (2015a), 'Member-Based Enterprises: The Spotlight on Financial Services Co-operatives', Inaugural publication, TIAS School for Business and Society, Tilburg University, 13 February 2015.

banks abolished this requirement a long time ago. This was mainly due to fundamental changes in the economic structures of countries, i.e. from an agricultural to an industrial focus, increasing individualism and large innovations in payments services as well as the upcoming demand for mortgages due to increasing popularity of home ownership. Since IT investments require large amounts of money, co-operative banks had to start serving the emerging mass retail markets to reach a certain scale for their operations. The average member to customer ratio now stands at 30%, which implies that a large majority of customers are not members of a co-operative bank (anymore) and that customers are not automatically members. Besides, the homogeneity of the member – and customer – base has diminished tremendously as a result of social, economic and competitive developments in the course of time. Initially, members of co-operative banks were mainly farmers or craftsmen in cities, which simplified the risk control and management of the early local credit co-operatives. This diverse member base has surely thwarted the functioning of the governance over time. Nowadays, it is much more challenging to reconcile the potentially divergent interests of members with more diverse backgrounds and needs. Since only – representatives of – members play a formal role in local and central governance, they are theoretically in the position to ensure that local co-operative banks stay close to their original mission and traditional business orientation. It is true though that the value of membership has eroded over time, as the original motive to become a member of co-operative bank, i.e. obtaining access to affordable financial services, has lost its validity in Western Europe.¹¹ Regardless, co-operative banks are an important part of the diversity and plurality in European banking. In 2013, the total number of members amounted to approximately 78 million, i.e. 18 percent of the entire population in the respective European countries are members of a co-operative bank. The average domestic market share in retail loans as well as in retail savings is more than 20 percent.

The vast majority of credit unions have to restrict membership to people who come within a 'common bond', whereas co-operative banks have no restrictions. The World Council of Credit Unions (WOCCU 2013) estimates that credit unions serve around 208 million people and possess USD\$1.7 trillion in assets. This comes down to a penetration rate of about 8%, i.e. the total number of reported credit union members divided by the economically active population age 15-64 years old. Collectively, the credit union movement is smaller than the (European) co-operative banks. If we add up the totals for credit unions and co-operative banks, credit unions have around 18 percent of total assets¹².

The third category of banking co-operatives is the building society sector, which mainly exists in the United Kingdom and Australia. Building societies are owned by their saving and borrowing members. The business model of building societies is generally fairly simple. Members save at the society and these funds are used to grant loans to members wishing to acquire property, which is the collateral to the loans¹³.

The fourth – and rather small – category of banking co-operatives comprises banks which are set up by other co-operatives. The Co-operative Bank in the United Kingdom was an example of the latter. This bank was established by the Co-operative Group, but had to be rescued by hedge funds due to a malfunctioning governance which led to ill-considered and costly expansionary decisions¹⁴.

11 This aspect touches upon the issue of the motives for customers to become a member. According to my knowledge, this topic is a rather unexplored territory in European co-operative banking (EACB 2007, 60 million members in Co-operative Banks: What does it mean?, Brussels). The most important reason to become a member seems to be trust in the co-operative and customers' satisfaction with the quality and pricing of products and services.

12 Birchall, 2013.

13 Butzbach, O. (2014), 'Alternative Banks on the Margin: The Case of Building Societies in the United Kingdom', in *Alternative Banking and Financial Crisis*, O. Butzbach en K. von Mettenheim (Eds.), Pickering & Chatto Publishers, pp. 147-167.

14 Kelly, C. (2014), *Failings in Management and Governance*, report of the independent review into the events leading to the Co-operative Bank's capital shortfall.

Commonalities and differences in co-operative bank governance

Table 6.1 summarizes the main similarities and differences among co-operative banks. In the last column, the corresponding governance features of SHV banks are included for the sake of comparison. Before the most salient aspects of this table are discussed, it must be noted that the governance structure of co-operative banks has constantly evolved in reaction to and/or in anticipation of economic, technological, competitive and regulatory changes over more than one hundred years. Without this adaptability, co-operative banks would probably not exist anymore.

The first column highlights important unifying characteristics of co-operative banks, which date back to the time of their inception. The most fundamental one is that co-operative banks are member-governed institutions, with direct or indirect representation of members at all levels of governance. Every co-operative bank adheres to the democratic principle of 'one member, one vote' and applies an open membership policy. Most local and/or regional co-operative banks are funded predominantly by retail deposits raised locally and do not have external shareholders, i.e. equity/capital providers with voting rights. As a consequence, co-operative banks have a different governance structure and business orientation than SHV banks. By definition, co-operative banks operate in a bottom-up manner (starting point is the member base) which creates a framework of checks and balances between local co-operative banks and the central structure (if any).

Generally speaking, customer-members own the nominal valued shares or certificates in local banks. The Swiss Raiffeisenbank and the Dutch Rabobank are exceptions, since their membership entails no – financial – obligations, but only rights. In Switzerland and the Netherlands, members of co-operative banks were fully liable for members who wanted a loan, but this requirement has been abolished a few decades ago. At all other co-operative banks, some financial reciprocity between members and local co-operative banks still exists today, i.e. the International Co-operative Alliance's principle of member economic participation still pertains to these banks. For most European co-operative banks, a member share or certificate ranges from € 5 to € 100 (and the total amount of member shares is capped to a maximum). Unlike stock shares, co-operative shares do not give members an ownership claim on the reserves of the local bank. Instead, they give a right to some dividend, and are redeemable at cost should the member leave the co-operative. It is impossible for current cohorts of members to convert a local co-operative bank into a joint-stock bank (Public Limited Company status) and to redistribute the built-up reserves. Therefore, one could say that the reserves of co-operative banks are in 'dead hands'. All in all, co-operative banks are predominantly funded by retained earnings, member shares and customer deposits, though some of them rely on external funding and equity to varying degrees.

Co-operative banking groups are thus formed of a number of autonomous banks, servicing distinct communities (with respect to geography, economic structure, etc.) with potentially distinct needs. Co-operative banks are governed by their members (clients-owners), with direct or indirect member representation at all layers of governance. Local members or member constituencies elect Non-Executive Board Members, or in some instances called local supervisors, who monitor and control local/regional co-operative banks. Almost every local or regional bank operates with a local board consisting of Non-Executive Board Members and at least one professional banker (e.g. general manager of the local bank). Due to the large number of members, central governance bodies are not based on a direct democracy, but function with a representative democracy. Repre-

“The governance structure of co-operative banks has constantly evolved in reaction to and/or in anticipation of economic, technological, competitive and regulatory changes over more than one hundred years.”

representatives of locally elected Board members have a seat in central governance bodies, thus influencing the policy and strategic course of the entire organization. The rights, obligations and responsibilities of – representatives of – members in local and/or central governance bodies are laid down in internal statutes, articles of association, or by-laws. An informal survey reveals that around 5 percent of the members are willing to take part in internal governance bodies. Around 780,000 members (i.e. 1 percent) do actually participate in the governance of European co-operative banks. These members are ambassadors and advocates of co-operative banks in society.

Co-operative banks are made of a network of affiliated banks and that individual local banks have collectively set up a group-level entity, being an association, a co-operative or a corporation. The individual banks own the capital of the group-level entity when it has a corporate or co-operative legal structure (APEX). Such group structures with centralised business functions allow co-operation in ways that create efficiency gains through economies of scale and scope. This has inevitably led to a decline in autonomy and discretion of local member banks in managing their banking business and operations.

Here the similarities among co-operative banks end because the level of integration between local/regional banks and the responsibilities and activities of the group-level entities vary considerably across co-operative banking groups as column 2 shows. Group-level entities in the form of central banks with the most extensive responsibilities have the following roles:

1. Supporting local banks (i.e. product development, ICT, marketing HR, etc.);
2. Banker's bank for the group;
3. Mandate for the preparation and/or execution of the overall strategy;
4. Holding company for (inter)national subsidiaries;
5. Supervisory role over local co-operative banks.

All APEX organisations act as central service providers for local co-operative banks. Many centrals serve domestic business clients that are too large for the local co-operative banks from a risk concentration perspective, while retaining local relational banking and institu-

BOX 6.2. LEVELS OF INTEGRATION OF CO-OPERATIVE BANKING GROUPS

Four different levels of integration can be discerned across co-operative banking groups:

- **Basic co-operative group** does not have an Institutional Protection or a Cross Guarantee Scheme and has very limited centralised functions.
- **Decentralised co-operative groups** have a legal framework in the Capital Regulations Requirements (art 113(7)). They have an Institutional Protection Scheme, limited centralised functions, independent local banks supervised by national supervisor and the management of central body cannot issue instructions to local banks.
- **Consolidated co-operative banking groups** also have a legal status (article 10 or article 113(6) CRR). They have a Cross Guarantee System, are supervised directly by the European Central Bank (ECB), have many centralised functions, the management of the group entity can issue instructions to local banks (preventing default) and the group entity decisions are binding.
- **Fully integrated co-operative banking group.** This category is characterised by a single banking license for co-operative banking group, Consolidated supervision, member representation on local and central level, totally integrated banking business. This category of co-operative banking groups will comprise one co-operative banking group as from 2016: Rabobank. However, the Co-operative Bank in the UK also belongs to this category.

TABLE 6.1 CURRENT SIMILARITIES AND DIFFERENCES IN GOVERNANCE REGIMES OF CO-OPERATIVE BANKS

	Similarities	Differences	Comparison with non-co-operative banks
Structure	<ul style="list-style-type: none"> Local banks are full banking entities (banking license) 	<ul style="list-style-type: none"> Size and number of local banks and branches 1, 2 or 3 tier group structure Degree of integration within the group 	<ul style="list-style-type: none"> Local/regional entities do not have a banking license
	<ul style="list-style-type: none"> Group-level entity is founded by local banks and/or the members 	<ul style="list-style-type: none"> Nature of group-level entity (association, co-operative, corporate) Nature and size of (inter)national activities of group-level entity 	<ul style="list-style-type: none"> Group-level entity ('parent') establishes and owns the local / regional entities if any
Governance systems	<ul style="list-style-type: none"> Option for number of levels in governance 	<ul style="list-style-type: none"> Actual number of governance levels (1 to 3) 	<ul style="list-style-type: none"> One main level of governance
	<ul style="list-style-type: none"> Representation of members (= customers) at all levels of governance 		<ul style="list-style-type: none"> Representation of shareholders/ owners in the governance No involvement of customers in the governance
	<ul style="list-style-type: none"> Customers are not automatically members, but membership is open to all customers Democratic system to elect Board at bank's level ('one member, one vote') 	<ul style="list-style-type: none"> None or limited financial liability of members (member shares or certificates, ranging from € 5 to €100) Election of group-level entities' Board either directly by members or by their representatives and appointed management in the local banks 	<ul style="list-style-type: none"> Board is directly elected by shareholders based on the amount of shares owned
	<ul style="list-style-type: none"> Capitalisation takes place primarily via retained earnings Capital is in 'dead hands': current members have no ownership claim on reserves Local and regional banks are predominantly funded by retail deposits raised locally 	<ul style="list-style-type: none"> Degree of dependency on external funding and/or external capital (tier 1, 2 or 3) Existence of third-party investors and/or shareholders (through listed or unlisted entities) 	<ul style="list-style-type: none"> Shareholders capitalise bank, hardly via retained profits Greater dependency on wholesale funding Shareholders determine the dividend policy and provide directions for – returns on – investments
	<ul style="list-style-type: none"> Elected members are Non-Executive Directors in Boards (in a supervisory capacity)* or Supervisory Board Members Diversity of backgrounds of Non-Executive Directors 	<ul style="list-style-type: none"> Governance bodies at group level Composition of governance bodies (members, managers, outside Non-Executive Directors) Eligibility requirements for Non-Executives Directors Mandatory members or not mandatory Weight of fit and proper tests (light or heavy) 	<ul style="list-style-type: none"> Non-Executive Directors at top level are primarily chosen for their reputation and professional capacity Rather one-dimensional profile of Non-Executives favouring banking and financial experience / expertise
	<ul style="list-style-type: none"> Varying degree of autonomy of local banks regarding the expression of the co-operative identity, key business and prudential decisions (within agreed scope) 	<ul style="list-style-type: none"> Supervisory and regulatory role of group-level entities regarding local banks Controlling versus non-controlling vis-à-vis official regulators/ supervisors Split of decisions and responsibilities 	<ul style="list-style-type: none"> Very limited autonomy of local / regional entities on prudential decisions Very limited room for local entities to differentiate in pricing and servicing

Source: the table is based on investigations of governance structures of European co-operative banking groups and information from other studies[†] (e.g. Di Salvo, 2011).

Note: * The Dutch Rabobank is the exception. At the local level, an elected Non-Executive (Supervisory) Board exists next to an Executive (professional) Board of Directors. Rabobank will however change its governance model fundamentally in 2016. It will move to one banking license and one consolidated balance sheet. † Di Salvo, R. (2011), 'The system of co-operative banks in Europe. Governance, strategic structures and evolutionary trends', working paper.

tional foundations in social and political networks. Then, there are centrals that undertake national and/or cross-border activities or act as a holding company for domestic and/or foreign subsidiaries. The size and nature of such operations carried out by centrals vary greatly. Besides, the established common entities by local banks can be listed or non-listed, with or without the presence of third-party shareholders.

Depending on the level of integration within the co-operative banking group¹⁵, the local banks and the regional and central institutions either report consolidated as well as separate figures or report only separately. In addition, some group-level entities are responsible for the execution of internal solvency and liquidity mechanisms, and/or internal protection schemes (IPS; supervisory role) to ensure the overall stability of the network. To perform the latter task adequately, the respective group-level entities have supervisory powers that provide a common set of standards for local banks to adhere to. These monitoring devices usually exert a strong disciplinary influence on member banks (and their management), apart from the intrinsic peer pressure within the network. In this case, a dual governance structure exists. On the one hand, local co-operative banks monitor the central institution that they have established for support or to perform (inter)national activities as a holding company, while at the same time the central organisation exercises prudential and behavioural supervision over the member banks.¹⁶

In summary, there is no single governance model that, in all its detail, is common to every co-operative bank (see column 2). This means that there is no completely homogeneous set of co-operative banks across Europe.

There is a rich diversity in precise business models, structure and governance. The European co-operative banking sector can, therefore, be characterised as *'Commonality with Diversity'* in that there is a set of basic governance principles that are common to all co-operative banks while at the same time differences exist in the practical way of operation in many areas. Each governance structure is shaped by circumstantial and/or historical elements.

These factors comprise the geography (size of the country), national banking market characteristics, consumer behaviour and preferences, complexity and size of the co-operative banking group and regulation and supervision (legislative burden).

However, the essence, roots and design of the governance of all co-operative banks differ significantly with those of non-co-operative banks on many points. Just one exemplary aspect, in SHV banks, the 'parent' owns the subsidiaries (see column 3), whereas local co-operative banks are the parents of the central institution and the owners of the subsidiaries. This leads to large differences in governance dynamics between co-operative and SHV banks.

Limiting non-co-operative activities and the dependency on external funding

Most local co-operative banks are primarily funded by retained profits and customer deposits and operate in less integrated networks, e.g. the German Volks- and Raiffeisenbanks (V&R) and the Italian BCC banks. They use local savings to fund local loans to households and SMEs. Their (balance sheet) growth potential is largely determined by

¹⁵ The level of integration varies from loose associations like the Italian Popular banks to highly integrated groups like Rabobank and Finnish Financial Co-operative Group.

¹⁶ In Finland, The Netherlands and Portugal, the APEX institution is officially responsible for the delegated supervision over the legally independent local banks on behalf of the European Central Bank.

the capital formation via retained earnings and by retail deposit growth. This means, for instance, that the central banks of the German V&R banks, DZ and WGZ, do not attract additional financial means for the local co-operative banks. This feature results in fully locally oriented co-operative banks; local savings are used for the development of local communities via local credits. In this situation, local governance can operate relatively independently and is mainly shaped by local developments. The flipside is that smaller co-operative banks – like the German V&R banks – cannot service large customers on their own, due to risk limitations.

There are also co-operative banking groups that have issued all kinds of (hybrid) capital instruments via their central institution to acquire additional funding and/or equity for their local banks. Rabobank is a case in point. Since the 1990s, local co-operative Rabobanks are confronted with a deposit gap, i.e. the local deposit growth was too low to accommodate local credit demand. The central institution started to issue hybrid instruments to obtain funding for the local banks. Consequently, local Rabobanks could fully meet the credit demand by households and SMEs. The flipside was that Rabobank became more dependent on wholesale funding and had to comply with the requirements of the financial markets, e.g. to get a credit rating and fulfil stricter reporting requirements. The shared ambitions of local banks and their central institution led to a highly integrated group with mutual risk sharing and necessitated internal supervisory and regulatory rules. These factors reduced the scope for local deviations in banking practices and pricing and led to a higher level of alignment of local strategies with the overall group strategy. The freedom to choose how to express co-operative identity has remained predominantly local, though.

Then, there are a very small number of co-operative banks that have become partly listed to acquire additional capital to grow more and faster, e.g. the largest Italian Popular banks and 13 regional banks of the Crédit Agricole group. The corresponding external shareholders do not have voting rights relative to their shares. It is more common that the central institutions of larger and more integrated co-operative banking groups attract wholesale market funding for their own national and international growth and activities. These institutions act as holding companies for non-co-operative subsidiaries and/or group entities, which are sometimes (partly) owned by external investors. In a few instances, the central institutions are partly listed themselves, i.e. partially owned by external investors or shareholders. For example, the central institution of Crédit Agricole, Crédit Agricole S.A., is partly listed, though the regional co-operative banks hold the majority of the shares. The Austrian Raiffeisen banks own a central bank (Raiffeisen Zentral Bank), which has a minority stake in the listed Raiffeisen Bank International.¹⁷

Over the years, a number of co-operative banking groups have transformed into hybrid financial co-operatives with relatively large central institutions or central banks. The main advantage is obviously that they could realise their growth ambitions and enter new areas of financial services, like leasing, insurance, investment funds and investment banking. This contributed to diversification of their business and enabled them to offer a wide array of services to their member-customers. The larger European co-operative banking groups have opted for different business models when conducting business outside their home country. The Austrian co-operative banking groups acquired banks in Central and Eastern Europe after the collapse of Communism. By contrast, the Dutch

¹⁷ Some academics and policy makers have stated in the past that a major weakness of co-operative banks is that they cannot easily extend the capital base by issuing shares. This is ascribed to the governance framework of co-operative banks which may hamper raising capital, particularly in times of distress (e.g. Gutierrez, E. (2008), 'The reform of Italian co-operative banks: discussion of proposals', IMF Working Papers, WP 08/74, International Monetary Fund, Washington D.C.). I think that this alleged shortcoming is based on a weak argument, since quite some listed banks faced difficulties in acquiring fresh equity capital from shareholders when they were in trouble amidst the credit crisis.

Rabobank is now predominantly focussed on the food and agricultural sector in its international business.

“Apart from the positive effects, one cannot neglect the governance risks associated with a large expansion of co-operative banking groups outside the traditional co-operative core.”

Apart from the positive effects, one cannot neglect the governance risks associated with a large expansion of co-operative banking groups outside the traditional co-operative core. First, it seems inevitable that the introduction of external funding providers or investors reduces the governance autonomy of the original owners of the co-operative banks, i.e. members. Strategy and policy making of co-operative banking groups simply becomes more complicated, even though external capital providers may not have voting rights or just a minority stake in central institutions or subsidiaries. In the end, the reliance on external funding or equity could lead to an erosion of the co-operative profile and an estrangement between local co-operative banks and the central institutions with its group subsidiaries. Most of the times, the profit targets of externally financed subsidiaries are higher than those for the co-operative bank, but the risks involved are also higher. This bears the risk of divergent internal governance models or even conflicts of interest between co-operative banks and other group entities, particularly because the latter have no co-operative organisational form and usually apply another orientation than the local co-operative banks.

Two recent cases in European co-operative banking corroborate this point. First, the Finnish Financial Co-operative Group bought back all listed shares of a subsidiary in May 2014 for € 3.4 billion to eliminate this kind of complication in the working of its governance. On its website, this step was motivated by saying that this co-operative bank ‘was born to be owned by customers’. Second, around 90 percent of the sector of Italian Banche Popolari is forced by decree to transform into joint-stock companies by the Italian government in 2016. The main reason is that their governance structure has become rather opaque. Many large Popular Banks have external shareholders without voting rights and the ‘one member, one vote’ principle does not lead to effective checks and balances in the governance. The latter drawback is related to the fact that Non-Executive Board Members appeared to have difficulties in understanding the implications of this hybrid capital structure and could not really understand the large business activities of ‘their local’ co-operative bank outside its original local territory.¹⁸ Professional executives could hence operate without sufficient effective countervailing power and external disciplinary forces; the governance had become neither fish nor fowl. Both examples underscore the importance of assessing the pros and cons of the desirable size and form of external funding and capital thoroughly. Light-footed decisions could have far-reaching and irreversible implications for the governance of co-operative banking groups.

Another potential impediment for the functioning of the governance is the presence of listed subsidiaries in the group. In this situation, it may become more difficult to freely discuss the strategy of the group in local and central governance bodies, because of the sensitivity of these discussions on the price of the listed capital instruments or shares. If members are for this reason constrained from freely discussing the policy and strategy of the group, it is obvious that the internal functioning of the democracy and governance is obstructed.

For a variety of reasons, most central institutions have gained in importance and size over the years. As long as they are primarily aligned with supporting local co-operative banks without initiating their own activities, this does not really pose a governance challenge.

¹⁸ The largest Popular Bank, Ubi Banca, has a balance sheet total of around EUR 120 billion. This bank cannot be qualified as a purely local co-operative bank.

In this situation, one could argue that they are contributing to cutting down on risks and increasing the stability of the group¹⁹. However, if they grow in size and start to undertake all kind of activities themselves (via domestic or international subsidiaries), they can represent a risk for the entire group. The banking professionals could start pursuing other objectives and/or enter into more risky activities compared to local retail banking. In practice, most centrals and subsidiaries do undertake less retail banking activities, but more wholesale and treasury activities which tend to be more volatile.

To contain the risks of activities outside the co-operative part, it is necessary that the activities of the centrals and subsidiaries are approved and monitored by qualified member representatives in central governance bodies. Executives of the central are accountable to these representatives. For co-operative banking groups, it seems advisable to restrict the size of the activities outside the co-operative core of 30-40 percent of total activities. If the activities outside the co-operative core outweigh those of local banks, there is a risk that the eventual losses or write downs cannot be borne by local banks. Historical evidence demonstrates that major losses or write downs at co-operative banking groups are rarely concentrated at member banks, but mostly occur at their group-level entities.

Shaping the views of regulators and supervisors

This section buttresses the fourth recommendation mentioned in the introduction. International and national regulators and supervisors have introduced a series of new rules and guidelines that directly and indirectly affect the governance of banks, both commercial and co-operative²⁰. Moreover, the European Commission's Capital Requirement Directive IV rightly emphasises the importance of sound governance and lists some requirements for the role of governance bodies inside banks. Non-Executive Board Members play a very important role in the governance of co-operative banks. Recently, many co-operative banks have embarked upon permanent education programs to boost the level of professionalization and sophistication of directors. It is deemed vital that they are well equipped to challenge professional managers on their strategic decisions, matters of compensation, and risk policy. Non-Executive Board members cannot be 'docile' and must intrude on management decisions. However, regulators should not go overboard with their requirements for Non-Executive Board Members. The new regulations in question should account for differences between co-operative banks. Indeed, Table 6.1 reports significant deviations between small stand-alone banks and large consolidated groups. The treatment of co-operative banks by supervisors should differ accordingly. Hence, it is crucial that the

“Many co-operative banks have embarked upon permanent education programs to boost the level of professionalization and sophistication of directors.”

BOX 6.3. PROPORTIONALITY PRINCIPLE

The principle of proportionality is a long established principle in European banking regulation. It states that requirements should apply in a manner proportionate to the size, scale and nature of operations of an institution, as well as to the nature, scale and complexity of the risks associated with its business model and activities. In the co-operative context, this includes protection schemes, bottom-up group governance and split of activities between local/regional banks and central structures, as these have prudential consequences.

¹⁹ Desroches and Fisher, 2005

²⁰ European Banking Authority, 2011; Basel Committee, 2014

principle of proportionality is applied for governance requirements at respectively the local, regional and group level of co-operative banks.

Since the European Central Bank has taken over the leading role in banking supervision in SSM (Single Supervisory Mechanism) countries from national banking supervisors in November 2014, it is crucial to demonstrate and explain how the co-operative governance works for enhancing transparency towards regulators and building confidence among customers and members.

The main message for supervisors is that they should duly take into account the governance characteristics of the co-operative model which have both a prudential and co-operative purpose dimension. For instance, the democratic election of members of supervisory boards or members of the board of directors in a supervisory capacity (Non-Executive Directors) with a diversity of backgrounds – and not just banking experience and technical skills – can be viewed as a clear asset of co-operative banks and has proven useful for good governance.

Indeed, these Non-Executives are generally reluctant to steer co-operative banks in the direction of riskier banking activities like investment banking and wholesale banking.

It must be acknowledged that Non-Executive Directors fulfil a supervisory role, but that they cannot be a substitute for control by the European Central Bank or national banking supervisors, which have more information and means than Non-Executive Directors. Equally important is that Non-Executives are also elected for their experience and expertise in other key areas like management, law, management of human resources, sales management, marketing, IT, innovation, etc. These competences go far beyond just banking and financial skills and external supervisors have little experience with all these issues. Besides, Non-Executives are mostly member-customers of co-operative banks and feel engaged and attracted by this type of organisation.

“Apart from its important prudential role, the Boards are in fact the custodians of the co-operative purpose.”

Apart from its important prudential role, the Boards are in fact the custodians of the co-operative purpose. This contrasts with SHV banks, where board of directors (supervisory board members) are primarily selected for their banking and financial experience. The Great Financial Crisis has shown that the latter qualifications are no guarantee for better governance or results. In the recent past, bank defaults or problems have particularly occurred with boards composed of persons all with very similar backgrounds. They mainly encompassed financial experts or technicians focused on maximising profitability and leverage.

Deville and Lamarque²¹ (2015) stress that new – capital and liquidity – regulations will also impact on the general principles of co-operative functioning, including their structures.²² These seem to push for the centralization and unification of small co-operative structures and standardization of practices such as credit risk scoring. Ferri and Pesce (2011)²³ assert that these developments could lead to disproportional rises in compliance costs of regulation for smaller co-operative banks, resulting in a ‘too-small-to-comply’ trap. Needless to say, co-operative banking groups with a sustainable business model should neither be forced to opt for a more centralised governance structure and/or amalgamation of smaller co-operative banks nor be put into financial and organisational trouble as a

21 Deville, A., and E. Lamarque (2015). *Diversity of co-operative bank governance models questioning by regulation: An international qualitative research*. Working paper 2015- 1, Paris

22 The Annual Report 2014 of the European Association of Co-operative Banks provides an informative overview of the implications of eminent changes in supervisory and regulatory regimes for co-operative banks.

23 Ferri, G., and G. Pesce (2011), Regulation and the viability of co-operative banks, in *'The Amazing Power of Co-operatives'*, publication of the International Summit of Co-operatives 2012, Québec, pp. 325-340.

result of regulatory requirements or governance adjustments which are actually meant to prevent banks from getting into these kind of difficulties.

Key is that one organisational form should not be favoured by the lead banking supervisor in Europe (ECB) and the European Resolution Authority (which will be installed as from 2016) over another to simplify their task; they should not apply a 'one-size-fits-all' approach. It would be a big mistake if supervision and regulation would automatically lead to more integration and consolidation among principally viable local co-operative banks, also owing to a 'forced' introduction of elements of 'shareholder value banks' in their governance structures. The supervisors and regulators should not design rules that would devoid the co-operative model of its content by challenging its founding principles. Hence, it is crucial to adhere to the proportionality principle.

“The supervisors and regulators should not design rules that would devoid the co-operative model of its content by challenging its founding principles.”

Beneficial effects of co-operative governance

Although some co-operative banking groups encountered major governance related issues in recent years, the entire co-operative banking sector is very sound. On balance, one can conclude that the governance of co-operative banks leads to distinct outcomes which are visible in 'hard' figures. First, they weathered the Great Financial Crisis of 2007-2010 relatively well and did not need large scale government support²⁴. But also in more recent years, their overall performance has deviated from that of all other banks²⁵. Structurally, their assets are dominated by retail loans to households and SMEs. In 2013, their loan to asset ratio was more than 50 percent, while the same ratio for all other banks amounted to 37 percent. Overall, co-operative banking groups are funded to a larger extent by retail deposits and to a lesser extent by wholesale funding in comparison with all other banks; the funding resilience of co-operative banks is relatively high. The business model of co-operative banks tends to be more geared towards retail banking activities instead of more risky wholesale banking activities than many SHV banks. It also seems that their loan and deposit growth is significantly more stable than that of all other banks. In good times, co-operative banks' credit growth is more moderate, whereas their credit expansion is higher in recessionary times. Their behaviour seems thus to be counter-cyclical, which brings benefits to the wider economy. Finally, co-operative banks are generally a more stable and safer part of the entire financial services industry. They usually operate with higher capital levels and their returns on assets and equity are on average less volatile. This is mirrored in relatively high credit ratings for co-operative banking groups compared to most SHV banks.²⁶

“On balance, one can conclude that the governance of co-operative banks leads to distinct outcomes which are visible in 'hard' figures.”

Concluding contemplations

An important take away from this Thought Piece is that governance in co-operative banks has both a prudential and co-operative purpose dimension. Non-Executive Board Members do have a prudential role, but are also the custodians of the co-operative purpose. These two dimensions interact with each other as the co-operative specificities have prudential implications²⁷. In essence, the governance structure should remain conducive to a healthy performance both as a bank and a co-operative. This is best assured with competent and credible Non-Executive Board Members who prevent professionals from

24 EACB (2010) *European Co-operative Banks in the Financial and Economic Turmoil: First Assessments, Research Paper, Brussels*.

25 Groeneveld, J.M. (2015b) *European Co-operative Banking: Actual and Factual Assessment report prepared for the 6th Convention of the European Association of Co-operative Banks on the 3 March 2015, TIAS School for Business and Society, Tilburg University*.

26 This remark holds for co-operative banking groups which receive a rating based on consolidated data.

27 Deville and Lamarque, 2015

empire building²⁸. In order to stay viable, co-operative banks must of course be financially solid, innovative and efficient as well as able to withstand competition to ensure continuity for their members. Looking at the empirical evidence, the member-based governance of co-operative banks translates into a visible and noticeable focus on retail banking. This type of banking is characterised by relatively stable revenue streams and a moderate risk profile. Internal arrangements and protection schemes are also part of their governance structures and contribute to their structural stability.

I envisage three major governance challenges for European co-operative banks. The first is to balance the benefits and risks of the domestic co-operative activities versus all other (inter)national activities via central institutions. The second is to find alternative funding sources and capitalisation without jeopardising the functioning of the member-based governance. Finally, all co-operative banks together must continuously shape banking authorities' perspective and proactively formulate answers to expected prudential governance questions. If these challenges are mastered, co-operative banks will continue to contribute to diversity among credit institutions in terms of governance, size, business orientation, and risk appetite²⁹. Consequently, considerable systemic and societal benefits of pluralism in the banking industry will be maintained.

28 Fonteyne, W. (2007). Cooperative Banks in Europe – Policy issues. IMF Working Papers, WP 07/159, International Monetary Fund, Washington. D.C..

29 Ayadi, R., D. Llewellyn, R. H. Schmidt, E. Arbak, W.P. de Groen (2010), Investigating Diversity in the Banking Sector in Europe: Key Developments, Performance and Role of Co-operative Banks, Centre for European Policy Studies, Brussels

7

7. The eternal triangle: the crucial role of the Chair and Chief Executive in empowering the board

CHRIS CORNFORTH

Linkages between this chapter and inherent co-operative governance properties: humanism, joint ownership and control, and democracy.

This chapter takes a practical look at the need to pay closer attention to key relationships (chair and chief executive, chair and board, chief executive and board). Four reasons are given: separating governance from management is not possible; management often controls “the main levers of power”; the board cannot represent members’ interest and sustain co-operative principles and values on their own; and chairs must facilitate the workings of the board and relationship with the entire management team.

The author labels relationships as “the heart of good governance”. This is especially true within the people-focused governance. A humanistic paradigm assumes that highly skilled and competent managers have interests that are in-line with the interests of members. As a starting point, this alignment would naturally result in high levels of trust between management and the board. Thus, a co-operative will have stronger relationships, as suggested by the author, if they are working from within a humanistic framework.

A gap in skills and expertise is discussed in this chapter as a governance risk that must be mitigated (e.g. education and training, outside expertise, skilled Board Chair). This expertise issue is a thread in a number of chapters in this volume, including Birchall, Simmons et al, Mangan, and Mills. Bridging this gap, which seems to plague co-operatives of all sizes and forms, must be done in ways that do not infringe upon inherent co-operative features – humanistic management, member ownership and control, or democratic properties. For example, independent directors should not be appointed simply to access industry expertise without proper co-operative strategies training; they must be as much a part of the co-operative governance fabric as all other elements of the structures, which may be counter-intuitive in agency frameworks. It is also important to deploy education and training that reinforces the nature of co-operative governance, including highlighting the complementary leadership roles (inherent in a humanistic approach) among directors, executives, and strategic stakeholders.

The author acknowledges the importance of alignment between the board and management with regards to co-operative principles and mission. He suggests that the focus of the CEO will be on the success of the business, and it is the responsibility of the Chair (and Board) to ensure that the business continues to adhere to co-operative principles and mission in how the business is managed and governed. The implication is not that management is responsible for the business and the Board for co-operative identity; it is critically important that co-operatives avoid such a separation of roles. Under the assumption of the humanistic model we propose, there is no separation of the business from the organization’s values – the latter are integrated within the co-operative business strategy.

Connecting this chapter to network governance design concepts: small independent basic units, subsidiarity principle, polycentricity, and multiple stakeholders.

Cornforth’s discussion about relationships between the chief executive, chair and the board is a valuable discussion, relevant to most organizations including co-operatives. This chapter’s scope does not include discussion of potential governance structural changes and the presumed governance and management structure is a traditional hierarchy. Overlaying a network governance approach would reach similar conclusions regarding the importance of relationships but would increase the number of important relationships – multiple stakeholder environment and various decision-making bodies.

Some of the potential issues attributed to the relationship between the chief executive and chair, or chief executive and board, can be resolved by increased access to information and expertise from other strategic constituents with a compound board/network design. Unitary boards rely on the executive to provide relevant and timely information, and concentrate decision-making among a small set of relationships (board and management). A multi-stakeholder, compound board structure would provide multiple sources of information to directors of a supervisory board and spread decision-making to other boards or councils. This structure, however, still involves people. Thus, conflict resolution skills and communication skills of directors, executives, and other participants at all levels of decision-making remain a relevant focus area for effective co-operative governance.

7. The eternal triangle: the crucial role of the Chair and Chief Executive in empowering the board¹

CHRIS CORNFORTH

What are the most important factors in determining whether a co-operative is well governed or not? Paradoxically it is often the chief executive and the chair, and how well they relate to each and facilitate the work of the board and the relationship with members. Yet the important role of the chair and chief executive often seems to be overlooked in initiatives to improve co-operative governance. The vast majority of effort has been devoted to improving governance structures and boards themselves, for example: separating the roles of chair and chief executive, establishing audit committees, developing codes of practice, standards for board members, board self-assessment, board member training and development.

While these initiatives are clearly very important they tend not to give enough weight to important features of the triangular relationship between boards, chairs and chief executives. First, that it is not possible to completely separate governance from management – the roles of boards and executives are interdependent. For example while it may be the board's responsibility to make strategic decisions it is usually management that have the time and expertise to formulate strategy. This means that roles may overlap and change over time requiring a degree of flexibility and negotiation. Second, while boards have a good deal of formal power, being the ultimate authority within the organisation, it is often management that controls the main levers of power. Managers have the information and resources at their disposal to better understand the challenges the organisation faces and to make changes. As a result there is always a danger that a chief executive and their executive team will dominate the board and their proposals not be given adequate critical scrutiny. Third, while it is a responsibility of a co-operative's board to represent members' interests and sustain the co-operative's principles and values, the board are unlikely to be able to do this by themselves. Chairs and board members rotate, and it is management and staff that provide the continuity and carry out the day to day work of the co-operative. If management and staff do not understand, or are not committed to, the co-operative principles and values then they are going to be difficult to sustain². Fourth, chairs can play a crucial role both in facilitating the workings of the board and mediating the relationship with the chief executive and executive team so that it empowers the board and the wider membership rather than disempowers it.

The rest of this chapter will examine each of these key relationships in turn: chair and chief executive, chair and board, chief executive and board. It will look at the practical steps that chairs and chief executives can take to make these relations work well and enhance effective co-operative governance.

¹ I'm grateful to Dr Mike Aiken and the editors for their very useful comments on earlier drafts of this article.

² Davis (2001) makes this argument very strongly; suggesting a variety of ways of developing value based co-operative management. Davis, P. (2001) 'The Governance of Co-operatives under Competitive Conditions: Issues, processes and culture', *Corporate Governance: The International Journal of Business in Society*, 1, 4, 28-39.

Chair - Chief executive

The chair and chief executive are at the heart of many crucial relationships within any co-operative. A good working relationship is one prerequisite for an effective board, and for developing good relationships with the executive team, staff, members and other key stakeholders. Conversely a poor working relationship can damage the working of the board, organisational performance and accountability to members.

Tensions and sometimes conflict can arise between chairs and chief executives because their roles are ambiguous and tend to overlap. For example who is responsible for representing a co-operative externally? Is it the chair or chief executive, or does it depend on the circumstances and their respective strengths and weaknesses? While formal role descriptions can help clarify responsibilities, they are often not enough by themselves. Where ambiguities remain there needs to be some discussion and negotiation over who does what. Ideally these need to reflect strengths and weaknesses of chair and chief executive, and the constraints they may face. For example, it will be important to consider the circumstances of the chair, which can vary a lot between co-operatives, in some co-operatives the chair may be a voluntary and/or part-time role, meaning that he or she is not available to carry out certain tasks or roles.

Another reason why it is good for the chair and chief executive to periodically reflect on how they are working together is that the relationship will need to evolve over time as circumstances change. For example, when a chair is new the chief executive may need to spend more time helping the chair get up to speed with the organisation's strategy and with the challenges it faces, and coming to grips with their role. Similarly, a chair is likely to need to spend more time with a new chief executive, particularly if they have been recruited from outside the co-operative, making sure he or she has a thorough induction to the organisation and is aware of the expectations of the board.

“Research suggests that establishing mutual respect and trust is crucial in developing a successful relationship between a chair and chief executive.”

Research suggests that establishing mutual respect and trust is crucial in developing a successful relationship between a chair and chief executive.³ Openness, honesty and sensitivity are important in developing trust and mutual respect. If there is defensiveness or withholding of relevant information, there is a danger of distrust and a negative relationship developing or even a power struggles. If this persists a vicious circle can develop where the relationship deteriorates, sometimes to breaking point, with damaging consequences for the board and the organization⁴.

However, developing a trusting relationship between chair and chief executive does not mean blind trust. If a chair is too close to the chief executive there is a danger they may not have sufficient distance to question proposals from the chief executive and hold them to account. There is also a danger that the two may become a dominant coalition that makes it difficult for the board to question their proposals. A key role of the chair is to provide support when needed and act as sounding board for the chief executive, but ensuring that management's proposals are subject to critical scrutiny by the board.

While it is vitally important that both chair and chief executive are committed to co-operative principles much of a chief executive's time will inevitably be spent on trying to ensure the success of the co-operative as a business. As a result the chair has an important role in trying to ensure that this is not at the expense of the co-operative's principles or mission.

3 Robinson, R. and Exworthy, M. (1999) Two at the top: A study of the working relationship between chairs and chief executives at health authorities, boards and trusts in the NHS, London and Birmingham: NHS Confederation. Roberts and Stiles (1999) 'The Relationship between Chairmen and Chief Executives: Competitive or Complementary Roles, Long Range Planning, 32, 1: 36-48.

4 Stiles and Taylor (2002) Boards at Work: How directors view their roles and responsibilities, Oxford: Oxford University Press: 107

This involves making sure that management proposals are scrutinised by the board for the likely impact on the co-operative's members and the co-operative's identity as well as on the performance of the business.

In the discussion so far we have assumed the chair is not the chief executive. This separation of roles is often regarded as good practice. For example, the UK Consumer Co-operatives Code of Governance stipulates that the Chair should not be an employee of the co-operative and hence not the chief executive. However, in some co-operatives such as Desjardins in Quebec, Canada the roles are combined. While clearly this can work, there is a danger that it further increases the power of the chief executive and may make it more difficult for the board to adequately scrutinise or challenge the proposals of the chief executive and executive team. It also takes away what can be an important sounding board and source of advice for the chief executive. As a result it may be necessary to put in place other structures to ensure the chair/chief executive is adequately supported and appraised. For example the chief executive may report to and be appraised by another senior board member(s).

Chair-Board relationship

Boards are groups that usually only meet intermittently, yet they need to work well together as they have to make collective decisions. The Chair has a vital leadership role in ensuring board members are able to work together effectively and with the executive team. It is important therefore that the chair makes sure that there are opportunities for board members and senior executive(s) to get to know each other, and that there are opportunities for team building. For example, away days or strategic retreats can be particularly good for this purpose, it can also be valuable to allow time before or after board meeting for the board and executives to socialise.

Recent research in North America and the UK on the chairs of non-profit organisations suggests that it is inter-personal and leadership skills that distinguish effective from ineffective chairs⁵. The least effective chairs were not seen as team players, perhaps pursuing their own personal agendas, and less able to deal with inadequate performance of other key actors. Effective chairs were also perceived as being *socially aware, helping and service motivated*. Those chairs who were perceived to perform well engaged in leadership behaviours that created a *good environment* for both their board and executives to work in by: *being fair and impartial, being open to new ideas, not distracting from the organisation's goals by imposing their own personal agenda, providing autonomy and independence* for the board and chief executive. They were also good at *team building* through: *valuing team members, encouraging and acknowledging different contributions, and creating a safe climate where issues can be openly discussed*.

One of the dilemmas in co-operatives, particularly if there is an open nominations policy for board elections, is that there is no guarantee that board members will have the skills and experience to make an effective contribution on the board and be able to hold management to account. It is important therefore that the chair and chief executive ensure that there is good induction and training available to board members. However, skill gaps may still persist. Where this is the case, the chair and board should consider co-opting outside board members to fill any gaps and/or calling on outside experts as the need arises. Interestingly the Co-operative Commission⁶ in the UK made a recommendation in 2001 that up

“It is *inter-personal and leadership skills* that distinguish effective from ineffective chairs.”

5 Harrison, Y. Murray, V. and Cornforth, C. (2014) 'The Role and Impact of Chairs of Nonprofit Boards', in Cornforth, C. and Brown, W. (eds.) *Nonprofit Governance: Innovative perspectives and approaches*, Abingdon, UK:Routledge.

6 Co-operative Commission (2001)

to two external independent directors could be appointed to fill skills gaps, although it's unclear to what extent this recommendation was adopted. Lack of board members with suitable experience and expertise has been blamed for some of the governance failures at the UK Co-operative Group and Bank⁷. It also takes time for new board members to become effective. As a result, it is good practice to stagger board elections, with only a minority of the board changing in any one year to ensure a degree of continuity and that not all the expertise built up by the board is lost. It also means that more experienced board members can mentor newly elected members until they gain experience and confidence.

Much of the work of boards takes place in meetings. As a result it is vital that chairs are skilled at running meetings. All too often board meetings are less effective than they might be because they are poorly chaired. Common problems are that: papers arrive late and board members are not adequately prepared, management spend too long making presentation leaving too little time for discussion, meetings run on too long without a break, too much time is spent on less important issues and so not enough time is devoted to important items, a few people dominate the meeting and others find it difficult to get their views heard. Effective chairs will ensure that meetings have appropriate agendas and the necessary information; that enough time is spent on discussing key issues; that everyone is able to participate; keep to time and that there are opportunities such as away days to discuss longer-term strategic issues.

An important part of the board's role is to oversee the work of the executive, setting goals and targets and expecting high standards. Similarly the chair (and chief executive) can play an important role in helping to make the work of the board productive and rewarding by expecting high standards of performance and behaviour from board members. Many organisations are now setting out clear role descriptions and codes of practice for their boards, so it is much clearer to board members what is expected of them when they join the board. This is also a good opportunity to set out the co-operative's mission and principles that it expects all board members to further.

Research suggests that chairs tend to rate their own performance more highly than chief executives and board members rate the chair's performance. While this is common across sectors⁸ too large a gap could indicate potential problems, with chairs thinking they are performing well while other key actors have a lower opinion of their performance. It is important therefore that chairs receive *feedback on their performance*. Formally this can be done through annual 360 degree board appraisal processes, where board members and senior staff are given the opportunity to feedback on the chair's performance. Informally chairs may seek more regular feedback, for example checking at the end of board meetings how well those present think the meeting has gone and whether any issues could have been handled better. One way of doing this is through a simple evaluation sheet collected at the end of meetings.

Chief executive-board relationship

Often the chief executive and the executive team are in the strongest position to help make sure the board of their organisation works well, and that the co-operative serves its membership. There are eight key things that chief executives can do to help their boards be effective.

⁷ Birchall, J. (2014) 'Innovation in the governance of large co-operative businesses: the alarming case of UK Co-operative Group', *International Journal of Co-operative Management*, 7, 1, 22-28.

⁸ See Kakabadse, A., Kakabadse, N. and Myers, A. (2009) *Boards, Governance and Leadership of the Third Sector -Scotland Study: Report on Findings*, Cranfield Business School, UK.:32

HELPING STRUCTURE THE BOARD'S WORK.

Boards require a structure and resources to do their work. Effective chief executives work with the chair to ensure this is in place. For example establishing a schedule of board and sub-committee meetings, organising periodic away days, making sure agendas are agreed and papers are available well in advance of meetings, and working with the board to make sure committees have appropriate terms of reference.

PROVIDING THE BOARD WITH RELEVANT, TIMELY INFORMATION.

In order to carry out its role effectively the board relies crucially on the executive to provide relevant and timely information about the decisions it has to make. Much of this information is routine such as budgetary reports, financial statements and performance indicators, but others will depend on the issues and challenges the organisation faces at the time. It can be quite a difficult balancing act for the executive to provide the right information at the right time: too much information and the board may drown in the detail, too little and they may miss key issues. Common problems include presenting boards with undigested management reports that obscure important issues in detail, not allocating enough time to discussions, or slipping important issues on to the end of agendas, when everyone is tired and dying to get home.

BRINGING CO-OPERATIVE PRINCIPLES AND IDENTITY TO THE FORE.

For any co-operative to succeed it needs to be a successful business, but that alone is not enough. When making new proposals it is important that executives also consider the impact on members and the mission of the co-operative as well as likely impact on the business as a matter of routine. For example in one housing co-operative board papers routinely considered the likely impact on tenants as a part of reports to the board.

ASSESSING CO-OPERATIVE PERFORMANCE.

There is an old adage in management that what gets measured gets managed. There are well established ways of measuring a business's financial performance, but co-operatives are established to serve their members' interests, which may include social as well as financial goals. It's important therefore that executives find ways of assessing and regularly reporting on the organisation success as a co-operative – how it meets members' needs, sustains member involvement and meets its social goals.

Help develop the board. Effective executives can play an important role in developing the board, for example by helping to induct new board members, introducing the board to the organisation and its staff, and working with the chair and board to arrange appropriate training and support. With the chair, the executive can also help facilitate communication between board members and team building, through for example providing opportunities for social interaction and celebrating success.

RAISING AWARENESS OF KEY CHALLENGES AND OPPORTUNITIES.

Because it is their full-time job executives are often in a better position than the board to identify important challenges the organisation faces - alerting the board to important new opportunities or threats and to facilitate strategic 'conversations' about how the organisation might respond. Similarly, they are often in a better position to identify performance problems or internal weaknesses that need to be addressed, and to help look for better ways of doing things. Often these issues are better dealt with at periodic 'away-days'

where boards and staff have the opportunity to think about longer term issues away from the routine business of the board, or the day-to-day pressures of work.

CREATING THE RIGHT CLIMATE.

Boards can only function well if there is a climate of openness and trust between board members and the executive team, where constructive criticism and challenge are accepted and valued. It is the board's job to subject management proposals to critical scrutiny to ensure they are sound and in the best interests of the co-operative and its members. This places important responsibilities on both parties if it is to work well. Management have to be willing to expose their ideas to critical examination and be open to making changes. In addition they have to be prepared to let the board know when things go wrong or are not working well. It can be very tempting for executives to want to hide bad news perhaps hoping they can deal with the issues before the board finds out. This is a high risk strategy with the danger that when issues do come to light it can undermine trust between the board and executive. Equally board members have a responsibility to ensure their contributions are constructive and that they give managers and staff appropriate support where needed.

HELPING TO MEET THE NEEDS OF BOARD MEMBERS.

Finally it is important for executives to remember that people get involved on boards for a variety of other reasons as well contributing to the governance of their co-operative: contributing to a business, community or cause they believe in, friendship, skill development, to make useful contacts or to gain recognition. Executives may be able help board members meet these wider needs, perhaps by offering training, involving people in the right sub-committee or working group, or involving them in social events. Board members are more likely to be committed and effective if they feel their needs are being met, while they are contributing to the co-operative.

“At the heart of good governance are relationships.”

To sum up, many of the reforms aimed at improving co-operative governance have concentrated on structural changes. While these are important, at the heart of good governance are relationships. A board is much more likely to work effectively if the chair and chief executive can work together effectively and realise that a crucial part of their role is to help support, develop and service the board they work with. This is not something that can be done as an afterthought, but requires planning, thought and time, and above all the right attitude to form a constructive working relationship both with each other and the board.

8

Governing Resilient Co-operatives: A competence based model

CLIFF MILLS

Linkages between this chapter and inherent co-operative governance properties: humanism, joint ownership and control, and democracy.

Mills bases his model on the emerging approaches in public sector reform in the United Kingdom. He is a proponent of a radical overhaul to the Rochdale model of governance for large co-operatives, rather than an evolutionary approach whereby tradition impedes progress. We are in agreement with this radical spirit, although the author presents different views on the required changes from those in this report's Introduction. Keeping in mind that governance of co-operatives is diverse for many reasons, some readers may find this a more appropriate avenue for change.

Humanism: Although the author takes a humanistic view of governance, he identifies practical and legal problems for very large co-operatives operating under the Rochdale model in the UK. Mills argues that in a highly competitive and complex business environment, a non-expert Board of directors cannot govern a large co-operative. The approach is therefore to redesign the model of governance so that the focus of the board is on business expertise (both executive and non-executive directors); but with this board having more constrained powers, namely to deliver a business which has been agreed with members' elected representatives to whom the board remains accountable. The author observes the need for the largest co-operatives to be prepared to look beyond the movement for filling the top jobs.

On the other hand, we underscore the importance of co-operative expertise and competencies in all decision-making operations and structures (including management interfaces), because a narrow view of a technical skillset without a co-operative skillset is unfitting, in our view¹. Co-operatives ought to avoid governance structures where some constituents have a deep understanding of co-operative enterprise while others do not.

Democracy: If the democratic process delivers representation and a co-operative requires competence, are these two elements mutually exclusive? This chapter argues that assuring competence requires selection, and so a different mechanism is needed to ensure that the members' voice is heard through their elected representatives. We observe that many (large) co-operatives still rely on open, democratic nomination and election processes without seemingly catastrophic results; others put some controls in place to ensure a level of competence and expertise (e.g. the "evolutionary approach" commented on by the author); and some employ many controls to streamline the election and/or appointment process (e.g. more in-line with the preferred approach presented in this chapter).

The author finds it important that a democratic body is elected, with a function to appoint non-executive directors and hold them to account, but this body is not seen to make any operational decisions.

Joint ownership and control: The chapter highlights the important role for members to influence business decisions. It envisions members working with the expert board of directors in setting forward plans of the co-operative, and holding non-executive directors to account.

1 For a similar position see Couchman 2015 (Mimeo)

Connecting this chapter to network governance design concepts: small independent basic units, subsidiarity principle, polycentricity, and multiple stakeholders.

This chapter leaves room for much debate on the best approaches to co-operative governance. While we suggest network governance with nested components and subsidiarity principle as the 'design of choice', we also recognize that all components of this design may not fit or be easily adapted to all situations. The central idea presented by Mills is a dual governance structure – democratic body (representative of members) and Board of Directors (comprised of expert executive and non-executives). As stated by the author, "the model seeks to avoid creating two rival decision-making organs; rather it creates a collaborative model where "representativeness" is designed to work collaboratively with "competence."

Multiple Stakeholders: The public service example used in this paper is based on the involvement of multiple constituencies (public, employee, volunteers, etc.) with representation on a democratic body. The suggested approach is one where public/customer representatives are in the majority to "support the concept of operating for public not private benefit". This allows for the engagement of multi-stakeholder co-operative membership.

Polycentricity: The author revisits the issue of representativeness versus competence in co-operative governance, stating that the co-operative model in its traditional form is designed to deliver representativeness when what is needed in large co-operatives is business competence. As a solution the author proposes a tiered structure with a membership elected democratic body (not responsible for running the business) and an expert board comprised of non-executive and executive members, but with more limited powers than a traditional board. This governance design ensures business competence, but it is a departure from the multiple centres of power we have advocated for in the introductory chapter.

Rather than separating representation and competence into separate apex bodies, a more elaborate compound board design would address the issue of competence by a multi-centric framework with each stakeholder group in charge of questions in their domain of expertise and influence. Rather than an expert board of independent directors, we argue, the (expert) supervisory board in a multi-centric framework would be comprised of delegated representatives of all constituent groups able to communicate their decisions (for example, employees are experts in human resource issues; consumers in ethical consumption; suppliers in supply chain management; and so on). This group would need to have access to technical expertise outside of their domains.

8. Governing Resilient Co-operatives: A competence based model

CLIFF MILLS

Introduction

For very large and complex businesses, the Rochdale model of governance raises issues of credibility and competence, illustrated by the recent travails of the UK's Co-operative Group. Yet in the UK and beyond, many are interested in new models of ownership for public services and see a co-operative or mutual approach as an obvious possibility. A novel approach to governance is evolving in this context which approaches competence and democracy in a different way. It could be a template for much wider application.

The starting point

The traditional or historical co-operative (Rochdale) governance model is a pragmatic mechanism which enables a small number of individuals to undertake decision-making functions on behalf of a potentially much wider membership.

It is an elegant and simple approach which is still the basis of governance of many co-operatives today. The rules of the society specify the size of the committee or board, and any qualifications which candidates must meet in order to be eligible to stand for election, such as a minimum age, and minimum purchasing or other participatory requirements. Subject to that, any member may put themselves forward for election, and every member has one vote in such election. Members cast their vote(s) based upon the reputation which candidates have amongst the membership, or the rules may specify the extent to which candidates may canvass support, or rely on a personal candidate's statement.

This is a fair and transparent way for the many to choose a smaller number of representatives to act on their behalf. It involves a delegation of power by the many to the few; as the rules today usually state explicitly, it gives to the board all powers to act in the name of the society except those powers which are reserved to the members in general meeting (typically changing the rules, electing and deciding remuneration of board members, appointment/removal of auditor, approval of distributions, etc.). In the UK, members also retain by statute the power to decide to discontinue the business and wind it up; and the power to make certain other decisions such as merger. But subject to such reservation of powers to the members, **the board can exercise all other powers of the society.**

The Rochdale model has been used in a wide range of businesses but its greatest success was in running local shops selling food and basic provisions. Whilst obviously skill was needed in purchasing, storing, preparing for sale, general organisation and financial management, the level of skill involved was not beyond the reach of those familiar with running a substantial household. This meant that the business itself did not need anything special or particularly technical from its board, beyond general common sense, the ability to understand basic financial budgeting, an inquisitiveness to be satisfied that all is well, and personal honesty and integrity.

The most important "qualification" beyond this was that board members were typical of customers; and that they would instinctively, as well as by personal contact with other customers, understand their needs and represent them. They needed to be good at "representativeness", and most likely that would be the basis on which they were elected.

The practical limits

At some point in terms of its increasing scale, complexity and nature (and for present purposes we do not need to explore where that point arises), a business starts to need individuals for particular roles in management which require specific skills. Things start to get beyond the capacity of a general manager or shop-keeper; a qualified accountant is needed, somebody trained in HR, a specialist property manager. As the work-force also grows and itself becomes specialised, a need arises for an individual with the personal characteristics to be a business leader or chief executive. The **needs of the business** are changing.

At first, the democratically elected board can still cope. It may include individuals who have some of the different types of skills the business needs – sufficient at least to be able to ask some probing questions of the increasingly specialised managers. Training and development programmes can also assist those who have never previously had to understand a cash-flow statement, balance sheet or profit and loss account. By working collaboratively with the professional management, the elected board can continue to do what it does best – represent members – whilst also maintaining some sort of oversight of management. But the risks are increasing.

The first risk is that a manager with a particular expertise fails to identify a potential problem, and none of the board members have sufficient knowledge such that they would identify it. They are not experts. The second risk is that the business faces some significant challenges, resulting in the need to make some difficult strategic decisions (mergers, acquisitions, disposals). Whilst the chief executive might not be out of their depth in looking at such issues and advising what is best, nobody else within the management or board may have this experience at this level. The board members are not themselves required to have experience as leaders of large complex businesses.

The third generic risk is that the management team, or one of them such as the chief executive, is actively pursuing a personal agenda which has more to do with advancing their personal career or increasing their remuneration than what is best for the society and its members. This might also involve corruption. In this situation, where an individual with a great deal of personal executive power may be starting to use that power for questionable ends, the risk is that the board may lack the knowledge, skills and collective self-confidence required at this level of business to challenge the relevant executive and rein them in.

Legal limits

There are not just practical limits. As a business becomes larger and more complex, the Rochdale model starts to become problematic within UK corporate law. This is because the duties owed by the director of a corporate entity to that corporation are partly defined objectively.

In the format now codified by statute in the Companies Act 2006¹, a director of a company must exercise “reasonable care, skill and diligence ... [such as] “would be exercised by a reasonably diligent person with the general knowledge, skill and experience **that may reasonably be expected of a person carrying out the functions carried out by the director ...”**”.

¹ http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf

The Companies Act 2006 does not specifically apply to a co-operative society, but it is likely that a court looking at the duties of a director of a society would start from the statutory definition, which was itself in effect a codification of the previous common law position. Whilst the court would certainly recognise that elected directors would not have the same level of skill and experience as a highly paid executive, the existence of the objective test recognises that the law has expectations of those entrusted with much power; particularly if they are remunerated.

So the first legal problem with the Rochdale model is that people who do not necessarily have the requisite skill and care to have oversight and responsibility over a substantial business nevertheless owe, as directors under their society's constitution, legal duties of skill and care which may well be (and often probably are) beyond them.

The second problem is the legal anomaly that whilst the constitution makes the elected directors responsible for the oversight and control of the business (for which they need skills which they do not necessarily have), the executives who certainly should have such skills and experience in running such a business, are **not** constitutionally responsible because they are not directors. Yet in spite of the fact that they are not directors or board members under the constitution, the law would nevertheless treat them as "shadow" or de facto directors because of the role they were carrying out.

So whilst the elegant simplicity of the Rochdale model remains as relevant today as in the era in which it evolved, in relation to large and complex businesses it has serious practical and legal limitations. These limitations have been witnessed in a number of situations over the years, most recently in relation to the Co-operative Group (UK) where at least some of the risks identified above have had disastrous effects. The problem I am identifying here however is not any failing on the part of any specific organisation or individuals, but a failure of design when the model is applied to a large and complex business; because in that instance the model expects – indeed requires – board members to have attributes, which its design (i.e. election from a pool of non-expert candidates) is not intended and may be unable to deliver. It is designed to deliver "representativeness"; what the business needs at board level is competence.

Where next?

I am using the word "competence" not with a view to suggesting that in previous situations elected board members have been incompetent; I am using it to denote having appropriate business or commercial training to a level sufficient to adequately do the job required – namely to monitor and scrutinise highly paid professional executives. In 1844, the aim was to establish a form of business which was owned and controlled by a local community, which was economically sustainable and had governance arrangements fit for purpose. The Rochdale Pioneers achieved this, with spectacular results.

The requirement in large co-operatives today is different: **businesses of a certain size and complexity have particular governance requirements which cannot be met by the Rochdale model because that is not what it was designed for.** How can those needs be met in an approach which preserves co-operative nature and remains within the International Co-operative Alliance's statement of Co-operative Identity?

There are essentially two ways to approach this question. The first is by adjusting or "tweaking" the Rochdale model in a way designed to address the competence question but without sacrificing the co-operative nature. This is what might be described as an "evolutionary approach", whereby using techniques and ideas from elsewhere, gradual

changes are made to the familiar model so that it becomes appropriate to meet today's challenges.

The second is a more radical approach which involves starting, as the Pioneers effectively did in 1844, with a blank sheet of paper, and asking how a large and complex co-operative might be designed to meet the challenges of today based on the co-operative vision captured now by the International Co-operative Alliance's definition:

A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

Whilst there is no desire to “throw the baby out with the bath-water”, this approach may be needed, for two reasons. The first is that in the last 170 years in the UK there has been little if any real evolution of the Rochdale governance model and the law surrounding it, such that it is now seriously out of date in meeting current needs. By comparison, UK company law has gone through dramatic statutory transformation over the same period, with four or five wholesale revisions. Additionally in the last 25 years or so the statutory evolution of companies has been supported by the evolution of regulation beyond the law, through corporate governance developments starting with the Cadbury Report, then the Combined Code and now the Corporate Governance Code. Whilst the UK co-operative sector has adopted its own governance codes,² without the underlying legal developments such codes have been of limited benefit.

The second reason is even more powerful. Whilst the evolution of company law and corporate governance for companies has played a massive role in enabling investor-ownership to become by far the dominant form of ownership in today's world (a dominance which currently sees no real threat or even arguably any significant challenge), it is a form of ownership which faces its own huge challenges. These are both internal: e.g. excessive board power evidenced by run-away remuneration, poor formal accountability to shareholders who exercise very limited formal influence or control as owners; as well as external: e.g. the exercise of the real influence and control by the market, such that the pursuit of profit becomes the only objective, with resulting wholesale disregard for any interests beyond those of shareholders. Radical new thinking is needed.

So whilst the evolutionary approach feels safer, **current circumstances insist that we need to be prepared to be radical.** Since their origins, co-operative and mutual forms of ownership have always been established as alternatives to private investor-ownership. Indeed they have set out to challenge an approach which is financially focussed on the interests of investors, by advancing an alternative which expressly and overtly has a much wider focus (economic, social and cultural), aimed at any who seek access (persons united voluntarily), not just those who can afford it. So in looking for something new, we risk constraining our imagination if we limit ourselves to modifying a vehicle which in the current context is no longer fit for purpose.

The challenge today is to demonstrate not only that there are other potential business models to that of investor ownership, but that a co-operative model is itself a viable and credible approach for large and complex businesses.

² The Corporate Governance Code of Best Practice for consumer societies <http://www.uk.coop/consumercode> and the Worker Co-operative Code of Governance for worker co-operatives <http://www.uk.coop/workercode>

The Public Service Mutual Model

In the context of public sector reform in the UK, a new approach is emerging which addresses the issues of competence and democratic control in a completely different way. This approach started in the health sector for hospitals,³ and by developing the basic concept it has subsequently been introduced into other areas – community health services, social housing, leisure services, and youth services. For reasons to do with UK law, the new emerging organisations are unable to use the word “co-operative” to describe themselves as they are established under different corporate structures, but they are striving towards something which in ownership and governance terms, many would describe as co-operative. In the National Health Service (NHS), the new model was expressly stated to be modelled on traditional co-operative and mutual organisations. These are all comparatively large and complex organisations (some very large and complex)⁴ delivering vital services to people in communities, and it is therefore appropriate to explore what ideas they may have to offer large co-operatives.

The model works as follows. At grass-roots level, individuals can become members as either customers of the business (public members) or employees (employee members). There may be other constituencies of membership (e.g. volunteers) depending on the nature of the service. The constituencies of members each elect a specified number of representatives onto a democratic body. Employees have a substantial representation, but public/customers are generally in the majority to support the concept of operating for public not private benefit. If elected representatives so wish, they can also include representatives from e.g. statutory agencies, or the voluntary sector in the democratic body.

The democratic body is not in charge of running the business. This is because those elected to this body do not have the necessary skills or experience to carry such responsibilities; but they do have the appropriate skills and background to represent and give voice to the membership, and to influence the organisation’s affairs. Although the democratic body does make certain important decisions, the model seeks to avoid creating two rival decision-making organs; rather it creates a collaborative model where “representativeness” is designed to work collaboratively with competence. We will return to this.

It is the board which is responsible for running the business. In this model, the board comprises a majority of independent non-executive directors (which includes the chair) and a minority of executive directors (full-time employees). The non-executive directors are appointed and can be removed by the democratic body; the executive directors are appointed and can be removed by a sub-committee of non-executive directors.

The CEO sits on the board (alongside one or two other executive directors) because this model recognises that (a) the CEO is most likely the person with the greatest skill, experience and knowledge of the business, and so **should** owe legal duties as a director/board member; (b) the law will treat the CEO as a director anyway, whether or not the constitution gives them that role; and (c) in reality the CEO exercises a great deal of power given their role, and there is a constitutional lack of transparency (or a constitutional anomaly) if the CEO has such legal and practical power but is not constitutionally a member of the board. This board design is closer to that of companies, though with one very important difference which we will return to later.

It is the norm in the UK and many other jurisdictions for the boards of substantial companies, whose shares are traded on a stock exchange, to comprise a minority of executive

³ NHS Foundation Trusts, created by statute in 2003

⁴ For example, Central Manchester University Hospitals NHS Foundation Trust employees nearly 13,000 people, and has a turn-over just under £1 billion.

directors, and a majority of non-executive directors. The executive directors are the ones who have the personal authority on a day-to-day basis to make decisions in their designated area of specialty (finance, HR, commercial etc.). As such they are bound to use their power in what they consider to be the best interest of the company for the benefit of the members as a whole.⁵ However, it is the board which collectively holds all the power, and when an executive director acts in the name of the company under their delegated authority, the whole board is responsible for their actions. The boards of listed companies are therefore required to have other non-executive directors (i.e. they have no personal power to act in the name of the company) in order to look after the interests of the owners, to stand back and have a longer perspective, and to act as a counterweight to executive directors who are likely to be focussed on in-year performance, especially if it is linked to their remuneration.

Executive directors of large companies are strong and usually ambitious individuals who are confident in holding and exercising power. Consequentially, it is essential that they do so within a context where they are properly scrutinised and held to account. This requires them to be surrounded on the board by individuals who also have experience of operating at a senior level in commercial and other organisations; who have the requisite skills and training to challenge executive directors; and who are of comparable strength of character. Their role as non-executive directors is to be independent and objective, and to represent the interests of the shareholder-owners in the board room. This new public service mutual model adopts the same approach, seeking to ensure that at board level there is the requisite level of skill and competence, and full duties owed by the executive directors.

The “representativeness” is taken out of the board in this new model. The board’s role is to take responsibility for running the business. But **the business does not belong to the board: directors are merely the agents of the members, and the voice of members is given full effect through the democratic body.** This democratic body not only has the power to appoint and remove all of the non-executive directors (i.e. to “hold them to account”), but it also has a number of other important functions including:

- Approval of forward plans
- Approval of remuneration and other terms and conditions of non-executive directors
- Appointment and removal of auditors
- Responsibility for membership strategy

To those from a co-operative background, it might appear that this approach gives away too much power to unelected experts. However, it ensures that the members, through the democratic body can review the past through regular reports from management; challenge and question what is going on at the present through its contact with directors in its regular meetings; and influence the services to be provided in the future, by working with the board to develop future plans based on what the members want and need. So although this model gives significant power to an unelected board of executive and non-executive directors, that board’s power is restricted to delivering what members’ elected representatives have approved. The board’s power is therefore more limited than in a company, addressing the excessive and unbalanced power of company boards identified above. This approach, however, through the democratic body creates a more realistic basis for member involvement and control of large and complex organisations. It also results in a much clearer and more transparent allocation of power between members and their elected representatives on the one hand, and hired agents on the other. This can be illustrated by exploring the design approach.

⁵ Section 172 Companies Act 2006

The design approach

The design approach needs to work from two directions: from the needs of the business for the reasons explained above, and in terms of securing the co-operative nature. Some co-operators may feel uncomfortable starting from the needs of the business, but unless the business needs are met, long-term co-operative sustainability is clearly an issue.

Design approach – needs of the business

The starting point is that a business requires senior leadership and management with the right skills, competence and training. Across the business spectrum and range of business models, finding the best candidates for specific jobs involves specifying the requirements of the job and the characteristics of the person needed, advertising the search to the broadest possible range of candidates, and then from the list of those available selecting the best candidate who fits the criteria specified. Essentially this is an objective exercise, often involving specialist recruitment advisors. This is because the process of finding and appointing the best candidate itself requires special expertise, which in the arena we are talking about is crucial if the best candidate is to fill the post.

For this reason, there is no logic in trying to find the best candidate for commercial leadership/executive management by a process of election. Election is a process for finding the candidate that individual members of the electorate prefer personally. This may have nothing to do with whether that person is best qualified for the business. The UK retail co-operatives have recognised this fact for many years, with boards appointing their chief executives to run their businesses, and those appointments have come from within the movement. The reality now is that the largest societies have to be prepared to look beyond the movement to find individuals with appropriate levels of skill and competence to hold the top jobs. Ideally they would have a high level of **co-operative** business competence, but in reality at this level this may not be the case. This itself creates challenges to ensure that a board does contain (or have access to) an appropriate level of co-operative business experience. This further underlines the problem of using elections as the method to choose board members.

Having started with a skills-based search to find the best candidate, there is similarly no logic in switching at the last minute to a process of election from a short list. This could easily result in the appointment of the second or third-best candidate when viewed against the business criteria. We need a system which delivers the best person for the job.

So **the starting point, for securing business competence at the level of the toughest competition and where the stakes are highest, is selection, not election.** Otherwise, the organisation starts with one hand tied-behind its back. As a matter of principle, this should not create a problem because those appointed are simply agents, charged with delivering what members want.

But if the process at this point is designed to produce individuals who are amongst the top in their field, and who are therefore most likely to be strong-minded individuals and big personalities, then it is essential that such individuals are counter-balanced by a number of other individuals in a non-executive capacity, who are used to operating at a similar level in a commercial context, or who have other skills, expertise or experience (e.g. high level public office/sector, academic, professional) so that collectively the non-executive directors include a range of skills to provide an effective foil or counter-weight to those of the executives.

This results in a board which superficially resembles that of an investor-owned company, but it will be different in some crucial respects. Like on the board of a company, the role of the non-executive directors is to be independent and objective. It is not for them to be partisan to any particular constituency, or to be representative of any particular point of view or geographical area – to do this would undermine the objective and independent nature of their role.

Their job is to scrutinise what the executive directors are doing; to challenge and question at a high and a detailed level; to question external advice to ensure that it is reasonably competent; essentially to use their skills and experience to check that the executives are doing what the society and its members expects of them, and doing it to a standard that is expected at this level of business. **They need to do this specialist task from an understanding of how a co-operative should work, and work differently from an investor-owned business.**

It should be noted that with a very large and/or complex organisation such as we are considering here, for this board of directors to have **all** of the powers of the corporation other than what is reserved to the members in general meeting is at best questionable. With large corporations employing thousands of people, and turnover on a scale which many people find difficult to fathom, it is a huge amount of power for such a small group of individuals to have.

In truth this is the problem at the heart of the design of the investor-owned company. Directors of public companies are too powerful, and inadequately constrained within the corporation's own legal framework. That model relies at least in part on the external market, because the internal mechanisms of governance are insufficiently effective to hold powerful directors in check. Without the influence of the market, the internal legal controls of investor-owned businesses are clearly inadequate for very large businesses. Clearly this is a problem for companies, which needs to be addressed.

Whatever the corporate entity, those ultimately in charge are merely agents who have been entrusted with power to do things in the name of the corporation. It is not their business; they are merely custodians or trustees of the executive power given to them. It is therefore appropriate to consider whether they should indeed be given so much power. So, for example, should it be entirely within the gift of the hired agents to decide what the business will do next year? Certainly not in a co-operative. **It is fundamentally important in a co-operative organisation that the members have some real influence over what their business is doing from year to year.** This is the very least required by the Second Co-operative Principle-Democratic member control. The members should be setting or at the very least working alongside the board to develop and set the forward plans of their society, and it is the job of those given executive power to deliver those plans.

So we now need to turn to the question of democratic member control and accountability. Where a group of individuals is given a large amount of power, it is critically important that such power is exercised within a context of real accountability. "Accountability" starts with the obligation of those who hold power to explain how they have used that power. We call that "giving an account", where they describe in detail, commonly through a "report and accounts", how they have used the assets available to them, and what state they are in. The next part of accountability is where those who have received that account either congratulate, or correct, or replace them. We usually call this "holding to account". It is a continuous ongoing process, with certain points in an annual cycle where particular events in the chain of accountability occur.

“It is fundamentally important in a co-operative organisation that the members have some real influence over what their business is doing from year to year.”

It doesn't work particularly well in an investor-owned company. Shareholders are generally too detached – and/or too uninterested in the business – to want to get involved. Theirs is a financial interest only.

It is very different in a co-operative. Although members may have a financial interest, both personally through owning shares, and collectively in the business remaining solvent, their interest is in the society continuing to trade and to deliver what they need. This means that members themselves, or through elected representatives, need to have the power to influence what the business does from year to year.

But they also need to make sure that those holding power are doing a good job – whether to congratulate them, correct or replace them. I have already touched on the problem above that it can be very difficult for elected individuals, even when they significantly outnumber executives numerically, to keep executives in check, and find the courage to remove them should that be necessary. This means that the holding to account needs to be approached differently.

In the model we are describing here, the first level of scrutiny of executive directors is not by the elected representatives of members, but by the non-executive directors (NED). This is both appropriate and necessary. The NEDs have, or should have, the skills and experience to challenge and test what executive directors are doing. In order to do this, they need access to information at a high level; and if they are to do the job properly, they need to be legally and constitutionally responsible for doing it, so that legal redress is available if they do it negligently.

So the first level of scrutiny and challenge happens within the board room, where full information is available for the NEDs to see and understand what is going on.

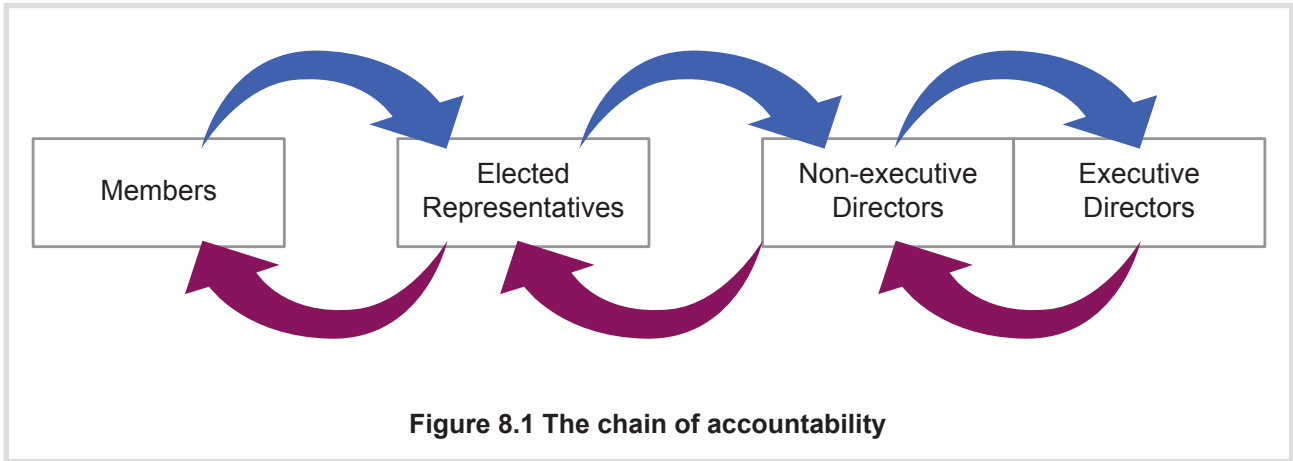
But the role of the NEDs, in reality, is to be the specialists holding the executive directors to account, on behalf of the members and their representatives. Specialists are needed for this role at this level of business; but the NEDs are doing a job for the members, and they should be required to report regularly to members or their elected representatives, so that the latter can make sure that they are doing their NED role well, and can similarly be congratulated, corrected or replaced.

This approach can be illustrated as follows. The blue arrows indicate the power of election/appointment and replacement; the pink arrows denote the responsibility to give an account. The constant revolving process e.g. between the NEDs and the Executive Directors denotes an ongoing and continual process of accountability. A similar process is taking place at the next level, where elected representatives hold the NEDs to account. The final tier is the one at which members elect their representatives. Through this mechanism, those at the sharp end with day-to-day responsibility for delivering services are ultimately accountable to their member-owners.

In this way, **this design approach seeks to deliver both competence in directing large and complex businesses, and effective member-ownership and control, ensuring that the business delivers what the members want.**

Concluding comments

At the heart of this radically different approach to governance in UK co-operatives is a very significant change. In this approach, elected representatives no longer hold the legal powers and responsibilities for the business. Instead, those powers and responsibilities



are allocated to selected and appropriately qualified individuals who are answerable to members and their elected representatives, and who crucially are responsible for delivering future plans which have been shaped by members.

In the traditional Rochdale approach, **constitutionally** the democratically elected board holds the legal powers and responsibilities for the business; but the **reality** is that the chief executive and management team are the ones who hold the legal and practical power, and elected representatives can be side-lined because they lack the skills and experience to do what the constitution expects of them. This model seeks to address this problem, and at the same time to secure the maximum benefits of member and democratic ownership.

It is important that the challenges of co-operative governance are confronted. New thinking is needed to ensure that our largest societies operate under arrangements which meet the needs of the business and ensure that they will prosper as co-operatives. The approach described above should and could be explored within the co-operative sector in the UK but currently it continues to develop as one of the options for the country's co-operative approach to governance in public services.

9

Finding the Balance: Staying Focused on the Local Member

PATRICK G. MANGAN

 EDITOR'S CORNER

Linkages between this chapter and inherent co-operative governance properties: humanism, joint ownership and control, and democracy.

Federations are a fascinating mechanism in the co-operative movement that safeguards mutual benefit through interconnectedness among co-operatives.

Humanism: In the self-design of a federation's governance structures primary co-operatives agree to the process, the arbitration mechanism, and the scope of the federation. Built on trust and reciprocity, the contribution to the network is voluntary and agreed to by the members.

Joint ownership and control: The importance of solidarity in a federation is paramount and a key driver in this chapter's discussion. All members must balance the interests of their individual co-operative with those of the federation, potentially creating a tension. If co-operatives lose sight of the purpose of the federation and take a narrow view in favor of one or more members, the benefits of the federation may be lost (e.g. economies of scale, centralized benefits, risk mitigation). Joint contribution to a solidarity cause is the essence of federated co-operatives. As such, their governance design has to clearly define issues under the solidarity purview that trump autonomy and self-interest.

Connecting this chapter to network governance design concepts: small independent basic units, subsidiarity principle, polycentricity, and multiple stakeholders.

Federations such as the power generation and transmission example used in this paper are focused in terms of the products and services as well as membership type and structure. The governance structure as described is traditional: member representation from a network of independent co-operatives flows up to a federation apex board. In contrast, other federations are multi-faceted in terms of product and service offerings and/or membership (e.g. the Mondragon Corporation Co-operative, the Desjardins network, or Rabobank, to name just a few), plus may have more complex governance structures (e.g. delegate structures, councils, multi-layered boards). Regardless of composition, federations are natural environments for the application of network governance concepts.

The author acknowledges the potential for many layers existing between the apex governing body of a federated (or networked) system and the ultimate member-owner, and this is pointed to as area for potential disconnect with the needs of member-owners. This concern is a perfect example of why network governance is so important for co-operatives and how this potential disconnect can be eliminated. The author points to advisory groups, member surveys, pilot programs with members, and nominations and elections processes as a few tactics to ensure that the federation engages with and stays focused on the needs of all members.

Federations should take a close look at their governance structures and integrate network governance design principles to strengthen member involvement, ensure multiple viewpoints are considered, avoid unitary board structures, and decentralize decision-making according to the **subsidiarity** principle. The tension between central bodies and the autonomy of the individual co-operative enterprises are negotiated in the day-to-day work of the Mondragon Corporation and its co-operatives and is also taken up in debates of the Congress and other senior bodies (see the Freundlich Chapter).

9. Finding the Balance: Staying Focused on the Local Member

Examining the Tensions between Principles 4 and 6

PATRICK G. MANGAN¹

One of the foundational strengths of the international co-operative movement has been its ability to evolve over time to meet the needs and challenges of the contemporary world. The constant in this evolution has been the importance of the local member. Changing social, political, cultural and economic conditions, paired with a progressive spirit of experimentation, have caused co-operators to evolve the original Co-operative Principles through progressive vision, inspiration and experimentation.

This chapter explores the challenges and tensions in governing a large federation, specifically the tensions that can emerge between the 4th principle of *autonomy and independence* and the 6th principle of *co-operation among co-operatives*, and the challenge of meeting the needs of a diverging membership. To illustrate the tensions between the fourth and sixth co-operative principles within federated systems, we use two examples - electric co-operatives in the U.S. and a large consumer co-operative in the U.K. Several lenses are used in this examination, including governance challenges, local member importance, cautionary examples, and recommended guidelines.

PRINCIPLE #4 AUTONOMY AND INDEPENDENCE

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

PRINCIPLE #6 CO-OPERATION AMONG CO-OPERATIVES

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

2014 International Co-operative Alliance

The Origins of Autonomy and Independence and Co-operation among Co-operatives

The growth and success of Rochdale and other co-operative societies in the 1850s raised the issue of whether co-operatives could work together to advance the movement. Could co-operation among co-operatives help local co-operatives to achieve common goals, improve margins and preserve their local identity while continuing to provide affordable and reliable goods and services? A mature, organized form of such co-operation is a federation or network.

¹ Director of Governance Education, National Rural Electric Co-operative Association, United States

Today, principle #4 discourages co-operatives from entering into any business relationship that potentially removes the ability to make autonomous and independent decisions on behalf of the members while at the same time Principle #6 encourages business relationships among co-operatives in order to achieve economies of scale that bring greater value to the local member. Can co-operatives find the balance?

WHAT IS A FEDERATION?

A wholesaling, federated co-operative (or federation) is most typically an organization in which all of the members are themselves co-operatives. Each member co-operative in a federation is a separate business entity that owns a membership stake, entitling it to voting rights in the affairs of the federation. Generally, federated co-operatives may perform one or more of the following functions: marketing products, purchasing supplies, providing products/services in a wholesale arrangement, and/or providing other types of support services to their members (e.g., accounting, advocacy, or consulting). Ultimately, the federated co-operative contributes to improving the circumstances of each and every *local* member through collaborative action.

A federation, then, is the epitome of principle #6, *co-operation among co-operatives*. However, when the members of a federation become overly concerned with exercising their independence *from the federation* – as opposed to being independent from outside influences that could weaken the democratic nature of the co-operative enterprise – various tensions can result. A misunderstanding of principle #4, *autonomy and independence*, may be the culprit. The tensions, discussed further here, may be ameliorated when co-operators gain a better understanding of the true meaning of these Principles and recommit to them.

THE BENEFITS AND RISKS OF FEDERATIONS

Brett Fairbairn posits that co-operative federalism has three chief benefits: (1) economies of scale; (2) centralization benefits without losing advantages of distinct, local identities for the federation members; and (3) minimized risk of failure to the federated enterprise when one or more local members fail.

Fairbairn notes, “The federal idea, uniting as it did both commercial efficiency and local autonomy, became a fundamental feature of the Rochdale movement. Like the ideas of functional specialization and consumer importance, it was a co-operative principle that evolved through the movement’s growth. Unlike those two ideas, however, one can argue that federalism was implicit in the original statutes and early behavior of the Pioneers—in their commitment to local action and their record of working together with other co-operatives.”²

IS RISK OF FAILURE MINIMIZED TO THE FEDERATED ENTERPRISE WHEN ONE OR MORE LOCAL CO-OPERATIVES FAIL?

As noted earlier, Fairbairn suggests that one of the intended benefits of a federated system is risk minimization. The failure of one local co-operative can have a significant, but typically not fatal, impact on the integrity of an entire federated system. Consider the impact of a single electric distribution co-operative providing power to a large mining operation that suddenly moves its operations overseas. Serving the mine might represent 60% of the distribution co-operative’s total retail sales of electricity and, in turn, a substantial portion of the load being served by the generation and transmission co-operative

² Fairbairn, Brett (2012). *The Meaning of Rochdale: The Rochdale Pioneers and the Co-operative Principles*, Centre for the Study of Co-operatives, University of Saskatchewan, Canada, page 14

(G&T). With funding secured on the basis of expected sales to its member co-operatives, the G&T co-operative has built power generation assets to satisfy all of its member distribution co-operatives' power requirements, and each are bound by an all-requirements contract. Losing the mine as a member triggers a cascade effect within the federated system. First, the local co-op's total power requirement would be significantly reduced, which in turn could leave the G&T with a large amount of unsold electricity. Ideally, the G&T can sell this excess electricity in the wholesale power market and remain whole, but that is by no means certain. If the excess power cannot be sold, then the G&T's sales are reduced. The G&T's assets are largely debt-financed, so a significant loss in revenue may jeopardize the G&T's ability to pay its loans. Thus, all G&T member co-operatives feel the impact of the loss of this one large consumer served by a single member co-op, but they are likely to survive. Here we see that the risk of failure still exists, but is minimized for a single distribution system through adherence to the co-operative value of solidarity. Even though this risk has not been eliminated through the federation, the federated system provides several advantages, including the covering of a member distribution systems' losses by pooling capital into non-divisible reserves for such adverse events, expertise and leadership into the future, and access to new energy sources and other innovative opportunities.

Without question, the commitment to local autonomy, coupled with the successful federated co-operative experiment, spurred unimagined success within the co-operative movement. The seeds of potential tension were also planted between the individual co-operatives that formed the federated co-op and the federated system itself, in some cases leading to a significant crisis within the system.

“The commitment to local autonomy, coupled with the successful federated co-operative experiment, spurred unimagined success within the co-operative movement.”

Two Examples of Tension between Principles #4 and #6

ELECTRIC CO-OPERATIVES IN THE UNITED STATES

To help jump start the economy and relieve unemployment during the Great Depression in the 1930s, President Franklin D. Roosevelt organized the Rural Electrification Administration (REA) to extend electrical service to rural areas. The belief was that bringing electricity to rural America would permit rural residents to enjoy the benefits and comforts of electricity and yield efficiencies on the farm that might just aid the ailing U.S. economy.

After almost two years, the REA program was considered a failure because investor-owned utilities did not seek the available REA loans. The low density of population in rural areas would not produce a rate of return high enough to meet shareholder expectations. American farmers soon banded together and asked the REA to loan them the money to exercise self-help and build electric distribution systems for themselves and their communities. The Roosevelt Administration agreed to expand rural electrification through the use of the co-operative business model. The 1930s and 40s marked a groundswell of electric co-operative formations; and by 1953, 90 percent of the nation's farms were electrified. Electricity revolutionized farming -- dramatically increasing productivity, standards of living and life expectancy of overworked farm families.

In 1938, five electric distribution co-operatives in Wisconsin joined together to form the first federated generation and transmission (G&T) co-operative to provide each member co-operative with a reliable, affordable electric power supply that was lacking. Other rural electric co-operatives that initially relied on investor-owned and municipally-owned power suppliers for their wholesale power needs began to experience higher costs for power as well as lack of availability. As a result, more and more electric co-operatives decided to band together to create power generating co-operatives to meet their wholesale power

supply and transmission service needs. Today, there are 65 co-operatively-owned G&T co-operatives supplying, or otherwise contracting for, the bulk power needs of 668 out of the 840 electric distribution co-operatives in the United States. Each member co-op of the G&T agrees to purchase most or all of its electric energy from the G&T. These “all requirements contracts” facilitate the G&T’s acquisition of capital to generate or purchase and transmit electric energy. As explained by a federal appellate court, the all-requirements contract between a G&T and its members is not a “routine arm’s-length requirements contract between unrelated, private for-profit parties.” Instead, a distribution co-operative member’s participation in the G&T “co-operative system” and its “interrelationship” with the G&T and the other G&T members make this contractual relationship unique. The contracts are “interdependent, joint and mutual contracts” that share a common purpose of securing loans for the G&T. The court noted the “interdependency” of the G&T members, and each member’s “realization of benefits” at the G&T level.³ This is perhaps the clearest statement in U.S. jurisprudence regarding the unique interrelationships found in a federated system.

This example of co-operation among co-operatives helps to ensure the availability of reliable and affordable electricity to 42 million people in the U.S. It also ensures that these consumers have a voice in the production, delivery and consumption of an essential service they use every day. Consumers participate in the representative democracy of the G&T, electing their distribution co-operative boards of directors on a one member, one vote principle. The distribution co-operative boards then in turn each elect one or more representatives to the G&T board ensuring representation for each member co-op.

“With any federated or networked system, the more layers between the ultimate member-owner and the governing body at the apex of the federated system, the more potential for a disconnect with the needs of the member-owners.”

With any federated or networked system, the more layers between the ultimate member-owner and the governing body at the apex of the federated system, the more potential for a disconnect with the needs of the member-owners. Electric distribution co-operatives have employed a number of tactics to help ensure the focus remains on the member-owners, such as establishing member advisory groups, conducting frequent member surveys, and piloting programs to test member acceptance before full implementations. Board of director nomination and election processes also should be designed to ensure appropriate member representation at both the local co-operative and federation levels.

AS FEDERATIONS GROW - GOVERNANCE MUST EVOLVE IN THE U.K.

A second example of tensions between principles 4 and 6 is drawn from The Co-operative Group (“The Group”) in the UK. In this case, an aggressive merger strategy intended to achieve greater economies of scale for members (co-operation among co-operatives) coupled with a convoluted governance structure ultimately jeopardized The Group’s autonomy and independence.

The Group is the largest consumer co-operative in the UK, with a diverse range of retail co-operative businesses and eight million individual members. It comprises a family of businesses, including food, financial services, funeral care, and legal services. Prior to its purchase by The Group, the Co-operative Wholesale Society had engaged in a range of business moves, including takeovers of a supermarket chain and a building society, as well as the rescue of several weakened co-operative societies in the UK. As Johnston Birchall suggests in his white paper *The Governance of Large Co-operative Businesses (2014)*, The Group’s business risks were exacerbated by the financial meltdown of 2009. Things continued to worsen and in 2014, large financial losses caused The Group to lose control of its subsidiary, the UK Co-operative Bank, which has resulted in The Group itself coming to the verge of bankruptcy.

³ Tri-State Generation & Transmission Ass’n v. Shoshone River Power, Inc., 874 F.2d 1346, 1355, 1359-60 (10th Cir. 1989).

Subsequent analysis of the recent history of The Group points to two failures as primary causes for recent catastrophes. First, as The Group branched into the increasingly risky world of mergers, acquisitions and high stakes finance, its governing board may not have kept pace with the level of knowledge required to fulfil its fiduciary duties, specifically the oversight function. Second, The Group lost touch with its local consumer-owner when it implemented a new multi-layered governance structure in 2001. Ivano Barberini warns that mergers and acquisitions can potentially whittle away at the relationship with the members.⁴ This failure was evident with The Group.

There are a number of mechanisms that can be deployed to ensure that a board of directors is prepared to address business risks and complexities. Regular director education programs are paramount; outside business consultants with deep expertise can be tapped for guidance, and regular communication between the federated system and its members is essential.

Observations & Recommendations

As we have discussed, challenges and conflicts can emerge within federated co-operative systems, including governance challenges, relationship risks, and divergent member needs. Here, we will discuss these challenges and offer some guidance on how to navigate them through a series of questions.

The tensions that exist between Principles #4 and #6 are an area in which apex organizations must step up and provide leadership. Federations have bylaws and policies in place which provide clear guidance on fiduciary duties, resolution of conflicts of interest and loyalty to the federation. But, where does a board (or a director) turn when conflicted with strong sense of loyalty to both the federation and their local co-operative or some similar dilemma? What are the “rules of the road” then? Surely the path is less clear.

In the *Republic* 2500 years ago, Plato asked the question “who watches the watchers”.⁵ He described a society where people lived and worked under the protection of a “guardian class” charged with looking out for the interests of the society as a whole. Under the co-operative business model, the board of directors is the guardian class.

HOW DO THE FEDERATED SYSTEMS’ ECONOMIES OF SCALE BENEFIT THE LOCAL CONSUMER?

Drawing another example from the rural electric co-operatives in the U.S., the power purchase commitments between a G&T and its distribution co-operatives facilitate the distribution co-operative providing affordable power to its members. This commitment provides the security for underwriting loans to the G&T to finance needed generation plants and transmission facilities. The local, member distribution co-operatives benefit through this pooling of demand and the centralization of functions at the G&T level. They also benefit from the specialized expertise of the G&T necessary to navigate the complexities of wholesale power supply and transmission operations and markets.

Economies of scale, another of the three benefits Fairbairn identifies for federation, can also bring greater risk and complexity to the business. As Birchall points out, the larger an organization becomes in order to reap economies of scale, the more complex it is to manage. This is as true in co-operative collaborations as it is in other business models. Governance must keep pace with both the size and complexity of the business.

“Governance must keep pace with both the size and complexity of the business.”

⁴ Barberini, Ivano (2009). *How the Bumble Bee Flies*, Co-operation, Ethics and Development, B.C. Dalai Editore

⁵ Boudreaux, Greg (2009). *The Boardroom Paradox*, Foremost Press, Cedarburg, Wisconsin, p. 103.

Additionally, complexity of a business incurs a cost, and eventually this cost may come to outweigh the savings gained from greater scale. An example of this is The Co-operative Group UK. The series of mergers and acquisitions over several decades that was discussed earlier, seemingly driven by a desire to leverage retail and financial strength, created a behemoth over which The Group's governing board appears to have been out-matched. Red flags along this path should have been raised when The Group entered markets with which it had no familiarity or expertise, such as construction and food retail. Such a diverse and complex business should have prompted questions about growing risks. Probably the largest red flag was the apparent failure by the governing board to carefully consider the compounding complexity created with the aggressive path of multiple mergers and acquisitions. Boards of federated co-operatives considering expansion into new lines of business should ask themselves – How will this merger/acquisition impact our members? What could go wrong? What is our strategic vision? Why are we merging/acquiring? What expertise and resources do we have (or do we need) to be successful in this business line? Is a merger or acquisition the best alternative to securing additional benefits for members, or can those benefits be realized some other way that affords less risk?

MANAGING CONFLICTS OF INTEREST: INDIVIDUAL AND ORGANIZATIONAL CONSIDERATIONS

At the federated level, the governing board member's role is to consider and act on behalf of all the federation's members, not just the director's local co-operative. The director, however, must also act in a manner he or she reasonably believes to be in the best interests of his or her local co-operative. As long as the federation and the local member co-operative have *unified* interests, this requirement is relatively simple. However, if the federation and the local member co-operative have *conflicting* interests, then the federated director is in a quandary – how can he or she satisfy the duty of loyalty to both? The federated director may communicate, and possibly advocate, the interests of his or her local co-operative at the federation level. Further, a federated director may even seek to convince other directors that his or her co-operative's interests are aligned with the federation's interests. Ultimately, however, when voting or otherwise acting as a federated director, the director must act in a manner he or she reasonably believes to be in the federation's best interests. This is easier said than done, and while the letter of the law in the U.S. is clear, it raises difficult issues for the conflicted director, when his or her loyalty is divided. Establishing a policy or set of guidelines that the federation board has agreed to follow that identifies potential conflict situations as well as the actions considered appropriate for the federated director to take (e.g., communicate position, advocate, attempt to persuade fellow directors) may be prudent.

DO THE LOCAL CO-OPERATIVE AND THE FEDERATED CO-OPERATIVE HAVE UNIFIED OR CONFLICTING INTERESTS?

Typically, the board of directors of a federated co-operative is made up of one or more designee(s) from each member co-operative with each member allocated one vote. Using the U.S. rural electric co-operatives as an example, the all-requirements contract between a G&T and its members is considered by many to be the linchpin of the G&T and member co-op relationship. Under this contract, each G&T member agrees to purchase most or all of its electric energy from the G&T. These all requirements contracts facilitate the G&T's acquisition of capital to generate or purchase, and transmit the electric energy. Under this

contract and the Co-operative Principles of democratic member control, the interests of a G&T and its members are usually unified.

While the interests between a G&T and its members are usually unified, they may, at times, conflict. For example, while increasing the price of wholesale electric power may benefit a G&T's financial position (addressing Principle #6 – co-operation among co-operatives - and ensuring the financial strength the federated system for the benefit of all its members), it may hinder a local co-operative's relationship with its consumer-members (addressing Principle #4 *autonomy and independence* – a local co-op's responsibility to look out for its local member-consumers). Conversely, while retiring patronage capital (capital credits) may hinder a G&T's financial position, it may benefit the member co-op's relationship with its local consumer-members. In addition, a G&T and its member co-op may disagree regarding power supply decisions – for financial, environmental, political, or other reasons. Likewise, a G&T and its members may disagree regarding, among other things, the allocation of costs, setting of rates, treatment of generation sources owned by retail consumer-members, extension of the wholesale power contract term, and wholesale power contract requirements to purchase most, but not all, electric energy from the G&T. Because the G&T's assets and services are intended to benefit all the members, divergent views among local distribution members can make it difficult for the G&T to chart a course that satisfies all its members.

HOW CAN A FEDERATED BOARD ADDRESS A DIVERGENCE OF INTERESTS?

First, it is helpful to remember that the same issue can exist at the local co-operative level. At either level, the board of directors is the body that has the challenging task of balancing different interests and finding solutions. Because membership in a co-operative is voluntary (though there may be contractual provisions to be satisfied before a member can exit), this provides a strong incentive for boards to drive to consensus and resolve conflicts. Board members that possess collaborative negotiation and conflict resolution skills can be a tremendous asset to their co-operatives. Having board policies in place that help frame discussions on divergent issues and establish “rules of the road” to keep discussions constructive (e.g., active listening to all sides, checking for understanding of each board member's interests, generating multiple options in search of a win-win solution) can also help.

Adopting a consensus decision making model⁶ – at least for certain matters – may be another tactic for co-operative boards to consider.⁷ In this decision making model, the focus is on addressing minority concerns, rather than the typical “majority rules” democratic process. The advantages to this approach include a focus on long-term unity and relationship building. It may not be appropriate for a particular group, and board members may not be familiar with its techniques.

Conclusion

Large federations present unique governance tensions and challenges. While there is no magic solution or “one size fits all” approach to resolving these tensions, there are touchstones that can provide guidance, specifically, the seven co-operative principles, a well-informed board attuned to the needs of the local consumer, and belief in and con-

⁶ The consensus decision making model is a departure for those co-operatives that have adopted Robert's Rules of Order where outcomes are determined by a majority.

⁷ See generally, http://cultivate.co-op/wiki/Consensus_decision_making.

tinued commitment to the importance of the local member. Boards must continually ask themselves if board structure, composition, expertise and engagement are adequate to meet the challenges faced by the federation. Further, apex boards must take the lead in collaborating with co-operators worldwide to acknowledge, discuss and navigate today's toughest issues. Barberini discusses crisis as a constant feature in enterprises "founded to last", reminding co-operators "that a crisis must be first and foremost recognized and understood in its proper dimension."⁸

Notes

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⁸ Barberini (2009) p. 65

10

Governance in Solidarity

JEAN-PIERRE GIRARD

Linkages between this chapter and inherent co-operative governance properties: humanism, joint ownership and control, and democracy.

Humanistic governance: The chapter talks about the renewed interest in multi-stakeholder co-operatives (MSCs) and highlights their governance challenges. The multi-stakeholder form extends membership to diverse groups of individuals or organizations engaged with the co-operative as workers, consumers, or other stakeholders. This element in and of itself does not guarantee a humanistic governance approach as a principal-agency mindset could still be in place in a MSC. If stakeholders are viewed as purely self-interested parties, ignoring the elements of trust and reciprocity underpinning co-operative organizations, it creates a multiple agency framework that is more difficult and more complex to manage than a single member co-operative (see Box 1.1. in the Introduction). Evidence suggests the opposite is true¹ - MSCs do not often fall into the agency trap, but build a co-operative community around issues of social justice, or joint benefit. These co-operatives are often termed “solidarity” co-operatives to highlight the solidarity (rather than the stake-holding) component, and a shared interest of all user-types in the sustainability of the organization. A humanistic model of governance is a natural fit for MSCs.

Ownership and Control: The diverse nature of membership in a MSC necessitates complex governance structures. The author emphasizes the importance of respecting the ownership and control rights of all members, thus the composition of governance bodies is critical coupled with support for education and training, equitable access to information, and engagement mechanisms.

Democracy: This feature is highlighted in the chapter as the essential property of co-operative enterprises, and is a relevant consideration for all co-operative types. The author stresses the need for deliberative democracy as an opportunity for more elaborate communication between different stakeholder groups. The type of democratic deliberation to ensure member voice is determined by the members themselves, and it may be diverse in various aspects of the organization, or change over time.

Connecting this chapter to network governance design concepts: small independent basic units, subsidiarity principle, polycentricity, and multiple stakeholders.

Multiple stakeholders: The MSC form is widespread and diverse, as illustrated by this chapter. From special legal frameworks, to spontaneous organizing under the general co-operative law, they function in many industries and regions. A more specific legislative framework for MSCs is found in Italy, France, Quebec, and within solidarity economies throughout Latin America. Within our introductory framework for co-operative governance, the multi-stakeholder (solidarity) form takes centre stage, particularly in our argument that employees should have a more deliberate voice in all co-operative organizations.

Polycentricity and subsidiarity: Network governance design is well suited for MSCs (solidarity co-operative s). While the author discusses challenges of the MSC form within the unitary board structures, additional richness of the model can be conjectured in a polycentric design. From regional representation to various member types, stakeholders/users can be engaged in particular domains of their expertise. Representatives of parallel board structures (decision-making centres) are then represented on the supervisory board and engaged in strategy (Mondragon's MSC members offer an example). This design would help avoid the situation the author describes as “MSC board [becoming] a negotiation table for specific concerns of a group of members”.

Co-operatives are also known to resort to horizontal expansion (spinoffs - e.g. Mondragon) and to connect into a multi-stakeholder solidarity network of sister organizations, typically with cross directorships². This has been a solution in jurisdictions that do not allow multiple member types within a co-operative, yet collaboration of different stakeholders is desired to support a particular purpose (ecological conservation areas; fair trade supply chains; and the like).

1 Vezina, Martine and Jean-Pierre Girard 2014. Multi-stakeholder Co-operative Model as a Flexible Sustainable Framework for Collective Entrepreneurship: An International Perspective, in Gijssels, C., L. Zhao and S. Novkovic (eds) *Co-operative Innovations in China and the West*, London, Palgrave MacMillan, p. 64-80

2 Examples of such co-operation abound. One close to home for us is the Just Us! Coffee Roster in Wolfville, Nova Scotia, with a sister organization Just Us! Development and Education Society (JUDES) and a Fair Trade Investment Fund.

10. Governance in Solidarity

JEAN-PIERRE GIRARD¹

This chapter raises the key points and related ideas aimed at shaping the parameters of multi-stakeholder co-operative (MSC) governance². The content draws from various research and writing projects on the subject, from national and international points of view but also from the author's field experiences as a consultant and as a MSC board member.

The first section provides an overview of the MSC form and how they have manifested themselves in various contexts globally. The second section introduces the notion of stakeholder and suggests a simple typology of membership structure for multi-stakeholder co-operatives from different countries as there is no one size fits all approach. Since MSCs welcome stakeholders with various interests, it also means potentially operating with a certain degree of tension among the various interests. In the third section, this tension is discussed including thoughts on the co-operative lifecycle and the challenge of keeping a strong sense of member engagement alive in the co-operative.

The fourth section focuses on democracy as a key principle of co-operative identity which holds true in a MSC. Without vibrant engagement and the opportunity for active participation by each member category, it could provoke among some members a lack of belonging to the co-operative, an imbalance between different groups of members, and, at a certain point, a member category could be eliminated. How do we conceive of democracy in a MSC so as to engage and empower each member group? Deliberative democracy is argued to be the best suited democratic approach for a board of directors dealing with diverse member categories.

The final section addresses the MSC's day-to-day operations and emphasizes the importance of a clear definition of the roles and responsibilities associated with the distribution of power in the co-operative ; the need for efficient internal and external communication closely in link with transparency; the preparation and leadership of the board; and relevant management skills.

Multi-stakeholder co-operatives in context

Faced with the emerging and complex societal claims, often at the intersection of social and economic issues, a complex multi-stakeholder co-operative form is able to create fruitful partnerships in civil society and is attracting attention in a growing number of countries. The name simply refers to presence of more than one member category or stakeholder type. These could be, for instance, users and workers but it could also include volunteers, financial partners, or supporting members. Regardless of membership categories and their numbers, there is a strong concern for solidarity with the mission of the organization among all member categories in a multi-stakeholder co-operative.

In some cases, MSC has been legally recognized, thus having specific provisions with detailed rules about, for instance, member categories or voting rights for each class of member. Other times, MSCs function informally or, in many countries, under the general legislation that applies to all co-operatives and does not preclude multiple member types.

“A complex multi-stakeholder co-operative form is able to create fruitful partnerships in civil society and is attracting attention in a growing number of countries.”

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² At the heart of co-operative organizations we have the notion of stakeholders rather than shareholders. The Oxford definition of stakeholder is: *Denoting a type of organization or system in which all the members or participants are seen as having an interest in its success.*

In this case, the MSC has the responsibility to define their rules of membership within their by-laws.

In some cases, MSCs are restricted to a particular functional area, like social co-operatives in Italy who must be involved in social, health and education services (A-type co-operative) or work reintegration of disadvantaged persons (B-type co-operative), or can be a combination of A and B type. In other cases, no specific areas of intervention is prescribed, so the MSC could be functioning in a great variety of activities, including multipurpose or multi-functionality, combining for instance, agriculture and health, financial services and a general store. In the Italian example, there are often contractual relationships between the co-operative and a public or para-public agency, as well as the option of government membership in the co-operative. Therefore, upholding autonomy and independence of a MSC is very important.

Finally, depending on the situation and context, a MSC could be promoted and supported by a social movement or organized into a federation to benefit from networking, shared knowledge, or funding. Alternatively, the MSC could be a project of an isolated group of persons without a connection to other resources, including specific training programs for MSC governance. In this latter case, since there are no specialized resources assisting the co-operative, it is more difficult to be sustainable.

In face of these factors, as well as the relative novelty of the MSC model as a legally recognized form, compared to the predominant single-stakeholder type (SSC), we need to consider the impact on governance of such co-operatives. Governance literature suggests that multi-stakeholder presence will significantly complicate governance, since each stakeholder group has different, and potentially conflicting, interests. The governance challenge is amplified when the MSC is involved in more than one area of activity. However, a clear common purpose and solidarity among stakeholder groups may reduce the likelihood of these tensions arising.

Stakeholders and MSC typology

Historically, the co-operative movement mainly chose the single stakeholder category of co-operative (workers, users) for its governance model with the business of the co-operative focusing mainly, but not always, in one area of activity (e.g. finance, agriculture, housing). Within this structure, the co-operative focuses on the satisfaction of member needs in terms of price, quality, access or other, instead of maximizing the return on investment. The democratic structure of the co-operative – general assembly, board of directors, active member participation – must keep the notion of member satisfaction as a mantra. This is the *raison d'être* of the co-operative and a crucial condition for its sustainability. Over time, with successes and failures (including demutualisations), the sector's comprehension of effective SSC governance has evolved.

The Italian experience with social co-operatives introduces a different definition for the co-operative stakeholder. In the 1960s and 1970s, the growing expectation for civil society's participation in organizing services, coupled with the inability of the welfare state to meet needs of people (e.g. with handicaps or addictions, the homeless, or minors with difficulties reintegrating into the job market), shaped the basis for the introduction of social co-operatives³.

³ Girard, Jean-Pierre, Enzo Pezzini and Isabelle Mailloux 2000. "Les coopératives sociales italiennes: description et éléments de réflexion sur le contexte québécois", Montréal, *Cahier de recherche* 115, Chaire de coopération Guy-Bernier (UQAM) in collaboration with the Corporation de développement économique communautaire Centre-Nord, 43 p.

It is important to note that during the first 20 years, there was no specific law for social co-operatives. It was only in November 1991 that the Italian government provided the legal framework for social co-operatives, law 381. Even though the law does not require a multi-stakeholder governance structure, a social co-operative could have user members, worker members, volunteer members, financing members, legal entities, and public or legal persons involved in the development and funding of the social co-operative. In fact, most of the more than 10,000 social co-operatives in Italy use the multi-stakeholder model.

Many other countries decided to follow the Italian example by enacting law for MSCs (Portugal, France, Greece, the provinces of Quebec and Manitoba in Canada, among others), but each country adopted the model to fit their perspective. Other countries recognise MSC but have drawn on inspiration other than the Italian model like Mexico, Venezuela, Vietnam, and Uruguay⁴, or assume the MSC form without specifying it in the law (Croatia is one example⁵). Today, when we talk about MSC, the picture of stakeholder co-operatives is complex⁶:

- in some countries we could have multiple categories of members while board membership may be limited to a single category;
- in other countries, the number of board members by member category is specified (all member categories are present on the board, at least with one member representative); and,
- in some cases, the legal framework determines the possible member categories without any flexibility for additional categories, for instance, limiting membership categories to users, workers and supporting members as is the case in Quebec.

The MSC form has many nuances and complexities, but the common idea is the presence of more than one type of stakeholder represented in the co-operative's membership.

The tension among members' interests in MSC

Setting up a SSC in terms of member needs is quite clear and easily manageable: If it is a consumer co-operative, the organization will try to offer the best quality products at a competitive price; in case of worker co-operative, the challenge is to offer jobs with good working conditions and pay. The question of member needs is more challenging in the case of MSCs. For example, how does the co-op combine the interest of the users (looking for the cheapest price to buy the service or the product) and the workers (expecting the highest wages)?

At the point of co-operative inception, the mission of the MSC must unite the common interests of all member types and include the participation of all interested stakeholders (i.e. member categories). Also, the context in which the MSC is being established is important: Does the co-operative benefit from the support of a social movement that already facilitates dialogue among various stakeholders? It will be easier to start a MSC with stakeholders already experienced in volunteering or working within organizations that are open to discussion and are sensitive to different points of view.

“The MSC form has many nuances and complexities, but the common idea is the presence of more than one type of stakeholder represented in the co-operative's membership.”

4 This information came from a recent study: Girard, Jean-Pierre (Eds) 2014. *Better Health & Social Care How are Co-operatives & Mutuals Boosting Innovation & Access Worldwide? An International survey of co-operatives and mutual at work in the health and social care sector (CMHSC 14)*, Montréal, LPS Productions, 271 p. http://productionslps.com/wp-content/uploads/2014/10/International-survey-co_op-and-mutual-Health-and-social-care-CMH-SC-14.pdf

5 Novkovic, Sonja and Tea Golja 2015. Co-operatives and the civil society: Potential for local co-operative development in Croatia. *Journal of Economic and Organizational Diversity*, forthcoming

6 Vezina, Martine and Jean-Pierre Girard 2014. “Multi-stakeholder Co-operative Model as a Flexible Sustainable Framework for Collective Entrepreneurship: An International Perspective” in Gijssels, Caroline, Li Zhao and Sonja Novkovic (eds) *Co-operative Innovations in China and the West*, London, Palgrave MacMillan, p. 64-80

Furthermore, we need to consider the life cycle of the co-operative⁷ in order to understand governance challenges that emerge as member engagement changes and solidarity becomes more difficult among various member categories. When a co-operative is initiated, it generally benefits from a highly engaged membership that is open to discussion and willing to compromise. This process is facilitated by a membership that is generally a small group where everyone knows each other. In the early years, everyone works hard in order to ensure sustainability of the organization. This can even include a high degree of volunteer contribution from various member categories.

Over time, the composition and size of membership is likely to change. The co-operative welcomes new members, and the founding members may leave the co-operative. In most cases, the co-operative hires more and more staff, replacing the volunteers. There is a more impersonal relationship among members. At this point, it can become harder to deal with the tension among various members. Promoting common interest above personal interest is compromised without appropriate skills and training resources.

This could be amplified by other considerations. Worker members may decide to join a union. How does the MSC deal with the worker members' and union expectations⁸? What is the impact of the extension of membership to public bodies, including representation on the board of directors, when the public bodies give important contracts to the co-operative? Does the co-operative have the ability to manage these complex situations where the autonomy of the organization could be at risk?

How can the question of tension between various stakeholders be addressed? There is no simple answer because it is in the DNA of the MSC to welcome various stakeholders with different interests. An important point is certainly the starting mission of the MSC: Why did members decide, at a certain time, to create the MSC? From the moment various stakeholders decide to set-up a co-operative, they have an agreement on purpose and a justification for moving forward together. This is the cornerstone of the MSC: the underlying reasons behind the various member categories' decision to work together.

What happens after 5 or 10 years, when the founding members leave their position on the board, or leave the co-operative? Are the next generation board members aware of why the co-operative was established? What about the management side? Will the memory of why the MSC was established be erased through day-to-day management of the co-operative, financial or human resources problems, or market competition? How do we maintain the gatekeeper function for the co-operative mission tied to all members? The co-operative has to continue reminding members and staff of why it was established in the first place⁹, but it also has to continue to thrive as a conglomerate of diverse members.

From another perspective, if the MSC's business environment changes dramatically, do all stakeholders participate in updating the co-operative's mission? Alternatively, if consensus is not reached, and the MSC shifts its purpose, it may suffer from a lack of alignment with the interest of some members. The latter scenario increases the risk that one member group will dominate with the co-operative possibly transforming into a SSC or, as a last resort, the co-operative may simply disappear.

7 Vienney, Claude 1994. *L'économie sociale*, Paris, Édition la découverte, 126 p.

8 This is the case in some home care co-operatives in Quebec (Canada)

9 This can be accomplished through various media - training courses, mentoring, short videos, etc.

Supporting member participation and using deliberative democracy to empower MSC members¹⁰

Democracy is a key principle of the co-operative identity thus putting co-operatives at the forefront of democratization of the economy.

This democratic power is not linked with the importance of capital (as is the case with the investor-owned business model) but with the individual: one member, one vote. As quoted in the International Co-operative Alliance's Blueprint for a Co-operative Decade, at the heart of democracy we have the notion of participation: "*Co-operatives are sites for learning how to participate in democratic decision-making, and, as such, they generate public good which exceeds their economic imperative. Thus, democratic participation in co-operatives supports both better business decisions and stronger community*"¹¹.

Since MSCs welcome various member categories, these co-operatives need to excel at member participation across all categories of membership. The co-operative must be aware of the specific situation of each member group and support their participation.

What is the best approach to conducting discussions and decision making processes within the MSC, especially by the Board of Directors? Since we need the input of all types of members, deliberative democracy is suggested. This approach focuses on deliberation as a way to produce enlightened and socially validated choices. This is the notion of *plural democracy or democratization of democracy*. It is important to keep in mind, democracy consist not only of participation or choice but also building capacity to make educated choices, or choices for the common good or the general interest. This is important since co-operatives are not operating to maximize profit but have other concerns, including members' satisfaction and/or positive community impact. By definition, MSCs requires dialogue, arbitration, effort and compromise in order to give meaning to the democracy required by a diverse set of stakeholders with diverse types of engagement with the co-operative .

Deliberative democracy "*requires a large investment of effort, a process of collective learning, and the formation of social capital and a climate of confidence*"¹². In a field study conducted among four MSCs in Quebec (Canada) from 2004 to 2007, only one MSC seemed able to manage effective deliberative democracy, and they largely benefited from this kind of democratic deliberation; the engagement of the various members are stronger than in other co-operatives in the study¹³. Deliberative democracy requires resources to empower the various member categories and time for the learning process.

In some ways, deliberative democracy is similar to the notion of slow democracy, a new trend coming from the USA: *slow democracy encourages us to govern ourselves locally with processes that are inclusive, deliberative, and citizen powered*¹⁴. Following a path of deliberation is in contrast to the well-known management notion of rapid decision making processes within a hostile environment that includes competition.

“MSCs requires dialogue, arbitration, effort and compromise in order to give meaning to the democracy required by a diverse set of stakeholders with diverse types of engagement with the co-operative.”

¹⁰ This section refer mainly to Lévesque, Benoît, Patrick de Bortoli and Jean-Pierre Girard (2004) "Social Cohesion and Deliberative Democracy: A Challenge for Co-operative in Building the Common Good", in Fairbairn Brett and Nora Russell (eds) *Co-operative membership and globalization New Directions in Co-operative Research and Practice*, Saskatoon, Center for the Study of Co-operative, University of Saskatchewan, p. 51-62

¹¹ International Co-operative Alliance, Blueprint for a co-operative decade, p. 8

¹² Lévesque, De Bortoli, Girard, op. cit., p. 59

¹³ Girard, Jean-Pierre with the collaboration of Geneviève Langlois (2008) "Les coopératives de solidarité: une forme organisationnelle pour renforcer la cohésion sociale? Synthèse d'une recherche", Montréal, ARUC-Économie sociale, Université du Québec à Montréal, *cahier C-04-2008*, 44 p.
<http://www.aruc-es.uqam.ca/Portals/0/cahiers/C-04-2008.pdf>

¹⁴ <http://slowdemocracy.org/>

“It is a cultural shock to undertake deliberative democracy when representative democracy coupled with quick decision making is almost universally used as a decision making approach.”

Finally, leading a deliberative democracy process is not easy. It takes practice and experience. Without proper training and preparation, it would be very hard for a new board chair to lead such a system of democratic decision-making without risk of collateral damage, such as sliding into micro- management. To date, there is limited training available for deliberative democracy¹⁵, but there is a growing interest in the subject. It is not only a question of ability or skill of the leader, but living with deliberative democracy in a MSC needs the agreement of all stakeholders. It is a cultural shock to undertake deliberative democracy when representative democracy coupled with quick decision making is almost universally used as a decision making approach.

Benefits of deliberative democracy, as shown in a growing number of studies, are that taking more time for decisions can be helpful in the evaluation of future options and outcomes, plus enhancing the sense of members belonging to the organization.

Participation and deliberative democracy need to be kept in mind in the MSC. As noted by Münkner¹⁶, by-laws are of critical importance to achieve this balance. Rules need to allow a reasonable and accepted distribution of voting rights, representation on the governing bodies, and distribution of power.

The challenges in managing MSCs¹⁷

Is it possible to manage a MSC in a way that recognizes the contribution of all member categories while also implementing internal policies that reflect such sensitivities? Since we have a growing number of MSCs in various countries, the answer is yes, but how does it work in practice? Fundamental points include:

1. Definition of the power, roles, responsibilities and respect of area of activity
2. Transparency and communication
3. Preparation and leadership of board members
4. Management skills

POWER, ROLES, RESPONSIBILITIES, AND RESPECT:

In a co-operative with various stakeholders, it is vital that everyone understands clearly the role and expectations of each stakeholder. For instance, taking time to read and understand the co-operative by-laws is very relevant, but do we consider such activity as compulsory for new board members? The elected members must understand their role when they are sitting on the board – one of common interest rather the personal interest tied to their member category.

The MSC board is not a negotiation table for specific concerns of a group of members. Instead, the board must focus strategically on the overall best interest of the co-operative (common interest).

For example, the person or the group of persons representing worker members could share with the board the sensitivity of this group of members during a discussion on co-operative finance, but it is not an occasion to engage a discussion on wage or salary of the staff. For user members, the same principle applies: the board is not the place to fight for the price of services offered by the co-operative.

¹⁵ <http://slowdemocracy.org/slow-democracy-resources/>

¹⁶ Münkner, op. cit.

¹⁷ This section is mainly based on a master essay of 3 students on the governance of MSC in Quebec (under the name, solidarity co-operative): Tremblay, Andrée-Anne, Hadjia Saidou Kindo Indatou and Maria Cécilia Zuluaga (2007): "La bonne gouvernance dans les coopératives de solidarité", Sherbrooke, IRECUS, Université de Sherbrooke
http://www.usherbrooke.ca/irecus/fileadmin/sites/irecus/documents/essais/tremblay__indatou__zuluaga_essai.pdf

TRANSPARENCY AND COMMUNICATION:

Dealing with various interests and various stakeholders requires transparency in the decision making process to avoid tension and distrust. The board and the executive director (ED) must be as clear as possible in their decision making process. Interconnected with this notion of transparency is communication. The challenge is to share relevant information versus overdosing through various communication channels which will generate lack of interest from members. Some basic screening of the information that will be shared is probably necessary. And how does communication work? Communication must be two-way, bottom-up, top-down, and horizontal. One-way communication would be a dead end in a MSC. Since MSCs are very often connected not only with members but also with other non-member stakeholders, the communication must be internal and external. Today, with Internet resources, it is simpler than ever to share information and engage in dialogue.

PREPARATION AND LEADERSHIP OF THE BOARD:

In an MSC, the board plays a key role as a voice of member needs and expectations. In this sense, every member category must be represented at the board of directors. All board members need to be well prepared and supported in this essential role of member voice in the MSC framework, but also in all questions related to the co-op performance, and comprehension of the co-operative legal framework. As in all types of co-operatives, the MSC board is engaged in monitoring the executive director (ED) or CEO performance and their own board performance.

MANAGEMENT SKILLS:

The required management skills of the ED of a MSC are complex. Other than the basic skill to manage an organization, the ED must have a clear understanding of the membership base and appreciation for their various points of view. At the same time, they must develop the co-operative and ensure its long-term sustainability. If, in addition, an MSC is a multipurpose co-operative, it becomes even more complex. Unfortunately, there are very limited educational resources to train ED for such complex management challenges. What are the options? Other than following a specific training program, another approach is to be coached by a person like an ED of another MSC. Depending on the co-operative size, the ED must also make sure the other senior staff are aware of the specific nature of a MSC. A good way to learn in such complex organizations is from each other. Facilitating communication is a key skill of MSC's ED.

In summary

MSCs are relatively new in the co-operative legal landscape, but they are facing a bright future in dealing with important societal challenges, including social exclusion, the capacity to merge various resources for a superior interest, etc. There are various ways to conceive a MSC in terms of numbers of member categories, voting rights and other characteristics, but what they have in common is the presence of at least two types of members. Like any other business, MSCs must be economically viable but as highlighted in this chapter, their sustainability as a MSC is closely connected to the effectiveness of their governance.

Co-operative Governance and the Blueprint for a Co-operative Decade

The International Co-operative Alliance's Blueprint for a Co-operative Decade presents a global strategy for the co-operative movement in pursuit of a 2020 Vision. The three main objectives are to become the:

1. leaders in economic, environmental and social sustainability;
2. business model favoured by the people; and
3. fastest growing form of enterprise (Blueprint p.6).

To reach these objectives, the Blueprint identifies five interconnected themes (**participation, sustainability, identity, legal frameworks, and capital**) and suggests actions to be implemented across the co-operative movement in pursuit of the 2020 Vision.

The first theme discussed in the Blueprint is Participation, which includes the topic of governance. In particular, co-operatives are called upon to “elevate participation within membership and governance to a new level” (Blueprint p.8).

Co-operatives are a better way of doing business because they empower individuals through participation and ownership (Blueprint p.9). This makes them more engaging, more productive and more useful in the contemporary world. Democratic member participation is seen as one of the co-operative sector's most valuable resources, a source of competitive advantage, and a major part of what characterises a co-operative in contrast to investor-owned businesses.

“The individual member has a role to play in a co-operative which goes beyond the basic economic relationship of customer, worker or producer. Collectively members own their co-operative, and through democratic arrangements they participate in its governance. Individually they have a right to information, a voice, and representation.” The Blueprint uses the word “participation” as shorthand to refer to this bundle of rights.



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