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**EXTENSION**

# Aligning the Cooperative Board

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**Phil Kenkel**

Regents Professor and Bill Fitzwater Cooperative Chair

During the last 10 years, the job of a cooperative director has become more difficult. Cooperatives have become larger, more geographically diverse and complex and operate in much more volatile markets. All types of boards face increased scrutiny and accountability. The cooperative board of directors is charged with enhancing the long-term value of the cooperative, mitigating risks and constructively monitoring the CEO. Cooperative board members are required to spend more time in their roles and be even more involved. Despite the increased efforts, many boards wonder if they meet the expectations of members. In addition to effort and commitment, cooperative boards need a clear framework for continuous improvement. One such framework is the concept of board alignment.

Alignment is a relatively recent, but very useful framework for promoting improved board performance. The concept is often applied to corporate boards. In that context, it is often focused on whether the incentives of the board and CEO are aligned with the long-term interest of the shareholders. Director compensation is another topic, but it is safe to say the decisions and objectivity of cooperative directors are not typically influenced by their compensation package. While the alignment of financial incentives is not an issue for cooperatives, several dimensions of board alignment apply directly to cooperative firms.

The concept of alignment encompasses basic competencies and best practices, but also provides a framework for continuous improvement. Board alignment requires the board to be internally aligned. It must also be aligned with the overall strategy of the cooperative. The board must be aligned with the CEO. Finally, and most importantly, the board must be aligned with the long-term interest of the membership. While there are many commonalities among aligned boards, the process and outcomes of alignment are unique to culture, personalities and business environment of the cooperative. There are best practices for board operation but the ultimate test is the long-term success of the cooperative. Each element of board alignment is discussed in the following section.

**Organizational alignment occurs when strategy, goals, tactics and cultural values are mutually supportive and when the systems and people of an organization are linked and compatible with each other.**

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## Internal Alignment

Internal alignment begins with a sense of clarity on the roles of individual directors and the board as a whole. This begins with an understanding of director roles and responsibilities (a mainstay of director education programs) but also encompasses a culture of clear expectations for board members. Those expectations can guide the nominating committee in recruiting directors and create a blueprint for board evaluation. An internally aligned board has efficient processes and decision making. Board procedures should be fine tuned to reflect the current circumstances of the cooperative. Each board must craft a system that works for their board. The board must consider the frequency, format and length of board meetings. The board must prioritize its informational needs and have accurate and timely information while avoiding information overload. Operational information and budgets must be provided in a format the board can readily understand and compare with strategic goals. The board agenda and information packet must be distributed with sufficient lead time and directors must invest the time to be prepared for the meeting. Otherwise, valuable time is spent on clarifying irrelevant facts rather than important decisions.

Internal alignment also requires good team dynamics. Like any effective group, an effective board must be comprised of peers who respect and work well with each other. Boards are not natural teams. Group dynamics must be developed. In an aligned board, all of the members participate in the meetings and the debates. The board chairperson plays a key role in creating and maintaining a productive team culture in the board room. The board chair must be able to promote constructive debate, summarize and frame decisions. The chair must understand the importance of healthy debate. In today's environment, it is essential for the board to consider issues from various points of view. Boards are generally not held accountable for making the wrong decision but they can be liable for not giving enough consideration to a matter. While debate and even the perspective of a devil's advocate can be essential, the board chair must also be able to build consensus among board members.

## Barriers to Internal Alignment

There are numerous barriers to internal alignment, but two common areas are board politics and underperforming

directors. Board politics typically result from conflict between constituency groups. Those constituencies may relate to geographic districts, different farm operations (small versus large, crop versus livestock) or even different tenures on the board. In a national study of cooperative directors, the majority of directors reported conflicts between interest groups as an issue in their board room. Fortunately, they also indicated the conflict did not dominate board discussions. Cooperatives with board slots for geographic districts can be particularly susceptible to conflicts, resulting from misplaced loyalties. Conflict emerges when board members perceive their job as guarding the interests of their district instead of just communicating the unique perspective of their constituency. Aligned directors understand their job as board members is to vote in the best interest of the cooperative, even if the final outcome is not advantageous to their district.

**The two most common impediments to internal alignment are board politics and underperforming directors.**

Addressing the problem of an underperforming director is one of the most sensitive issues for internal alignment. In some cases it is productive to suggest additional training. For example, a director who is not contributing to monitoring finances or risk management may become engaged once their comfort level with the subject increases. In other cases, an over-extended director may have to be asked to trim other time commitments. There is no easy way to ask an underperforming director to resign, but the board chair is typically the best person to address the issue. In an aligned board, directors are committed to performing at their full potential and have the courage and self-confidence to address their educational needs. They must also have the courage to give and accept constructive feedback on personal effectiveness.

The description of the internally aligned board is not complete without discussing board composition. The single most important factor in determining board effectiveness is the skill and dedication of the directors. Effective, internally aligned boards have the “right people on the bus.” Internal alignment requires a balanced combination of experience, financial expertise and diversity of perspectives. While continuity is important, a degree of turnover on the board helps to maintain a fresh perspective. Boards composed of directors with long tenures often fall prey to group thinking and have reduced objectivity in questioning the decisions and opinions of the CEO or board chair. The cooperative board room needs different perspectives. Imagine a soccer team with 12 goal keepers. It wouldn't allow many goals, but it also wouldn't score any goals.

The challenge of recruiting and retaining talented directors is complicated by the significant time and work commitment

**Too many cooperatives rely on term limits to remove the underperforming director. If a board member has no interest in or no potential for performing well in the board role, it is time to encourage, and eventually insist that they step down.**

of board service and by the cooperative culture of modest or even trivial director compensation. Board selection is a member responsibility. Nevertheless, successful cooperatives must develop the culture and procedures to ensure multiple quality candidates for each open board seat. Some cooperatives have established associate board member positions. The associate board members participate in board discussions but do not vote. The associate board can be a vehicle for recruiting and grooming board members. New directors receive a comprehensive orientation. The orientation should be structured to enable new directors to gain an understanding of the cooperative's operations and its risk profile.

## **Alignment with the Cooperative's Strategy**

The board of directors also must be aligned with the cooperative's strategy. Board members who are not aligned over strategy typically retreat to just a monitoring role. Poor strategic alignment hampers the board's ability to prioritize issues. The board of directors is charged with guiding the cooperative's strategy to achieve long-term value creation for the member-owners. While strategic planning is a board function, strategy is often proposed by the CEO. It is then developed through an interactive dialog with the board. As part of the dialog, the board must consider whether the cooperative has the financial and human resources to implement the strategy. The board should not only be involved in formulating the strategic plan, but should also be a strategic adviser to the CEO on continual basis.

An aligned board has clarity in regard to the cooperative's strategy. This allows the board to establish priorities and to balance board meeting time between monitoring past performance and analyzing changing conditions impacting future strategy. In an aligned board there is not just a consensus on strategy; the directors actively own the goals. Strategic alignment helps the board through decisions involving capital expenditures, acquisitions and divestitures. Directing a cooperative is a continuous balancing act. Upgrading infrastructure comes at the cost of reduced cash patronage or delayed equity retirement. An aligned board has a vision for the cooperative guiding them through those decisions.

**A good test for strategic alignment is to poll the board mid-year about the number one priority for the cooperative. If there are five different answers, the board is not strategically aligned.**

Strategic alignment also involves congruence over risk management. The board's role in risk management is one informed oversight. The board must not be involved in the day-to-day risk management activities but should debate and develop a shared vision for the cooperative's risk appetite. There are numerous methods of estimating or quantifying risks. The board can compare that risk to the cooperative's financial reserves, borrowing capacity or the portion of member equity that could be lost. Ultimately, the risk appetite is a philosophy. The board must be comfortable that they are prepared for all reasonably likely outcomes. They can then satisfy themselves that risk management processes are in place to control risk exposure within their capacity to absorb losses.

Management succession is another important aspect of the strategic vision. The succession of the CEO and key staff

has become a critical governance topic for most cooperatives. In general, the time and effort devoted by the board to the succession of the cooperative's senior leaders is inadequate. While no uniform procedures for succession planning exist, it should be a top priority to address on a regular rather than ad hoc basis. Boards should be involved in identifying talented leaders and developing an expanded pipeline of qualified internal and external candidates. The board must be aligned in their vision for the CEO position and their philosophy toward hiring from within or reloading with external talent. Although succession planning can be a sensitive topic, succession planning should be integrated into the strategic planning process. Bringing succession planning to the planning agenda should not depend on the CEO's initiative. It is a responsibility of the aligned board.

## Alignment with the CEO

Getting the relationship with the CEO right is the first, and perhaps the second and third most challenging issue for the cooperative board of directors. The board must ask the right questions, challenge assumptions and demand the flow of information to the board to ensure a thorough understanding of the cooperative. At the same time, the board must restrict its efforts to its fundamental role of oversight and not preempt the CEO's responsibility for running the cooperative. A board who interferes or micromanages undermines the effectiveness of the CEO and also makes it difficult to hold the CEO responsible for results. On the other hand, a board detached from the cooperatives operations risks abdicating its governance role. Achieving the right balance is critically important.

In an aligned board there is a partnership between the board and CEO. As easy as that sounds, there are a number of inherent challenges to an effective partnership. The board and CEO have somewhat different time perspectives. The board has a long range perspective, while the CEO focuses on day-to-day issues, keeping the future in view. The board devotes substantial, but still limited, time to the cooperative's affairs, while the CEO devotes continuous attention. Board members have extensive knowledge and experience as producers but their knowledge about the cooperative is primarily based on the information provided by the CEO. The board is a deliberating body who reach consensus decisions after discussion and debate. The CEO makes individual decisions, often on a short time frame. These are not impediments to an effective partnership, yet they are realities that must be considered.

No board engages or retains a CEO without great confidence in the person and high expectations for performance. An effective and enduring partnership is created by communication and adjustments on both sides. For example, the board provides feedback on matters about which it expected to be consulted on and matters it expects to be informed on. The CEO adjusts his/her decision process and information flow. The CEO might then provide information on the current business environment and operating performance. That board can then adjust their advice toward strategies designed to survive the short term or longer term issues, such as infrastructure and equity management. Board and CEO alignment comes from well-defined roles, mutual respect and excellent communication. As with many issues, it is easier to develop these elements during periods of relative calm. It is, therefore, essential for the board to continuously focus on improving the Board/CEO partnership.

## Alignment with the Members' Long-Term Interest

Perhaps the most nebulous dimension of the aligned board is alignment with the long-term interest of the membership. Boards must make a number of inter-related decisions on cash patronage, retaining funds through allocated and unallocated equity, investing in infrastructure and retiring previously issued equity. These decisions create the alignment challenges. A board that fails to retain adequate reserves and reinvest in infrastructure is out of alignment since they are not protecting the long-term stability of the cooperative. Conversely, a board that creates excessive unallocated reserves may not be aligned because they have not considered the member's long-term return. Long equity revolving periods create alignment issues. At 8 percent interest, a stock refund that will not be redeemed for 30 years has a present value of 10 cents on the dollar. The common practice of issuing qualified stock refunds (taxable to the member when issued) instead of non-qualified stock refunds (taxable to the member when redeemed) also is an alignment issue. The historical justification for issuing qualified stock refunds was that the member's marginal tax rate was lower than that of the cooperative corporation. It is no longer clear that qualified stock maximizes the member's long term after tax return.

**Aligning the cooperative with member interest involves aligning assets with the core membership needs, maximizing profits through efficient operation, managing the balance sheet for liquidity, solvency and adequate reserves, then distributing all residual cash to member owner as cash patronage and equity retirement.**

A number of metrics and tools can guide toward alignment with member interests. The board should monitor the cooperatives return on assets and return on equity and other measures of profitability and efficiency. Goals for solvency and liquidity should be set during strategic planning sessions. Decision aids such as the "Goodman Formula Calculator" (available at [www.agecon.okstate.edu/coops](http://www.agecon.okstate.edu/coops)) can be used to determine the profit level required for various combinations of asset growth and equity revolving periods. Enterprise risk management can be used to evaluate the cooperative's risk exposure and set goals for adequate risk capacity. Consultants and cooperative specialists at land-grant universities can help model the cash flow and the member return implications of alternative equity management programs. The board should have a set of financial tools at their disposal.

## Creating the Aligned Board

Complete board alignment is a goal that provides the incentive for continuous improvement. There is not a simple set of practices that creates the aligned board, but a number of factors contribute. Education is an obvious component. New directors should receive a comprehensive orientation that allows them to understand their duties, roles and responsibilities. The orientation should also help them understand the cooperative's operations and its risk profile. The education process should not end there, but rather be a continuous commitment.

Boards need educational programs on a wide range of topics. Some of the major categories are governance, strategy and finance. Education on risk management and CEO succession planning has recently come to the forefront. A wide range of educational programs are available from regional cooperatives, state cooperative councils, land-grant universities and other organizations. Each board can customize their educational efforts. Non-traditional approaches such as case studies, educational tours and team building can be effective.

The relationship or “chemistry” between the board chair and CEO is a major contributor to the Board-CEO alignment. The board chair can be thought of as the gatekeeper for the board while the CEO is the gatekeeper for the staff and operational issues. Both leaders need to cultivate a partnership. The chair can serve as a sounding board for the CEO concerning emerging issues and courses of action. The chair can create a buffer for the CEO, making sure that tough questions are put forth in a constructive rather than conformational format. The CEO can provide the chair with insights on the business environment and policy and strategic issues that may need the board's attention. Informal meetings, outside of regular board meetings give time for both the chair and CEO to reflect on issues before framing the concerns for board deliberation.

The chair and CEO also need to work together in establishing meeting agendas. This will assure there's sufficient meeting time to discuss and resolve strategic issues as well as monitoring operational results. Boards are now expected to devote greater attention to internal controls, risk management oversight and other emerging issues. However, most cooperative boards still meet only 10 to 12 times per year. It is critical that the board prioritizes their activities and manage their time efficiently

Effective communication helps to align the board with member interests. Member communication is an important, but often overlooked duty of the cooperative board. This board responsibility is unique to the cooperative business model. Member control is an essential cooperative principal. In order to exercise control, cooperative members must be informed about the operating environment and decisions facing the cooperative. Members must understand the cooperative's performance to judge the board's decisions. Informed members are able to provide feedback to the board of directors. Their ultimate feedback is through their vote in the board election process.

Direct contact should continue to be a mainstay of director-member communication. However, as the cooperative membership becomes more diverse, the board should develop multiple communication channels. Newsletter articles (both print and electronic), a director comment section on the website (perhaps even a blog where comments can be obtained) and regional listening sessions can all be effective vehicles to inform members and invite feedback. Cooperatives are increasingly exploring social media and those technologies are uniquely positioned for two-way communication. Many younger producers who would not express opinions to a board member will respond to a blog, Tweet or Facebook posting.

The board needs diverse vehicles to disseminate information to all target audiences within a cooperative.

A final contributor to board alignment is board evaluation. Only a minority of cooperative boards systematically evaluate their own performance. The majority of boards that have implemented evaluations are pleased with the impact of the process. Board evaluations typically begin with directors rating overall board performance. The evaluation can be expanded to the directors rating their individual performance. Some professionals advocate eventually including peer-to-peer evaluation. That level of evaluation can be problematic unless the directors have the comfort level to give and accept constructive feedback on personal effectiveness.

The best practice is to start small and gradually build up the effort. A good starting point is to evaluate the board's internal alignment and processes. Directors can rate the overall board performance in meeting preparation, information availability, meeting format, decision making, group dynamics, goal setting and other dimensions of board activity. Over time, the evaluation process can be expanded to consider the full spectrum of board alignment. Boards can design their own process or call on outside expertise. There are a multitude of consultants ready and willing to guide boards through the evaluation process and there can be benefits to working with an outside facilitator. However, it is important to choose a facilitator who has a proven track record of working with cooperative or similar boards. A generic checklist may ultimately prove to be a waste of the board's time.

The board evaluation process can help fine tune the board meeting process and build team dynamics. Evaluation results can also be used to set priorities for education and development. An ongoing evaluation process provides a subtle check against underperforming directors. Boards with an effective self-evaluation process in place also report they are more comfortable evaluating the CEO. The real value of the evaluation process is derived when the results are presented and they discuss what measures to act upon. If the board is not directly engaged in the feedback and action process, it is not enlightening.

**Good boards are made up of accomplished leaders who value continuous improvement. Those directors work to find ways to make a good board better!**

## Summary

The board of director's is elected by the membership to assure that their long-term interests are being served. Meeting this responsibility requires highly accomplished individuals and a high performing team. As board members draw from their knowledge and skills to represent the members' interest, they also should apply those skills to professionally manage the board. The concept of board alignment provides the framework for continuous improvement. Board alignment should be a conscious strategic initiative for every cooperative board.

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