

WHAT

CO-OP



DIRECTORS



DO



PREFACE

This publication is part of a series designed to visually present basic information about cooperatives. Illustrations have been created for easy conversion to 35mm slides or overhead transparencies.

The series was written by Gene Ingalsbe, former director of information for USDA's Agricultural Cooperative Service, now retired. The series consolidates and updates an initial group of highly illustrated publications developed by C. H. Kirkman, Jr., former cooperative education specialist, now retired. Series content covers what a cooperative is and how one is organized, what functions cooperatives perform, and what are the responsibilities of key participants — members, employees, the manager, and directors.

This publication focuses on the board of directors. It covers characteristics members should consider in choosing a director to represent them, alternatives for nominating and electing directors, and functions and responsibilities of directors.

Cooperative Information Report 14
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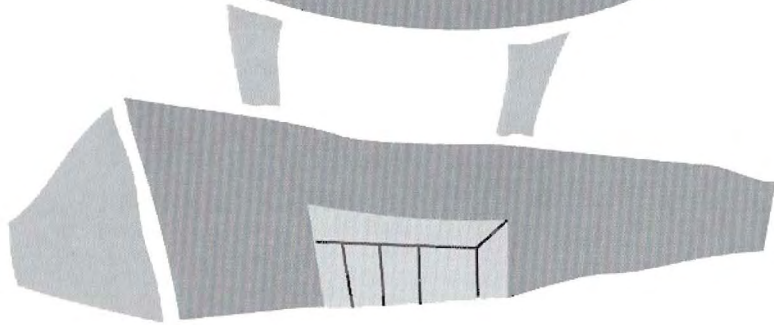
Consolidates and supersedes CIR 14,
What Co-op Directors Do and CIR 15,
Measuring Co-op Directors.

WHAT

CO-OP



DIRECTORS



DO

THE CO-OP BOARD OF DIRECTORS



Cooperatives usually have too many owners for all of them to participate often in helping make business decisions. So the owners elect a few people who they feel can best make most decisions for them. This leadership group is called the board of directors.

The board of directors, most importantly, functions to direct the business affairs of the cooperative. It is the cooperative's central decision center. In carrying out this responsibility, however, the board performs several important supporting roles. It is a listening post, hearing from management and membership. It is a communications hub, imparting information between members and management. It is an advisory body to members and management, providing recommendations and guidance. But in every role and action, the board is accountable to members.

The cooperative's bylaws determine the nature and composition of the board through written provisions describing director eligibility, method of selection, term of office, and board organization. A typical board will have seven to nine members. To function in an organized manner, directors elect from among themselves a chairman, vice chairman, secretary, and treasurer. These officers are sometimes designated as the executive committee, which in larger boards may include one or more additional directors. Other board committees may be formed to assign oversight of particularly important aspects of the cooperative, such as finance or member and public relations.

Meetings are held on a set frequency, often monthly, with pre-determined dates desirable. An agenda is developed. Minutes are kept. A nominal amount of compensation may be provided, usually to cover directors' expenses to attend board meetings.


The following pages present additional information on: (1) who makes a good director; (2) how directors are selected; and (3) what directors do.



LISTENS
INFORMS
ADVISES

PART I

WHO



**MAKES A
GOOD DIRECTOR**

SELECTING A DIRECTOR

Selecting good directors is perhaps co-op members' most important ownership responsibility. Their decision may determine how effectively the cooperative contributes to the profitability of their farm or other business.

When considering an individual for the cooperative's board, a member might ponder the answers to several questions. Would I be comfortable having this individual make personal business decisions for me? Does the individual demonstrate the ability to think through a problem independent of others? Would this person place the best interests of the cooperative above personal interests or special interest groups? Does this person demonstrate leadership qualities? Would this person as director enhance the cooperative's image? Is the person respected in the community?

Does the potential director appear to keep up with current events, particularly in agriculture and the sectors in which the cooperative is involved? Would this person be a vigorous and effective promoter of the cooperative? Would this potential director be vigilant in keeping the cooperative oriented to serving members' best interests?

While a "yes" answer to these questions shapes the underlying characteristics of a good director, other more tangible and specific qualities need to be present.

A GOOD DIRECTOR SHOULD BE ABLE TO:

MAKE GOOD

BUSINESS

DECISIONS

ENHANCE
CO-OP'S IMAGE



THINK
INDEPENDENTLY



PLACE
CO-OP'S
INTERESTS FIRST



PROMOTE
CO-OP



SHOW
LEADERSHIP



ENSURE
SERVES MEMBERS



SELECTING A DIRECTOR, continued





A good potential director uses the cooperative's products and services fully. Just doing so makes a visible statement of belief in the value of cooperative effort. Further, maximum use gives the member first-hand, cutting edge knowledge about the cooperative's services, which provides a sound basis for directing change. Maximum personal support also enables the member to be an effective director in seeking new members and encouraging present members to increase their patronage.

Members demonstrating a genuine interest in the cooperative's performance have a quality needed to be a good director. Instead of just complaining to others, or "voting with their feet" by trading somewhere else, they seek answers to their concerns from their director or the manager. They realize that ultimately cooperative performance is their responsibility.

Members who participate regularly in decisionmaking exhibit a key director quality. They attend meetings and express their views. They volunteer or accept requests to serve on committees, or to represent the cooperative. They vote regularly on issues presented to them. They encourage others to help the cooperative better serve members' needs.

A POTENTIAL DIRECTOR . . .

U S E S T H E  F U L L Y



IS INTERESTED IN ITS
PERFORMANCE



PART  C  PATES  N DEC  S  ON-MAK  NG

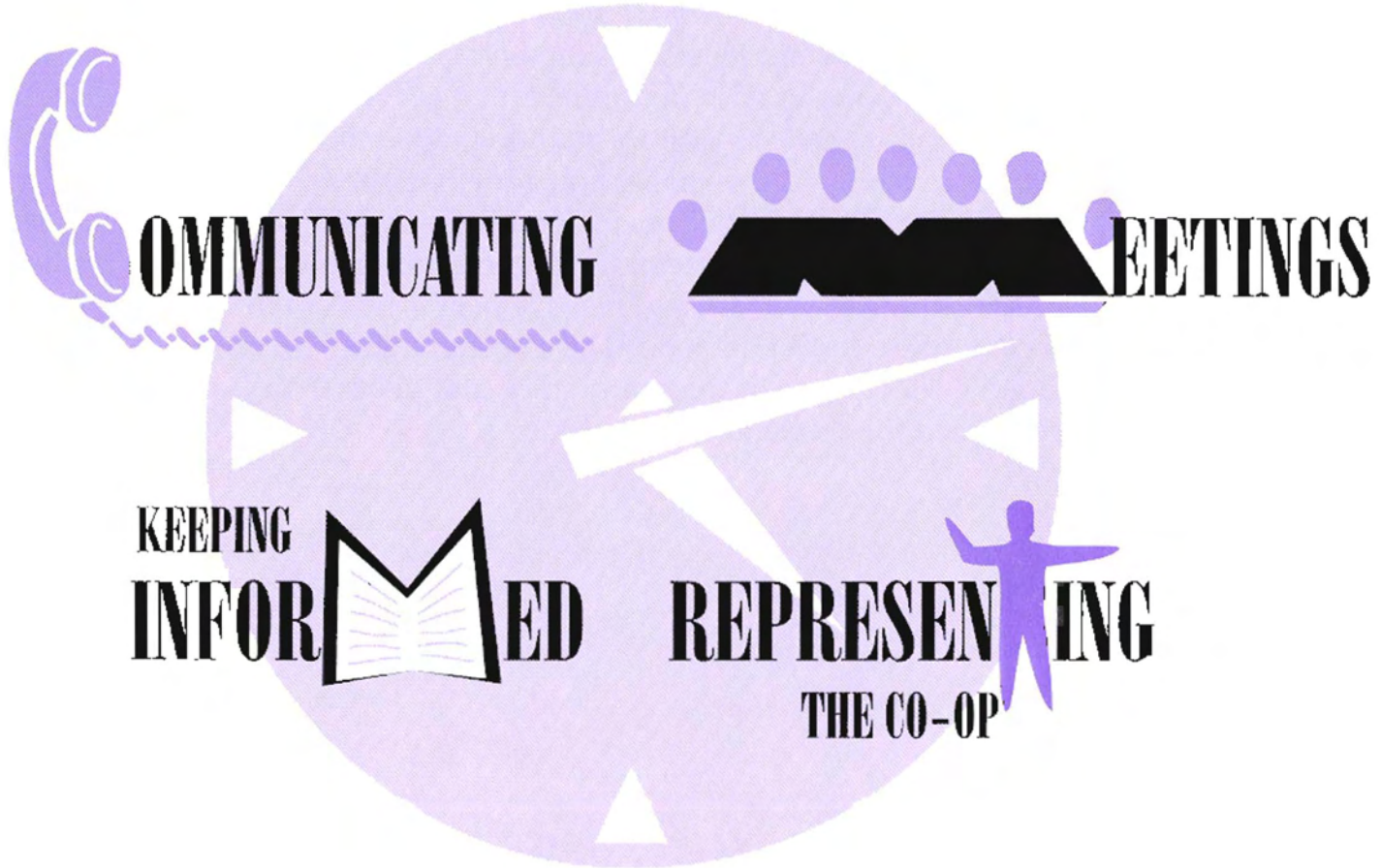
SELECTING A DIRECTOR, continued

Serving on the board of directors can take a lot of time. So persons being considered for the board must have the time to serve, or express a willingness to make time to carry out the formal — and informal — duties of a director.

Typically, documented time for official cooperative business — travel to and from meetings, meeting time, and committee work — may be only 1 or 2 days per month. But it is unaccounted time that can add up. Directors may spend time writing letters, or writing and giving talks. They read materials to prepare for meetings, or just to become better informed. Self-directed or formal training to be a better director takes time. Directors get phone calls from members, or questions whenever or wherever they meet. With every visit to the cooperative, the director is vulnerable to “take a minute or two” to consider an issue or some aspect of the cooperative’s activities.

Directors are often asked to represent the cooperative at community events, and perhaps to take leadership roles in community organizations in behalf of the cooperative. Particularly in larger cooperatives, they are periodically asked to visit State and Federal legislators. Often, cooperative-related time will be at the expense of the director’s farm-business or personal time.

A GOOD DIRECTOR HAS TIME FOR:



SELECTING A DIRECTOR, continued

Some people seem to have a knack for picking up information, piecing facts together, being right on target with their views, and well known for having something worthwhile to say. Chances are they are good conversationalists, but with a keen ability to listen. They demonstrate a talent for expressing their views in a clear and well organized fashion. Look for these attributes in selecting a director. A key requirement for a good director is to establish two-way communications with the manager, other directors, and members.

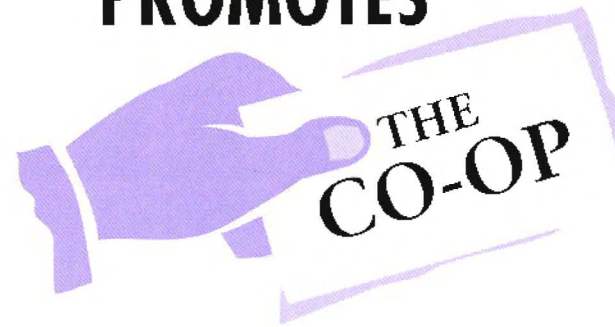
Needed actions to maintain the vitality and growth of the cooperative aren't always readily apparent at the time decisions must be made. And some decisions may be unpopular to a sizable segment of the membership. Directors with good communications skills are needed to clearly present the rationale for board and management actions to the membership.

As a good communicator, a director can be a powerful force for strengthening member support, promoting the cooperative in the community, and in other ways influencing the business environment in which the cooperative operates.

A GOOD COMMUNICATOR:

STRENGTHENS MEMBER SUPPORT

PROMOTES



SELECTING A DIRECTOR, *continued*



unique business judgment is needed by directors of a cooperative. As members, they run a profit-oriented business as a sole proprietorship, a family partnership, or in a few cases a family corporation. As directors of a cooperative, they are responsible for a service-oriented business owned by hundreds of producers.

Fundamental business principles, such as adequate capitalization, sufficient cash flow, operating efficiency, and quality control, still apply. But the new application of business judgment comes from the special relationship between member and cooperative. Decisions must be sound and beneficial from the standpoint of both, rather than at the expense of one. And rather than gaining approval by discussion at the family dinner table, the directors must have the support of a majority of many owners. Thus, decisions must attempt to strike a balance in addressing needs of members, whether they own large or small, general or specialized operations.

Whether a member has sound business judgment may be difficult to determine. Farm or other business size alone may not be a valid indication, nor the member with the newest equipment or freshly painted buildings. A better barometer, perhaps, is the member who, over time, seems to be making the most with available resources and is known to be a solid thinker. Members with relevant college degrees or other business experience could bring a special expertise to the board.

A DIRECTOR SHOULD HAVE:

GOOD

BUSINESS

JUDGMENT

SELECTING A DIRECTOR, continued

Pointing to the need for honesty and trustworthiness in directors should not even have to be mentioned. But it is important to point out news media reports to the contrary in the business world. At the extreme are examples of dishonest or illegal acts that have caused businesses to fail. Short of that extreme are instances in which actions of officers of a company cost the owners a great deal of money, either from business transactions or subsequent legal actions.

A director should have good personal traits and exhibit even temperament. Nothing is more disruptive than an emotional outburst in a board meeting. Thin skins and quick tempers don't make good directors. Rather, the member who demonstrates an ability to get along with other people has a quality needed in a director. In assessing all the qualifications a member exhibits, an important final question to resolve is: Will this member's personality mesh with those of other directors and the manager?

Members should choose a director with the kind of personal character they are comfortable with as the representative of the cooperative and, in some respects, with each of them personally—on any occasion or in any situation.

A POTENTIAL DIRECTOR:



the ability
to get **along**
with **others**

SELECTING A DIRECTOR, continued



Members who are involved in community activities are potentially good directors. They may belong to civic, church, and school organizations; participate in fund raisers or community booster projects; or be involved in another business, even perhaps a cooperative. They may be active in organizations extending outside of the community, such as commodity trade associations, farm organizations, and academic and professional clubs.

Their suitability and capability to be a director would be even stronger if they are serving, or had served, in a leadership role in these activities.

Such involvement gives the director a wealth of information sources and personal contacts who could be valuable in many situations. Further, the director would have a broader understanding of the personal and institutional relationships that make up a community. Such a background gives the director a perspective to help direct the cooperative's operations within the larger context of its community and business environment.

A POTENTIAL DIRECTOR IS KNOWN FOR:

I **N** **V** **O** **L** **V** **E** **M** **E** **N** **T**
IN THE **C** **O** **M** **M** **U** **N** **I** **T** **Y**



PART II

HOW



**ARE DIRECTORS
SELECTED**





SELECTION METHODS

Director selection methods can vary according to the cooperative's size, structure, and function. A method that works well for a small local-area centralized cooperative may not be suitable for a large federation of local or regional cooperatives disbursed regionally or nationally.

Larger organizations must be more attentive to equal or equitable representation when deciding on selection methods and voting rights. Cooperatives' democratic control principle has been interpreted most commonly to mean equal voting rights, yet the principle does not preclude using proportional voting to achieve equability in serving members.

Selection methods under normal circumstances are presented here. Not covered are situations requiring the filling of an unexpired term, or when mergers and consolidations occur.

Usually, but not always, the cooperative's bylaws provide guidance on how directors are to be selected. State statutes may contain provisions related to director selection.

The nominating committee is presented as the preferred method, although valid rationales exist for alternatives.

SELECTION METHODS CONSIDER:

EQUAL OR **EQUITABLE**

DEMOCRATIC OR **PROPORTIONAL**

SELECTION METHODS, continued



any cooperatives elect directors “at large,” meaning the entire membership can vote directly to fill each director position, and each director represents the entire membership. As a cooperative grows, or the composition of its membership changes, or it combines with one or more other cooperatives, the “at-large” method may become impractical.

A cooperative then must develop a different system to produce equitable representation of the membership. One method is to divide the cooperative’s territory into geographical districts with nearly equal membership numbers. Another is to establish roughly equal territories based on volume of member business. Some cooperatives may establish districts along major commodity lines. A few large cooperatives have provisions for a public “at-large” director who can contribute a special expertise, such as an agricultural economist, a lawyer, or a financial or governmental affairs specialist.

DIRECTORS MAY BE SELECTED BY:

GE  GRAPHY

BUSINESS  LUME

COMM  DITY

PERS  ONAL EXPERTISE

SELECTION METHODS, continued

The making of an effective board of directors begins with the proper use of a nominating committee. This small committee, typically three to five persons, can exert significant influence on director selection even though most cooperatives' bylaws provide for nominations from the floor.

How the nominating committee is selected can vary. Bylaws may determine the procedure. Additionally, a handbook describing the duties of the nominating committee would be helpful. The committee may be appointed by the board chairman, or elected by the membership.

Regardless of method, the members need to be familiar with director qualifications, the articles and bylaws, and leading candidates among the membership. Directors, hired management, or staff should not serve on the committee. However, former directors have the experience to be good committee members.

Through personal contact, nominating committee members ask potential candidates whether they are interested in serving on the board and also determine if they meet the qualifications specified in the bylaws. A biographical sketch of each candidate should be developed and made available to the membership before the election. An ideal slate offers at least two candidates for each position, thus giving members a choice.

Some cooperatives may have such a large membership or be so widely scattered that district member caucuses may be needed to nominate candidates. In some cases, members nominate candidates through mail balloting, with the two candidates receiving the highest number of nominations becoming part of the official slate.

TO IDENTIFY POTENTIAL DIRECTORS . . .

A  **NOMINATING**

COMMITTEE
IS HELPFUL

PART III

WHAT



**DIRECTORS
DO**



RESPONSIBILITY CHARACTERISTICS

Understanding the difference between manager and director roles is a key requirement for board effectiveness and harmony, and the roles in a cooperative are unique among businesses. That uniqueness centers on the employee-only status of the manager in a cooperative, compared to the manager in other businesses typically sharing in ownership. In a cooperative, the manager is seldom a member of the board. A more decisive difference exists between the director and manager roles and responsibilities.

Directors maintain a longer term and more strategic perspective. They are concerned with how the cooperative can better serve members' needs and what general changes may be necessary in organizational and operating policies. The manager is action and tactical oriented in running the day-to-day operations in response to the goals and objectives set by the board. Members delegate direct control of the cooperative to the board of directors, who in turn delegate daily operational control to the manager.

DIVISION OF RESPONSIBILITY



 A purple lightbulb icon with rays emanating from it, positioned to the left of the text.
LONG-RUN
DECISIONS

 A purple classical column icon, positioned to the left of the text.
IDEA
DECISIONS

PRIMARY
CONTROL



 A purple stopwatch icon, positioned to the left of the text.
SHORT-RUN
DECISIONS

 A purple graphic of a road with dashed lines receding into the distance, positioned to the left of the text.
ACTION
DECISIONS

 A purple steering wheel icon, positioned to the left of the text.
OPERATIONS
CONTROL

PRESERVE CHARACTER

P reserving the cooperative character would seem to be an easy responsibility for directors. Each State has at least one statute that describes the principles and practices a business must follow to be regarded a cooperative. Federal laws also have requirements specific to cooperatives related to government programs, antitrust, and taxation. Additionally, the cooperative's articles of incorporation and bylaws state what the cooperative is and how it must operate. Directors can be held legally liable as individuals for violating these laws and regulations.

However, a subtle but very real threat to the cooperative character can develop over time. Management and board philosophy can drift from the cooperative's formerly adopted mission or by losing touch with members' changing needs. Without continual education of the key participants — manager and staff, directors, and members — the cooperative character, except that defined by law, can slip away with perhaps not even a whimper of protest and become regarded the same as any other business.

DIRECTORS . . .

STAY WITHIN THE

LAW **W** **S** **BY-LAWS**

AND THE

CO-OP **SPIRIT**

SAFEGUARD ASSETS

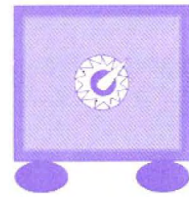


Members invest money in a cooperative with expectations of some kind of beneficial return, whether it is in the form of fulfilling a need, increasing income, or otherwise contributing to an enhanced quality of life.

They entrust the board of directors to make sound business decisions that not only protects their investment but also increases the value in terms of producing benefits. Directors are held accountable for both their actions and those of hired management. The board is responsible for equitably distributing benefits, often among a diverse membership. In doing so, directors must judiciously weigh the needs of the cooperative as a business and the requirement to return benefits to member owners.

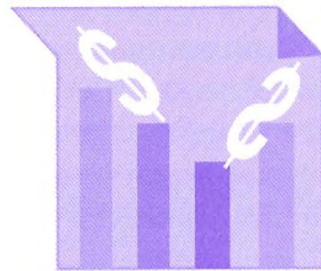
Such critical financial decisions demand independent review. Therefore, the board is responsible for retaining an outside and independent individual or firm to audit the cooperative's financial decisions and records each year. The annual report to members documents the results of that audit.

DIRECTORS . . .



protect assets

make sound decisions



hire auditors yearly



HIRE MANAGER

The single most important decision the board of directors makes that can determine the success or failure of the cooperative is hiring the manager. And among the more difficult board decisions is deciding to fire the manager for unacceptable performance. Finding the right manager takes a diligent search and objective appraisal of candidates' qualifications. Beyond business education and experience, the board looks for characteristics of leadership, compatibility of attitudes and goals, and knowledge of the uniqueness of the cooperative.

The board delegates control of the cooperative's day-to-day operations to the manager, including the freedom to hire and fire staff, develop business plans, make financial decisions, sign contracts, and represent the cooperative in business and community activities. The board provides direction, guidance, and control of the manager through bylaw provisions, written policies, budgeting, strategic planning, reporting requirements, and performance accountability.

A written job description, personal performance criteria, and clearly stated and achievable business objectives provide the basis for the board to conduct an annual review of the manager's performance.

The performance review process provides the board an opportunity to discuss the manager's strengths and weaknesses. A successful session produces ways to improve performance, including an agreement on what is expected of the manager during the coming year.

DIRECTORS . . .

HIRE,
DIRECT,
AND
APPRAISE
THE
MANAGER

SET POLICIES

A policy is a statement that provides guidelines for actions to attain the objectives of the cooperative, and reflects the cooperative's basic philosophy. It is the duty and responsibility of the board to originate and approve general policies that relate to functions the cooperative performs and how it conducts business. These policies cover all aspects of cooperative activities, internally and externally. They provide a basis for making consistent decisions that can minimize conflict and maximize equitability.

Policies may be broad in content, such as describing the desired role for the cooperative in the community; or quite specific, such as setting hours of operation and observed holidays.

Policies cover board and manager functions and relationships; member, employee, and public relations; organizational requirements; and operational activities such as credit, pricing, functions performed, purchasing, marketing, and services provided.

Policies should be written, approved with a board official's signature, and reviewed periodically — some at least once a year — to determine if they are still applicable or need to be updated.

DIRECTORS . . .



DISTRIBUTE BENEFITS



At the end of the business year, the cooperative's performance is recorded on a yearend statement of operations and balance sheet. The board of directors must then determine how the net income (or loss) will be distributed.

Several demands on net income must be considered. It is prudent business management to set aside a portion of the net income in a reserve fund, in case an unexpected event with adverse financial impact should occur. Cooperative principles require that benefits be returned to members on the basis of their patronage, but also that members must finance their cooperative on the basis of use. So the board must decide the percentage of the patronage refund to be paid to members in cash and how much they should reinvest to operate the cooperative. Federal tax law requires that at least 20 percent of the refund must be paid in cash.

Reinvested patronage refunds become the member's equity (ownership) in the cooperative. As new equity is accumulated, old equity is revolved back to the member. This is called equity redemption, and it is the board's responsibility to assess the financial strength of the cooperative and decide how much of the old equities can be paid back to members.

DIRECTORS . . .

DETERMINE



DISTRIBU**TION**

AND



REINVESTMENT



PLAN FUTURE

Directors are the ideal planners of the cooperative's future. As members, they know what needs the cooperative should strive to fulfill. As directors, they can provide leadership in developing the plans to meet those needs and see they are carried out.

The planning process begins with an assessment of the general business climate, both for the cooperative and for members and how that climate may change over the planning time period. Long-range planning considers organizational growth, either internally or through merger, in terms of business volume, membership, and territory served. Plans are developed for replacing or adding new facilities and equipment. Changes in products and services are considered. Financial and personnel requirements are estimated. Strategies are developed, timetables established, and progress review and evaluation points set.

Although planning for the cooperative's future is the responsibility of the board of directors, the actual planning process is carried out jointly with operating management. Larger cooperatives may even have a planning unit and involve substantial contributions to the plan itself from key staff members.

DIRECTORS . . .



ASSESS BUSINESS **CLIMATE**

DEVELOP  **LONG-RANGE** PLANS

EVALUATE THEMSELVES

Self evaluation can lead to self improvement, even when it occurs subconsciously without form or direction. However, persons — or groups — in positions of leadership need to make a conscious effort to evaluate their performance in an organized manner. A board of directors needs to go through a formal process each year to determine how well it fulfilled the cooperative's objectives.

Regardless of the format or system, the evaluation goal is to determine the individual strengths and weaknesses of directors in carrying out their duties and responsibilities and their effectiveness as a board. Performance elements range from those specific and measurable to those general and judgmental.

Performance that is specific and measurable can be determined as simply as with “yes” or “no” answers, dollar amounts, percent attained, or by other concrete evidence. Was an annual audit conducted? Did the board meet as planned? Was the manager evaluated? How well was the business plan carried out? Were policies reviewed? Was the long-range plan updated?

General and judgmental elements may be assessed only through the composite opinions of individual directors. How well did the board work with the manager? Were board meetings conducted harmoniously? Was the board dominated by the manager or the board chairman? Did directors place member interests above their own? Did the board focus on member needs?

In addition to looking at director and board performance related to the cooperative's business operations, performance needs to be assessed in terms of carrying out responsibilities to members and personal and business relationships in the community or territory in which the cooperative operates.

ANNUALLY, DIRECTORS DO A . . .

SELF-E**VALUATION:**

SPECIFIC &**MEASURABLE**

GENERAL & JUDGMENT**AL**

MORE INFORMATION



The Rural Business-Cooperative Service (RBS) of USDA Rural Development provides a wide range of assistance for cooperative directors.

RBS conducts research, collects statistics, provides onsite technical assistance, and develops educational materials. The RBS Cooperative Development Division helps farmers and other rural residents organize cooperatives and provides continuing assistance as needed. RBS develops both general and specific educational materials on cooperative organization and operation. Periodically, the staff conducts director workshops, particularly for directors of new cooperatives. RBS publishes a bimonthly magazine, *Rural Cooperatives*, oriented primarily toward managers and directors. A catalog, *Rural Cooperative Publications*, Cooperative Information Report (CIR) 4, lists about 150 titles about cooperatives. A few publications particularly valuable for directors are:

- Annual Audits — Board Responsibilities, CIR 41
- Cooperative Finance and Taxation, CIR 1, Section 9
- Cooperative Management, CIR 1, Section 8
- Director Liability in Agricultural Cooperatives, CIR 34
- Equity Redemption Guide, CIR 31
- Sample Policies for Cooperatives, CIR 39
- Tax Treatment of Cooperatives, CIR 23
- What Are Patronage Refunds? CIR 9
- Working With Financial Statements, CIR 43

**U.S. Department of Agriculture
Rural Business-Cooperative Service
1400 Independence Ave., SW, Stop 3257
Washington, D.C. 20250-3257**

Rural Business-Cooperative Service (RBS) provides research, management, and educational assistance to cooperatives to strengthen the economic position of farmers and other rural residents. It works directly with cooperative leaders and Federal and State agencies to improve organization, leadership, and operation of cooperatives and to give guidance to further development.

The cooperative segment of RBS (1) helps farmers and other rural residents develop cooperatives to obtain supplies and services at lower cost and to get better prices for products they sell; (2) advises rural residents on developing existing resources through cooperative action to enhance rural living; (3) helps cooperatives improve services and operating efficiency; (4) informs members, directors, employees, and the public on how cooperatives work and benefit their members and their communities; and (5) encourages international cooperative programs. RBS also publishes research and educational materials and issues Rural Cooperatives magazine.

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