University of Wisconsin Center for Cooperatives

The Cooperative Business Study

Summary Results

Brent Hueth and Anne Reynolds

July 1, 2014

University of Wisconsin–Extension

UNIVERSITY OF WISCONSIN–MADISON

Cooperative businesses perform a diverse range of economic functions in the U.S. economy, but unfortunately there is little systematic reporting on their governance and operations. While there are a multitude of textbooks and how-to guides for running sole-proprietor and investor-owned companies, it is difficult to find even a mention of cooperatives in standard college curricula on business ownership and management. The Cooperative Business Study is aimed at filling this gap. We hope that the results of our study will provide useful information to: cooperative practitioners seeking to learn how other cooperatives manage their affairs; educators and students seeking knowledge about business ownership; and legislators, analysts, and government officials responsible for programs and policies directed at business ownership.

Cooperative ownership presents a unique range of challenges to managers. Perhaps most important is the diversity of economic interests represented by member owners. Having a clear and measurable objective for performance would seem a prerequisite for effective management, yet cooperatives often struggle to aggregate members owners interests into a single measure. Also important is the dependence on member owners for board expertise and equity finance. From one perspective, this is a constraint limiting access to expertise and capital from outsiders. However, for managers seeking to benefit from cooperative ownership, these constraints can also be viewed as opportunities to engage member owners, and to encourage organizational loyalty. Our survey touches on these, and many other, topics that are critical to successful cooperative governance and management.

Methodology

Our research team conducted recorded phone interviews, typically lasting between 40-60 minutes, with the CEO and Board Chair from cooperative businesses in our sample. We interviewed each person separately as a reliability check on firm-level information, and to seek individual-specific (potentially complementary) perspectives on critical shared roles such as succession planning for the CEO, strategy setting, and budget control. For each individual, we collected information such as age, education level, tenure at the firm, and prior experience with cooperative businesses. Similarly, we collected background information about the business itself: age, reason for forming; current terms of membership; general description of membership classes; economic sector; and basic financial data. We also asked each CEO to send a hardcopy or electronic version of their current bylaws, membership agreement, and most recent annual report.

Subsequent questions asked survey respondents to describe specific governance practices at the firm and to assess some aspect of the other (paired) individual's activities. For example, we asked the CEO about board member preparedness for board meetings, and the Board Chair about the CEO's role in nominating new director candidates. Questions about relations between management and staff were best answered by the CEO (e.g., number of direct reports to CEO, and constraints on communication between board members and the management team), while questions about relations among board members were best answered by the Board Chair (e.g., communication among board members outside board meetings, and individual board members' motivations to participate on the Board). These responses provided complementary information on how the firm is governed and managed.

However, there were also instances where we sought potentially competing interpretations of how the firm is governed. For example, we asked to what extent does the Board or Management set strategy and how active is the Board in monitoring capital expenditure? For this type of query, we trained interviewers to ask open-ended questions, which were then coded qualitatively on a 1-5 scale by the interviewer. We developed a scoring system for each of these open-ended questions so that we could analyze large numbers of interviews.

Coverage

We selected firms into the CBS study population through a series of stratified random samples of the national census of cooperative firms developed in UWCC's project, Research on the Economic Impact of Cooperatives (http://www.reic.wisc.edu). Because this study focused on governance of cooperative businesses by an elected board external to the firm itself, we excluded worker owned and housing cooperatives from this study. Overall, our research team conducted 774 interviews of individuals representing 485 unique cooperative businesses. The following figure (Figure 1) summarizes sector coverage of firms in our sample which includes cooperative businesses in the agricultural, credit union, farm credit, grocery, healthcare, town-mutual insurance, and utility sectors. The "Other" sector includes a diverse group of cooperatives that did not fit into the larger sectors.

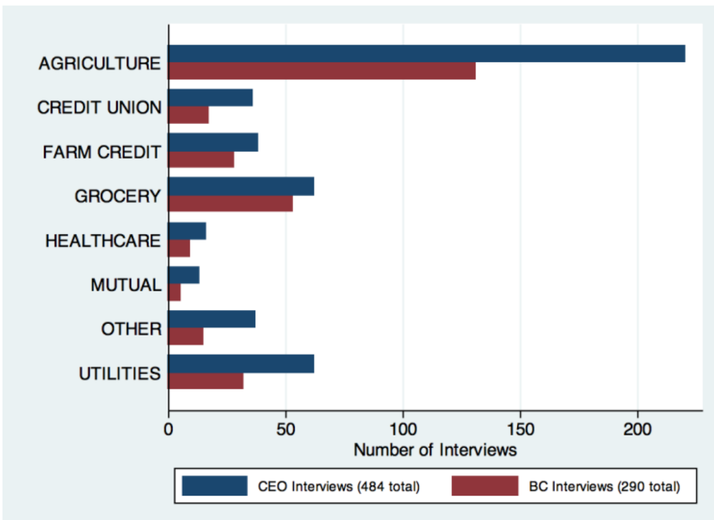

Figure 1. Survey Coverage.

Results Summary

For the purpose of this document, we summarize responses for a few select questions to provide a sense for the variety of practices observed across firms and economic sectors in our sample. In the final section, we provide a tentative explanation for some of the variation in practices that we observe. Figure 2 summarizes the size (measured by number of members) and firm-age distributions of firms in our sample. The shaded regions between the vertical lines associated with each sector account for over 50 percent of the data (the "inter-quartile range") with the solid line representing the median value, and the "whiskers" showing the extent of spread between the smaller (younger) and larger (older) firms as 1.5 times the 25th and 75th percentiles.

Cooperatives in the credit union and utility sectors have the greatest number of members and show the largest variation in size of organizations. These sectors include both very small and very large firms. Firms in the town-mutual and agricultural sectors are similar in median size and show relatively little variation in size. Cooperatives in the agriculture, farm credit, and mutual sectors have the longest history with many firms reporting more than 50 years of existence.

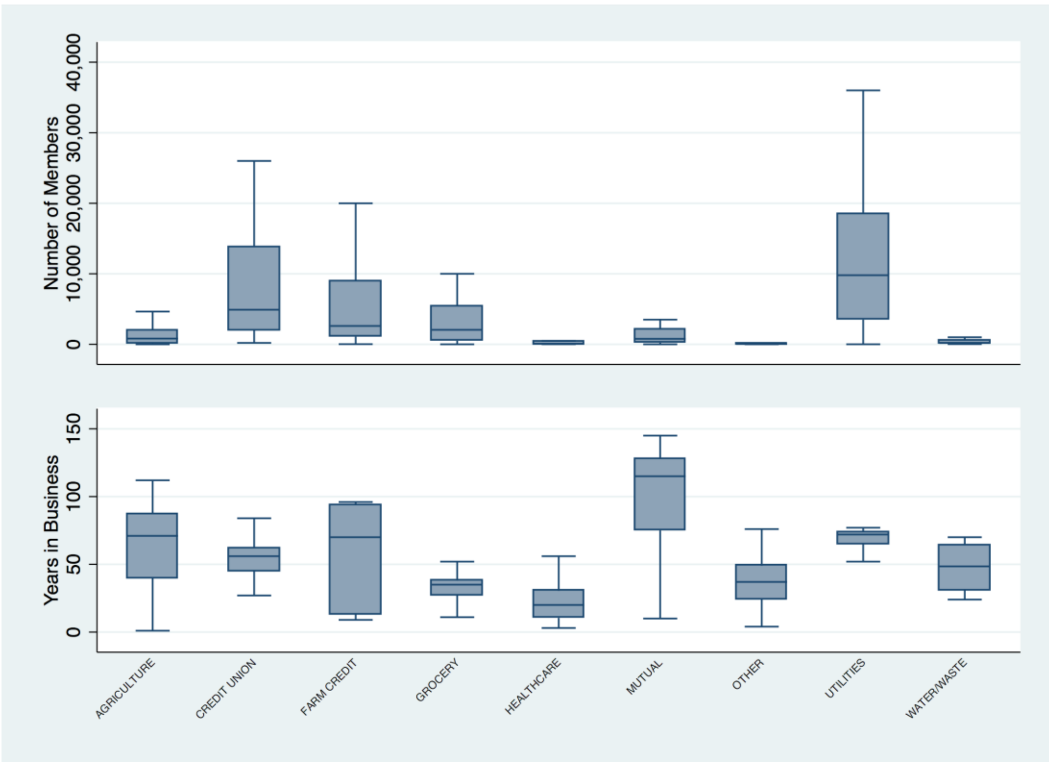

Figure 2. Average number of members and years in business.

Member Participation in Governance

In order to gauge member engagement as owners, we asked the CEO of each firm to estimate the percentage of members who voted in the last director election, and the percentage who attended their last annual meeting. In general, we expected these numbers to be similar, but possibly different if the cooperative allows electronic or mail-in voting. Figure 3 summarizes responses to each question averaged over all firms in a given economic sector. Credit union and mutual sectors stand out with relatively low levels of member engagement, while the healthcare, other, and to a lesser extent agriculture sectors, stand out for having relatively high levels of engagement.

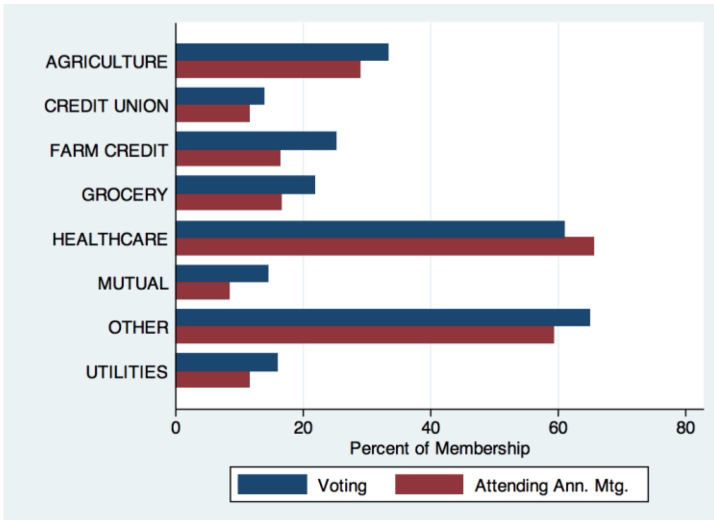

Figure 3. Participation rates for board elections and annual meetings.

A related signal of member engagement is competition for board seats. We asked respondents to tell us how many seats are up for election each year, and to report the number of genuinely competitive elections during the last 5 years. The cooperatives in our sample typically have 3 seats open for each election. The number of competitive elections varies widely. Some cooperatives reported only two competitive elections over the past 5 years, while others reported up to twelve.

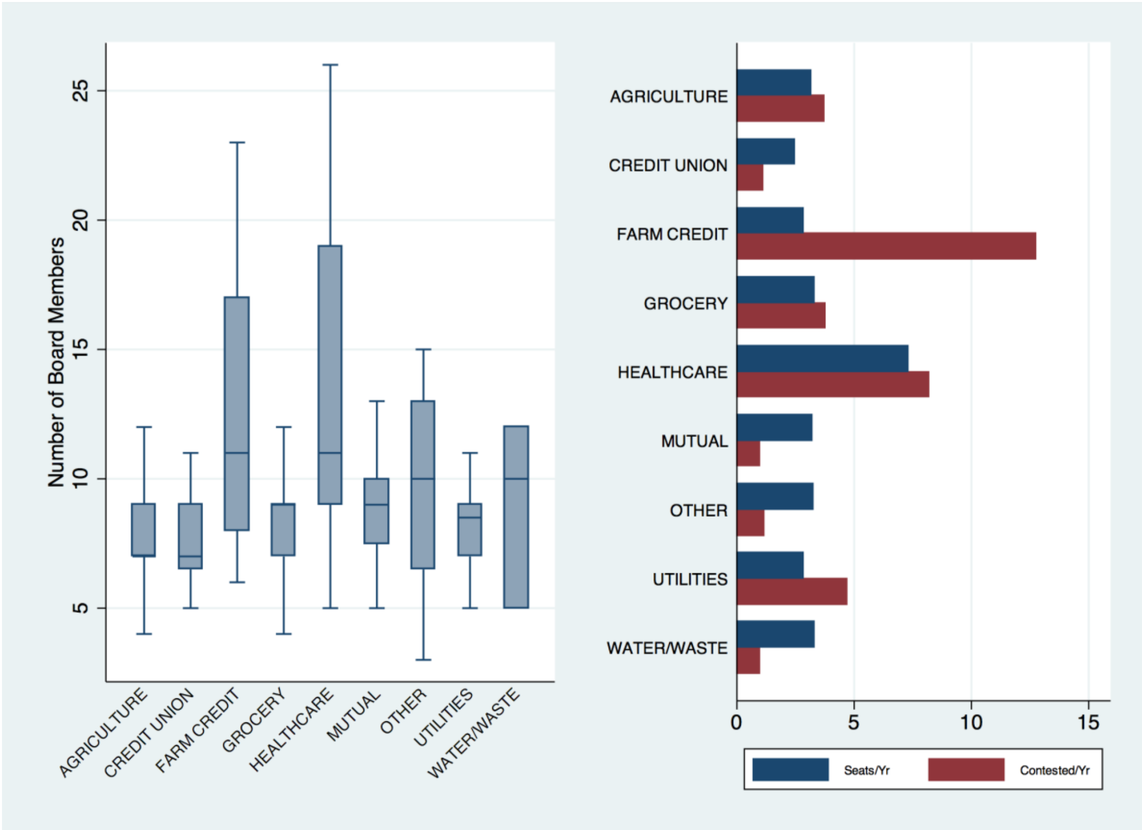

Figure 4. Average number of total board seats, open seats, and contested seats annually.

Board Characteristics

Board size can be an important factor in the ability of directors to discuss issues thoroughly and come to agreement. There is significant variability in the average board size across sectors, with cooperatives in the healthcare and farm credit sectors having the largest boards. With the exception of these two sectors, cooperatives have an average fewer than 10 directors on their boards (see figure 4).

We assessed the level of director experience by asking what fraction of the board had 3 or fewer years of experience on the board, and what fraction had 20 or more years of experience. The credit union and mutual sectors, and to lesser extent utilities, stand out for having relatively longer tenured boards. Grocery, healthcare, and the other sector stand out for having relatively shorter tenured boards.

We asked about number of women directors. Agriculture, mutual insurance, and utility sectors all have extremely low levels of participation by women on their respective boards. In contrast, the grocery and other sectors have over 40 percent board representation by women. We also asked about the role of non-members in the board room. These non-members could range from board advisors to non-member directors with voting rights. The farm credit system requires voting by non-member advisors on the their boards so it is not surprising that nearly all farm credit firms in our sample report voting by non-member directors. Voting by non-member directors is extremely unusual in the agriculture, credit union, and grocery sectors. A fraction of cooperatives in every sector reported the presence of non-voting board advisors in the board room.

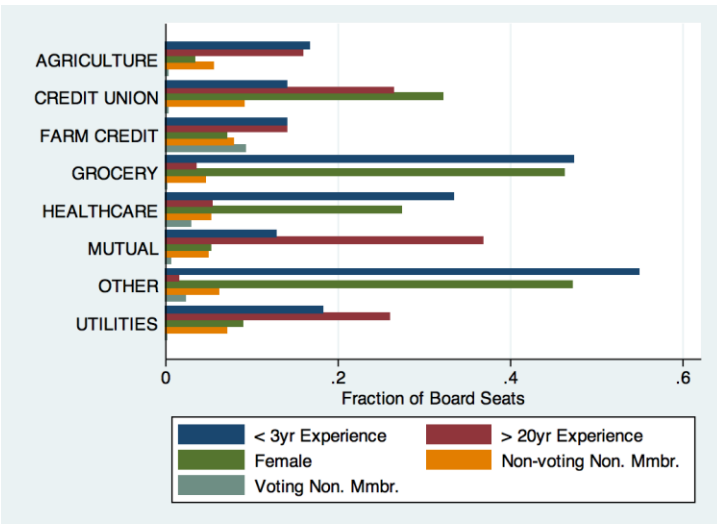

Figure 5. Board Experience, gender, and non-member participation.

Screening Board Members

Cooperatives differ from most other forms of businesses in their principle of democratic ownership. Most cooperatives have allowed (or encouraged) self-nomination by members for board seats. The data in figure 6 describes the extent to which new board members are recruited, in contrast with self-nomination. In particular, we inquired about the extent to which the board must actively recruit new directors, and whether the CEO is directly involved in board member selection. CEOs of credit unions and mutual sectors report significant recruitment effort, but less so in the other sectors. Perhaps surprisingly, respondents in all sectors report some level of CEO involvement in the process of recruiting and selecting new board members.

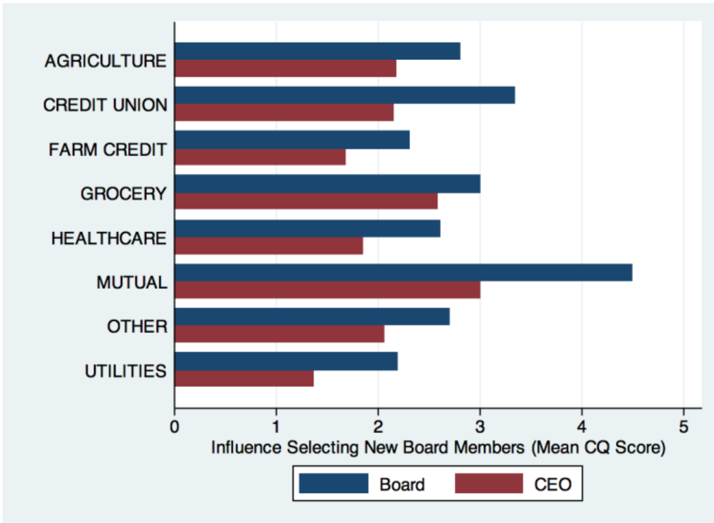

Figure 6. Board and CEO influence over nomination and selection of new board members.

Meetings

The number and length of board meetings can be an indicator of directors' commitment to monitoring and strengthening the cooperative. For most sectors, there are monthly board meetings, lasting less than 5 hours. Farm credit cooperatives have longer meetings on average. Grocery cooperatives stand out for having more meetings of shorter duration, possibly reflecting the proximity of their members to the business. Town mutual insurance cooperatives stand out for having a few short meetings.

We asked both CEOs and Board Chairs the question "how prepared are board members for the board meeting?" Board Chairs rarely report that most board members are unprepared, but CEOs sometimes do indicate that their boards are poorly prepared. Given the subjective nature of the question, we would not always expect agreement. However, it is notable that in 10 percent of firms CEOs indicate that several board members are unprepared, while in 10 percent of the firms BCs indicate that almost everyone comes prepared with questions and concerns. In other words, the BCs for these same firms think their boards are highly prepared, while the CEO has a less favorable impression.

We asked the BC and CEO to assess the time they spend preparing for board meetings. On average, BCs report spending at least as much time as their CEOs. We also asked the CEO to estimate the time spent by staff in preparing material for board meetings. On average, the health care, credit union and farm credit sectors, all subject to significant regulatory oversight, each devote considerably more staff time to preparation for board meetings than staff from cooperatives in other sectors.

Communication beyond board meetings

Interaction outside the formal board meetings can be an important factor in building a strong governance team. To gauge the extent of informal interaction among board members, the CEO, and executive staff, we asked about communication on business matters outside board meetings. We asked the same pair of questions of the CEO and BC. There is substantial agreement between the CEOs and BCs in our sample that board members do not often communicate with staff outside board meetings. Over 40 percent of the BCs in our sample report no communication with staff. However, more than a quarter of CEOs indicated that board members occasionally communicate with management outside of board meetings.

Board Assertiveness

To gauge how active boards are in monitoring and controlling business decision making, we asked about agenda setting for board meetings and budget control. Nearly 50 percent of the firms in our sample report that the CEO prepares the agenda with little or no input from the board chair. Almost 20 percent of the firms report that the Board Chair has no input on the agenda, and nearly 30 percent report that the CEO is largely responsible for setting the agenda, with some input from the BC. For approximately 10 percent of firms, the CEO indicates that the BC is solely responsible for setting the agenda.

When asked about the involvement of directors in creating and monitoring the firm's budget, most cooperatives report a moderate involvement by the board. The board receives regular budget reports, and is notified of changes, but rarely intervenes. Although this is the norm, it should be noted that significant involvement by the board in budget matters is reported more often than little or no involvement.

Strategic Direction

Response patterns for questions about the board's involvement in setting strategy are similar to those for involvement in budget setting. Both CEOs and Board Chairs most commonly report collaborative involvement in strategic planning, but also that board members are more often "active" than they are "passive."

Factors Associated with an Engaged Board

We have summarized a sample of governance practices across the cooperative businesses in our study. Some of the variation in practices we observed is a function of sector-specific factors. Other factors that can explain some of the variability in practices can include maturity of the organization, the size and structure of its membership, and whether members are using the services of the cooperative as a consumer or a producer. In this final section, we examine the factors that are associated with engaged boards. We explore three measures of engagement, all based on our interviews with CEOs: board preparedness, engagement in strategy setting, and participation in annual budgeting. We looked at how characteristics of the firm, board, and membership, affected the reported practices. We found that cooperative firms that are more mature tend to have less engaged boards. Perhaps surprisingly, we find that cooperatives with more members tend to have more engaged boards. The effect of board size on board engagement varies across the measures. Larger boards tend to be less engaged in strategy, but more prepared and more engaged in budget matters. This behavior may reflect difficulty in providing a unified vision for strategy with a large board. Adding non-member advisors to the board (voting or otherwise) tends to be associated with more active boards across all measures of engagement. However, we cannot know whether outside advisors "cause" boards to be more active, or whether it's the active boards that hire outside advisors.

The membership of a cooperative does not participate in board activities directly, but they do elect board members. In this regard, it is interesting that when the membership is more active (in terms showing up to vote for board elections), boards are also more active. Note that it is difficult to say which factor is most important. We don't know whether active boards encourage more member participation, or whether active members encourage more active boards. Lastly, we looked at the effect of the background of the CEO on measures of board engagement. We found that CEO's with more work experience in cooperatives reported lower engagement by their boards on budget matters. One possible explanation is that boards are more trusting of their CEO when he or she has strong cooperative background, but further research would be required to confirm this.

Conclusion

Evidence provided in this preliminary report suggests there is substantial variability in board structure and behavior of U.S. cooperative businesses. Some of this behavior is specific to particular economic sectors and cooperative types, but even controlling for these effects, substantial differences remain across individual cooperatives. Do these differences reflect unique needs of each cooperative, or the influence of particular individuals? More important is understanding if any of these differences support effective board behavior and, ultimately, better cooperative performance. These are the types of questions we hope to answer as we move forward with the Cooperative Business Study.