CANADIAN CENTRE FOR THE STUDY OF CO-OPERATIVES (CCSC)

Chair Selection, Tenure, Evaluation, and Remuneration: A Co-operative Perspective

"No single board member has the opportunity to have a greater influence on the board's success than the chair."

Orlikoff and Totten 2009

Author(s): **Marc-Andre Pigeon**, *CCSC Director and Assistant Professor, Johnson Shoyama Graduate School of Public Policy*

March 2020

usaskstudies.coop

JOHNSON SHOYAMA
Canadian Centre for the Study of Co-operatives
UREGINA USASK

Canadian Centre for the Study of Co-operatives
101 Diefenbaker Place
University of Saskatchewan
Saskatoon SK Canada S7N 5B8
Phone: (306) 966–8509 / Fax: (306) 966–8517

E-mail: coop.studies@usask.ca
Website: http://www.usaskstudies.coop

This Occasional Paper originated as a paper prepared for delivery at the Ostrom Workshop (WOW6) Conference, Indiana University Bloomington, 19–21 June 2019.

TABLE OF CONTENTS

1.0 INTRODUCTION

As a co-operative, it can be hard to know what to do or think about governance, especially as it relates to the matters of selection, tenure, evaluation, and remuneration of the board chair. The vast corporate governance literature is focused on researching and suggesting best practices for investor-owned, publicly traded companies, not co-operatives. Moreover, most of the academic literature focuses on the board as a whole, leaving chair-related matters to consultants and less specialized sources.

This research paper addresses the question of how a co-operative might approach board-chair selection, tenure, evaluation, and remuneration. We start from the assumption that there is no one-size-fits-all approach to these matters—a best practice for one co-operative may not be a best practice for another, even though they may draw inspiration from the same co-operative principles and broader governance literature.

Given the relative paucity of academic literature addressing these specific chair-related questions, I approach the rest of the discussion by inferring ways of thinking about these questions through a two-pronged literature review. The first covers competing theories of governance. Because it is likely to be more abstract, I placed this optional discussion in Appendix A, which also includes a first attempt to extract some potential implications of these competing views on the questions at hand.

The second approach draws on this overview to look at the question of board effectiveness, a topic that the literature suggests hinges very much on the chair's ability to perform his or her role. We supplement that review by framing it within the context of the Canadian Centre for the Study of Co-operatives's approach to governance.

We then move to a discussion about the implications of the broader governance literature and the Centre's research on the questions posed at the outset: What should a co-operative consider when deciding on board-chair selection, tenure, evaluation, and remuneration?

2.0 THE CHAIR AND BOARD EFFECTIVENESS

As the literature review in Appendix A discusses, the bulk of academic governance research—at least in the Anglosphere (US, UK, Canada, Australia, New Zealand)—is grounded in a principal-agent understanding of the board's role. The principal-agent framework (also called agency theory) is based on a particular understanding of human motivation; given our presumed tendency towards self-interested behaviour, the board's task is to oversee management and ensure it acts in the interests of investors. When applied to co-operatives, principal-agent-grounded researchers draw analogies between investors and members. This analogy implies that members—as represented by the board—must ultimately hold the co-operative management to account.

However, as the literature review also notes, there are competing perspectives to agency theory such as stewardship, stakeholder, resource dependency, and managerial hegemony theories. The review also addresses two other ways of thinking about governance—what I label the firm-specific investment theory and the public-sector approach to governance. Some of these perspectives are more open to thinking about human motivation differently from the simple extrinsically motivated,[1] self-interested individual who is at the heart of agency theory. They also draw on comparisons to governance norms in other countries where agency theory is not so pervasive (Clark 2016; Jansson, Larsson-Olaison, Veldman, and Beverungen 2016).

Instead of assuming that management's (self) interests always threaten to diverge from those of owners, these other perspectives place emphasis on:

- a more collegial board/management relationship (stewardship theory)
- the importance of a board that reflects key stakeholders (stakeholder theory)
- the benefits of fixed remuneration (public-sector governance practices)

Each of these theories about the board's function differs in important ways, but that does not mean they are mutually exclusive. It is almost unavoidable that firms, including co-operatives, implicitly or explicitly draw on different threads of these theoretical approaches to shape their practices. While these other theoretical perspectives are becoming more common in governance research, the principal-agent perspective is still dominant.

There has been little academic research into actual board processes that might address questions around board-chair selection, tenure, remuneration, and evaluation. Instead, most researchers have assumed the perspective of the "usual suspects" and focused narrowly on the board's role by examining structural factors that are assumed to drive firm performance, measured by profitability/share price (Finkelstein and Mooney 2003).These structural factors are:

- the presence of independent directors (there should be some; more is better)
- the size of the board (smaller is better)
- the alignment of board members with the interests of investors (through share ownership)
- whether the board chair is also the CEO (the roles should be separated)[2]

Researchers with a more practical focus have remarked upon this vagueness, this most "hidden" of processes (Leblanc 2005, 654).[3] Leblanc, for example, quotes Sir Adrian Cadbury, a UK corporate executive and chairperson who helped stimulate much of the popular debate about board governance, as noting: "So many of the academic studies have tried to draw conclusions about what works and what does not by analyzing structures. It is a process, the way in which board members work together, that counts" (658).[4] Leblanc goes on to suggest that looking at what constitutes effective board processes means looking at theoretical approaches grounded in something other than agency theory and the assumptions that underpin it. It also means developing an empirical understanding of the processes and competencies of directors, especially the board chair.

There is a body of work that has taken up the gauntlet. Forbes and Milliken (1999) emphasize the importance of board processes that foster the kind of "collective knowledge" that can help the board exercise its oversight function as a decision-making group and ultimately drive firm performance. The basic premise is that the sum of the board is greater than its parts. In other words, you cannot infer everything you need to know about a board's effectiveness by simply looking at its demographic profile and its mix of gender, skill, knowledge, and external representation.

To illustrate, Forbes and Milliken (1999) point to "small-group decision-making" research showing that more cohesive boards experience less turnover than boards that lack cohesion. Cohesive boards also help members bond more closely with one another and experience greater satisfaction in their roles. This, in turn, helps address the demographic question by minimizing the loss of firm-specific knowledge and hard-to-find, sector-specific skills. Or, as one researcher noted, "What distinguishes exemplary boards is that they are robust, effective social systems" (Sonnenfield quoted by Leblanc 2005, 654). And as the latest research shows, the chair has a crucial role in building this system.

Beyond cohesiveness, Forbes and Milliken (1999) propose three factors that can help predict an effective board and, ultimately, firm performance:

- *Effort Norms*: A cohesive board tends to elicit greater expectations around preparation, participation, and analysis that become embodied in what the authors refer to as "effort norms." It is not difficult to imagine that the combination of lower turnover and greater board effort might also make it easier to succession plan around senior board roles such as the board chair, vice-chair, and chairs of board subcommittees.
- *Cognitive Conflict*: While the ability of the board to function cohesively as a group is important for board effectiveness, it also comes at the risk of board groupthink, an outcome that can be predicted by the absence of "cognitive conflict" or simply, constructive debate around different ways of looking at an issue or problem. The ability of a board to generate this kind of constructive debate not only reduces the risk of groupthink but is positive for board effectiveness in its own right. It can generate novel and critical thinking that results in strong direction to management, especially in a complex, multistakeholder regulatory environment like the one in which many co-operatives operate. Further, the ability of a board to engage in this kind of productive and respectful clash of ideas can also be a powerful signal to management of an engaged board, one that is mindful of its role of representing members and other stakeholders.

  Productive debate can also help sustain and augment effort norms—no one likes to be unprepared for a vigorous and important discussion where competing ideas are at the table. But of equal importance, it provides an important way for board members to use their knowledge and skills to their fullest effect in the service of the corporate entity. Of course, there is always a risk of having too much of a good thing. While cognitive conflict can have positive effects, it can also—if not properly managed—lead to disaffection, nonparticipation, and, ultimately, withdrawal from the board.

- *Skills and Knowledge*: Another key driver of board effectiveness is the ability and willingness of board members to use their knowledge and skills in these challenging conversations. This will be related to the degree to which the board is able to engage in productive cognitive conflict. Of course, this can only happen if the skills and knowledge are there to begin with. On this, Forbes and Milliken point to the importance of recruiting board members with knowledge and skills not only in the relevant disciplines (accounting, legal, marketing, etc.) and sector(s) but also in matters specific to the firm.

3.0 BOARD CHAIR AS COACH

There is a small but growing body of work that explores the empirical side of Forbes and Milliken's work. Gabrielsson, Huse, and Minichilli (2007), for example, focus their attention on the board chair's role around interacting and shaping the conversation with fellow board members, namely, making board decisions related to setting corporate strategy. This work is over and above the more traditional, individual, or solo, activities of a board chair—things like setting the board agenda, moderating discussions, acting as a figurehead for the organization, or supporting the chief executive officer by acting as a sounding board.

In playing these more social roles, the board chair has to be mindful that s/he cannot exert direct authority over his or her peers; unlike an executive team engaging with their employees, the board chair cannot dictate a decision or strategic direction. Gabrielsson, Huse, and Minichilli (2007) present research findings from a survey of more than six hundred Norwegian board members that show how an effective chair approaches these collective board tasks as a "coach," someone who can bring about a sense of "teamwork."

How does a skilled chair go about building this team culture? The authors suggest that the chair as coach needs to nurture four collective behaviours, all of which point to the importance of encouraging board members to bring their knowledge and skills to the fore:

- *Creativity*: The chair must have the ability to present ideas and solutions that, while they may not always be creative in and of themselves, help move the conversation in a more creative direction.
- *Openness and generosity*: The chair needs to create an atmosphere in which board members feel free to say what they think, even if that means sometimes challenging the ideas of other board members. As discussed earlier, however, the chair has to make sure these conversations do not veer into the overly personal and lead to unproductive cognitive conflict.
- *Criticality*: The chair should nurture a questioning attitude in the boardroom, one in which board members carefully scrutinize the information provided by the CEO.
- *Preparedness and commitment*: The chair should encourage board members to come prepared for the meetings, which are likely to have packed agendas. Unprepared board members can bog down important conversations.

The chair not only needs to cultivate creativity, openness, criticality, and preparedness, but should also embody and demonstrate these traits in their own behaviour. There is, however, a literature that is a bit more definitive about what kind of personality type a board should look for in selecting a leader.

The chair not only needs to cultivate creativity, openness, criticality, and preparedness, but should also embody and demonstrate these traits in their own behaviour.

4.0 BOARD CHAIR AUTHENTICITY

In an empirical study based on survey evidence from board chairs at Canadian credit unions,[5] Guerrero, Lapalme, and Séguin (2015) find that "authentic" board chairs tend to foster motivated and committed board members as well as a strong "team climate," at least in part through their ability to generate a "safe climate" for dialogue.[6] In a team-climate environment, the board is comprised of individuals who feel committed to the organization, adopt its outlook, and act in its interests. These are all traits that are associated with reduced turnover and positive outcomes for the organization, as Forbes and Milliken (1999) suggest.

What constitutes an "authentic leader" who can build this team climate? According to Guerrero, Lapalme, and Séguin, the literature identifies four key traits:

- *Self-awareness*: People who have this trait accept their strengths and weaknesses and understand how experience can give meaning to life.
- *Relational transparency*: Individuals with this characteristic are authentic—they present just as they are, with no artifice.
- *Balanced processing*: Those with this disposition welcome competing views and are able to process conflicting perspectives and available information to make decisions.
- *Internalized moral perspective*: People with this attribute are resistant to group pressure because they are guided by a strong sense of morality.

5.0 THE PERSPECTIVE FROM THE MANAGEMENT LITERATURE

With the notable exceptions discussed above, the more formal academic literature does not appear to dig too far into what makes a good chair, let alone address the matters of evaluation, tenure, and remuneration. The more pragmatic, management-oriented literature, however, does provide some additional insight.

Drawing on their analysis of submissions to an "outstanding chairperson" award in the UK, Dulewicz, Gay, and Taylor (2007), for example, identify four "super clusters" that are associated with exceptional leaders:

- *Investor relations*: The chairpersons who scored well in this area were strong negotiators and communicators, particularly with shareholders. Applied to a co-operative or a credit union chair, this super cluster points to the importance of selecting a board chair who has a good rapport not only with members but also with external stakeholders.
- *Ethics and integrity*: The finalists for the UK award all demonstrated high integrity and ethical standards. These are individuals who are "unlikely to do anything questionable or ask that of others" (1067). These traits—plus openness, honesty, and transparency—are recognized and admired but also seen as integral to ensuring strong participation by all board members and good oversight by the board as a whole.
- *Intellectual/cerebral*: Exceptional candidates with these qualities tended to be strong, critical thinkers ("devil's advocates") able to communicate their views clearly and effectively.
- *Interpersonal*: High achievers in this area were good listeners and empathetic, but also demonstrated an ability to encourage broad board participation — constructive, critical dialogue that allowed everyone to save face (what I called productive "cognitive conflict" earlier) — that nevertheless allowed them to move the conversation towards consensus.

Shekshnia's recent (2018) article in the *Harvard Business Review* (HBR) on how to be a good chair—informed by a survey of two hundred board chairs in thirty-one countries as well as eighty interviews of board chairs—underlines the importance of helping the chair understand that they are *not* the chief executive officer. For former CEOs who become board chairs, this means exercising restraint by remaining impartial and not taking centre stage, but also showing patience with the process by resisting the CEO impulse for quick decision making. A CEO-turned-chair has to guard against the tendency to focus on "outputs" and direct their attention instead to high-quality inputs—strong board agendas, high-quality board material (including minutes), and strong board processes. It also means not acting like the boss. The chair represents the board; the board is the "boss." As a twist on the "team-based" research, Shekshnia suggests that while "teaming" is important, board members, with their busy schedules, might resent overt efforts such as off-site team-building exercises (bearing in mind that this research focused on large investor-owned companies).

Still, the consensus seems to be that the ability of a board to function as a team is crucial. In an earlier HBR article, David Nadler (2004) says that only a team approach can enable a board in its role of challenging management, inquiring without meddling, and providing guidance to the CEO. He adds that teams don't just happen—they have to be built. He goes on to offer some recommendations, including conducting board self-evaluation, planning agendas carefully to allow for meaningful input, ensuring that information strikes the right balance between too little and too much, and building a culture of openness and participation. While not explicitly addressing the matter, the implication is that the board chair plays a critical role in bringing the board together as a team.

While there is growing consensus in the academic and management literature that the chair has an important role in building the board culture and encouraging a team approach, much less work has been done on actually assessing the board chair (Orlikoff and Totten 2009). Leblanc (2005) provides a questionnaire that does just that. On the matter of competencies and behaviours, for example, Leblanc includes a question that asks whether the board chair has demonstrated a strong ability to build a "cohesive team" and "governance culture." Another inquires as to whether the chair meets and communicates regularly with the rest of the board. And still another addresses whether the board feels that the chair acts ethically and with integrity.

Other questions in Leblanc's survey focus on more traditional chair roles such as oversight on behalf of shareholders (e.g., relationship with the CEO; arranging for external expertise as necessary) and meeting management (e.g., agenda setting, time management).

Orlikoff and Totten (2009) suggest several steps that a board can take to facilitate the kind of evaluation proposed by Leblanc. These include establishing a written job description for the position of board chair, developing criteria to assess the board's performance, and creating and applying a clearly defined process for conducting chair performance reviews.

6.0 INTERDEPENDENCIES, LEGITIMACY, AND COGNITIVE FRAMES

The literature on board effectiveness points strongly to the conclusion that co-operative entities should prioritize identifying a board chair who can "coach" fellow board members in a way that helps them work as a team, take effective decisions, and strategize about the future. This points to the need to select a board chair who has strong social skills. But this research is not the full story, at least in part because it is built largely on studies of investor-owned corporations. And as the research suggests, it is important to consider firm-specific variables such as the sector in which the firm operates (Gabrielsson, Huse, and Minichilli 2007).

The Canadian Centre for the Study of Co-operatives (CCSC) has developed a governance framework that draws not only on the academic literature discussed in Appendix A, but also on the Centre's long experience of analyzing both successful and failed co-operatives. This framework starts from the premise that governance can best be defined as the set of formal (e.g., voting rules, board selection rules, etc.) and informal rules (e.g., norms) that determine who has power to make what decisions.[7] Building on this definition, the CCSC view suggests that the board should be thinking about these formal and informal rules from three vantage points: strategic interdependencies, legitimacy, and cognitive frames. We discuss each in turn and relate these perspectives to co-operatives.

6.1 Strategic Interdependencies

The concept of strategic interdependencies involves what are termed "social dilemmas" — situations where the pursuit of self-interest by each individual does not necessarily result in the most efficient or effective outcome. In situations with strategic interdependencies, the choices made by one individual or group can have repercussions on the choices made by others (and of course vice-versa). In such circumstances, creating the right set of incentives (understood broadly to contain both financial and nonfinancial aspects), beliefs, and environments can have positive spillover effects on the other parts of the organization, while creating the wrong set can have negative consequences.

While board members in investor-owned firms would be well served by integrating this frame into their deliberations, the "interdependent" lens is particularly important for a co-operative, given what is often a values-based mission, stakeholder-like boards, deep links to the community, and its place in the larger co-operative ecosystem. To see why, it's helpful to think of interdependencies along two dimensions, namely internally and externally oriented interdependencies.

6.11 Internally Oriented Interdependencies

The internally oriented interdependency perspective draws our attention to three threads of the theoretical governance literature. From a stewardship point of view, the chair clearly has an important role in encouraging the board to be mindful of how its decisions might support or undermine a team culture both at the board level and among the other strata of the organization.

From an agency perspective, the chair has to be ever mindful of the potential for opportunistic, self-interested behaviour by the chief executive officer. The crucial assumption here is that no matter how much a board operates as a team, the principal-agent problem is always a potential issue. There is *always* a risk that CEOs might act in a way that is disadvantageous to the organization. And good board dynamics can turn bad because the world around the co-operative is ever-changing.

In their effort to distill lessons learned from the failure of large co-operatives, Couchman and Fulton (2015) point to five factors that appear to be predictive of eventual demise. The first of these is CEO overconfidence, which can arise particularly in situations where the co-operative or the broader sector is struggling and the CEO presents him/herself as having all the answers. In these cases, the CEO might convince the board to "roll the dice" on a big investment or abrupt change, which is a second factor that can contribute to a co-op's demise. However, high-risk decisions can only happen if the board fails to provide clear values-based direction to the CEO—one that effectively rules out this kind of hubris and over-reach. This lack of board oversight is a third predictive factor for the failure of co-operative governance.

The fourth is a growing sense among the board, management, and employees that co-operation is the problem rather than the solution. This can lead to the fifth factor—the hiring of people who have only "thinly concealed contempt for co-operative values" (Couchman and Fulton 2015, 4).

To illustrate the internally oriented interdependency perspective more concretely, consider the board chair remuneration question. Imagine, for example, that there is a broad societal trend towards greater compensation for board chairs, including variable-pay compensation. In considering a reset of chair remuneration, the board should be sensitive to the impact of its decisions on relationships not only between the chair and CEO and within the board, but also among the various strata of the organization. If the board chair's compensation is increased to a level that is seen as excessive by fellow directors, it could undermine the board's "team" mentality. This could lead to other board members demanding more pay or otherwise disrupt the board culture.[8]

Similarly, if the new higher compensation is perceived as excessive by employees, it could undermine efforts to build a broader employee/executive compensation structure—like the one many co-operatives strive for—that seeks to develop an intrinsically motivated workforce rather than one driven strictly by extrinsic incentives (salary, the threat of job loss, etc.). A negative perception of chair remuneration could also undermine an organization's brand in the broader community, thus eroding member recruitment, business activity, and the ability to realize the organization's mission. These latter examples show how, in an important way, the interdependency perspective directs our attention to think about the intrinsic (and extrinsic) interrelationships in terms of their impact on legitimacy perspective, as described below.

6.12 External Interdependencies

In determining remuneration, co-operatives also have to be mindful of underpaying the board chair because it may send a signal that erodes the institution's credibility with other, external stakeholders. Indeed, the external interdependency lens points to the importance of maintaining confidence not just with members and the community but also with other co-operatives, regulators (where applicable), and governments.

The external-interdependency perspective similarly points to the important role the board—and by implication, the chair—has in thinking about governance from the vantage point of the company's different funders. In his comparative analysis of governance across nations, Clarke (2016) observes that Japanese and German companies have tended to rely more on retained earnings to generate growth when compared with their Anglosphere counterparts. By minimizing their need for external funding, these firms have been able to operate much more freely—and with a longer-term perspective—than their Anglosphere competitors.

In determining remuneration, co-operatives also have to be mindful of underpaying the board chair because it may send a signal that erodes the institution's credibility with other, external stakeholders.

This external perspective also draws our attention to the importance of selecting a board chair who is perceived as credible with members, the community, and external stakeholders. Recruiting this kind of individual points back to the remuneration question, but also to the question of tenure. Even if a co-operative is able to find a chair with the requisite stature, it will almost surely take that individual time to fully understand the organization's governance structure (its set of formal and informal rules) and the internal and external interdependencies discussed here.

6.2 Legitimacy

As the discussion about perceptions around remuneration shows, the interdependency lens almost unavoidably raises questions around legitimacy—how much compensation is perceived as too much or not enough are core questions of legitimacy.

The concept of legitimacy is well understood in the political arena but rarely examined in governance research. From an agency perspective, the legitimacy question gets subsumed under the corporate mission of delivering profit maximization. The share price acts as a barometer of legitimacy—if the price is going down, this might suggest a problem with the company and ultimately lead to a change in management or the board.[9]

In a co-operative context, the question of legitimacy is paramount for the same reason that it is in the political arena: like governments, co-operatives are ultimately democratic institutions with all the attendant imperfections. Similar considerations apply: the co-operative membership is likely to have interests and preoccupations broader than profit maximization. Yes, they want excellent service at competitive prices, but they probably also want to feel good about their money and know that by doing business with a co-operative, they're helping accomplish something more than simply doing their business at a reasonable cost. Moreover, there is liable to be some segment of the membership that doesn't feel this way but values something else.

As suggested earlier, the legitimacy perspective is also critical from an external interdependency perspective. All things equal, regulators and policymakers will tend to give weight (or they should) to a co-operative that is perceived as legitimate by its membership. In credit unions, for example, this kind of organization is less likely to experience liquidity problems resulting from members leaving it, more likely to attract new members and additional business, and generally poses less risk than a credit union that does not focus on the legitimacy question.

In terms of structuring compensation for the board chair, public sector governance practices—and the intrinsic motivation perspectives—all suggest that the board chair should be paid, largely if not exclusively, in terms of fixed compensation, the better to elicit the chair's focus on teamwork and the larger organizational mission. If there was nevertheless a desire to add some variable component to the chair's compensation, then some consideration might be given to tying that performance pay to the co-operative's ability to meet its larger social objectives.

As far as the actual quantum of pay goes, Bebchuk and Fried suggest that when investor-owned firms set executive compensation at or above the fiftieth percentile of their peer group, it is behaviour "consistent with a picture of boards that do not seek to get the best deal for their shareholders, but are happy to go along with whatever can be justified as consistent with prevailing practices" (2005, 14).

6.3 Cognitive Frames

In the practitioner world, and arguably across the competing theoretical governance perspectives, there is broad agreement that one of the primary roles of any board is to determine strategy—the corporate entity's roadmap for the unknown, and to some extent unknowable, future. The CCSC perspective similarly emphasizes the importance of this activity, but does so by drawing on the cognitive literature around how humans go about the process of mapping the future.

The crucial insight here is that we selectively interpret the past—often based on our own unique trajectories and experiences—to imagine what the future might look like. In other words, we all come at this process with a certain amount of "baggage," often with emotions—despite our best rational intentions—providing an implicit weighting that filters past experience and shows the way forward. We are also under the influence of well-known cognitive biases such as loss aversion (the tendency to weigh losses more than we do symmetric gains), recency bias (the tendency to weigh recent events more heavily than distant ones), and others. We are hardly the fully rational beings that agency theory assumes.

Over and above these individual-level considerations, cognitive frames point to the importance of being aware of certain "meta" narratives—ways of thinking about the past, present, and the future that we all digest in one form or another through our media consumption and social interactions. In a co-operative context, boards will want to be especially aware of the dangers of adopting ways of thinking drawn from the world of investor-owned institutions without filtering them through a co-operative lens.

The chair has an important role in identifying the cognitive frames—both personal and meta—that often drive board conversations but are frequently ignored. To do so, the chair also has to develop an understanding of the personalities around the table—their strengths, their weaknesses, and their emotive backgrounds. As the chair comes to acquire these understandings, s/he will be in a better position to help foster the kind of productive cognitive conflict, effort norms, and group cohesion that the literature suggests is important to promote board effectiveness.

7.0 IMPLICATIONS: CHAIR SELECTION, TENURE, EVALUATION, AND REMUNERATION FROM A CO-OP PERSPECTIVE

What does all of this mean for board-chair selection, tenure, evaluation, and remuneration?

I have already hinted at some answers. First, I stress that there is no easy one-size-fits-all solution, a point underlined by practitioner-oriented literature and critical scholars. Dulewicz, Gay and Taylor (2007, 1,057), for example, quote Cadbury, the long-time UK corporate executive and governance pioneer, as saying "Different boards require different types of chairmen (*sic*)," noting that "a particular kind of chairman (*sic*) will suit a particular board at a particular time." He also states that "one element of choice is between a chairman (*sic*) who will broadly maintain the company on its existing course and one who is likely to feel that a change, either of direction or of pace, is needed."

From the critical scholarship (Clarke 2016; Jansson et al. 2016), the key point is for the board to think about its objectives and set up the governance structure accordingly: you get the governance that you design for.

In his analysis of governance structures from different parts of the world, Clark (2016) shows how governance practices in Germany and the UK are more likely to draw (implicitly or explicitly) on stewardship and stakeholder perspectives rather than agency theory. As a result, governance practices tend to be oriented towards longer-term thinking: board tenure in these countries is likely to be longer, remuneration is often fixed, and evaluation—we can only assume—is more collegial than under the principal-agent framework that dominates the literature and approaches prevalent in Anglosphere countries. In countries such as Canada and the US, a shorter-term way of thinking—driven in part by the incentive structures built into board remuneration—is more likely to generate creativity, disruption, and radical change.

The literature makes clear that the board chair has a weighty job. The chair's leadership must generate a sense of teamwork that inspires board members to apply their skills to the fullest extent, demonstrating strong and consistent effort. An effective chair should allow for and encourage constructive debate (cognitive conflict) and, at the same time, nudge the conversation towards a consensus. S/he must also (along with the governance committee) think hard about the broad corporate objectives—their time horizon and strategic vision—and design a governance system that gets them there.

To arrive at these outcomes, a successful chair needs time to develop an understanding of fellow board members—their strengths, weaknesses, and even deeper emotional selves. This does not, however, exhaust the scope of the role. The board chair also has to consider the interdependent nature of the organization and the way board decisions affect internal and external relationships. As one of two primary spokespersons for any co-operative, and as a key interlocutor with external parties, including regulators, the board chair has to be able to communicate effectively with these external and interdependent stakeholders.

All of this takes time.

And this is true regardless of who comes into the role. The new chair will invariably be missing at least one piece of the puzzle. While they may have a strong understanding of the external environment (e.g., the retail sector), they may lack the kind of tacit knowledge that would help them understand the internal interdependencies. They may know what chair compensation looks like in the rest of the retail sector, but do they know what employees at the co-operative perceive as fair? Yes, other board members and the CEO can help the chair acquire that knowledge, but the chair has a special duty to make sure that knowledge finds its way into "collective knowledge."

Table 1, below, summarizes this discussion by filtering it through the co-operative perspective.

Table 1: Board Effectiveness: Co-operative and Financial Institution Considerations

	Co-operative Considerations	Policy Considerations	Board Effectiveness in the Context of Interdependencies, Legitimacy, and Cognitive Frames
Chair Selection	Board members are drawn from the ranks of members. Given prominence of the role, chair should be relatable to membership.	Board chair may be expected to interact with policymakers/regulators on a regular basis and must be credible. Board chair is also a key spokesperson for the co-operative and must, again, present credibly.	Has the candidate shown s/he has the right set of attributes to help generate a "team" mentality? Does the candidate demonstrate an appreciation of the co-operative's strategic interdependencies, between and among management, the board, and employees (vertically), and within the board (horizontally) itself? Does the candidate demonstrate an understanding of the co-operative's external interdependencies, i.e., vis-a-vis its regulator, the broader community, the rest of the co-operative sector, and other stakeholders? Given the high-profile nature of the role, is the candidate perceived as legitimate from a co-operative perspective? Is s/he committed — and known to be committed — to co-ops, co-op principles, and co-op values?
Chair Tenure	Board positions must come up for periodic membership review, calling into question the ability of a board chair to have a long fixed tenure.	Chair should be able to demonstrate experience/under-standing of the sector, given high-profile role. Policymakers and regulators may interpret tenure as signaling that understanding if the chair is perceived as credible.	If chair tenure is of a short duration, does that impair the ability to recruit a chair with the requisite skill set, particularly at a larger, more complex co-operative? Even if a co-op is fortunate enough to have members who present themselves for the board (and the chair) with the requisite experience and knowledge of the sector, how long does it take for those individuals to fully understand the co-operative's set of formal and informal rules in a way that would augment their effectiveness at the board table?

	Co-operative Considerations	Policy Considerations	Board Effectiveness in the Context of Interdependencies, Legitimacy, and Cognitive Frames
Chair Evaluation	In the absence of a barometer like the share price, how can members know if their board chair is doing a good job?	Policymakers, regulators, and industry best practices increasingly create an expectation that boards will conduct periodic self-evaluation.	If one is done — or if one is under consideration, the co-operative may want to consider supplementing assessment tools like the one proposed by Leblanc (2005) with some of the following questions: • Has the chair helped the board operate as a "team?" • Has the board chair demonstrated an ability to foster a degree of cognitive conflict (i.e., good vigorous discussion) that nevertheless allows for consensus? • Has the chair demonstrated an ability to move the board towards a shared strategic vision of the future? • Has the chair demonstrated an ability in working with management to impart that vision clearly to management, employees, and external stakeholders? • Does the chair demonstrate awareness of the co-operative's strategic interdependencies and legitimacy considerations or, similarly, is the chair able to elicit these understandings from the board?
Chair Remuneration	Members may expect the remuneration practices of their co-operative to differ from those of investor-owned banks/other entities.	Policymakers and regulators are unlikely to influence these practices directly, short of high-profile negative media coverage around compensation levels. Investor-owned companies typically tie board compensation to share prices through stock options.	Are the co-operative's chair compensation practices consistent in their *form* with those applied to executives and employees? Has the co-operative considered expanding the scope of its relevant peers to include public sector or nonprofit positions of similar stature? Is the co-operative's practice of setting compensation consistent with its values? Does setting its target as some percentile of the market contribute to "ratcheting" of board compensation more generally? Is the co-operative's chair compensation package sufficient to attract a qualified candidate who will commit to the time and effort needed to fulfill the role properly? If not, what component is lacking? What portion of chair compensation consists of fixed remuneration? If there is a variable portion, how is it set, and is it consistent with the co-operative's values? Has there been any consideration given to setting variable remuneration—if there is any—to reflect larger co-operative strategic objectives? Does chair compensation strike the appropriate balance of being perceived as legitimate by the board, management, employees, the community, and external stakeholders?

8.0 CONCLUSION

The academic and practitioner literature on governance is dominated by agency theory. While this literature is rich with pragmatic suggestions around *board* selection, tenure, evaluation, and remuneration, there is much less said about these matters from a chair perspective, apart from stressing the importance of separating the board chair/CEO roles. The other, competing theories, similarly, pay the matter little direct attention.

To get at the questions posed at the outset, we focused on distilling some insights and questions from the board effectiveness literature augmented by what we have called the CCSC governance approach or framework, a way of thinking about board processes that has been informed by long engagement with the academic literature and the application of that literature to the co-operative sector. The CCSC takes the approach that there are no one-size-fits-all "answers" to the questions. Rather, we think each of the questions needs to be filtered through each co-operative's own particular circumstances — its interdependencies, legitimacy requirements, and cognitive frames.

That said, our analysis does suggest some questions that could help drive towards a set of answers that make sense for a co-operative. In some cases, we can even venture some tentative recommendations to be tested through a workshop.

On the question of tenure, we think there is merit in having boards consider three- or four-year terms. A longer tenure could serve as a self-selection filter for attracting a highly committed chair who has the time to adapt to a role deeply influenced by a co-operative's business, its stature in the co-operative sector, the broader co-operative eco-system, and its profile in the community.

On the question of remuneration, co-operative boards need to think very carefully about this matter, not only from a traditional incentive perspective—how much do you need to pay so that it's worthwhile for someone to take on a weighty role?—but also from a legitimacy and interdependency perspective. What kind of compensation represents a balance between the incentive objective and the potentially conflicting perception of what is legitimate by different stakeholders?

On the question of selection, co-operative boards should search for someone who can generate and sustain the practices that the research shows produce an effective *team*, who can help the board towards just the right mix of cognitive conflict, effort, and deployment of skills/knowledge, while allowing for cohesion and ultimately consensus.

On the question of evaluation, we suggest co-operative boards need to assess the chair against his/her ability to not only build an effective team culture but also to demonstrate an understanding of the organization's interdependencies, its vital legitimacy perspectives. Chair evaluation should also help develop the ability to identify and address cognitive frames and biases.

Sir Adrian Cadbury once remarked that "when we attend a meeting of any kind, we can sense almost from the start whether the chairman (*sic*) is competent or not" (Leblanc 2005, 654). The trick is to develop a set of processes that capture that intuitive I'll-know-it-when-I-see-it understanding of good leadership. The research surveyed here presents some promising ways of getting there.

APPENDIX A: LITERATURE REVIEW

The Principal-Agent Frame

While the governance literature is varied, it is generally premised on what is called "principal-agent" or "agency" theory (Cornforth 2004; Goth, Mckillop, and Wilson 2012; Shleifer and Vishny 1997). Distilled, agency theory says there is a very good chance that the interests of owners will diverge from those whom they hire to manage their corporate entity. This is especially true as firms grow larger and the social distance between management and owners increases.

Agency theory is grounded in what is called the "contractual" view of the firm. It starts from the premise that firms are created when an owner or many owners start a firm and contract with management to operate the business. They do so because the owners either lack the specialized skills to run the firm or would like to "cash out" of a firm they already helped build, or both.

While in theory these contracts should spell out every contingency, this, of course, is not possible, because no one knows what the future holds and therefore owners cannot bind management to courses of action that would address all future events. As a result, owners must inevitably cede some degree of decision-making control over the firm to management. Management's ability to exercise control over the firm is increased in situations where the ownership is dispersed, poorly informed, or simply "free riding" on the efforts of others to monitor and control management.

In their review of the governance literature, Shleifer and Vishny (1997) identify several principal-agent problems that arise from these two issues: the inability to bind management to all future states and the free-rider problem of poorly motivated and ill-informed owners.

For instance, management can expropriate owners in a variety of ways by taking money out of the firm without their knowledge or consent or, less dramatically, by "featherbedding" their work environment through perquisites or pursuing projects that benefit them rather than the owner(s). In the literature, this more subtle "personal gain" behaviour is often framed as management re-investing in the business rather than paying out surplus funds to owners, or adopting "poison pills" aimed at discouraging takeover offers that could result in a change in ownership and management.

The literature points to three broad institutional approaches to mitigating this risk of misalignment between management and owners. First, policymakers can ensure strong legal protection for small shareholders by imposing a "duty of loyalty" expectation on management. Second, the principal-agent problem can also be addressed in situations where there are large investors/owners who have both the incentive and means to oversee management. Third, firms can align management behaviour with the interests of owners by tying remuneration to the company's share price.

At a more granular level, the literature—especially as it moves from theory to more management-type applied research—offers some familiar principal-agent-inspired recommendations on board best practices.

- The board sets strategy, management follows.
- There should be a separation of the board chair and executive roles.
- Long board tenure may improve knowledge/skills, but it heightens the risk of "capture" by management and should be limited.
- It is important, particularly in the banking sector, to have a board comprised of subject-matter experts.
- Above all, board members must be constitutionally disposed to challenge management, as necessary, to avoid managerial opportunism and ensure alignment with the board's strategic direction.

Applications of Agency Theory to Co-operatives and Credit Unions

While agency theory is rooted in the study of shareholder-owned corporate models, it is also the basis for a considerable amount of the literature on co-operative governance, particularly in the credit union arena. Nevertheless, this literature generally acknowledges some important differences between investor-owned firms and co-operatives / credit unions (Pohler 2017).

- Co-operatives and credit unions are owned by their members, who are also the users of their services rather than a set of investors (i.e., shareholders).
- The primary goal of co-operatives and credit unions is something other than maximizing profits.

- Co-operative and credit union board directors may receive compensation, but not in the form of actively traded shares.
- Co-operative and credit unions rely on the intrinsic motivation, mission orientation, and values fit of board members and managers.
- Co-operatives and credit unions may face greater co-ordination costs associated with democratic governance processes, especially when members differ markedly in terms of demographic, lifestyle, or other importance ways.

However, some of these differences may be more apparent than real. In a survey of governance practices in Canada and the United States, Goth, Mckillop, and Wilson (2012) document relatively weak member participation in the credit union democratic process and point to research showing that principal-agent problems are arguably more severe in large credit unions because they cannot use share prices to align management and owner interests. They conclude their study by recommending that larger credit unions eliminate elected boards and instead have members vote for a nominating / board-selection committee that would in turn populate the board with the required professional expertise.

Further, Pohler (2017) points to research showing that some co-operative boards have done a poor job of reigning in management, leading to overly optimistic forays into business lines that ultimately proved the undoing of the co-operative itself. As discussed earlier, the Couchman and Fulton (2015) examination of factors that predict the failure of large co-operatives makes the same point.

The same principal-agent foundation can be seen in some Filene Research Institute work on credit union governance. In their review of credit union board renewal practices, Spirrizzi and Fullbrook (2015) remark that "the board must not forget that it is the ultimate decision-making authority of the credit union and that senior management owes a duty to the board, not the reverse." Hoel (2011) takes the principal-agent perspective as his starting point but asks, provocatively, "Who really owns credit unions?" and goes on to express deep skepticism about the capacity of members and the board of larger credit unions to truly fulfill their oversight function. He suggests, rather, that the most effective "governance" mechanism is for members to simply stop doing business with a credit union that fails to meet their needs.

Governance guidelines for financial institutions such as those developed by the Office of the Superintendent of Financial Institutions (OSFI) also show the unmistakable influence of principal-agent theory, albeit inflected by the uniquely important role of the banking sector. OSFI describes the board's primary duties as focused on setting strategy, managing risk, overseeing senior management (and board succession planning), and ensuring a robust audit function ("audit plans"). There are other telltale signs such as the recommendation that the board chair should be separated from the CEO, "as this is critical in maintaining the Board's independence and its ability to execute its mandate effectively." Unlike British Columbia's governance guidelines for credit unions, OSFI's guidance document makes no explicit allowances for credit unions, noting only that OSFI understands that a federally regulated financial institution's corporate governance practices "may depend on its size; ownership structure; nature, scope and complexity of operations; strategy; and risk profile."

Other Theoretical Perspectives

Given the ubiquitous nature of agency theory both in academic circles and in the more pragmatically oriented management literature, it is tempting to think that there is no other way of conceptualizing governance.

In the early 2000s, some leading governance scholars actively encouraged this idea, suggesting that the principal-agent approach to thinking and doing governance had triumphed or was well on its way to out-competing other ways of thinking and doing governance. Clark (2016) quotes leading scholars Hansmann and Kraakman as writing:

> Despite very real differences in the corporate systems, the deeper tendency is towards convergence, as it has been since the nineteenth century.… Although there remained considerable room for variation in governance practices and in the fine structure of corporate law throughout the twentieth century, the pressures for further convergence are now rapidly growing. Chief among these pressures is the dominance of a shareholder-centred ideology of corporate law among the business, government and legal entities in key commercial jurisdictions. There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value. This emergent consensus has already affected corporate governance practices throughout the world. It

> is only a matter of time before its influence is felt in the reform of corporate law as well. (32–33)

As Clark notes, however, the Hansmann and Kraakman view suffered from unfortunate timing because it emerged around the time of major governance problems at large firms like Enron and WorldCom and the subsequent financial crisis that called into question the wisdom of principal-agent-inspired governance practices, particularly around remuneration.

There are, however, other perspectives on the function of governance. And while not entirely at odds with principal-agency theory, they often start with a different understanding or definition of what constitutes governance. Cornforth (2004) itemizes four competing perspectives. We discuss these briefly here, with particular attention to the stewardship and stakeholder approaches, since these appear to have exerted some influence on co-operative governance practices.

We augment these perspectives by referencing recent literature that suggests there may be value in studying the way governance works in public institutions such as government departments, agencies, crown corporations. We begin, however, by discussing a recent reformulation of principle-agent theory.

Firm-Specific Investments and Motivation Theory

It bears repeating that the principal-agent perspective assumes that people are self-interested, the implication being that managers look out for their own interests at the expense of the entity's owners. There is, however, another increasingly common view about human motivations rooted in research findings from behavioural economics and psychology. For the purposes of this discussion, there are two key findings from that work.

First, people are inclined to care about others and not just themselves. There is compelling evidence, in fact, that this kind of pro-social thinking is a key human evolutionary advantage (Gintis and Bowles 2011). Second, we can design institutions that, to a greater or lesser extent, activate this type of behaviour.

Osterloh, Frey, and Zeitoun (2011) suggest that this understanding of human behaviour has important implications for thinking about governance, particularly in knowledge-intensive sectors such as banking, where corporate success hinges on "firm-specific investments" by employees. The dilemma is that a lot of what we do on the job is not easily portable to other corporate entities. The more an employee "invests" in firm-specific knowledge, the greater the financial and other costs of job loss. As a result, they may be motivated to "free ride" on the firm-specific knowledge of others, particularly if individual contributions are difficult to observe—a likely scenario in the kind of team-based work that characterizes knowledge industries.

From this vantage point, Osterloh, Frey, and Zeitoun (2011, 57) see the firm as not so much a "nexus of contract" but rather a "nexus of firm-specific investments." The question for the board, then, is to think about designing an institution that motivates employees to make these kinds of firm-specific investments. This brings them to recommendations for board design—some of them familiar—e.g., the board provides monitoring and strategic advice—but others less so.

For example, they recommend that boards should be elected not only by shareholders but also by employees. The firm-specific investments made by employees are a form of "residual claim"—similar to shareholder, or member, residual claims (often required by corporate law)—and should be recognized as such in terms of (proportional) representation. Second, Osterloh et al. suggest that the board should think carefully about building an institutional environment that increases the likelihood of pro-social behaviour by employees. This is key to motivating knowledge workers to make firm-specific investments in a team setting.

Third, management and the board must take great care to design human resource practices that activate—or "crowd-in"—what is called intrinsic motivation, which is contrasted with the external motivation of salary, incentives, and job loss that does much of the heavy HR lifting in most workplaces. Under the right institutional design circumstances, individuals who are intrinsically motivated are willing to contribute to collective endeavours or goods voluntarily—the kind produced by knowledge workers—and to punish those who do not. What are these design principles? While beyond the scope of this paper, there are three key features that relate back to the board chair question, particularly around remuneration

- *Autonomy*: Remuneration practices have to be carefully designed to crowd in behaviours linked to intrinsic motivation such as autonomy and reciprocity. The authors point to some experimental research showing that fixed salaries activate a sense of reciprocity, which in turn generates a higher work effort than piece-rate work.

- *Supportive feedback*: Intrinsic motivation is only activated and supported when individuals receive feedback that reinforces their sense of work responsibility and efficacy. This is why unexpected symbolic rewards—perhaps recognition for a job well done at a staff meeting—can crowd in intrinsic motivation.
- *Social-relatedness*: People respond well—and contribute more to team-based work—when they are given some direction on the kinds of behaviour that are socially acceptable and expected. Experimental evidence has shown how simply changing the labels of a game from "Wall Street Game" to "Community Game" can direct players more towards team-based production.

The Osterloh, Frey, and Zeitoun view of corporate governance is arguably a less radical departure from the principal-agent perspective than the other approaches discussed next. Its authors take pains to stress that there is nothing *normative*—or ideological—about their view. It is built on the same "efficiency" considerations that underpin the principal-agent perspective but disagrees on how best to achieve a competitive, efficient firm, particularly in knowledge-intensive sectors.

We next turn to other better-known theories of governance.

Democratic Theory

The democratic theory of governance is the one most familiar to co-operatives and credit unions. It starts from the premise that the board is democratically elected (one member, one vote) and represents member interests by setting the co-op's strategic direction and exercising oversight over management. Because of its democratic selection method, this theory de-emphasizes the importance of board member expertise in favour of *representation* of the members.

Despite its emphasis on one-member, one-vote democratic forms of representation, this theoretical perspective still carries elements of principal-agency theory, particularly in its strong focus on the board setting strategic direction and providing oversight to management.

Managerial Hegemony

As the name suggests—and contrary to what agency theory would imply—this model points to evidence showing that "managerial power has played a key role in shaping executive pay," with negative consequences for investors and the broader economy (Bebchuk and Fried 2005, 2).

From this perspective, the principal-agent problem is not just between shareholders and management but between shareholders and the board as well. It is, in a sense, principal-agency theory without the hopefulness that market forces will fix the problem.

Bebchuck and Fried (2005) identified a number of social and psychological forces—in addition to simple constraints on time—that might compel the board to align with and reward management in an unjustified way. These factors include collegiality, team spirit, a natural desire to avoid conflict, friendship and loyalty, and cognitive dissonance (many board members are themselves executives and may, drawing on their own work experience, fail to see excess-compensation problem).

Over and above these considerations, Bebchuck and Fried, whose research is on investor-owned firms, point to the fact that corporate CEOs often exert considerable influence over who gets on the board (in terms of the slates) and director compensation. They argue that the threat of takeover—often seen as a key disciplining mechanism over executives in principal-agent theory—is much less than it appears, given staggered director elections and "poison pills." Bebchuck and Fried suggest there are ways of addressing these problems, most of which boil down to two matters. The first is more more *effective* transparency—full and clear disclosure of executive pay, including perquisites and pension benefits as well as clearer reporting on pay for performance. The second is improved pay arrangements so that executives do not, for example, benefit from windfall gains (owing to generalized market activity) and receive pay more clearly tied to longer-term objectives.

From this managerial perspective, some — but not necessarily Bebchuck and Fried — would suggest that the board's function is largely ceremonial, providing legitimacy to decisions taken by the executive (Cornforth 2004). Bebchuck and Fried are more hopeful, pointing to regulatory changes as well as the influence of large shareholders on governance practices. There are some nuances to the pessimism inherent in the managerial hegemony perspective: Boards may have latent power that effectively constrains the scope of management behaviour. If you push them too far, they will act. Broader social norms, for example, are likely to provide some rough outer limits to excessive CEO compensation. Moreover, boards are likely to have considerably more control over management in crisis situations.

While this perspective was developed with large investor-owned entities in mind, some scholars who specialize in co-operatives write as though it is also appropriate for some larger co-operatives. While more explicitly framed in a principal-agent framework, the work of Hoel (2011) and Goth, Mckillop, and Wilson (2012), cited earlier, offers commentary that seems aligned with this theoretical viewpoint.

Stakeholder Theory

Stakeholder theory starts by assuming that corporations are social constructs that have obligations much larger than simply maximizing profit for their shareholders. As some of the key architects of this theoretical approach, Freeman, Wicks, and Parmar (2004, 364) suggest that in the stakeholder view of governance, "concern for profit is the result rather than the driver in the process of value creation."

This is a different starting point from the principal-agent perspective, which sees profit maximization as the firm's *raison d'être* and, moreover, a useful management tool, given the inherent complexity of the world (i.e., it is easier to focus on one thing—profit maximization—than ten things). The stakeholder view is in fact deeply critical of this foundational aspect of principal-agent theory. The idea that the firm should only maximize shareholder value "is not a value-neutral theory and contains vast ideological content" (Freeman, Wicks, and Parmar 2004, 365). This different starting point has important implications.

It means, for example, that boards should pay close attention to corporate and stakeholder values; they are not incidental or by-products of profit maximization but the heart of the entity's being and well-being. It also suggests that corporate boards should be broadly reflective of these values and hence the broader community.

In one of the earliest contributions to the stakeholder perspective, Freeman and Evan (1990) underline the board-representation perspective by stressing that shareholders are just one of several stakeholders that constitute a corporation. In fact, shareholders benefit from a privileged ability to exit the corporation by selling their shares at relatively low transaction costs compared with other stakeholders—employees, suppliers, customers, and the broader community. Like Osterloh, Frey, and Zeitoun (2011), Freeman and Evan emphasize the firm-specific nature of these other stakeholders' investments—employees have firm-specific skills and knowledge, suppliers set up firm-specific infrastructure (e.g., a factory), customers have firm-specific habits (e.g., banking customers with automatic withdrawals), and communities have firm-specific structures (e.g., roads and services). Freeman, Wicks, and Parmar (2004) claim that the willingness to foreground corporate and stakeholder values uniquely equips management to address tensions among these stakeholders—tensions which if ignored can undermine the firm.

As Cornforth (2004) notes, the stakeholder model is particularly influential in the governance practices of nonprofit boards and the public sector, although it has also had an impact on other corporate entities, particularly as it concerns gender, racial, and other forms of board representation that have historically been lacking in Anglosphere countries.[10]

Stewardship Theory

The stewardship view (Donaldson and Davies 1991) is arguably the theoretical perspective that represents the most radical departure from agency theory. Rather than assuming conflicting interests between management and the board, it assumes alignment: the board's job is to shepherd, guide, and work hand-in-hand with management. The management-board relationship is a partnership rather than adversarial. Stewardship theory assumes that management has the same interests as the board, namely, to improve organizational performance.

From this perspective, corporate entities should focus on recruiting board members who have the required expertise and connections to support management in its role. This theory also emphasizes the importance of board training, recognizing that no one board member is likely to know everything s/he needs to know about the corporation. For co-operatives, the stewardship perspective can represent a challenge; there is no guarantee that the membership will elect people with the requisite skill set to the board.

The stewardship model draws heavily on the view that humans are not necessarily or entirely self-interested. They are often—and perhaps mostly—driven by pro-social objectives, a view discussed earlier in terms of motivation theory, but which is also foregrounded in the work of leading stewardship theorists like Donaldson and Davies (1991).

Public Sector Governance

There is another strand of governance research that appears to be less a unified theory than an amalgam of practices that Benz and Frey (2007) suggest might help inform governance in other institutional environments. They identify four public sector governance practices that provide some insight into how corporations, including co-operatives, might rethink the way they do governance.

- *Fixed remuneration*: The compensation of politicians, bureaucrats, and judges is characterized by a tendency to pay employees fixed compensation. Where pay-for-performance practices exist, this component of income tends to be small relative to the overall compensation or private sector practices. The premise here is that the people who set and judge the rules governing pay should not be given the incentive to manipulate them in their own favour; there is also a sense that it is difficult to measure the output of public officials. By contrast, recent experience has shown how pay-for-performance practices can be manipulated by corporate executives. Notwithstanding the use of outside auditors, corporate executives have considerable power to influence the "measuring rod."

  According to Benz and Frey, the use of fixed compensation has some benefits beyond mitigating risk. It tends to incent public officials to focus on the content of their work—the broader public good—rather than fighting a zero-sum battle with other employees to advance their narrow interests in achieving incentive targets. None of this is to say that public officials should be poorly compensated—the research shows that if pay is too low, officials can be incented to take bribes or otherwise engage in corruption.

- *Division of power*: The division of power in the public sector—among Parliament, bureaucrats, and the judiciary—acts as an important check on the potential for excesses by any one arm of government. Benz and Frey say there may be scope for thinking about the application of this idea to the corporate sphere and suggest, for example, instituting the practice of having an audit committee comprised of entirely independent directors. The audit committee could also have responsibility for appointing, retaining, and overseeing the work of external auditors, thus removing one possible way for executives to influence the measuring rod. While this is an increasingly common practice, the authors go a step further and suggest that the audit committee could be elected directly by owners. Again, the basic premise is to create another institutional body that provides a check on management behaviour.

- *Rules of succession (fixed terms)*: The senior ranks of the public sector are characterized by fixed terms, a requirement for re-election after the term, and limits on consecutive or total re-elections. In Canada, politicians typically are elected for four-year terms, give or take. In Ottawa, the heads of major public sector agencies such as the Bank of Canada are appointed for seven-year terms. In the Canadian judiciary, terms generally run until a certain age is reached (seventy, seventy-five) although practices vary in other countries, where more restrictive terms are the norm. Benz and Frey suggest that these kinds of practices might be usefully applied in the corporate sector. They confer several advantages, including a pre-set end of office, genuine competition for board seats as terms/re-election limits are reached, and an incentive to think long term about the business. The authors further cite research showing that job security can lead top managers to make more firm-specific investments of time and effort.

- *Institutionalized competition*: Institutionalized competition is the political practice of parties competing against one another in a democratic system. While co-operatives already have the democratic aspect of this practice, they sometimes come up short in terms of having genuine competition for open board positions.

To conclude this discussion, Table 2 present a *sketch* of what each of these perspectives might mean for the questions at hand — namely chair selection, tenure, remuneration, and evaluation.

Table 2: Implications of Different Theoretical Perspectives for Chair Selection, Tenure, Evaluation, and Remuneration

	Principal-Agent	Firm-Specific Investment & Motivation	Democratic	Stewardship	Stakeholder
Chair Selection	Strong knowledge / skill-set to draw from in order to hold manage-ment to account	Strong ability to motivate team mentality	Selected by membership; must reflect membership	Strong ability to motivate team mentality where team is defined as board *and* management	Represent a key stakeholder group; able to foster discussions that reconcile tensions among stakeholders
Tenure	There should be clear limits to avoid capture by management	Must demon-strate an ability to effectively "coach" team; given lack of discipline tools, likely to take time	Unclear, but if following public practices, 4–5 years	Longer-term given the importance of thinking about the board/CEO relationship as a partnership	Unclear, but may be of shorter duration given shifting power balance among stakeholder groups
Evaluation	Performance measured against company share price activity or equivalent metric in a co-operative	Ability to evoke the sense that board members are part of a team	Performance measured against ability to deliver on corporate (not profit-maximizing) mission	Performance measured against ability to deliver on corporate mission; agnostic to corporate form	Ability to guide discussions that reflect and integrate the interests of various stakeholders
Director Compensation	It is common practice to pay directors at investor-owned companies some portion of their compensation in the form of stock options, but there have been increasing calls for longer-term incentive arrangements that align director, executive, and employee compensation (Leblanc 2013) through stock options and/or other market-based incentives	Fixed compensation to focus on team building as opposed to self-interested objectives	Fixed compensation; possibility of small proportion of variable pay so long as it aligns with interests/vision of members and doesn't violate co-operative principles	Fixed compensation	Compensation practices should not deviate too much from those of key stakeholder groups

FOOTNOTES

[1] Motivation is said to be "extrinsic" when, from the employee's perspective, it is seen as emerging from "outside" the individual. An individual whose work effort is determined solely by reference to salary, incentive pay, and work benefits could be said to be extrinsically motivated; an individual who is intrinsically motivated, by contrast, finds motivation in the work itself. The former tend to see themselves as "controlled," whereas the latter are more autonomous. We also discuss this topic under the heading of "Firm-Specific Investments" in Appendix A.

[2] Finkelstein and Mooney (2003) present research findings that, contrary to what is assumed/predicted, suggest these structural factors have little or no influence on performance.

[3] Dulewicz, Gay, and Taylor (2007) suggest that part of the challenge with conducting qualitative studies of governance processes—and the predominance of empirical studies about governance structures—is the fact that most boards are reluctant to allow outsiders inside to study their activities.

[4] For a discussion, see: https://en.wikipedia.org/wiki/Adrian_Cadbury.

[5] Based on the fact that the authors are all Québec-based and the way they frame the empirical discussion, I suspect the credit unions in question are Desjardins caisses. As the authors are careful to note, their findings may not be as applicable to other types of organizations.

[6] The authors look at a third "intervening" variable to explain board commitment and motivation—namely, the perceived relationship between the board chair and the CEO. They find that commitment and motivation are increased when the quality of the relationship is perceived to be high.

[7] It is important to stress that this is not a theory of governance but rather a definition that can be applied to any of the theoretical perspectives discussed in Appendix A.

[8] Bebchuk and Fried (2005, 13) point to a research finding that "companies with higher CEO compensation have higher director compensation as well—and that such high pay levels appear to reflect insider 'cooperation' rather than superior corporate performance."

[9] To illustrate, Tesla's share price has fluctuated closely in response to chief executive officer Elon Musk's controversial Twitter activity, which markets have interpreted as indicative of Musk coming under tremendous stress owing to the company's challenges with turning a profit. See, for example, "A Brief History of Elon Musk's Market-Moving Tweets" at https://www.wired.com/story/elon-musk-twitter-stock-tweets-libel-suit/.

[10] To illustrate, the federal Department of Finance has proposed mandating a "comply or explain" model on federally regulated financial institutions around gender representation. See "Department of Finance Canada Launches Second Stage of Consultations on Federal Financial Sector Framework."

REFERENCES

Adler, J. 2016. Who's Bullish on Banks as Utilities? It's Not Who You Think. American Banker, 18 April, available at: https://www.americanbanker.com/opinion/whos-bullish-on-banks-as-utilities-its-not-who-you-think

Altman, M. 2011. Behavioural economics perspectives: Implications for policy and financial literacy. Research paper prepared for the (federal) Task Force on Financial Literacy.

Bebchuk, L.A., and J.M. Fried. 2005. Pay without performance: Overview of the issues. *Journal of Applied Corporate Finance* 17, no. 4: 8–23.

Benz, M., and B. Frey. 2007. Corporate governance: What can we learn from public governance? *Academy of Management Review* 32, no. 1: 92–104.

Clark, T. 2016. The continuing diversity of corporate governance: Theory of convergence and variety. *ephemera: theory & politics in organization* 16, no. 1: 19–52.

Cornforth, C. 2004. The governance of cooperatives and mutual associations: A paradox perspective. *Annals of Public and Cooperative Economics* 75, no. 1: 11–32.

Couchman, P., and M. Fulton. 2015. *When big co-ops fail.* Saskatoon: Centre for the Study of Co-operatives.

Davis, J.H., F.D. Schoorman, and L. Donaldson. 1997. Toward a stewardship theory of management. *Academy of Management Review* 22, no. 1: 20–47.

Donaldson, L., and J.H. Davis. 1991. Stewardship theory or agency theory: CEO governance and shareholder returns. *Australian Journal of Management* 16, no. 1: 49–64.

Department of Finance. 2017. "Department of Finance Canada Launches Second Stage of Consultations on Federal Financial Sector Framework." August 17. Available at: https://www.canada.ca/en/department-finance/news/2017/08/department_of_financecanadalaunchessecondstageofconsultationsonf.html

Dulewicz, V., K. Gay, and B. Taylor. 2007. What makes an outstanding chairman? Empirical findings from the UK non-executive director of the year awards, 2006. *Corporate Governance* 15, no. 6: 1056–69.

Financial Institutions Commission of British Columbia. 2013. Governance Guideline.

Finkelstein, S., and A.C. Mooney. 2003. Not the usual suspects: How to use board process to make boards better. *Journal of Management Executives* 17, no. 2: 101–13.

Forbes, D.P., and F.J. Milliken. 1999. Cognition and corporate governance: Understanding boards of directors as strategic decision-making groups. *Academy of Management Review* 24, no. 3: 489–505.

Freeman, R.E., and William M. Evan. 1990. Corporate governance: A stakeholder perspective. *Journal of Behavioral Economics* 19, no. 4: 337–59.

Freeman, R.E., A.C. Wicks, and B. Parmar. 2004. Stakeholder theory and the "the corporate objective revisited." *Organization Science* 15, no. 3: 364–69.

Frey, B., and R. Jegen. 2000. Motivation crowding theory: A survey of empirical evidence. CESifo Working Paper, No. 245.

Fulton, M., B. Fairbairn, and D. Pohler. 2017. *Credit unions in Canada: Design principles for greater co-operation*. Saskatoon: Centre for the Study of Co-operatives.

Gabrielsson, J., M. Huse, and A. Minichilli. 2007. Understanding the leadership role of the board chairperson through a team production approach. I*nternational Journal of Leadership Studies* 3, no. 1: 21–39.

Gintis, H., and S. Bowles. 2013. *A co-operative species: Human reciprocity and its evolution.* Princeton: Princeton University Press.

Goth, Peter, Donal Mckillop, and John Wilson. 2012. *Corporate governance in Canadian and US credit unions*. Filene Research Institute, research report.

Guerrero, S., Lapalme, M-È., and M. Séguin. 2015. Board chair authentic leadership and nonexecutives' motivation and commitment. *Journal of Leadership & Organizational Studies* 22, no. 1: 88–101.

Haidt, J. 2001. The emotional dog and its rational tail: A social intuitionist approach to moral judgment. *Psychological Review 108: 814–34.*

Hoel, Robert F. 2011. *Power and governance: Who really owns credit unions?* Madison, WI: Filene Research Institute.

Jansson, A., U. Larsson-Olaison, J. Veldman, and A. Beverungen. 2016. The political economy of corporate governance. *ephemera: theory & politics in organization* 16, no. 1: 1–17.

Kahneman, D., and A. Tversky. 1984. Choices, values and frames. *American Psychologist* 39: 341–50.

Kirkpatrick, G. 2009. The corporate governance lessons from the financial crisis. OECD *Journal: Financial Market Trends* 1: 61–87.

Leblanc, R. 2005. Assessing board leadership. *Corporate Governance: An International Review* 13, no. 5: 654–66.

Leblanc, R. 2013. Reforms to director compensation need to occur. *Canadian Business*, 10 July, available at: https://www.canadianbusiness.com/blogs-and-comment/reforms-to-director-compensation-need-to-occur-richard-leblanc/

Lindblom, C. 1959. The science of "muddling through." *Public Administration Review* 19: 79–88.

Mian, A., and A. Sufi. 2014. *House of debt: How they (and you) caused the great recession and how we can prevent it from happening again*. Chicago: University of Chicago Press.

Nadler, D.A. 2004. Building better boards. *Harvard Business Review* 82, no. 5: 102–05.

Office of the Superintendent of Financial Institutions. 2017. Draft corporate governance guideline: Sound business and financial practices. November.

Orlikoff, J.E., and M.K. Totten. 2009. Evaluating the board chair. *Healthcare Executive* 24, no. 1: 60–62.

Osterloh, M., B. Frey, and H. Zeitoun. 2011. Corporate governance as an institution to overcome social dilemmas. In *Corporate governance and business ethics*, ed. A. Brink. Dordrecht: Springer.

Pohler, D. 2017. *Governance challenges in credit unions: Insights and recommendations.* Filene Research Institute, Publication #439 (11/17).

Shekshnia, S. 2018. How to be a good board chair: The key is to remember you're not the CEO. *Harvard Business Review*. March-April.

Shleifer, A., and R.W. Vishny. 1997. A survey of corporate governance. *The Journal of Finance* 52, no. 2: 737–83.

Spirizzi, A., and M. Fullbrook. 2015. *Entrenched or energetic? Improving credit union board renewal.* Filene Research Institute, Publication #373 (9/15).

JOHNSON SHOYAMA
Canadian Centre for the
Study of Co-operatives
UREGINA USASK

Diefenbaker Building, 101 Diefenbaker Place,
University of Saskatchewan
Saskatoon, Saskatchewan
S7N 5B8

Ph: 306-966-8509
Email: coop.studies@usask.ca