SP 2002-01
January 2002

Staff Paper

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Acknowledgements

The authors thank Robert Ludwig at The Hale Group, James Pierson retired Chief Operating Office of CoBank, and Professor Gerald White in the Department of Applied Economics and Marketing at Cornell for their review of this manuscript. Their comments were most helpful, but the authors are solely responsible for any remaining errors and omissions.

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QUESTIONS COOPERATIVE DIRECTORS SHOULD BE ASKING MANAGEMENT

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The most important responsibility of cooperative directors is to JUDICIOUSLY ASK THE RIGHT QUESTIONS OF MANAGEMENT. It has been suggested that some directors do not know all of the correct questions to ask of management, or how.

The purpose of this paper is fourfold: 1) To briefly describe how directors should pose questions to management, 2) To provide an extensive list of questions directors should know the answers to, 3) To outline a generic format for asking general questions and 4) To assist in identifying important board issues and how to handle them.

Certainly this is not a complete list of questions or possible director concerns. However, we hope it covers most of the important issues directors will confront in carrying out their fiduciary responsibilities. We also suggest that these questions may be used by nominating committees and members to explore the cooperative business philosophy and knowledge of director candidates.

In this paper, we have not provided answers to the questions. We assume directors that are elected to cooperative boards, in some cases multi-billion dollar companies, have sufficient business knowledge and experience to know the appropriate answers.

How Directors Should Go About Asking Management Questions In Board Meetings

Before asking a sensitive question in a board meeting, a director should first approach the Chair and/or CEO to indicate there is a concern on a particular issue. More often than not, your concerns will be readily answered by the Chair and/or CEO. However, if you are not satisfied with the answer from the Chair and/or CEO then you as a director have the right and the fiduciary responsibility to bring your concerns to the board. You do this by adding your issue to the current or a future board agenda. For this reason many board meetings begin with approval of the agenda.

On a rare occasion, the Chair will not allow an item to be placed on the board agenda. When this happens usually it is because the issue identified is either really a non-issue or may be a personal agenda item. (Yes, sometimes directors get elected with a special interest agenda.) However, in that very rare situation when a Chair refuses to take up a very real concern of directors and members, a majority vote by the board can put an issue on the board agenda.

Directors should always phrase questions in an objective, straightforward and businesslike manner. To prevent divisions between the board and management as well as among different directors on the board, we strongly suggest questions should never carry a “we versus them" connotation. Rather, issues should be raised in a way that preserves a team philosophy and effort among the board and management.

Only ask questions that have a "material" impact on the cooperative. This is why we used the word JUDICIOUSLY in our introduction. "Material" is an accounting term that most accountants are reluctant to define. However, here is our academic definition: Anything that is likely to have a 5% or greater impact on the organization's bottom line. Examples of material issues would be a new product or service, the performance of a processing facility, and the performance of top managers. Examples of non-material issues include: the employment status of lower level employees, selection of the cooperative's minor suppliers, and the make of equipment or vehicles purchased.

Make sure you get questions answered to your satisfaction. Often an initial question may not get to the heart of an issue. Rely on diligent fellow directors to assist you in following up on your inquiry. In other words, you may want to brief and enlist fellow directors prior to bringing a matter to the board table. Even if you must fly solo, be sure you get all your questions answered to your satisfaction, and see that appropriate inquiry or action will be pursued.

Board minutes should record all board decisions. For most decisions there is no need to include the board discussion in the minutes. However, in the case of major decisions it may be to the board and management's advantage to have the minutes indicate that important questions were asked and appropriate answers received. The purpose is to protect the board and management against any adverse litigation. In that rare case of a split board vote on a major issue, the minority may also want to ask that the vote be recorded in the minutes.

Finally, maintain absolute confidentiality of all board discussions and actions. Give management sufficient time to communicate any board decisions to members and the public. If a particular issue was brought to you by members, indicate to them that the issue has been brought to attention of the board, and that management will be communicating with members about its status in the near future.

Questions Directors Should Be Asking Of Management

We have divided the questions into five categories: a) strategic issues, b) financial issues, c) operational issues, d) marketing issues, and e) cooperative and member relations issues. Directors should expect many of the following questions to be answered in the regular written and oral reports management presents to the board.

Strategic Issues

What is the process used to produce the strategic plan that is annually presented to the board of directors for approval? Are any changes needed in the process used?

Do employees and members understand the cooperative's vision, mission and objectives?

What forces (i.e. technology, demographics, consumer demand, foreign competition, policies and regulations, etc.) are most likely to drive change in our industry over the next 5 years?

Who are our most serious competitors? And why?

Does the cooperative have sufficient capability and size to successfully compete and adequately fulfill our customers' needs over the next 5 years? If not, what are we doing to develop the capacity?

Are we employing the appropriate strategy for each business unit give its stage in the business life cycle?

What are the cooperative's goals over the next 5 years in terms of growth in sales and profitability as well as diversification? What is the acceptable range for these goals? That is, what is the minimum required and the desirable target? And how do our goals in each category compare with the industry?

Will the cooperative be able to grow, on average, at 2-3 times the rate of inflation over the next 5 years in order to cover increasing fixed costs?

Are all cooperative goals "SMART", i.e. specific, measurable, attainable, rewarding and with a well-defined time line?

Does our strategic plan primarily focus on internal or external growth? Why?

What types of contingencies have management considered in our strategic planning?

Are managers empowered and encouraged to take calculated risks?

Are the managers responsible for implementation of the strategic plan being evaluated against the achievement of our strategic goals?

If the cooperative has a financially disappointing year, what strategic changes would management recommend?

Describe the corporate culture of this cooperative. Is it the most appropriate corporate culture for our cooperative and industry?

Does the cooperative suffer from "paralysis of analysis"? That is, do we spend too much time studying issues rather that actively addressing them?

Does the cooperative have a succession plan for all key management positions?

Are the cooperative's managers actively developing a broad set of business skills, capabilities, and experiences? How?

Are our management personnel being actively recruited by top businesses? If not, why not?

Financial Issues

Do our financial reporting systems provide management, the board and the people responsible for various areas of our business the best and most up-to-date business information possible?

Does management think that the board requests too little or too much financial information?

Is the cooperative able to pay members competitive prices and earn a reasonable return (i.e. 8 - 12 %) on their equity? If not, why not?

Is the current level of equity optimal? Why or why not?

Does the cooperative have an optimal balance between the amount of debt and equity, as well as between the amount of short and long term debt? What has led us to that conclusion?

Is member equity being retired or revolved in a timely fashion?

What is the discounted value of the retained portion of members' patronage refunds?

Have we considered alternative equity programs, including those that allow members to capture the value of the organization when they leave the cooperative much like a stock price does for public corporations?

There are ways to make cooperative equity liquid so members can convert their equity into cash at any time. Has the cooperative explored these alternatives?

Do we have good working relations with our primary lenders?

What covenants and financial conditions have our lenders placed on the way we currently operate or may need to operate in the future?

What is the cooperative's weighted average cost of capital?

How are new capital investment projects evaluated?

What is the required rate of return on new investment projects?

How are large replacement investments analyzed?

How is risk assessed when analyzing investment projects?

Does the cooperative have appropriate systems in place to assure the optimal management of working capital? Describe our cash flow management systems.

Is the average age of our accounts receivable acceptable for our industry? In not, why not?

What practices do we have to assure against any major losses on accounts receivable?

What is being done to minimize the cost of inventories while assuring that we can service our customers' product needs on a timely basis?

Is our line of credit: less than adequate, just right, or more than adequate? Why?

On a scale from extremely conservative to extremely aggressive, characterize our financial management and accounting practices?

Has our independent auditor received full disclosure and the complete cooperation of management during our annual audit?

Were there any major financial items over which management and our independent auditor disagreed in terms of how they should be handled? What were those items?

What is being done to address any issues raised in our independent auditor's "management letter"?

Are any assets or liabilities being handled "off balance sheet"? That is, are there any items not included in our consolidated financial statements, including the guarantee of another entity's liabilities?

How much exposure does the cooperative have in terms of financial or marketing risks?

What risk management strategies (such as futures, options and derivatives) does our cooperative employ and what policies and procedures are in place to assure the strategies are not abused or could cause a financial loss to the cooperative?

Does the cooperative carry the correct insurance type and level of coverage to handle our most likely business risks?

Are adequate mechanisms in place to prevent the possibility of fraud and other illegal financial acts?

Operational Issues

What methods of bench-marking are used by our cooperative, and are we bench-marking ourselves against leading global non-cooperatives as well as other cooperatives?

Do you think the board and members are too risk averse, to the extent that it has hampered our operations and ability to compete?

Do you feel the board becomes too involved in operational issues?

What is our primary strategy for reducing per-unit costs of our products/services, specifically fixed costs?

What business areas of this cooperative will be obsolete in 3-5 years?

Are there any business units or activities that do not earn a competitive return? Why not?

Have we been aggressive enough in closing or divesting ourselves of losing operations?

Are there any areas of this cooperative that should be "outsourced", such as transportation, accounting, management information systems, human relations, etc?

Under what circumstances would we enter into a joint venture or strategic alliance, and are we continually exploring such opportunities?

Do we have excellent relations with our major input suppliers?

Is the quality of our top management people equal to or better than those of our competitors?

Do we offer competitive salary and benefit programs to management and employees?

Does the cooperative have IOS 9000 certification? If not, why not?

Are appropriate policies and procedures in place to assure compliance with all laws and regulations concerning labor, food safety, the environment, etc?

Marketing Issues

Is our marketing plan sufficiently aggressive?

Who our are primary competitors and what are their strengths and weaknesses as compared to our own?

Do we have an excellent idea of who our major customers are, why they prefer us, and what we must do to keep them satisfied?

Are we making every effort to anticipate the future wants and needs of our customers, and are we prepared to meet those wants and needs as they arise?

Are the cooperative's products and services properly positioned in the market?

What proportion of our products and services would you classify as value-added (i.e. unique to us) or as commodities (similar to our competitors). Is this the appropriate mix?

Given our product and service mix, are we the lowest cost firm in our industry? If not, why not?

Do all products and services the cooperative markets "pay their way"? That is, which products and services cover direct expenses only, partial overhead, and total allocated overhead?

What is the value of our brand name? How do we measure that value?

What is being done to protect and leverage our brand name?

In our marketing and advertising, are we exploiting the fact that we are a cooperative with close ties to members/producers?

Are we viewed as the provider of the highest quality products and services in our industry? If not, why not?

Do we have the policies and procedures in place to assure that our members deliver the quality and quantity of products that the market demands? Are there any exceptions to these policies and procedures?

What price premium do we derive from our quality image?

What are we doing to minimize the risks of food safety and food security problems?

Are we able to trace the origin and destination of all the products we market?

Does the cooperative have a HACCP (Hazard Analysis and Critical Control Point) system in place? If not, why not?

Describe our strategy with respect to research and development that results in new products or services? Is our philosophy to be: the market innovator, early adopter, or follower?

How do we measure the success of our investment in research and development? What is our return (i.e. ROI) on research and development, and how is it measured?

Are we utilizing the most efficient distribution channels?

How does our supply chain management system compare to our industry and sector?

What is the cooperative's strategy in terms of "category management"?

What is our strategy with respect to foreign markets?

What is our pricing strategy?

Are we the price leader in our markets and industry, and what is our strategy as the price leader?

Are we spending enough on advertising and promotion? Or too much?

How does our advertising and promotion spending as well as our research and development efforts compare to our major competitors?

Is our advertising and promotion strategy cost effective? How do we know?

What impact do government programs have on our operations and marketing efforts? What would be the impact if these programs are expanded, reduced or eliminated?

What policies and procedures are in place to assure we are in compliance with all marketing regulations and anti-trust laws?

Cooperative And Member Relation Issues

Are we the market of first choice for members and non-members? If not, why not?

How would you characterize member satisfaction and loyalty? How do you know?

Do members and employees know why we are and what it means to be a cooperative?

Do members have a "feeling of membership"? That is, do they know they will be listened to and they can have an influence on cooperative decisions?

Do we have effective two-way communications with members? If not, why not?

Do you feel the membership is sufficiently informed about our cooperative in such areas as: major policy decisions, operations, marketing strategy, financial status and cooperative governance?

Are we well positioned to serve the members of the future?

How well attended are member meetings and what types of issues are discussed at those meetings?

What can be done to generate more member involvement in our cooperative?

Do members appreciate that democratic control means winning some and losing some policy decisions that directly impact them?

Market security does not necessarily mean a cooperative should take and sell everything members can produce. Should the board re-evaluate our position concerning market security?

Could we better serve members by being a closed cooperative?

Do we have the optimal board size to conduct the cooperative's business?

Do you think our cooperative's nominating and election system assures that we get the best elected cooperative representatives? If not, why not?

Does the board need additional, outside directors to bring broader business expertise and objectivity to the board table?

Are sufficient resources being devoted to director development and education?

Given our resources, are we doing enough to develop and educate the next generation of cooperative leaders (i.e. members, managers and employees)?

How does management measure the impact of major policy decisions on different members (i.e. members of different size, location, age, etc.)?

Some member services are partially or completely subsidized by the cooperative. Which services do not pay for themselves, and what is the annual cost of each on the cooperative?

What proportion of our membership utilizes the subsidized services?

Do all members pay the full costs they impose on the cooperative?

Do we service large and small members differently or exactly the same? If we offer volume discounts are they economically fair to both small and large members?

Why doesn't the cooperative send timely, quarterly unaudited financial reports to members like public corporations provide their shareholders?

A Generic Approach To Cooperative Issues

A number of specific questions are listed above. But there are always issues that do not fit neatly into one of those categories or topics. Consequently, we present a general format for exploring an issue that a director realizes is important to pursue.

The Procedures To Follow And The Generic Questions To Ask

After briefly describing the situation, your's and member's concerns, as well as the sources of your information, move that the issue be placed on the board's agenda for discussion.

Find out if a previous board decision was made concerning this issue and the logic behind that decision. Have circumstances significantly changed to warrant current board review?

How is that policy or decision impacting members? Get the real facts, and separate symptoms from cause.

What alternative solutions have been identified and studied?

Is the current analysis of options sufficient, or is additional outside input from an advisor or a consulting firm needed?

What is management's recommendation, and why is this their preferred alternative?

How does this decision impact the cooperative in terms of costs and benefits?

What is the economic impact on total membership?

Does this solution impact all members the same? If not, how are they differentially impacted?

What are the risks of the proposed recommendation, and what can we do to minimize the risks?

How long will it take to implement this decision?

What type of review can the board expect from management after implementation? (Only in the case of major decisions)

How To Spot Issues That Need Greater Board Attention

The issues outlined below are approximately ordered by degree of importance for board attention from least critical to most critical.

Divergence Of Reality From Expectations

This is the most subtle, but probably the most common means of spotting problems early. A divergence of actual results from expectations is the first thing directors should take as a red flag. Often it is a gut feeling. Also, there may not be specific goals against which to compare actual performance. One example would be the sudden loss of several good people at whatever level. Another example would be a board decision (such as a new product or service introduction, a merger or an acquisition) in which there were risks the board knew about, but the decision did not live up to expectations. In all cases the board should explore the reason why.

Innocent Non-compliance With Cooperative Policies And Procedures

Usually there are a plethora of cooperative directives. It should be expected that all managers and employees abide by all policies, rules and regulations. However, there are times that something happens unexpectedly: an employee accident, a lawsuit, an environmental violation. Sometimes these are caused by non-compliance with board policies. (If not, there probably should have been a board policy.) They may be innocent, in that the person responsible was not aware of board policy or company procedures. The board must hold top management responsible. This also begs the question whether there are other policies and procedures of
which employees are not aware. This could be an indication that board policies are not being well communicated throughout the organization.

Sudden Unexpected Changes In Market Conditions

Sudden and unanticipated changes in market conditions are occasionally to be expected. Examples of major unexpected changes include: September 11th, a distant war, a significant and widespread drought. And then there are minor changes in market conditions. However, "changes in market conditions" can be used by management as an escape clause for not turning in the performance they promised. Be assured that management will always have a good reason for not making their goals. Those reasons should be challenged. The minor changes should have been anticipated and discussed before they occur. Its called "contingency planning".

Major unexpected changes must be dealt with as soon as possible. For example, it appears that food demand has been significantly reduced as a result of September 11. Are people eating less? No. They are eating out less. And it appears that there is less food wasted when people eat at home than when they eat out. Consequently, food companies now need to adjust to this reduction in food demand.

Not Meeting The Cooperative's Goals

This is the most common problem. The board can expect every possible excuse from management for not meeting plan or budget. Some are justified, others are not. Is the budgeting or planning process at fault? Were the goals unrealistic, or too challenging? If it happens once, shame on management. If it recurs, shame on the board.

Not Adapting To Anticipated Changes In The Environment

This is probably the most important responsibility of a board in terms of strategic planning. Identifying and understanding possible future changes in the environment should be an ongoing part of the board's annual planning efforts. It requires directors to understand the "big picture" concerning what is happening in global agriculture, your industry and business in general. It involves anticipating changes in government regulations, as well as market and general business conditions. Fortunately, if spotted early enough most major changes in the business environment can be anticipated in sufficient time for the organization to adapt.

Directors need to keep informed and educated about changing conditions that could impact the cooperative. The board should expect management to keep them up-to-date in terms of major changes in the cooperative's operating environment. If sufficient expertise is not available internally, then the cooperative should employ outside consultants to assist in identifying and explaining the implications of business changes. Both the board and management should be held accountable for not anticipating major change in the cooperative's industry.

A Major Financial Shock To The Organization

Examples include: your banker won't renew your loan or extend your letter of credit, or a major loss from futures trading. Some companies use a VAR (Value At Risk) calculation, which is the maximum one day loss in earnings from adverse movements in interest rates, commodity prices or foreign exchange rates, to measure the degree of risk from potential financial shocks. It is the board's responsibility to assure that management has sufficient financial and procedural controls in place to avoid or minimize a major financial shock. This is usually done through proper risk financial oversight, risk management tools, and the board working with the cooperative's independent auditors. Remember it is the board that employs the independent auditor on behalf of members/shareholders.

Continued Under-performance

While the board should expect some ups and downs in a cooperative's performance, constant under-performance can not be allowed to continue. Given that most boards receive monthly financial information in a timely manner and meet at least quarterly, the board has a responsibility to get to the bottom of continued under-performance quickly. How quickly depends on the cause of the problem. If it is caused by internal operational, marketing, or financial circumstances, the issue should be addressed within two to four months. If is caused by external or macroeconomic factors, it may take a little longer. In any case, this type of issue will often require significant action, such as a major change in strategy or possibly even a change in management.

Flagrant Violation Of Cooperative Policies And Procedures

Remember it is the board's responsibility to adopt appropriate policies and procedures, and it is management's responsibility to implement them. There is no reason for a flagrant violation of cooperative policies and procedures. Management must be held accountable by the board not only for implementation, but also for communication of those policies. Directors must find out why and how it happened. Also, the board must act to assure a flagrant violation of cooperative policies and procedures does not happen again.

Illegal Acts, Law Suits And Government Sanctions

Possible examples include a salesperson implicated in price-fixing, a dangerous plant mishap, or an under-the-influence trucker involved in a traffic accident. Get to the bottom of the issue immediately, and determine who had any involvement whatsoever. This is absolutely grounds for dismissal of those involved as well as possibly the line managers for not knowing about the situation or having a mechanism in place to prevent it from happening.

Summary

We reiterate: The most important responsibility of cooperative directors is to JUDICIOUSLY ASK THE RIGHT QUESTIONS OF MANAGEMENT. We have tried to specifically indicate how, when and which questions directors should be asking management. The purpose of this paper is to provide directors with some guidelines for asking the right questions in the right way.

Certainly, it is not our intent to encourage confrontation between the board and management, nor between directors. On the contrary, we hope directors and managers will find our suggestions professional, objective and business-like. We strongly believe that cooperative top management, that is all directors and management, view their activities as a team effort and work in the best interest of members.

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