

## **The Monitoring Dimension of Cooperative Governance**

*Phil Kenkel*

*Bill Fitzwater Cooperative Chair*

The principal agent theory is a rather cynical model of the firm which views the CEO and board as agents for the owners (principals) that may or may not be pursuing the principal's interests. If this framework seems unfamiliar think about asking the a room full of citizens whether their elected leaders are focused on the people's interest or their own interest in staying in power. You are sure to find someone in the room that believes there is a principal-agent problem, although I doubt they would use those terms. The principal-agent problem is thought to be reduced when the principal can monitor the agent. Almost every regulation focused on corporate reform has attempted to improve the ability of shareholders to monitor the board and CEO.

Monitoring is also built into cooperative governance. The structure of the cooperative board is in itself a monitoring mechanism. The board not only represents the owners and customers, they are owners and customers. That structure should help reassure the members that someone is "driving the cooperative like we own it". Unfortunately that same structure of the board creates a separate perceived monitoring issue. There may be a cynical subset of the membership that thinks the board members are receiving preferential treatment (a principal-agent problem). That makes it essential for the board members to avoid even the perception of different treatment.

The audit is another key monitoring structure. The audit provides an unbiased and professional report on the status and performance of the cooperative. While the audit is typically summarized at the annual meeting, it is a good practice to let any member who wants more detail to come to the headquarters and read the full report. Some cooperative have taken the additional step of asking a member to serve on the audit committee. For confidentiality reasons the member representative does not review the financial data but participates in the discussion of the scope of the audit and the review of internal controls. That provides another layer of reassurance that the cooperative's performance is being laid out to be monitored. All forms of member committees reassure the membership that impartial eyes are peaking behind the current and finding that the member's interest is first and foremost.

Proponents of the principal-agent theory also maintain that the cooperative leader's incentives should be aligned with the owners. I'll discuss that issue in my next newsletter.

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