

# DEMOCRATIC GOVERNANCE

THE DESIGN OF GOVERNANCE SYSTEMS FOR WORKER COOPERATIVES





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## INTRODUCTION

This paper discusses the means by which small worker cooperatives and other employee-owned organizations govern themselves. We examine mechanisms that foster widespread communication among the co-op members about matters of organization policy; that provide member-owners with meaningful influence in setting policy; and that protect the personal rights of members. Together, these mechanisms form what we call the **governance system** of the organization.

The governance system is one of three key components needed in a democratic organization. The other two are the **legal structure** of the firm (i.e., the articles of incorporation and the by-laws) and its **management system** (i.e., the means by which the work of the organization is structured, managed and coordinated).

**The Legal Structure:** The by-laws of the co-op provide the framework within which governance takes place. They establish the democratic rights of members, while the governance system provides the means for the members to exercise those rights regularly and to enjoy the protection they provide.

**The Management System:** The governance system operates alongside (but separate from) the management system. The management system is largely under the control of co-op managers or leadership, and focuses on carrying out the regular business of the firm. The governance system, on the other hand, provides the means for matters of organizational direction and policy to be dealt with democratically.

It is worth the time and trouble to design a governance system carefully. The responsibilities of various groups in the organization (such as membership, the board, management, special committees, and task forces) should be specifically spelled out, and it should be clear to all which person or group is to deal with which issues.

Failure to clarify such matters early invites confusion and misunderstanding later on when “hot” issues come up. Indeed, in co-ops where there is no well constructed and well-understood governance system, it is common to observe:

1. Managers or other leaders making policy decisions on their own, because neither the board nor the membership has the power and the means to direct their behavior.
2. Managers and leaders who are hamstrung by boards of directors or members who overrule them (or rebel against their decisions) rather than guide them with clear policies and objectives.
3. Co-ops plagued with conflict in trying to decide a controversial matter because no clear decision-making procedures have been established.

This report is meant to offer guidelines for the design of governance systems that help a co-op avoid these problems. We suggest some specific structures that can be used by members to exercise their rights – and to do so in an informed, responsible, and timely fashion. Throughout, we attempt to avoid the twin traps of powerlessness that are sometimes seen in democratic organizations: either so much structure and bureaucratic procedure that members cannot actually use the power they formally have, or so little structure that there is no available means to make a difference. We seek, instead, structures that empower people.

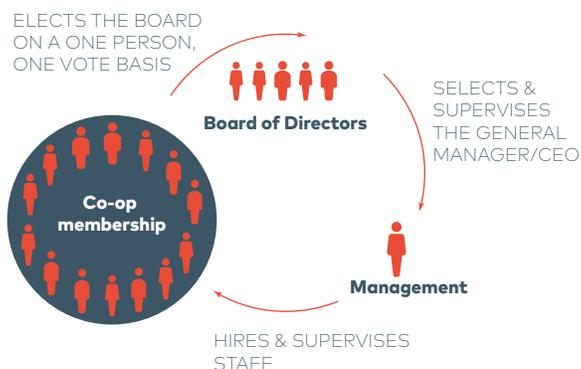
This report covers four major subjects. In the first, we discuss the objectives of governance systems in co-ops, and offer some general guidelines for setting up a system that meets these objectives. The second section outlines a “model” governance system for a small worker co-op of fewer than fifty members. Next, we suggest ways that this model system might be modified for particularly small co-ops (less than twelve members) and for larger co-ops (more than fifty members). Finally, we suggest some guidelines for installing and managing governance systems. Here we offer some ideas intended to increase the likelihood that a governance system will actually operate the way it has been designed to operate.<sup>1</sup>

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<sup>1</sup> Throughout, we present the material as if readers were planning a governance system for a newly-planned co-op. The material can also be used to review the adequacy of existing governance mechanisms to see if there are ways they can be improved. In practice, however, it is usually easier to build an excellent system from scratch than it is to significantly modify an established system.



Generally speaking the Governance system is designed to delineate and address the issues that are best left to a) the Membership, b) the Board of Directors, or c) the Managers or other leaders of the firm. While in many co-ops the same people fill many of these roles, understanding the distinctions between them is critical to developing an efficient system that improves both job quality and business performance.



**The Membership:** The members are the people who work at the firm and own it. As shareholders in a democratic firm they are responsible for all corporate matters and significant policy matters.

Additionally, the by-laws can specify issues that should be addressed by the membership as a whole. The membership usually meets once a year to elect the Board of Director, and to vote on any significant matters. To determine if an issue should be addressed by the membership, see if it passes the "Significance Test."



**The Board of Directors:** The Board is responsible for all Policy and Governance matters not handled by the Membership.

Specifically, they select key managers, approve the budget, and set the strategic direction of the firm. Generally, the board meets quarterly, although more or less frequent meetings are common. The Board also deals with policy matters through standing and ad-hoc committees. To determine whether an issue should be addressed by the Board, see if it passes the "Extensiveness Test."



**Management**

**Management:** Management are responsible carrying out the regular business of the firm.

There are many different styles of management although there are significant benefits in terms of productivity and performance if they employ democratic management practices. Management has considerable say in how the work of the co-op is carried out, and often will generate or review policy proposals for the board and membership, but they do not have the authority as managers to set policy.

**OBJECTIVES AND DESIGN GUIDELINES**

Typically, a co-op governance system will have three key objectives. In general, it is easier to approach these objectives if the following guidelines are kept in mind when a governance system is designed.

1. To establish organizational policies that are (a) of high quality (i.e., they accomplish what they are intended to accomplish), (b) responsive to the wishes of the co-op members, and (c) well-understood and accepted throughout the organization. The kinds of policies likely to be dealt with by the governance system include how fast the co-op should grow, strategies to address issues in a time of financial difficulty, or whether to expand the products or services. Of special interest to many co-ops will be policies that support democratic management practices.
2. To protect the personal rights of co-op members, and to deal quickly and fairly with member complaints about how they have been treated by the co-op (or by other co-op members). Such grievances might involve issues of racial or sexual discrimination, a belief by someone that he or she has been inadequately paid for some extra work done at the request of a manager, or a feeling by a member that he or she is being harassed by another member.
3. To make sure the governance system remains effective and efficient. This is done by regularly reviewing how well the policy-making and grievanceprocessing mechanisms of the co-op are functioning, and by revising these



mechanisms as needed. In effect, this part of the governance system monitors the functioning of the rest of the system, and initiates changes when required. Changes might be made, for example, if members felt they were not receiving information they needed to assess the adequacy of new organizational policies, or if there were a widespread belief that the procedures being used to handle grievances were unfair.

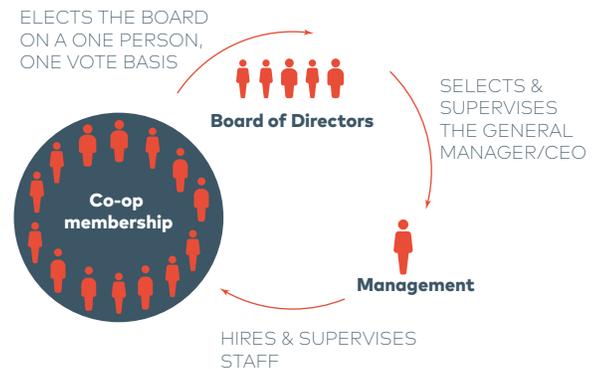
It should be clear to all co-op members what people or groups have responsibilities for which decision and activities. Managers or other leaders in the co-op, for example, usually have no authority to decide governance question. They may have considerable "say" in how the work of the co-op is carried out, and often will generate or review policy proposals for the board and membership, but they do not have the authority as managers to set policy<sup>2</sup>. Within the governance system itself, it is important to define clearly the authority and the responsibilities of (a) the co-op membership as a whole, (b) the board of directors, and (c) various committees or councils created by the board or the membership to perform specific governance functions.

### Keeping It Simple

The governance system should be as simple as possible. Complex systems that specify the procedures for dealing with all the possibilities that their designers can imagine often turn out to be awkward, inefficient, and harder to operate than simpler, cleaner systems. A good governance system should specify very clearly the basic organizational structures and procedures that will be used for dealing with governance matters— but should leave a great deal of room for members to develop specific procedures that are uniquely appropriate for special problems that come up. Moreover, a good governance system should not require sophisticated knowledge on the part of the members who operate it, nor should it require constant attention and fine-tuning. The challenge for those who design the system, then, is to construct a system that will get done what needs to be done and to do so as simply, efficiently, and inexpensively as possible.

The system should be readily available to co-op members and should involve as many members as

possible, so long as it does not become difficult to operate. Members need to have (and know that they have) access to policy-making and grievance-handling mechanisms. The more members who are involved in the operation of the system, the more likely it is that the system will produce decisions that people understand and agree with. But trying to achieve completely open access and full involvement by everyone can result in a governance system that consumes too much of the time and the energy of organization members.



The groups in the system should have real power to make decisions and to make sure those decisions are carried out. An impotent governance system is probably worse than no governance system at all. There are, however, two cautions to keep in mind. First, the power of the system should match the competence and experience of the co-op members who operate it. An extremely powerful group of people who are not well-trained or well-experienced in the business of a co-op can make serious mistakes. If most members are not experienced in managing an organization, this can be a real concern—although participation in the governance system is a good way to help co-op members build their management skills. Second, there should be built-in restraints to keep any single group (including groups within the governance system) from evolving into an unchecked, all-powerful elite. Care should be taken to make sure that the power of any one group in the system is balanced by that of other groups.

The four guidelines described above place some restrictions on how the parts of a co-op governance system (that is, the membership, the board, and special committees, or councils) can be organized and how they should operate.

<sup>2</sup> Naturally, managers have the same basic rights as other members, and may be elected to serve on the board or chosen for membership on governance committees just like anyone else.



We now describe a “model” governance system that might be appropriate for a co-op of up to fifty members. Then, we suggest some changes in the model that might be needed for co-ops that are smaller or larger.

## A MODEL GOVERNANCE SYSTEM

The basic structure recommended for small or moderate sized co-op of up to fifty members involves three different governance groups: (a) the total membership of the organization, (b) the board of directors, and (c) a special “grievance council.” In carrying out their governance work, these three groups will, as a matter of course, deal with the co-op management.<sup>3</sup>

### Components of the System

**The Membership:** The membership as a whole is the ultimate authority for co-op policies and decisions. Co-op by-laws typically provide that each member has one vote in electing members of the board of directors. Beyond this means of exercising authority, the membership should be directly involved in any decision that may affect the survival or the basic character of the organization.

**The Board of Directors:** The board of directors is elected by the members and acts on their behalf in making policy decisions that affect the co-op, and in negotiating legal or financial matters that commit significant organizational resources. Some co-ops, especially those organized as LLCs do not have formal Boards of Directors, we caution strongly against this for co-ops of more than 12 people.

Co-ops often elect people to their boards who are not members of the organization, but who have special expertise that the co-op needs (such as an industry expert, a banker, or a representative of the community in which the co-op is located).<sup>4</sup> Thought should be given to the size of the board of

directors. It is important to keep the board small enough to be manageable: rarely will a co-op board exceed a dozen members, and many boards will be smaller than this.<sup>5</sup>

**Board Committees:** Boards of directors typically have committees that work through issues before they are brought to a full board meeting for formal action. In addition to increasing the efficiency of a board’s functioning, a committee structure allows board members to develop special skills and interests in various aspects of the coop’s operation (e.g., its personnel policies or the management of its finances). A list of common board committees is presented in Exhibit 1. Which committees the co-op will need depends on the nature and complexity of the organization. Most small co-ops will not need all the committees listed; some will need a committee that is not listed to deal with a topic of particular significance for that organization. In thinking about board committees, it should be kept in mind that work not assigned to a committee will have to be done by the board as a whole.

We recommend that all co-op boards have a Governance Committee, and that this committee include both directors and co-op members who are not on the board. This committee can perform an important “watchdog” function by assessing the operation of the governance system, and recommending improvements when it determines that members are not as involved in making co-op policy as they should be, or that member rights are being inadequately protected.

The grievance council is responsible for protecting the rights of individual coop members, and for dealing with questions of perceived inequity or mistreatment that may be brought to the council by organization members. The council hears and acts on “cases” submitted to it; it may recommend new policies or procedures to the board (or seek

3 If worker of the co-op are affiliated with a union then it becomes the fourth group involved in the governance system. The role of unions is not discussed here because of the focus on small co-ops, The union generally does not play a significant role in small co-op governance even if most or all co-op members are union members. In large co-ops, a union can be a significant and constructive force in governance decision-making. For a discussion of the role of unions in cooperative organizations, see “The Union as the Legitimate Opposition in an Industrial Democracy” by David Ellerman (Industrial Cooperative Association Working Paper:1981).

4 When outside directors are elected special attention must be given to keeping them involved in co-op affairs, since they will be the only board members who are not also owners of the organization (and therefore, their “stake” in the organization may be less than that of worker-directors).

5 In some cases (e.g., when the co-op has to have extensive ties with the community or with representatives of the clients it serves) it may be necessary to have a fairly large board of directors. When boards are large, board meetings usually are infrequent (e.g. quarterly) and a good deal of the regular business of the board is delegated to committees that meet between regular meetings of the full board. Special care is required in such cases to make sure that the committees remain responsible to the board as a whole.

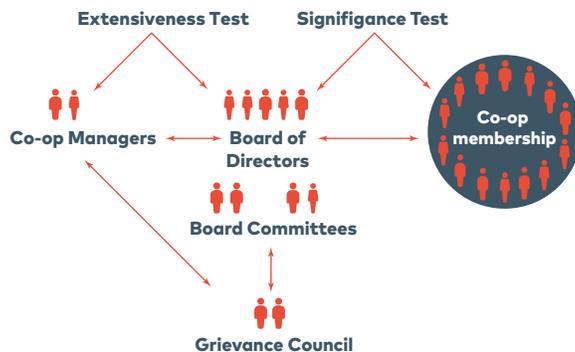


clarification of existing policies); and it may be consulted by the board, by managers, or by regular co-op members about questions of member rights.<sup>6</sup>

A grievance council should mirror the full diversity of the co-op membership. It should include both co-op managers and members who do not hold specific roles in the governance system. Moreover, if the co-op is diverse in gender, age, and/or race, these differences should be reflected in the council. But a grievance council should not be composed of “two of everything,” since that often would result in a group too large to do its work well. Generally, a grievance council should not exceed half a dozen members. If those members are chosen by election (a common method), the election procedures must ensure that the people chosen will reflect the diversity of the membership.

FIGURE 1: MODEL GOVERNANCE SYSTEM FOR A SMALL WORKER CO-OP

*A model decision-making structure for a typical small co-op showing the decision-making bodies and the tests used to determine which body makes each decision*



## DECISION-MAKING RESPONSIBILITIES

In this section, we discuss “who does what” in the governance system. How the various groups in the system relate to each other is illustrated in Figure 1.

### Board Responsibilities

We have referred several times to co-op members who have “managerial roles.” This is because almost all co-ops, even small ones, do delegate some managerial responsibilities to one or more members. Why? Because only an extremely well-disciplined group with excellent decision-making skills can operate efficiently and effectively as a collective all of the time. Since most co-ops do not have these characteristics (and may find continuous collective decision-making too difficult or too time consuming), authority for managing the day-to-day operations of the management system typically (and appropriately) is delegated to specific co-op members.

The first task in defining board responsibilities is to determine what issues rightfully belong to management, and what issues are policy matters—and therefore the legitimate concern of the board of directors. Without guidelines for deciding what gets dealt with by which group, there is a real risk that managers will gradually take over the policy-making responsibilities of the board, or that the board as a whole gradually will take over the on-going management of the organization. Either state of affairs is unsatisfactory.

### The Extensiveness Test: Is this a matter for Management or the Board?

In general, any issue that has extensive impact on the organization is a policy matter and should not be delegated to operating managers. An item passes this **extensiveness test** and is considered policy if:

1. It affects a large number of co-op members, or
2. It commits a substantial portion of the financial (or other) resources of the organization, or
3. It affects co-op operations, personnel, or resources over a long period of time.

<sup>6</sup> It is essential that the procedures used by members in bringing a complaint to the grievance council and how council deals with complaints, be explicit and understood by all. If these procedures do not already exist one of the first tasks should be to draft them for review by the board of directors. We recommend that assistance be sought in this undertaking because dealing fairly and promptly with emotionally charged complaints is a complex and risky business. The effectiveness of grievance procedures can effect both the credibility of the process within the organization and the vulnerability or the group to a lawsuit from disgruntled members or former members.



### IS THIS A MATTER THAT SHOULD BE LEFT TO MANAGEMENT?



Each co-op should determine for itself how many members, how many dollars, and how much time will signal that a decision or policy matter meets this three-part extensiveness test and therefore becomes the business of the board rather than that of operating management

To clarify this division of responsibilities as much as possible, each co-op should list the major issues that will be handled routinely by the board, incorporating the extensiveness test so it can be used for issues as they arise. Exhibit 2 illustrates such a list for a hypothetical co-op.

By making decisions about questions that pass this test, the board retains authority over all decisions that have an extensive effect on the organization as a whole.

#### Membership Responsibilities

As noted earlier, the membership of a co-op has ultimate authority in the organization. Yet there are some important legal constraints on what a membership can do, and when it can take action.

Incorporation laws in most states give some decision-making power to shareholders in traditional firms. Shareholder votes are required, for example, to amend the articles of incorporation, to dissolve the corporation, to sell major assets, to merge with another firm, to enlarge the board, and to elect directors. These laws were written to apply to all corporations, including both cooperatives and traditional firms. For this reason, they assume that owners typically are investors who know and care little about the operations of the firm, and they restrict the participation of owners to questions about the survival of the corporation and the selection of directors.

The worker-owners of a cooperative have interests in the organization that extend far beyond questions of survival and profitability. Co-op members should care—and usually do care—about

issues such as the rate of growth of the firm, the quality of the co-op's product or service, the personnel policies of the organization, and so on. And members of a cooperative should have involvement in any decision that affects the basic character of the organization.

Fortunately, there is a legal means for co-op members to have direct influence on such matters. Corporation law states that the board of directors has legal authority to manage the firm without consulting the owners (shareholders) - unless there are specific provisions in the by-laws or articles of incorporation that reserve certain powers for the shareholders.

Thus, a co-op may write into its by-laws a requirement that the board of directors refer certain issues to the membership as a whole for final decisionmaking. These issues must be specified clearly in the by-laws. They should include only those that members view as exceedingly significant (so as not to require the board to call membership meetings to decide about policy after policy).

#### The Significance Test: Is it a Membership Issue or a Board Issue?

While this plan gives the directors the right to make all policy decisions that are not explicitly assigned to the membership in the by-laws, co-op members should also have a "say" about other decisions of great significance for the organization, even if the formal decision is not theirs.

To provide for this, a co-op may require its board to refer to the membership as a whole (for review or discussion) any matter of extraordinary significance to the organization. Ordinarily, this is done only after the board has completed its own analysis of the matter, laying out likely consequences of alternative courses of action. Then the board brings the matter to the membership (either with a recommendation for action, or to seek member views on the options being considered), and makes a final decision after hearing and considering what members have to say.

### SHOULD THE BOARD CONSULT WITH THE MEMBERSHIP?





Consulting the membership is an expensive and time-consuming proposition in all but very small co-ops. For this reason, an issue should be taken to the membership only when it is truly significant. Routine policy-making is better handled by the board, which is smaller than the membership; and whose members presumably have developed some skills in analyzing and deciding about organizational policy.

Specifically, we suggest that the board consult formally with the membership as a whole only for items that pass the following **significance test**:

**Does the matter affect the likely survival of the co-op?**

If a board decision has consequences for the immediate or long-term viability of the organization, the membership should be consulted. This would be the case, for example, if a significant portion of the firm’s resources were to be committed to a potentially risky new venture, if a major loan to the co-op was to be sought, or if significant changes in the organization’s business plan or strategy were being considered.

**Does the matter have to do with policies for hiring or terminating coop members?**

The membership should be consulted regarding any change in co-op policy about the conditions under which members are invited to join or asked to leave the organization. In addition, membership control of hiring and termination policies helps protect freedom of speech in the co-op, because members can make sure that the leaders of the organization do not establish policies that allow them to fire people who criticize their performance. Finally, experience has shown that co-op members care intensely about policies having to do with the hiring and firing of their colleagues—and for this reason alone they should be consulted if the board is considering a change in those policies.

**Does the matter affect the basic character of the cooperative?**

If a board decision would significantly alter the kind of organization the co-op is, or what it stands for, the membership should be consulted before that decision is made final. This would be the case, for example, if a co-op founded to provide products to low-income people was considering changing its clientele to the well-to-do to improve profitability. Or consider a food store that is committed to the sale of nutritious products. If the board were considering adding lines of

tobacco and convenience foods of questionable nutritional value in order to expand the clientele of the store, the matter would have to come before the membership—because it could alter the basic character of the enterprise.

To summarize, the significance test identifies issues for which the membership must be consulted prior to decision-making by the board of directors. It provides for member involvement in policy that goes beyond that which is provided by state law or built into the by-laws of the co-op.

A summary of decisions that must be made by the membership, and those that the directors may make only after formally consulting with the membership, is provided in Exhibit 3. We strongly recommend that such a list, made specific for each co-op, be drawn up and approved by the membership. There is, inevitably, a good deal of judgment involved in deciding if a given matter is one for which the membership should be consulted. If a list using the categories provided in Exhibit 3 is available, at least there will be a shared basis for making that judgment

**Grievance Council Responsibilities**

The basic task of a grievance council is to deal with questions of perceived unfairness or mistreatment brought to it by individual co-op members (or by groups of members). To do this well, the council must be readily accessible to all co-op member—which is why the Council needs a diverse mix of member, and why the mechanics of submitting a grievance should be stated clearly in writing.

A grievance council should not serve as a “catch-all” group, to which one can pass any and all difficult or emotionally-charged problems. Unless there are limits on what the council handles, the quality of the decisions made by the council may suffer because of an overload of work, or the council may slip inappropriately into policy-making activities (i.e., by establishing precedents that have the clout of policy).

IS THIS A MATTER THAT SHOULD BE ADDRESSED BY THE GRIEVANCE COMMITTEE?





### **The Grievability Test: Is this a matter for the Grievance Committee?**

To guard against these risks, we recommend that a grievance council deal only with issues that meet two conditions. First, a person involved with a complaint should try to resolve the matter directly with the other person(s) involved, before bringing it to the council. If, for example, someone feels mistreated by a manager, the person should speak to the manager directly, or perhaps seek assistance from another member who might be able to help get the difficulty resolved at its source. A grievance council should go to work on a problem only after its members are convinced that reasonable attempts to resolve the matter directly have failed. And second, the kinds of grievances considered by the council should be restricted. Specifically, we recommend that the council only consider grievances that pass the following **grievability test**:

#### **Does the complaint involve a violation of existing organizational policy?**

If there is a policy covering a situation, but that policy is not followed (or not applied fairly), then the matter falls within the domain of the grievance committee. A co-op may, for example, have a policy prohibiting discrimination on the basis of race, gender or age. If a member feels he or she has been discriminated against for one of these reasons, then (assuming direct attempts to deal with the matter have failed) a grievance council should become involved.

#### **Does the complaint deal with a situation for which there is no applicable policy?**

If someone feels mistreated and no relevant policy exists (e.g. a member complains that she was not paid fairly for working an entire week of her vacation—but the organization has no policy about pay for time worked voluntarily during a scheduled vacation) then the matter falls within the domain of a grievance council. In dealing with the specific instance, the council might well develop some ideas for such cases in the future, and pass those ideas onto the board of directors for further consideration and possible adoption.

### **Does the complaint question the fairness of an existing policy?**

In this case, there is a policy covering the matter in question, the policy has been followed, but someone claims that they have been harmed because the policy itself is unfair. Consider the following situation: There is a policy allowing members two days off a year with pay for personal business. A member requests a day off with pay late to attend their mother's funeral. The request is denied, because they have used their two personal days. They appeal to higher management, arguing that the death of one's mother is a special case, and offers to 'borrow' a personal day from his next year's allocation. The appeal also is denied, on the grounds that the policy is clear and must be followed. After the funeral, the employee brings his complaint to the grievance council, claiming that the existing policy is unfair. While the council does not alter the existing policy, it could review the policy and decide whether to make a recommendation to the board that it be changed.

In summary, the grievance council should deal only with complaints (a) for which direct attempts to solve the problems have been tried, but have not worked, and (b) that also meet one of the three conditions listed immediately above. If a complaint does not pass this "grievability test," it should be handled on a routine basis by co-op management (see Figure 1).

A grievance council typically has full authority to deal with complaints that involve violations of existing policy. It is the "court of last resort" within the organization and it may order corrective action (such as reinstatement or termination of a member, or compensation of a member found to have been underpaid) when appropriate.<sup>7</sup>

The council also has responsibility for drafting policy to cover grievances for which no applicable policy exists, and for proposing changes in existing policies to make them fairer or more feasible for the organization to use. And the board of directors may actively seek the advice of the grievance council about policies it is considering that deal with members rights. But decision-making about policy changes is not the business of a grievance council.

<sup>7</sup> Each co-op will have to decide whether or not it wishes to give the council authority to terminate an employee for significant violation of co-op policy and whether or not it wishes to place an upper limit on the amount of cash awards the council can make on its own authority. The co-op may wish to reserve decisions about termination or large cash awards for board action. Larger co-ops may also consider using third part arbitration.



## COMMUNICATION

For co-op members to perform their governance duties well, they must have timely and clear information about what is going on. This requires continuous communication between groups in the governance system, between governance groups and management, and between governance groups and the membership of the organization. If, for example, the board is to establish policies that are responsive to the needs of management and the wishes of co-op members, it needs to hear from these groups; and members need to know what issues are being considered by the board so they can make their own views known. Moreover, they must be well-informed about key board decisions and about the overall performance of the cooperative, so they can make wise decisions in board elections.

The key to successful communication in a democratic business is to summarize critical information and share it widely—and to make more detailed information available to those who are especially interested in having it. Many coops err in one direction or the other, either providing members with too little information or so overwhelming them with details that they “tune out” of the decision making process. Both mistakes can result in decision-making by people who are inadequately informed about the issues being considered.

We suggest that three communication devices be used on a regular basis to ensure that sufficient information is exchanged among groups and individuals in a co-op:

### **Regular organization-wide meetings**

A regular membership meeting can be a core source of information in a small co-op, although in a firm with more than 15 members, this may not be feasible. At these meetings, management and the board report on important developments in the previous period, inform members about issues coming up for consideration, and consult with the membership about actions being contemplated that pass the “significance test”. At these meetings, in addition to fulfilling their governance review responsibilities, members respond to their leaders’ presentations and raise issues for

subsequent consideration by the membership, the board, or management.<sup>8</sup>

### **An information file**

The information file augments and supports membership meetings. The file should include the business plan, grievance council procedures, meetings minutes and other reference materials. Members should be able to examine documents at their leisure and do research on policies that affect or interest them.

### **Between-meeting communication throughout the organization**

The board, its committees, and the grievance council each must stop and think, at the end of each meeting, what they need to communicate to other groups in the organization. This will help keep the activities of the various governance groups coordinated with each other and with management. Equally important is some method of keeping co-op members up-to-date regarding matters being considered by various governance groups. If all co-op members work in the same office, a bulletin board can be used. Otherwise, announcements, requests for information, copies of proposals to be considered at the next meeting, and so on, can be distributed directly to the individuals via email, or with paychecks.

Clear and timely communication of governance information and business results (which are the basis for many governance decisions) is not a luxury in a co-op. In order for people to fulfill their responsibilities as members, directors, and committee members, they need the right information at the right time. A good governance system identifies communication needs, stipulates basic communication channels, and includes communication as part of the regular work of different people and groups in the system.

### **Democratic Governance Versus Democratic Management**

While the governance system outlines the formal structures of how communication needs to happen, it is the management systems that really drive the democratic practices the best co-ops employ. While beyond the scope of this report, it is worth noting the key elements of an effective democratic management system.

<sup>8</sup> Note that these meetings are in addition to the annual meeting of the membership. While employees who are not formal members of the co-op are legally prohibited from voting at the official annual meeting; the participation of all is invited at the regular meetings.



For ownership to be a motivational force, the link between an individual's actions and the company's performance must be clearly understood. There are four factors necessary to create a true ownership culture: communication & education, which are both cognitive in nature, and participation & rewards, which are structural in nature.<sup>9</sup>

**Communication** is central to creating an ownership culture. Members need regular updates on both the departmental level performance and the performance of the company overall. Information needs to be treated as a resource to be shared, rather than doled out on a need to know basis. This allows facts to replace rumors and misunderstandings.

**Education** is necessary so members truly understand the nature of the information that is being communicated. Members must understand both the structure of the business and their role within it, but also have the business literacy to assist in improving performance. Ongoing skills training allows staff to continually improve their performance, and leadership and supervisory development training ensures that leadership occurs at every level of the organization. While classroom type trainings are helpful, trainings at the point of need are of equal if not greater importance.

**Participation** serves two main purposes, first it fits within the member's expectation of having a say in how things operate as owners, but it also generates a higher level of productivity and profitability for the business. Through participation, members take their skills and knowledge to actually improve performance – sharing knowledge is only as helpful as the firm's ability to turn that information into actionable tasks. People have to want to participate – Some forms of participation are informal, asking employees for feedback on a regular basis. This requires supervisory staff to have a participatory mindset, when faced with a challenge, managers must as a matter of course consider who will be impacted and actively consider the following questions:

1. Who is likely to have knowledge about some aspect of the issue?

2. Who will have to implement any part of whatever decision is made?
3. Who will be affected by it?
4. Who will be held accountable for the effectiveness of this decision?
5. How quickly must the decision really be made?

This can present significant challenges for many supervisors and support systems to encourage and train people in this type of thinking is a necessary component of an effective engagement strategy.

**Rewards** are essential to align day to day employee behavior with increasing the long term value of the firm. Therefore, in addition to long term benefits such as accruing equity in the cooperative, it is necessary to develop short term incentives that immediately and tangibly reward staff for behavior that contributes to the long term success of the cooperative. This can take the form of cash bonuses based on performance measures (although the closer the payout is to the behavior the more likely staff will see the connection), or patronage dividends.

## ADAPTIONS TO THE BASIC MODEL

What we have presented above is a model that may be useful to small co-ops as a starting point for developing their own governance systems. In each application, it will be necessary to add, subtract, or modify features of the model system to meet the special needs of the cooperative that will use it.

Larger changes will be required for very small co-ops (i.e. of less than a dozen members) and for larger co-ops (i.e. of fifty or more members). In general, simpler structures can be used in small co-ops (where more complex designs would introduce redundancies and inefficiencies). In larger co-ops, more elaborate and structured systems often are required.

### Smaller Co-ops

A simple governance structure that might be appropriate for a co-op of less than a dozen members is shown in Figure 2. Only two groups are involved in the operation of this system: the

<sup>9</sup> This outline of keys to democratic management is based upon the article "Building Long-Term Value: Developing a High-Performance Ownership Culture," by Virginia Vanderslice and Alexander Moss of the Praxis Consulting Group. [http://www.praxiscg.com/sites/praxiscg.com/files/Building\\_longterm\\_value.pdf](http://www.praxiscg.com/sites/praxiscg.com/files/Building_longterm_value.pdf)

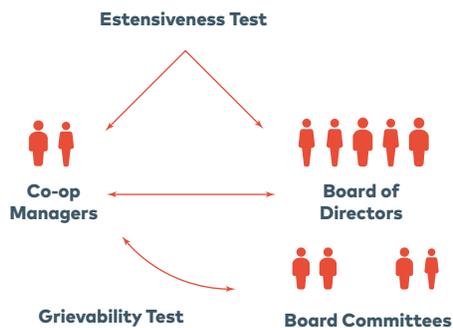


board of the organization (which includes its entire membership) and co-op management (i.e. those individuals with special responsibility for structuring or overseeing the productive work of the organization).<sup>10</sup>

Note that the separate grievance council proposed in the model system discussed earlier (and shown in Figure 1) is not present in Figure 2. In smaller co-ops, grievance questions can be handled more efficiently by a standing committee of the board.

FIGURE 2: MODEL GOVERNANCE SYSTEM FOR A SMALLER CO-OP

*A model decision-making structure for a very small co-op (12 or fewer members all who serve on the board) showing the decision-making bodies and the tests used to determine where decisions are made.*



The simple system illustrated in Figure 2 for small co-ops is not difficult to operate, and its communication requirements are minimal. The board is, after all, ‘Just us’—the membership. Yet even this simple governance system requires:

1. That members take the trouble to have special board meetings to address governance matters,
2. That an appropriate committee structure be created and items be routinely referred to committees for discussion and recommendation prior to full review by the board, and
3. That the “extensiveness test” described earlier be used to determine what is legitimate board business—and what is more appropriately handled by operating managers.

While there are some important advantages in being a small co-op (among them the capability of handling many matters informally as the work of the organization goes on), there also is a real risk that a small co-op will be so unstructured and informal in style that important policy matters never get the attention they need. Using a simple governance system as the one outlined in Figure 2 can help reduce that risk.

### Larger Co-Ops

The decision-making structure for larger co-ops (i.e. those with more than 50 members) is basically the same as the general model illustrated in Figure 1. The roles of the membership, the board of directors, the grievance council, and the operating management are the same as before; and the extensiveness, significance and grievability tests are used to route issues to the appropriate governance group.

However, in larger co-ops with more complex businesses, both managers and directors are likely to develop more specialized duties and become less accessible to the membership as a whole. Similarly, non-management members may become more specialized and involved in their own work—and less likely to deal with members outside their own unit in their day-to-day activities.

When this begins to happen, the governance system should be bolstered to make sure the members continue to be able to exercise their rights and responsibilities as owners. Specifically, larger co-ops may need structures and mechanisms to: (a) encourage continued high levels of communication and member involvement, (b) protect against erosion of the right to free speech in the cooperative, and (c) ensure that grievance mechanisms remain accessible to all members.

### Encouraging involvement and communication

There are at least two devices for accomplishing these objectives. First, board committees can be expanded to include members who are not themselves directors. These additional committee members would be responsible for bringing members’ concerns to the attention of the committees on which they serve and for soliciting the reactions of the other members to issues being considered by the committee. This device

<sup>10</sup> Indeed, in a very small co-op, it may be that no one has a special managerial role, in which case the board, the management, and the membership will overlap completely. We deal here only with co-ops in which some members do have special managerial roles.



increases two-way communication between the board and the membership without adding more governance bodies or increasing the complexity of the governance structure (that is, the structure is exactly as shown in Figure 1, but with non-directors also sitting on the board committees). Care must be taken, however, that the board committees do not get so large that their effectiveness declines. Generally, a committee should not be larger than seven or eight persons.

A second way to increase communication and involvement is to create “advisory councils” to assist the board in dealing with policy questions of continuing concern to the organization. These groups might parallel the board committees; or they might be formed on a “functional” basis (i.e. one council for each operating department or division of the co-op). Which type of advisory council will be most appropriate depends both on the kinds of issues that are most important to the co-op and on the preferences of the members.

An advantage of advisory councils is that they can increase the number of people who are involved in governance. Moreover, they expand the opportunities for communication and consultation about governance matters throughout the organization. However, they do add yet another set of groups to the governance system—and time and resources are needed to keep them functioning well.

Which of the two mechanisms for expanding involvement in governance in larger co-ops will be better for a particular co-op? Should a co-op choose expanded board committees, or would advisory board councils work better? There is no one answer to this question. It depends both on the kinds of policy questions that a particular co-op faces and on how much increased involvement and communication are needed. In general, however, the larger the co-op, the more likely it is that advisory councils will be the more appropriate device.

### **Protecting free speech**

One natural outcome of increased size and complexity is a tendency for an organization to become more and more dominated by a few leaders at the top. These leaders’ interest in maintaining their positions of power can tempt them to withhold information that might reflect negatively on their performance, or to actively discourage members from disagreeing with their ideas. To make sure that dissenting views continue to be heard and discussed in a larger co-op, and to increase the

chances that members will receive good answers to sensitive questions, the co-op may want to take special steps to safeguard open debate.

An electronic or paper newsletter that is not controlled by the leadership of the coop is one good way to do this. The editors of such a paper can encourage open exchanges of views on controversial issues, and through the “free press” members can express (and seek support for) differing viewpoints just as they do on an informal basis in a smaller cooperative.

Similarly, it may be appropriate for the membership meetings of a larger co-op to be organized and led by an independent, elected chairperson, rather than by an officer or a manager of the organization. The chair can make sure that there is ample opportunity in the meeting for members to raise issues and pose questions that the managers of the co-op might prefer to side-step.

### **Keeping grievance procedures accessible**

It sometimes is necessary in larger co-ops to provide special assistance to members in using the grievance procedure. As a co-op grows, grievance policies and procedures are likely to become somewhat complex. Members may be “put off” by the system or feel intimidated by it. Therefore to keep the system accessible, it may be necessary to train some volunteers from the membership to act as advocates for members who have grievances or complaints. These advocates, who are akin to shop stewards in a unionized organization, help members assess the legitimacy of their grievances (although they cannot keep a member from pressing a complaint, even if the advocate disagrees with it); they assist members in presenting their cases to management and (if needed) to the grievance committee; and in some cases they may even present members’ cases for them.

An advocate system can open the grievance process to members who feel that they do not have the skill to use the grievance system successfully. Further, the advocates would provide some social support to aggrieved members. Sometimes the availability of a supportive colleague can make the bureaucratic procedures of a large organization a bit less intimidating. On the other hand, the trained advocates may become a power center in the organization—perhaps even stirring up grievance business so they can use



them: new skills, or promoting a “we versus they” mentality in the organization to gain additional power and prominence. Moreover, reliance on advocates to process grievances can lessen the need for individual co-op members to speak their own minds and claim their own rights -behaviors that are valued in most worker cooperatives. So the decision to introduce an advocate system in a larger co-op should not be taken lightly. It should, instead, be arrived at only after a careful analysis of both the risks and benefits of the role for individual co-op members and for the overall organization.

Determining the right time to add governance structures. It is impossible to specify at exactly what size a co-op will need to bolster its governance system with the kinds of devices suggested above. The need for such structures will depend on how fast the co-op is growing, the amount of contact the members have with people in other parts of the organization, the management style of co-op leaders, and other factors.

Some of the structures we have suggested (such as expanded board committees and elected chairpersons for membership meetings) can be instituted easily and effectively in a co-op of twenty-five members as a preventative measure. The other suggested structures, however, can be more costly. Advisory groups can make co-op decision-making more complicated. A newsletter costs money and can take a good deal of time to produce. And, as stated above, an advocate system has risks as well as benefits for a cooperative organization. Rather than institute these latter devices ‘just in case,’ the governance committee might be better advised to stay alert for signs that they’re needed, and to install them only when a demonstrable need for them does appear.

## **MANAGING GOVERNANCE SYSTEMS**

In the preceding pages, we have dealt mainly with the design of governance systems for small co-ops. We have pointed out some of the structures that are needed in such systems, and we have suggested ways that these structures might be adapted for co-ops that are especially small or especially large. Throughout, we have avoided giving hard and fast rules, emphasizing instead the need to adapt governance systems to the particular requirements and challenges of specific cooperatives.

We turn now to the actual management of a governance system - getting it installed and helping it work the way it is supposed to after it has been put in place. Here we offer a number of guidelines to keep in mind in installing, managing, and fine-tuning a small co-op governance system.

### **Specify only the basics up front**

The temptation, in setting up a governance system (or any organizational system, for that matter), is to try to anticipate everything that might come up once the system is in operation. That is a mistake. For one thing, one can never anticipate ahead of time what the most pressing issues will be, and what kinds of mechanisms may be needed to deal with each and every one of them. For another, it is a healthy sign (not a sign of incompetence) to leave room for a system to evolve over time - and to provide the people who will be using the system some opportunities to influence its structure as they get to know it. So make sure the basic features of the governance system are well thought through and firmly established. Check to ensure that the system is simple, accessible to members, and powerful. And then step back and let the system develop its own unique features and way of operating within the basic structure that its designers have established.

### **Tune your system to the expertise of the people who will operate it**

Co-op members’ experience with governance work varies widely. In some co-ops, there are plenty of “pros,” members who have rich and varied experience in the management of democratic organizations; in others, most members will be involved in the governance of an organization for the first time in their work lives. If the people who will be responsible for the governance system are relatively inexperienced, the system should be simpler, and at first emphasize communication and consultation. Often designers of governance systems put in place “ideal” systems that require more experience and expertise than co-op members actually have.

If a simpler system that involves relatively little direct decision-making is installed, then it is important to be ready to “crank up” the system as members become more experienced in governance activities and knowledgeable about organizational issues. A system that may be fine for start-up may not provide members the opportunities they need (and that they may demand) later, when their



interest in being involved in the organizational decision-making has grown.

### **Recognize individual differences, and use them wisely**

In the preceding guideline, we addressed the readiness of the membership as a whole for significant involvement in governance activities. It is also the case that within any co-op there will be some members who have a natural talent for governance matters and others who are not so inclined or who have less talent for dealing with governance questions.

These differences should be acknowledged in selecting people for roles in the governance system. It can be fatal for a co-op to act as if everyone is equally suited for every function in the organization. Initially, this will mean that certain individuals will gravitate to more central positions in the governance system than others.

That is fine. But care also must be taken to ensure that those who are less inclined to seek (or be selected for) positions in the governance system are not left out—and therefore never have the chance to learn the facts and the skills that are needed in co-op governance. It may feel like walking a tightrope to balance between using the skills that some members already have while at the same time providing other members who have less initial expertise the opportunity and encouragement to develop them. But if it is a tightrope, it is one that must be walked if the long-term objective of widespread participation in the governance of a co-op is to be accomplished.

### **Get the governance system functioning quickly**

Once a governance structure is put in place, governance should begin. If it doesn't begin without delay people will start to wonder if the system is really needed, or if it is just some kind of window dressing. Soon after a system is installed, governance bodies must actually go to work on the goals, policies and oversight functions that will guide co-op management and set the direction of the firm. The grievance committee must be ready to act as soon as an issue is brought to its attention. Managers should be urged to get their business plans and programs ready for review by the appropriate governance groups without delay.

Everyone in the co-op—those who are deeply involved with the governance system and those who are not, needs evidence that the system plays

an important role in the overall operation of the organization. And they should not have to wait very long before that evidence becomes available.

### **Don't turn away expertise—but be careful about how it is used**

Sometimes co-ops struggle along trying to make significant decisions (e.g. about how to deal with capital needs or how to solve sticky marketing problems) without the benefit of technical expertise that may be relevant to those decisions. In such cases, it often seems sensible to recruit non-members who have the needed expertise (e.g. banker, a lawyer, a production expert) to help. Sometimes these individuals are engaged as consultants; other times they are asked to serve on the board of directors. Either relationship can be appropriate if the co-op does need what the non-members have to offer. But it may also turn out that the outsiders who have just the knowledge that is required are not supportive of all the goals of the organization. For example, a director who is brought in for her or his financial expertise may find the democratic structure of the co-op mind-boggling. And she or he may behave on the board in ways that undermine the aspirations of the co-op to have the members involved in significant decisions. Great care must be taken in the selection of outsiders, be they consultants or potential directors, to make sure that they support the overall aspirations of the organization—or at least that they are willing to be educated about those aspirations. Otherwise, the costs to the organization may outweigh the benefits of the special expertise that is gained.

### **Be careful that the small, intense governance issues do not drive out the big important ones**

When co-op members talk about governance, they often talk, with lots of emotion, about how upset everyone is that someone was fired last week, or about the knock-down-drag-out debate that is going on between the board and the general manager.

What doesn't get talked about so often, or with so much energy is how the long range business plan is shaping up. Or what criteria ought to be used to assess how well the top managers of the co-op are doing their jobs, or what strategy should be used to raise the capital needed to replace some obsolete equipment, or how much time and money should be spent on educational programs to help people learn how to function more competently in a democratic organization.



It is natural to focus in on personal or emotionally-charged issues, on things that are bothering people today or this week. We tend to put off until “later” longer term policy questions, even if they eventually affect the well-being of the organization much more than the immediate ‘easy’ issues. And “later” often turns out to be “never.”

Co-op members need to ensure that the currently “hot” governance items do not use up so much of people’s time and energy that they have nothing left to give to less intense, longer-term, but ultimately more important policy questions. If co-op leaders do not give personal attention to the governance items that have real importance for the long-term well-being of the firm, they run a serious risk that these items will be overlooked until it is too late to do anything about them.

### **Watch out for a blurring of the boundaries between the governance system and the management system**

We have taken pains throughout this paper to distinguish clearly between the business of a co-op’s governance system and that of its management system. Part of the reason we have emphasized the distinction is the tendency for management and governance work to become blurred. A governance group, for example, may find itself “naturally” getting into some of the issues that really should be the prerogative of co-op management. And managers, if unchecked, may “naturally” find themselves making decisions that are really policy matters—and therefore in the province of the governance system.

The advisory councils, suggested as a useful governance device for larger coops, may be especially prone to this problem. Sometimes advisory groups may find themselves dealing with issues that fall between the cracks of the governance and management systems - such as investigating a perceived “quality problem” in the co-op’s product or service. One the one hand, the issue has to do with performance questions: quality is not up to standard. On the other, the issue surfaces matters of organization-wide policy: just how important is quality to us, and to what lengths are we willing to go as an organization to have very high quality output?

There is nothing wrong with having a group address questions such as these - so long as both managers and the board actively recognize that the group is crossing the boundary between the

governance and the management system. What is to be avoided is the unhappy surprise that comes when it is discovered that an advisory council with a strictly policyrelevant agenda has started meddling with management decisions, or that a management-created task force that was supposed to solve a performance problem has started making organizational policy instead.

### **Don’t abandon the system in time of crisis**

It is ironic that the governance system, which may be most critical to the organization when a lifethreatening crisis appears often is circumvented at precisely those times. If the governance system is the best mechanism the co-op has for dealing fairly and openly with important matters, then it is just what is needed when important and urgent matters come up. Yet in such circumstances there is often a tendency for the top managers of the organization to meet and hash out informally what should be done. This is a big mistake, as it can both cut off important information and perspectives from other co-op members and undermine the credibility of the governance system for making decisions and formulating organizational policy in the future.

It may take a bit of discipline to stick with the governance system, as designed, when organizational walls are crumbling about you. But that is precisely the time when it is most important to use the system. And if it has been in use on a regular basis for more routine matters, it may be natural to turn to it when a crisis does develop. That is the time, if the design and management guidelines we have been discussing in these pages have been taken to heart, that co-op members should find themselves saying “Thank heavens we have a good way of dealing with this.” Ultimately, that is the payoff of the considerable investment that is required to design, install, and manage a governance system in a small cooperative.

### **EXHIBIT 1: POSSIBLE COMMITTEES FOR A CO-OP BOARD OF DIRECTORS**

**Governance:** Reviews the operation of the co-op governance system, and recommends changes when required to meet governance objectives. This committee is recommended for all co-ops.

**Finance:** Works with managers to develop financial plans, to devise strategies for meeting capital and cash needs, and to monitor the financial status of the cooperative.



**Long Range Planning:** Develops alternative long range plans for the co-op, based on (a) analyses of market trends and the likely future availability of resources (such as capital or new members), and/or (b) emerging changes in the wishes of organization members.

**Management Oversight:** Consults with managers as they develop their business plans, helps managers obtain the training or resources they need to do their work well, and monitors the degree to which managers achieve their stated objectives. Discusses any needed changes in management structure or management personnel before the matter is brought to the board as a whole.

**Personnel:** Reviews the organization's need for members with different skills and experience, and develops policies for recruiting, hiring, and developing membership to meet these needs. Develops personnel policies (e.g. regarding vacation practices, career paths, discipline practices) and oversees the implementation of these policies.

**Education:** Determines the kinds of educational programs needed to help directors, managers, and members fulfill their responsibilities, and arranges for these programs to be offered.

**Executive:** Consults with chair of the board of directors regarding board agendas and procedures, and takes action on behalf of the board when urgent matters come up that must be dealt with between regularly-scheduled board meetings.

## EXHIBIT 2: EXAMPLE OF A STATEMENT OF BOARD POWERS IN A HYPOTHETICAL CO-OP

The board of directors of the co-op has responsibility for the following activities:

1. Defining the goals of the organization and setting the policies that will be followed to achieve those goals.
2. Selecting the general manager of the co-op, defining his or her duties, and setting his or her salary.
3. Evaluating the performance of the general

manager annually, recommending training as needed, and replacing the general manager if necessary.

4. Controlling the finances of the co-op, including:

Approving all budgets and financial plans and authorizing all loans sought by the co-op.

Approving all personnel policies. *[Note: In the case of policies about hiring, firing, and laying-off personnel, the board may be obligated to obtain approval from the membership as well.]*

5. Making all other decisions that<sup>11</sup>:

Significantly affect more than 50% of the membership, or

Commit \$25,000 or more of the co-ops funds, or

Commit the co-op to a course of action (e.g. in a lease) for more than one year.

## EXHIBIT 3: POLICY ISSUES ABOUT WHICH THE CO-OP MEMBERSHIP MUST BE CONSULTED

Issues the membership decides:

1. Decisions assigned to the shareholders by state law.

Examples: Amending the articles of incorporation, dissolving or merging the corporation, recomposing the board of directors, electing directors.

2. Decisions assigned to the membership by the co-op by-laws.

Examples: A small number of important decisions that the membership wishes specifically to reserve for itself— rather than leave to the elected board of directors.

Issues the directors may decide only after formally consulting the membership (i.e.. those that pass the "significance test"):

1. Decisions that affect the likely survival of the cooperative.

<sup>11</sup> This item illustrates how the "extensiveness test" described in the text might be used in defining board powers. The percentages, dollars, and periods of time specified will, of course, vary from co-op to co-op.



Examples: Initiating a risky new venture, seeking a major loan, sale or purchase of assets exceeding some specified dollar amount, entering into a contract or lease for longer than some specified number of years, major changes in the business plan or strategy.

2. Decisions that alter policies for hiring or terminating co-op members.

Examples: Deciding to shrink the size of the co-op (or to enlarge it), changing policies about who can terminate a member for what reason, significantly changing recruitment and selection practices for new members, altering policies for handling layoffs.

3. Decisions that alter the basic character of the cooperative.

Example: Changing the major clientele of the organization, revising the long-term goals of the co-op, reconsidering a core organizational value (e.g., "editorial independence" in a newspaper, "nutritious products" in a health food co-op).

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### **About the ICA Group**

The ICA Group, the country's oldest national organization dedicated to the development of worker cooperatives, was founded on the belief that all people should enjoy economic self-determination as a means to foster an environment where workers' livelihoods and the communities where they live are stable and secure. We strive to facilitate such a society by acting as a catalyst for groups working to ensure workers have a meaningful say in their own economic future and through the development of firms that put these ideals into practice. [www.icagroup.org](http://www.icagroup.org).