Date: September 20, 2010
To: Madison Water Utility Board
From: Greg Harrington
Re: Preparing for the September 2010 board meeting

As we all know, our next step in implementing Policy Governance is to develop "Ends Policies." These are the policies that define the benefits we will provide to our owners and how much these benefits will cost our owners. This simple statement is associated with a number of complex questions (e.g., who are the owners?) and it will take us at least two meetings to develop initial answers to them. If we are lucky, we will get our answers "right" the first time, but it is possible that the board will continue to refine its answers over several, if not many, years of effort.

In Carver's opinion, we should consider the benefits and costs before defining the ownership. However, A.B. Orlik and Don Percy have sensed enough ownership anxiety among board members that they recommended we address who the owners are first. Given these differences of opinion, I have decided to break down our September discussion of ends policies into two parts:

- Education/information session on benefits and costs.
- Discussion and decision-making on who the owners are.

Education session on benefits and costs

Madison's ordinance says the board is responsible for the operation and management of the water utility. The ordinance allows us to delegate this responsibility to the general manager and we have elected to establish such a policy. One may ask, if the board delegates all of its responsibility to the general manager, then what is the board responsible for? In my opinion, our responsibility can be summarized by the following sentence: *The Madison Water Utility Board is responsible for assuring its owners that the Madison Water Utility is an effectively managed and governed water utility.*

We have learned over the last ten months that there is little guidance on what defines an effectively *governed* water utility. Fortunately, such is not the case on what defines an effectively *managed* water utility. In 2007, a group of six professional organizations in the water/wastewater industry collaborated with the United States Environmental Protection Agency to summarize years of management research and to promote effective utility management. This resulted in the publication of "*Effective Utility Management: A Primer for Water and Wastewater Utilities*" in June 2008. This was accompanied by an interactive web page located at www.WaterEUM.org. We have elected to use this guidance in developing our ends policies. As it turns out, some of this guidance may be best captured by additional executive limitations policies rather than new ends policies. We will need to decide this as a group.

As we discussed many months ago, the primer defines ten attributes of an effectively managed water utility. Importantly, the primer also provides example metrics for the ten attributes. These can be used to define the benefits to be provided and the costs associated with providing those benefits. Once we have agreed on a set of metrics, we can *objectively* provide our required annual report to the city council on the performance of the utility and its general manager. In my opinion, our annual report will be a powerful document with significant influence on the mayor and the city council.

The purpose of our board education session will be to review the interactive primer on the WaterEUM web page, and to use this information to help prepare us for the October 2010 board meeting. During the education session, board members will be encouraged to ask questions for clarification, but will not be encouraged to develop policies on benefits and costs. At the end of the education session, board members will receive a homework assignment for the October 2010 meeting.

Defining the Ownership of the Madison Water Utility

On the surface, it may seem obvious who the owners of our organization are. However, as you will see from the reading material being assigned to you, we have a number of choices to consider. Options include (1) all of our customers, (2) the citizens of the City of Madison, (3) the Madison City Council, (4) the mayor, and (5) other possibilities.

Your homework assignment for the September 29 meeting is to read the following documents and use what you learn to write down your definition of the Madison Water Utility ownership.

- J. Carver (2002). "Understanding the Special Board-Ownership Relationship." In *On Board Leadership*. Jossey-Bass: San Francisco, CA. 9 pages.
- J. Carver (2002). "Determining Who Your Owners Are." In *On Board Leadership*. Jossey-Bass: San Francisco, CA. 2 pages.
- J. Carver (2002). "Families of Boards, Part Two: Holding Companies." In *On Board Leadership*. Jossey-Bass: San Francisco, CA. 8 pages.
- J. Carver (2002). "When Owners Are Customers: The Confusion of Dual Board Hats." In *On Board Leadership*. Jossey-Bass: San Francisco, CA. 7 pages.

The documents will be available in pdf form as part of the agenda posted on Legistar (the first was already provided to you in July and should be review).

Please bring your ownership definition and your justification of it to the September board meeting, where we will break up into two or three subgroups to debate and refine our individual concepts into a definition that the board will approve.

Future Work

As noted above, you will leave the September board meeting with a homework assignment for the October meeting. At the October meeting, we will vote on our first cut of ends policies, to be refined over the next few years. In November, we will define and vote on our annual calendar, to include a date for submittal of our annual report to the city council and a separate date for our annual review of the general manager. We will also discuss and vote on how we connect with the utility ownership.

Understanding the Special Board-Ownership Relationship

BOARD LEADERSHIP, NUMBER 18, MAR.-APRIL 1995

NONPROFIT—and sometimes public—boards are often like employees in search of a boss. Where does their authority come from? When we speak of board effectiveness, on whose behalf is this effectiveness attained? When public and quasi-public boards are referred to as *civic trustees,* whose trust do they serve? Of course boards should be accountable, but to whom are they to be accountable?

At the outset, ownership appears to be a simple idea. It is comparable to the notion of stockholders but is a narrower concept than *stakeholders,* a term that includes all parties who have an interest in the organization. Staff members and suppliers certainly have a stake in the organization, but neither of these groups is the ownership. Before jobs are created that require a staff and suppliers, a reason for operating must exist. That is, some preeminent process must intend some outcome for somebody. Despite the initiator of such a process (legislators, founders, incorporators, or appointing authorities), the burden of continuing that process eventually rests with a governing board. If the governing body is given authority to choose which beneficiaries will be served and with what benefits, it will make that choice on someone's behalf.

The board-ownership relationship is the essential, defining relationship of an organization. Board members stand in for the ownership, operating on its behalf. The board can be seen as a microcosm of the ownership, a workable subpart of an awkwardly large group. The board's primary relationship is to the ownership, not to the staff. The board owes its authority to the ownership, not to the staff. Hence, the nature and identity of that ownership are critical to the development of board leadership.

FAQ →

To whom is a board accountable?

Let me narrow this topic. One could correctly say that a board is accountable to the law, or to community standards, or even to Western civilization. Such accountabilities exist but are not what I will deal with here. Certainly, these accountabilities are true even in a business corporation, yet we all have a more focused meaning for *accountability* when we speak of stockholders. If I open a retail store with my own money, the store would be accountable to the law and so forth, but I'd accept absolutely no dilution of the fact that in terms of ownership, the store is accountable to me. I own it.

My employees, suppliers, neighbors, and creditors have a legitimate stake in my store. They are critical stakeholders, and their interests merit respect. But not one of these obligations changes the fact that the store belongs to me. I would not only tolerate but also desire that employees have a sense of emotional ownership in the business. I'd even try to manage so that they could control their own jobs as much as possible and share in the store's profitability, perhaps through profit-sharing. None of these considerations, however, changes the fact that the store belongs to me.

The board can be seen as a microcosm of the ownership, a workable subpart of an awkwardly large group.

So when the Policy Governance model addresses the issue of ownership, it is defining this narrowly focused view of ownership. Nothing in the concept denies the importance of other interests. It simply recognizes that this particular meaning of ownership is imbued with a special significance that other meanings do not have.

Owners Are Not Always Obvious

FAQ →

Where does the board get its authority?

In some instances, who the owners are is clear. Most people would agree, I think, that the source of legitimacy for a school board's decisions is the population of its district, even though the school board as an institution is a creature of state or provincial legislation. The source of legitimacy for a city council is the citizenry of the municipality, despite the fact that the city is incorporated by virtue of higher governmental action. The source of authority for a membership organization is the membership. The source for many nonprofits is often an amorphous general public.

It is important to recognize that even though owners are equivalent to stockholders, they are often not legal owners. Members in an association and citizens in a city, just like stockholders, are legal owners. But for the many nonprofits that are quasi-public in their intent, their general public ownerships are not legally linked as owners. Because the ownership concept does not have to be legal in nature to have its effect, I often use the term *moral ownership* to describe those who own the organization, for in many cases their ownership exists only in a moral sense, not in a legal one.

In addition, corporate "memberships" are common under not-for-profit statutes. This membership has real meaning in membership associations. In quasi-public organizations (for example, social service agencies and hospitals), the membership is more a legal ritual than a truly meaningful group. Its utility may lie more in being a fundraising base or a public relations gimmick, but in such cases it bears little relationship to the broad-based ownership I've defined here. Consequently, it would be inaccurate to think of a legally required membership as the ownership without careful scrutiny.

The Stakeholder Confusion

Let's return to a frequent source of confusion: the concept of stakeholder. If we go back to the retail store example above, the reason an owner is not the same as a stakeholder becomes apparent. As demonstrated, *stakeholder* is a more inclusive concept than *owner.* All owners are stakeholders, but not all stakeholders are owners. Figuring out who the stakeholders are is fairly easy—they include everyone who has a stake in the organization. To begin to disentangle the concepts, let's look more closely at stakeholders.

> ← **FAQ**
>
> Is *owner* just another name for *stakeholder*?

The term *stakeholder* has gained great currency among nonprofits over the past few years, probably because it has played a role in corporate boards' acquiring a wider sensitivity. In the corporate world, the concept stretched minds that occasionally placed stockholder interests above environmental protection and even basic ethical conduct. For nonprofit boards, however, the stockholder-equivalent never fully developed to begin with, so there has been little myopia about owners to mend. Consequently, nonprofits' push to recognize an array of interested parties—stakeholders—in effect constitutes embellishment upon a hollow core.

> All owners are stakeholders, but not all stakeholders are owners.

Stakeholders are indeed an important assemblage. A typical stakeholder list for nonprofit and public organizations includes consumers (clients, patients, students, customers), corporate members (under some nonprofit statutes), the general public, funders, employees, consultants, suppliers, regulators, volunteers, user organizations (to public schools, for example, colleges and employers are user organizations), trainees, neighbors, researchers, professional societies, trade associations, and board members themselves.

To conceive of such a disparate grouping as stakeholders is a useful idea, even beyond its utility in expanding the consciousness of business leaders, so I've no argument with the concept of stakeholders. *But it is not the same concept as owners.* The board's primary accountability is to the owners. Owners form the vital legitimacy base, the fundamental reference group for a governing board. Stakeholders, by contrast, are the wider group to whom the board owes obligations of all possible descriptions.

FAQ →

How does traditional representational governance fit with Policy Governance?

All of which is to say that a governing board's first obligation is not to consumers, nor to the staff. The foremost debt of fealty is to the ownership. I know this statement sounds like heresy, especially in view of recent history, in which confounding the various roles has become politically correct. Colleges and universities in some jurisdictions have been forced into a cogovernance situation with a senate or other designated faculty group having as much power as the board of governors. Staff members of various organizations are given board membership so that there is "staff representation." Clients, patients, or students are given board seats in order to "represent" consumers. By mistaking stakeholders for owners, a whole host of consumers, advocacy groups, funders, staffs, unions, and other groupings are included as though they are equal partners in owning the organization. These actions reduce the effectiveness of governance by splitting the board's attention away from the real owners.

Staffs have been known to choose what the public (or membership or stockholders) wants more than the public does.

This distraction is particularly insidious in that other admittedly important groups are more visible and more present to most boards than is the ownership. When the elusive ownership role is not well defined and made an explicit object of board attention, it is natural for these other groups to acquire de facto ownership status. Of course, they move into the vacuum with their own agendas. Not uncommonly, this phenomenon of counterfeit owners leads a public service organization (for example, a mental health center, school system, counseling service, or branch of government) to operate as much for the benefit of its staff as for the public. Staffs have been known to choose what the public (or membership or stockholders) wants more than the public does.

So it is that citizens of a city, *not* city employees, own municipal government—and the city council had better speak for the citizen-owners. Citizens, *not* educators, own the public school system—and the school board is duty bound to represent them. Members of an association, *not* the staff, own the association—and the board had better govern putting members' interests first. Are staff members still important? Of course they are. Are they the owners? By no means—at least not in their role as the staff. Are the staff part of an amorphous group called stakeholders? Yes, they are, right along with the owners. And that is why we need a special category for owners, one not adulterated with other groups, no matter how important these other groups may be.

Members of an association, *not* the staff, own the association.

Keep in mind that defining an ownership in these terms does not suggest that a board should ignore nonowner stakeholders. The board should listen to anyone who can increase its wisdom. The difference is that the board *works for* the ownership, just as the CEO works for the board. This obligation to the ownership is not simply the board's primary obligation in the sense of its greatest obligation. It is the "point of departure" obligation, the one that frames all other obligations and within which obligations to other stakeholders are conceived and weighed.

The Consumer Confusion

Just as prevalent as is the flaw of allowing the staff to become the de facto owners by default, the most difficult confusion for boards lies in understanding why consumers should not be treated as the owners. After all, the business world has been inundated with the need to be "customer focused." This entreaty has been taken to heart by nonprofit and public organizations—and it should be. So why shouldn't the board's first obligation be to consumers?

Owners and consumers are both important groups of people. They have different relationships to the organization and are entitled to their respective prerogatives. But problems arise when the board does not recognize the difference, a particularly tricky task when consumers and owners are the same people. I'll explore this situation with you, but let us first examine how acting as a consumer is different from acting as an owner.

Consumers have the prerogative to demand good and courteous treatment. They have the right to be dealt with in a humane and civil way. They have the right to complain to whomever they wish, with no obligation to respect chains of command or the needs of other consumers. If you purchase a product at a retail outlet, you will exercise all these prerogatives if you feel the need. You'll demand your money back or replacement of the purchase if you receive shoddy goods. You'll write a nasty letter to the salesperson, president, or board chairperson if you want to. You don't have to worry about the needs of other consumers or the organization's need to be fiscally sound.

Owners have the prerogative to have a say in what the organization exists for, what business it is in, and how much return it should earn (for nonprofits and government, return translates into how much good is done per dollar—an ends issue). Owners must respect the chain of command, and they can only be heard along with other owners, for they don't have the individual rights that consumers have. After all, an individual owner is really only a joint owner with others.

To illustrate, I can go into a sportswear store and order a pizza. But as a customer I have no right whatsoever to tell the company that it should produce pizzas. I do have the right to demand good value and courteous treatment if I want to buy running shoes. No one would claim that consumers have the right to decide what will be produced. Only owners have that prerogative.

Now, let us complicate the matter a bit. Let's say I buy stock in the corporation that operates the sportswear store. Now I am an owner as well as a customer. Everyone understands that a majority of owners can, in fact, decree that their stores will henceforth be in the pizza market as well as in sportswear. But no one would expect that one stockholder (unless my stock is the majority!) could make such a command. Because even if I owned all the stock, I would never give an instruction to a single store employee.

A board of directors is established to gather the desires of multiple owners and to translate these competing wishes into strategic direction.

A board of directors is established to gather the desires of multiple owners and to translate these competing wishes (for short-term versus long-term gain, for example, or for emerging markets versus historically proven ones) into strategic direction. The board of directors is not a body established to represent consumers, nor does it need to be. (Which consumers would they be representing anyway? Yesterday's, today's, tomorrow's, or all potential consumers?) The board's job is to gather and process input from the owners.

FAQ →

What if the customers and owners are the same people?

Now, consider situations in which consumers and owners are the same people. A city council is a board that represents *city residents as owners*. It governs an organization that produces benefits for *city residents as consumers*. Its owners and consumers are not totally identical (visitors to a city will be consumers, but not owners), but are similar enough for me to make my point. If as a citizen I have views on how much taxation is worth how much protection from burglars, I am thinking as an owner. If as a citizen, I am upset at having been haughtily treated by a city employee or am happy that a police officer was courteous and helpful, I am thinking as a consumer.

But consider your city council or school board meetings wherein citizens complain or otherwise attempt to influence the council. Much if not most of what these officials hear is consumer input! Yet these boards hear little that could truly be called owner input. And when they do, it is not a representative sampling of all owners. Remember that as one owner I have no right to affect the sportswear store. As two stockholders, you and I together have no right to do so. Only a majority of owners has that right. So the city councils and school boards face a quandary: First, they hear only a small amount of owner input out of the many hours of citizen input they endure. Second, the owner input they do hear is from a self-selected, extremely small proportion of the ownership. (Indeed, most city councils and school boards can actually name the handful of persons they repeatedly hear from!)

This matter is not as clear-cut for quasi-public, nonprofit boards, though the same phenomenon exists for them. Almost no boards, with the possible exception of association boards, get the kind of ownership input that would enable the board to be a true organ of ownership. Even then, association boards tend to hear the consumer viewpoints of their members more than they receive ownership input.

Before sounding even more heretical than I intend, let me insert that the CEO's and operating organization's first priority is to the consumers, *once they have been defined.* Once it is clear, for example, what a social service organization is to accomplish and for which populations, the CEO must see to it that the identified consumers get what they should from the organization. For a public school board, once it is clear what the public investment is intended to produce (for example, literacy or democratic participation skills) and with which group of children (gifted, mainstream, developmentally disabled, or physically challenged), the CEO must ensure that these consumers benefit as they should from the system.

← **FAQ**

How does the board ensure that the organization has a customer focus?

With what legitimacy or on whose behalf did the respective boards make these ends judgments? If they had the right to define what benefits and which consumers, *they must have had that right before the consumers were defined.* The authority of the board must derive from another, preexisting source. And the source of one's authority has first claim on how the authority is used. In other words, the board derives its

> In nonprofit and public organizations, consumer focus is ordinarily more rhetoric than reality.

moral legitimacy from a base larger than itself, yet not tied to any particular consumer group.

Despite its initial sound, this concept is far from a repudiation of the consumer focus that has become a buzzword in organization development. Traditional board operation, overburdened and distracted by an endless stream of means issues, has neither the time nor the discipline to delineate ends criteria. We cannot expect organizations to have a powerful consumer focus when consumers and the satisfaction of their needs have been poorly defined. Consequently, in nonprofit and public organizations, consumer focus is ordinarily more rhetoric than reality. Social service agencies or city governments trying to implement a consumer focus is like someone with no concept of the multiplication table trying to use calculus. The staff can and should be more pointedly oriented to consumer satisfaction, but this orientation requires the board to determine who the consumers are to be and what is to be changed in their lives. The truth is that the staff can be more aggressively consumer focused if the board is obsessively owner focused.

> The truth is that the staff can be more aggressively consumer focused if the board is obsessively owner focused.

Ironically, using this approach, a school board will spend far more time talking about student benefits than does the traditional school board. But its interest in what to accomplish for kids is informed by and, in the end, governed by those who own the system. The board is an organ of ownership. It is not an organ of staff, nor is it even an organ of consumers. But out of its obligation to owners, it is interested in both staff and consumers and realizes that defining and achieving something for appropriately chosen consumers is the only justification for continuing the organization.

> The board is an organ of ownership. It is not an organ of staff, nor is it even an organ of consumers.

In other words, causing the board to relate primarily to the ownership rather than to consumers can lead to *more* pointed delineation of consumers than is the case with traditional board operation. After all, the board itself does not serve consumers; its staff does. The board, in a manner of speaking, serves the owners; it serves them by defining consumers, consumer benefits, and economical production on their behalf.

In summary, the ownership concept is critical in establishing the nature of governance, particularly in tracing board authority and accountability to their source. Consequently, the concept has far more than academic significance, but rather, in a more practical sense, fuels the planning of board job and agenda.

The ownership concept is critical in establishing the nature of governance, particularly in tracing board authority and accountability to their source.

Defining Ownerships

Defining some ownerships is easy . . .

Halton Region Board of Education—*the residents of Halton Region.*

Association of Community College Trustees—*community college trustees who are members of ACCT.*

Metropolitan Indianapolis Board of Realtors—*realtors who are MIBOR members.*

City Government of Plano—*citizens of Plano.*

. . . and defining some ownerships is more difficult

Public radio station KQED—*donors, general public in the listening area, talk radio show advocates?*

American Red Cross—*official members (volunteers) of the Red Cross or all Americans?*

National Endowment for the Arts—*the general public, the government, artists, writers?*

Girl Scouts of the USA—*girls, parents, society at large?*

An Essential but Often Overlooked Step for All Boards

Determining Who Your Owners Are

Board Leadership, Number 18, Mar.-Apr. 1995

Once a board understands the importance of connecting with its ownership, its next question is almost always, "Well, who is our ownership anyway?" It's shocking but true that most boards don't have a clear understanding of who their ownership is, a confusion that too often leads boards to undermine their own authority and subvert the governance process by listening too carefully to the wrong voices while ignoring the group to which they are legitimately obliged.

To begin this inquiry, first get a clear picture of who the owners *aren't*.

Determining ownership isn't always easy, but it's an absolute necessity for boards who wish to get in touch with the true source of their authority—and their own true governing power. But before you can contact your owners and hear their voices, you have to have a clear idea of who they are. To begin this inquiry, first get a clear picture of who the owners *aren't*. They are not the funders, the consumers, the regulators, or the staff. True, there are cases where, for example, funders and owners may turn out to be the same people, or where staff members are part of a larger ownership group.

See if the ownership question has already been settled for you. If your organization is created by a law, the legislation may clarify the matter or merely confuse it. A state board might find that its ownership consists of the general public, the legislature, or the governor, but just as likely lawmakers have left the point unclear. Membership associations are usually an obvious case of members-as-owners. Be careful in this latter situation, for members are also customers and in this inquiry you are only interested in members' ownership role.

It is not necessary that your owners know that they are owners. Indeed, for most nonprofit organizations operating as quasi-public agencies, most owners will have no idea that you exist. (Elected political boards will be better known.) It is not even important at this stage whether the ownership will be difficult or even impossible to reach for input. The task at this point is merely to establish who they are.

If you find that two or more distinct groups seem to be your owners, look harder to see whether you are being rigorous enough in definition. Is it really just one of the groups, though the other also deserves your ear? For example, is it general public *and* donors?; or all citizens of our county *and* people who've signed up as corporate "members"? Or is there a higher-order grouping that would resolve the matter? For example, for a public radio station, two seemingly separate groups, donors and classical buffs for instance, might be reframed as "all persons committed to a presence of classical music in everyday life." It is possible to have a "this and that" ownership, but don't accept dualities before investigating to see if more creativity or rigor is needed in the defining process.

← FAQ

Is it possible to have more than one group of owners?

Some boards will find that defining the ownership is quite easy, but for others it will be very difficult. Since a great deal of board energy in Policy Governance is put into interaction with the ownership, it is rather fundamental to have a carefully reasoned definition of who these important people are.

If you find that two or more distinct groups seem to be your owners, look harder.

This title may sound irrelevant to the Madison Water Utility Board, but read the material in the red box below and see how Carver relates this private corporation concept to public boards.

Families of Boards, Part Two: Holding Companies

BOARD LEADERSHIP, NUMBER 27, SEPT.-OCT. 1996

IN THE PREVIOUS ARTICLE, I introduced the Policy Governance treatment of *families* of boards. By that term, I mean arrangements wherein organizations are owned by other organizations. Hence, governing boards—which, by definition, are the top of their organizations—find themselves beholden to other boards. In the previous article, I showed how Policy Governance helps federations clear up potentially confusing governance issues. In this article, I will show how Policy Governance applies to strengthening the governance system of holding companies.

In the parent-subsidiary arrangement one organization owns—or "holds"—one or more others. Structurally, they are an inverted version of federations. In business, it is common for a single corporation to purchase other corporations. Holding companies are common; federations are infrequent. In government, a peculiar version of a holding company is found quite frequently, though stock ownership is not normally the way that ownership is evidenced. For example, city councils "own" a plethora of boards and commissions (parks, hospitals, airports, and other municipally related functions). Crown corporations (in the United Kingdom or Canada) and their U.S. version (for example, the U.S. Postal Service or state teachers' retirement fund) could be considered subsidiary organizations that have a unit of government as parent. In the nonprofit world, corporations sometimes spawn one or more subsidiaries to carry out functions best performed at arm's length from the original entity.

For this article, I'll define my terms this way: *parent* will mean the holding company itself, so I might speak of the parent board or the parent CEO or merely the parent. If I simply say parent, that will refer to the holding company as a unit without distinguishing between its board or staff. *Subsidiary* will mean a corporate body owned by a parent. Subsidiaries are separate corporations in their own right; otherwise they are merely divisions, departments, or chapters of the parent. *Parent-subsidiary family* or *holding company family* will mean the entire family of corporations in this arrangement. Now, let's examine peculiarities relevant to applying the principles of Policy Governance that I have found in parent-subsidiary families.

Confounding the Federation and the Parent-Subsidiary Forms

FAQ →

What happens when there is ambiguity about whether an organization is a federation or a holding company?

There are enough differences between the parent-subsidiary family and the federation that it would seem the two could never be confused. But I have dealt with many families of boards that have confounded the two forms in striking ways.

For example, a national organization I worked with had spawned regional chapters that were, for various reasons, incorporated in their home states. Chapters had been created initially as part of carrying out the purposes of the national organization. Because each regional chapter was a corporation in its own right, each had a governing board of directors. Historically, it was clear that the arrangement was of the parent-subsidiary variety.

Enter the ambiguity: Each chapter had staff. Each staff wanted to see its chapter free of the constraints of the national organization. This point of view was flattering to regional board members, so in little ways there developed an enmity between the regional and national organizations. Because national board members were also active in chapters (sometimes on their boards as well), it could be mistakenly assumed that the chapters were the owners of the national organization. Pretty soon some of the family's practices made it seem as though it was a federation family (chapters own the national) and some as though it were a parent-subsidiary family (national owns the chapters). The flurry of mixed messages threw everyone into a great deal of wasteful interactions, hurtful interpersonal transactions, and general organizational ineffectiveness.

This organization could function as a federation or as a holding company with subsidiaries. But it could not have it both ways without serious dysfunction of the people and the mission. The core problem (aside from the political one) is really a question of ownership. Organizationally, who or what owns whom or what?

Ownership

While the owners of this specific national organization are the thousands of individuals nationwide, the owner of the state groups is the national organization. This is one salient characteristic of the holding company family: The parent organization is the unambiguous owner.

If we were discussing business corporations, shares of stock would be the currency of ownership. When there is no stock, ownership is less concretely symbolized. So I am willing to accept softer evidence of ownership. If a nonprofit is created such that another organization is named as its single corporate member, that member is parent. For example, a hospital might create a foundation for which the hospital itself is the sole corporate member—hence able to choose the foundation's board and issue it directives. If the board of a governmental unit is created by, totally answerable to, and its board membership appointed by a larger or more inclusive unit of government, I would consider the authorizing, appointing authority to be parent. For example, a city council might be parent to a library or airport authority.

This is one salient characteristic of the holding company family: The parent organization is the unambiguous owner.

In these cases, the owner has the prerogative to direct the subsidiary board to act as though some other group were the owner. For example, a city council might instruct an airport authority that for considerations except tax rate implications it should act as though the population of some defined jurisdiction were the owner rather than the city council itself. Unfortunately, city councils along with many other parent corporations rarely make such matters clear to their subsidiaries or even to themselves. That leads us to another item to be cleared up: accountability.

Overlap in Lines of Delegation

I've already referred to an arrangement similar to a holding company commonly found in municipal governments. City councils create commissions, airport authorities, or other entities subservient to the city council yet operating at arm's length. The intent is the same as that of a holding company: to retain essential control over a function yet at the same time consign it to a separate organization. Even though the subsidiaries are ordinarily not incorporated (not strictly fulfilling the independent corporation requirement), their relationship to the city council is similar to that of subsidiary to parent.

City councils are not very careful about separating what they delegate to subsidiary boards and what they delegate to their city manager

City councils are not very careful about separating what they delegate to subsidiary boards and what they delegate to their city manager (CEO). I commonly find that there is disturbing overlap and, at best, great lack of clarity about delegation. For example, a parks board may think it is accountable for—and has authority over—parks and recreation functions, while the city manager understandably thinks that he or she is in that position.

Cutting Subsidiary Boards Out of the Loop

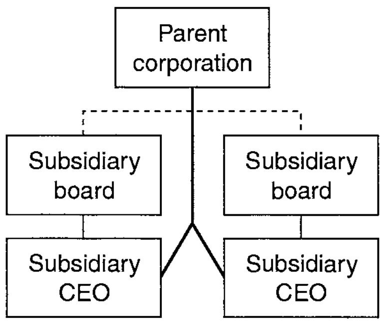
FAQ →

What is the line of authority in a holding company?

When a parent owns a subsidiary, the line of authority from parent to subsidiary should be from parent to the subsidiary board, not to the subsidiary CEO. Yet parent corporations regularly connect directly with subsidiary CEOs, bypassing the subsidiary boards and rendering them largely ineffective (see Figure 2.4). Several of my Catholic hospital system clients wondered why subsidiary boards were not as responsible as they'd like. Upon inspection, the parent was communicating with, delegating to, evaluating, and often even hiring and firing the subsidiaries' CEOs!

State and provincial governments issue instructions directly to the CEOs of funded agencies, thus bypassing the agencies' boards. This common practice is made to seem

FIGURE 2.4. Parent Corporation Inappropriately Linking Directly with CEO of Subsidiary Corporations



Note: For this illustration, the parent company is drawn without distinguishing parent board from parent CEO.

more reasonable inasmuch as governments communicate about so many items of managerial detail that bypassing local boards is an act of mercy. But communication on that level of triviality is necessary only because the governments haven't done their own jobs to begin with—stating expected ends and proscribing certain means. *Institutionalized entanglement in subordinates' means leads to circumventing the very boards governments rely on to oversee subsidiary performance.*

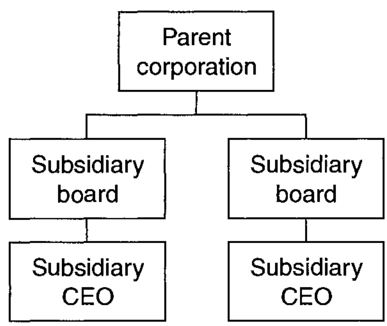
Institutionalized entanglement in subordinates' means leads to circumventing the very boards governments rely on to oversee subsidiary performance.

The parent should delegate to the subsidiary board and the subsidiary board only, not to the subsidiary CEO (see Figure 2.5). It should hold the subsidiary board accountable for playing the governing role well or else replace the members of that board. There should never be any question that the subsidiary CEO works for the subsidiary board and for no one at the parent corporation.

Empowerment Within Boundaries

Nonprofit and governmental organizations tend toward piecemeal authorization. That is, someone requests authority to do this or that, then a superior authority decides whether to grant the request. "May I do this?" is followed by "You are (or are not) authorized to do that" in a costly, continual grown-up version of the children's game "Mother, may I?"

FIGURE 2.5. Parent Corporation Appropriately Linking with Boards of Subsidiary Corporations



Note: For this illustration, the parent company is drawn without distinguishing parent board from parent CEO.

Piecemeal authorization turns subordinates into supplicants, a demeaning situation for those one should be helping toward decision making and professionalism. Policy Governance, by contrast, approaches authorization in a way that enhances the authority of subordinates while freeing superiors from the unending involvement in decisions more appropriately made at subordinates' levels. It does this by granting blanket authorization with associated boundaries: "Within domain A, you are granted complete authority, except that you cannot do X, Y, or Z." This Policy Governance approach to board-to-CEO delegation works just as well for a parent-to-subsidiary format. Subordinates (subsidiaries) know their decision latitude, so they can plan and problem solve accordingly. Their relationship with the manager (parent) is no longer based on "May I do this?" Those in the manager (parent) position are not repeatedly drawn into the subordinate (subsidiary) job and, therefore, away from their own.

Policy Governance enhances the authority of subordinates while freeing superiors from involvement in decisions more appropriately made at subordinates' levels.

Establishing a Stockholder Representative

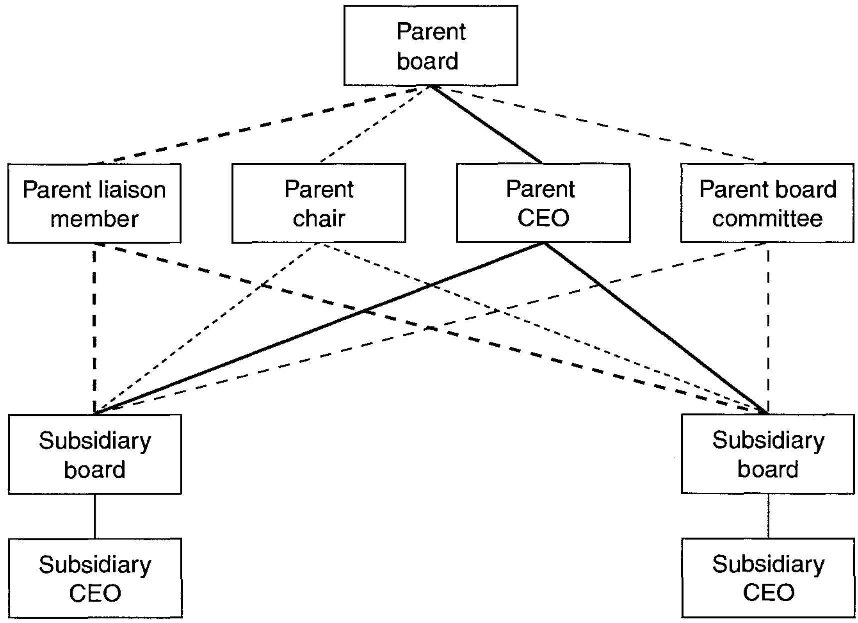
Assume that the holding company connects itself appropriately to the subsidiary board, not to the subsidiary CEO. If the lower end of the chain of command attaches to the subsidiary board, where does the upper end attach—just who at the holding company exercises the connection?

The parent board could itself be—as a group—the point of connection. If so, the parent board would be delegating directly to a subsidiary board just as it delegates directly to the parent CEO. Or the parent board could form a committee that would be empowered to "supervise" the subsidiary board. Or the parent board could instruct an officer—perhaps the chairperson—to carry out that task. Figure 2.6 illustrates the options.

Keep in mind that the attachment point is not merely an honorary or ritual position, nor is it merely for passing information. That group or person must be held accountable by the parent board for subsidiary performance. After all, he, she, or they will be in the direct line of authority and, therefore, the direct line of accountability. This is a serious matter, so the person or group must be chosen for the ability to exercise that role successfully.

Again, municipal government provides us with a good example of poor practice. City councils traditionally appoint a "liaison" to subsidiary boards—a member of the council who attends subsidiary board meetings and personally forms the link between council and subsidiary. For example, one council member would be named "airport

FIGURE 2.6. Delegation Pathways a Parent Corporation Might Use in Linking to Subsidiary Boards



Note: In most cases, using the CEO as "stockholder representative" offers the most accountability.

authority liaison." This common practice cheats the integrity of governance. It is a poor practice, first because individual council members typically do not represent the council as a whole but their own individual views. Second, they can easily run roughshod over the rightful authority to the subsidiary board by interfering with its authorized prerogatives—with nothing the subsidiary board can do about the encroachment that isn't politically risky. Insertion of such personal power severely handicaps proper board process. Third, the city council will not hold the liaison accountable for the subsidiary board's performance (and the liaison would likely not accept it); therefore, the liaison exercises authority with scant accountability.

Of course, a parent board could choose its chairperson as the liaison, but the chair is afflicted with the same complications that befall an individual liaison member. A committee could play the linking role, but committees are notably difficult to hold accountable for operational performance. Besides, we would now have inserted a "miniboard" between two real boards. With any of these choices, the parent CEO cannot be held accountable for subsidiary performance, thus rendering the board's most secure solution for total system accountability unavailable.

The most reliable pathway through which the parent board can exercise its ownership of subsidiary organizations is the parent CEO.

Consequently, the most reliable pathway through which the parent board can exercise its ownership of subsidiary organizations is the parent CEO. He or she can therefore be held accountable by the parent board not only for the parent corporation itself but also for the performance of the entire system. Who is better situated and motivated to accomplish that than the parent CEO?

In keeping with this view, the board of a very large insurance holding company client of mine appointed its CEO as "stockholder representative" to carry out the ownership connection. The stockholder representative appoints subsidiary board members, gives subsidiary boards their charge, and replaces subsidiary board members when necessary. With this sobering authority, the CEO was then legitimately held accountable by the parent board for the performance of the entire system of almost one hundred corporations.

Families of boards, whether parent-subsidiary or federation, are just instances of governance with a few extra parts. The principles of Policy Governance not only apply just as well as they do for single boards, but even more so—the more complex the system, the more benefit is to be gained from a powerful organizational framework.

When Owners Are Customers: The Confusion of Dual Board Hats

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OWNERS AND CUSTOMERS are distinct enough in business. Those who hold stock and those who purchase the product or service can be kept clearly separate even when someone on occasion plays both roles.

For many nonprofit undertakings, however, these separate concepts become confounded. Note that a nonprofit's *customers* are its beneficiaries—clients, patients, students, etc. A nonprofit's *owners*—equivalent to a corporation's stockholders—might be members (for a professional association), citizens of a jurisdiction (for a public school system or city government), or local organizations (for a national association or federation).

← FAQ

What if the customers and owners are the same people?

The most common error occurs when, perhaps for its rhetorical value, a nonprofit board proclaims that its first obligation is to its customers. More truthfully, its primary obligation is to its owners, on whose behalf and with whose empowerment the board *then* determines which customers will command the staff's obligation. There are *no* customers until the board decides who they will be by establishing the organization's priorities among service populations.

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Another example of confounding occurs when either fashionable inclination or funder requirement insists that a customer be on the board. Services should certainly be more customer-focused, but if this necessitates either tokenism (one person to "represent" the customer point of view) or distorting the meaning of ownership (disproportionate representation by customers compared with non-customer owners), then the organizational flaw is deeper than a perfunctory board membership will correct.

If the board has clearly decided who customers will be (what populations will be served), then the organization should pointedly listen to those customer groups in order to serve them more effectively. If the staff organization is so fundamentally askew that it is not doing this, adding a customer to the board addresses the wrong problem.

Having a funder representative on the board is a role conflict to be avoided.

Funding bodies will sometimes be represented on a grantee board. The conflict of interest is but thinly veiled, but more relevant here is the further confounding of owners and customers. For most nonprofits, it is far healthier to see funders as bulk customers than as owners. Bulk customers, however much homage must be paid them for fiscal sustenance, are entities with which the organization makes a deal. Having a funder representative on the board is a role conflict to be avoided.

Since ownership is an important element of enterprise, its indeterminate status leaves a conceptual vacuum.

The ownership dilemma is typically left undefined by nonprofit boards. For some, it is easy enough to identify owners. For example, the ownership of a professional association board is its membership. For many others, it is not so apparent. By ignoring the issue, the board leaves the group to which it is accountable forever unspecified. Since ownership is an important element of enterprise, its indeterminate status leaves a conceptual vacuum upon which other, more definitive groups encroach.

One such group is the staff. Staff can become owners without portfolio, simply because the board does not posit a more compelling case for a legitimate ownership. It is not that the board has decreed that its staff is its ownership. It is that, by failing to identify the true owners, the organization acts *as though* it exists to serve staff prerogatives.

Another definitive group is that of the organization's customers, who, because they are identifiable and sometimes vocal, can also move into the ownership vacuum. Vocal customers often do not represent customers as a whole, so that bogus ownership is expressed by a splinter group of customers. Such groups can whip board loyalties around as though it is they who should command primary board attention. City councils, county commissioners, and public school boards are examples. In countless open meetings, the board is buffeted about by these legitimate albeit mislabeled interests. The consequent rolling and swaying illustrate the need for a stable underpinning of legitimacy, a foundation the true ownership concept can provide.

> Vocal customers often do not represent customers as a whole, so that bogus ownership is expressed by a splinter group of customers.

I have dealt elsewhere with the rewards of keeping the owner and customer concepts separate, honoring each in different ways (see, for example, Carver, 1997). It is difficult to conceive of excellence in governance when these two groups are not kept distinct. Community social-service agencies may be morally owned by an entire community, but they exist to serve subpopulations beset by particular life difficulties. The community as a whole (owners) may, for example, own an effort to make normal life more possible for retarded people (customers). The board, representing this broad ownership, should as a body keep the concepts apart even when individual board members must strain to do so, as when a trustee has a retarded child in the program.

Organizations in which *all* board members are also customers present special challenges. Individual tendencies are not then so easily balanced by other members, for all members are in the same situation. Not only are they all customers, but they attained their board seats at the behest of other customers and, consequently, can legitimately see themselves as representing other customers. Trade or professional associations, interest groups, and organizational federations are examples.

Unlike social-service and health agencies, such organizations *exist primarily to serve their ownerships.* Their basic organizational design is—with no denigration intended—self-serving. Hence, the board of the Embroiderers Guild of America is both owned and designed to benefit people who enjoy embroidery. The board of Realtors is owned by and exists to make commerce better for its membership, individual Realtors. The American Hospital Association is owned by and exists for the success of its member organizations. (Often such federations also exist to attain broader goals than their constituent members can achieve acting as individual organizations. Success is construed here to include the attaining of members' more expansive ideals.)

The overlap of customers and owners, common but inconsequential in most community service organizations, is total and even integral to the purpose of such self-serving organizations. Are we to conclude in such cases that the owner-customer distinction has disintegrated? Not at all, as we shall see in our next section.

Maintaining the Distinction

Even in the organization which exists solely to serve its own ownership, governance will be more effective by observing the owner-customer distinction *as rigorously as if owners and customers were not the same people.* This is particularly cogent for individual board members as they seek to play their respective roles with integrity. A brief sketch of the board's role as governing body is necessary before outlining the appropriate board member mentality in this challenging situation.

The board governs as a single body, not as a collection of individuals. Although individual board members have no authority over the organization, the board as a whole has total authority. The board does not exist to help the staff but to own the business, even if in trust. The staff works for the board, not vice versa, though the volunteer mentality often obscures the compelling accountability this employment implies. If the board chooses to use a chief executive officer (CEO) to span governance and operations, then the board expresses its requirements only to the CEO, not to individual staff members. The board should evaluate its CEO only against criteria which have been set forth by the board as a whole at the outset. The evaluative relationship is never to be a capricious one.

While these characteristics are generally accepted as ingredients of good governance, they are seldom true in reality. In fact, the typical strategies of governance as we currently know it conspire *against* these ideals. But for this discussion, we need merely observe that the qualities of trusteeship, board holism, board hegemony, board-CEO linkage integrity, and board discipline are critical for effective governance.

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Unlike the ownership role, the customer role focuses on specific transactions between a customer or customer group and the organization. It deals with single supplier-consumer transactions specifically to maximize customer payoff. The customer need not consider long-range corporate well-being, planning processes, policies, procedures, delegation patterns, owners' wishes, *or even other customers.*

Individuals who serve on boards of owner-serving organizations partake of both worlds. They find themselves thinking as owners and as customers intermittently, often simultaneously, and always confusedly. As a customer, one expects to benefit from the organization's service or product. As an ownership representative, one expects a voice in what that service or product is to be. To make sense of this duality, board members must understand the following role differences.

Individual versus group authority. Even when extraordinary authority is vested in speaking as a customer (due to volume of business or size of constituency), it is expressed as an individual: *I* want this or that. However, an owner can give direction only when speaking with other board members as a group. The board has authority only as a body, not as a collection of individual voices. The *I* can only transact with the organization as a *we.*

Speaking for self versus speaking for others. As a customer, you speak for yourself. You may even speak for a number of customers similarly situated in order to have a greater voice. But you are not *obligated* to speak for others as you are when being an owner representative. Speaking for others must be done with fidelity. Thus, as an owner representative, you must reach out to hear the needs and desires of others. You are obligated to know what owners want.

Judging staff specifically versus judging staff universally. As a customer, your pleasure with the organization comes from staff who "represent" the organization to you, the personal contacts through whom your needs are satisfied or frustrated. As a board member, you judge the chief executive (the accountable embodiment of the whole organization), not individual staff members.

Speaking to anyone versus speaking only to the CEO. As a customer, you can and doubtlessly will speak to anyone whose ear you can command or who can satisfy your need. As a board member, though you can converse with anyone, your only authoritative path is to the CEO—and then only if it is not you but the board doing the speaking.

Pursuing the moment's need versus playing by the rules. As a customer, you can act out of your current needs. As an owner representative, responding out of the moment is likely to jerk the organization around in a dysfunctional and myopic way. Your board obligation, therefore, is to constancy of purpose rather than satisfaction of immediate needs.

Freedom to confront single-event issues versus obligation to "abstract up." Issues between customer and organization ordinarily present themselves as specific events while conducting business. But issues between board and organization require "abstracting up" to a higher, broader, or more inclusive level. As a customer, for example, you might complain that parking places are too narrow or that the shower in your hotel room does not work. As a board member, you can more effectively communicate your concern in terms of customer comfort or impeccability of guest rooms.

Potential adversary of the organization versus creator of the organization. The organization is whatever the board continues to create and empower. Consequently, a board which governs cannot have an adversarial relationship with its organization in the sense of standing outside and judging, as if the board has nothing to do with the situation. The board is leader of the team rather than extraneous observer. It has the authority to change whatever is unacceptable.

Customers, however, can easily take issue with the organization. Therefore, as a customer, you might be in an adversarial relationship with the organization, though as a board member you cannot be. A board member may well be at odds with other members about what should characterize the organization, but since the organization must be what the board as a body wishes, dissident members only have an issue with their colleagues.

Little required discipline versus extensive discipline. Customers do not need the discipline required of owner representatives to balance all the issues and to act responsibly. Owner representatives, however, must use vigilant discipline lest wholeness in the board process disintegrate.

Natural versus unnatural role. Clearly the customer role is a more natural one, more integrally related to our daily life, than playing owner representative. As an independent agent, you make economic transactions in your best interest. As a board member, you are an unseverable part of a group transaction with the chief executive. So acting only through a group dynamic takes an extra measure of devotion and thought.

Systematic Support in the Struggle

For board members of owner-serving organizations, the conflict of roles presents perpetual difficulty. The solution is threefold:

1. *Adopt an adequate governance philosophy.* Any approach to governance which does not respect the owner-customer distinction will *contribute* to the role confusion, rather than resolve it. Further, any model which fails to provide a practical design for the governance role will offer insufficient rules of discipline, thereby allowing proper governance to erode.

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All forms of conventional governance wisdom fail in these ways. Accepted practice, including the bulk of available literature, is overdue for fundamental conceptual change. My model for boards is intended (among other improvements in governance) to enable boards to deal more effectively with both owners and customers (see Carver, 1997).

2. *Support one another.* Trustees assume a challenging task, which calls for rigor and commitment. "Hard" devices, such as budgets, plans, committees, and reports, are necessary. But the "soft" mechanism of mutual support is also crucial.

Mutual support means helping each other stay true to a carefully designed discipline for board operation. It means recognizing that commitment to good process often fades in the face of conflict; therefore, *designed* discipline is necessary. It means not allowing politeness and tolerance for straying to become counterfeits of real support.

We must encourage dissent without being held hostage by dissenters. We must support each other in order to pursue excellence, not to excuse inaction.

3. *Develop responsible ownership.* Owners (such as a membership) can make their boards *less* effective, a phenomenon strikingly visible in large federations and in political jurisdictions. Parents assail school boards for trivial matters rather than lobbying for better student outcomes. Citizens urge Congress for favors rather than for more responsible government systems.

In each case, board members (or elected officials) can become advocates for specific customers, thus defaulting on their commitment to represent all owners. As long as owners (*citizens* in the case of political jurisdictions) reward such demagoguery, we will never have quality governance. Boards—exemplified by school boards and city councils—will continue to excuse themselves as victims of unschooled owners.

Boards are not usually well positioned to bring about more responsible owner behavior. A federation board's telling the membership to shape up might meet with the same favor as a school board admonishing the public. But there is a leadership opportunity for boards to teach, persuade, and set examples of disciplined owner behavior. Such leadership is akin to teaching your boss to be a better boss. It works best when the subordinate (in this case, the board) has the integrity to advocate improved process, rather than manipulating toward a particular outcome.

Federation boards at membership conferences might schedule workshops and discussions on the membership-board linkage and on governance itself. Political boards and councils can rearrange board meetings to involve citizens in strategic leadership. They need not teach by example that board meetings are for administrative detail and organizational housekeeping.