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Global Vision, Leadership and innovation in Agriculture

Agribusiness Governance

Finding the Green Zone

Tom Skerman -2016

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Section 1

Introduction

Welcome to Governance in the Green-Zone.

The original focus of my research hoped to highlight the contribution that traditional systems of corporate governance could make to improve the lot of primary sector businesses– a group that is dominated by owner-operators, overwhelmingly family businesses. The idea that business performance will necessarily be improved by embracing 'good governance' is gaining traction amongst many commentators. It is a notion that is receiving no shortage of support from industry groups, financial organisations, consultants and other service providers. The historically pale, male and stale world of governance has, ironically, become a bit trendy.


National Gallery

Prior to embarking on my Nuffield Scholarship I was happy to be a part of those supporters – assuming that mainstream principles of corporate governance would necessarily provide better outcomes for our SME agribusinesses. As a director of three Agri-business companies, I felt sure that my NZ Institute of Directors-certified learnings could be diligently repackaged to the benefit of primary producers.

Now, I'm not so sure.

While staying in Connecticut, USA I was fortunate to have a discussion with Christina von Bargen, a veteran global Investment Bank communications expert, encompassing internal and executive communications, media relations, marketing, advertising and sponsorship. While discussing the roadblocks the primary sector faces in telling its own story, Christina cautioned: "Before you even start, you must acknowledge that you cannot set out to educate others without a willingness to be educated yourself."

Not only is this important advice for our primary sector as it strives to win the hearts and minds of communities and consumers alike, it also marked a turning point in my own research, pointing to a need to place greater emphasis on the actual governance needs of our primary sector businesses before considering what the solutions might be. In short I needed a decent slug of education myself, which ultimately led me to the concept of Green-Zone Governance.

So what is "Green Zone Governance"? First and foremost, it is a grass-roots engagement with governance that seeks to add value where it is needed most by providing owner-managers with the resources they need to grow. The idea is to convey a sense of choice – a green light if you will - to develop a more nuanced approach to governance, one that sets aside the traditional preoccupation with control and compliance (holding to account) and strategy, in favour of service – bridging the gap between actual and potential performance.

A fresh approach is required because agribusiness is dominated by organisations for which the mainstream practices and disciplines of 'best-practice' corporate governance just don't quite seem to fit. Where the line between family and business is blurred. A world dominated not by professional management teams, but by benevolent dictators of both sexes and their (sometimes) loyal subjects. A world where fairness matters.

This report is primarily addressed to owners of agribusinesses, or Agri-SME's- where the CEO is probably un-sackable, where management is fundamentally inseparable from ownership, and where strictly commercial drivers sometimes play second fiddle to values, culture and personal needs.

My travel and research has provided me the opportunity to see, study and reflect on a wide range of governance issues across global institutions, regulatory agencies, industry and sector groups, large corporates and massive family businesses under professional management. In some instances, the entire purpose and function of the organisation is simply *to govern.* For organisations where there is *a clear separation between ownership and management* (for example, syndicates, widely-held corporates, co-operatives, and many Maori Trust organisations) the literature, commentary and resources on governance is practically endless, as are the opportunities to undertake governance training or to secure the services of an experienced governance expert or practitioner.

It has *not* been my aim in this report to regurgitate or re-frame, for example, the debate on the merits of Cooperatives in agriculture. This has been done many times by individuals with more expertise and authority than me. Nor has it been my intention or ambition to create another model of "how to do" mainstream corporate governance, as there are already so many to choose from.

Make no mistake, the Green Zone is not the sole domain of small business, of Mum and Dad operators, skirting on the threshold of viability. It is also the domain of very large, professional and complex businesses that remain under the ownership and direct control of entrepreneurial, risk-seeking founders and their families.

This report discusses why governance is important, what it actually is, and how an organisation might build its governance model over time, in a manner that suits its changing circumstances and needs.

Executive Summary:

1. Corporate governance has grown in prominence in recent decades to the point that it is promoted as a default business practice. This has more recently translated to a belief that *all* businesses should embrace good governance. In other words, corporate failure is often closely associated with poor governance, resulting in the widespread assumption that good governance is therefore a pre-requisite of corporate success.

2. Traditional corporate governance represents an ecosystem of rules, tools, influences and activities that collectively operate to direct and control an organisation.

3. While there is no single accepted theoretical base for corporate governance, one - Agency Theory - which seeks to address the risks arising from a separation of ownership and management - overwhelmingly dominates practice and education. However, the governance needs of the bulk of our SME agribusinesses are not satisfied by an Agency Theory approach:

    a. Governance as a means of **Control**: Strike one! SME-Agribusinesses are generally owned and operated by the same people or group, often a family, where Agency theory adds little or no real value, resulting in "management processes on steroids masquerading as governance."

    b. Governance as a driver of **Strategy**: Strike two! "Culture eats Strategy for breakfast."

4. Green-Zone Governance – the role of **Service**: An opportunity to re-calibrate the approach to Agri-SME governance based on Resource Theory, which seeks to bolster the capability, networks, outlook and expertise of the business and business owner as a whole.

5. In a family business, genuinely fair *outcome*s are realistically few and far between – which is why a commitment to a fair *process* is so important, and why Service-focussed governance can help.

6. Green Zone governance assumes you already have control over your own organisation, and that you have the culture you need to win. If you have neither, introducing a formal system of governance is the least of your problems. But project governance might help get you on track.

Recommendations:

1. All businesses, big or small, should care about governance or how their organisation is directed and controlled over time. To grow and thrive (or sometimes just to survive) every business navigates getting Better, Bigger or Branded, or they are buggered. I believe that New Zealand's agribusinesses will continue to get better and bigger. In a hyper-competitive global market that is increasingly demanding 'local farm food' it is perhaps easier to say 'build brands' than to actually do it. Perhaps the transformation impact of e-commerce platforms makes this the next great opportunity? Time will tell. Whichever path is chosen, adopting a level of governance appropriate for the firm's circumstances will play an important role in your success.

2. Before assessing whether or how your business needs to embrace a governance function you must first be absolutely clear that you have considered these two questions:

   Governance of what? Governance on behalf of whom?

   If the answer to these questions reveals that ownership and management are more unified than separate, an active governance function should focus first on Service, and then on Culture (or strategy if you must). As for Control – unless the issue is related to a project e.g. implementing a new financial management system or Health and Safety program where an external perspective can be valuable, or succession planning, sales, acquisitions etc. – the control responsibilities should remain entirely a part of the internal management and planning cycle.

3. By undertaking the governance self-assessment in the Appendix you can begin to develop the governance priorities for your organisation. The philosophy behind Green-Zone governance is not to try to fit an organisation into a pre-determined definition of governance, but to let the requirements of an individual organisation shape the governance model. In reality, for Agri SME's this will be achieved by substituting an approach to governance based on Agency Theory with one based on Resource Theory.

4. Form and Structure – do not get hung up on titles – An individual does not have to have to be appointed to a formal position such as Director or Trustee to fulfil a Service governance role. Arrangements can be as formal, informal or transitional as circumstances warrant.

5. Reach for the Stars – Rather than looking for a safe pair of hands, tap into the experience of people who have learned the lessons already – preferably as a part of a larger organisation. Avoid monoculture, and remember not to let your eyes mislead you; ultimately, diversity is found between the ears.

Acknowledgements:

In any field of study we are ultimately required to reconcile Theory with Practice. Sometimes the gap between the two seems so large that we are left wondering if they relate to the same topic. A study of governance is no exception. While multiple theoretical frameworks help build a picture of what might be considered 'best practice', in reality the nature of governance will always be determined by the context in which it is to be applied.

The opportunity to undertake a Nuffield New Zealand Scholarship has provided me with an opportunity to immerse myself in the worlds of both theory and practice across the global stage - a first-hand opportunity to see things in the world of agriculture that are both awesome and intimidating. Looking for scale? Try California's Central Valley intensive production of just about everything, or Central Washington's massive and increasingly organic horticulture industry. Worried about overbearing regulation? Consider a German vegetable grower's routine labour checkpoints complete with machine-gun toting officials. Worried about attracting millennial labour to your industry? There are options.*

My overwhelming impression is that primary producers and industries across the parts of the globe I travelled are defined more by what they have in common than what sets them apart. What we perceive to be our problems are not uniquely ours at all. Although fierce competitors on an international stage, all producers shared their concerns about the challenges of securing labour, the impact of regulation and compliance, the widening gap with urban communities and the sometimes real and sometimes surreal demands and accusations of environmental groups. We are all sometimes guilty of believing that what we produce is what the consumer should bloody well want, and every country's strategy seems to be to feed the top end of Asia's growing middle class.

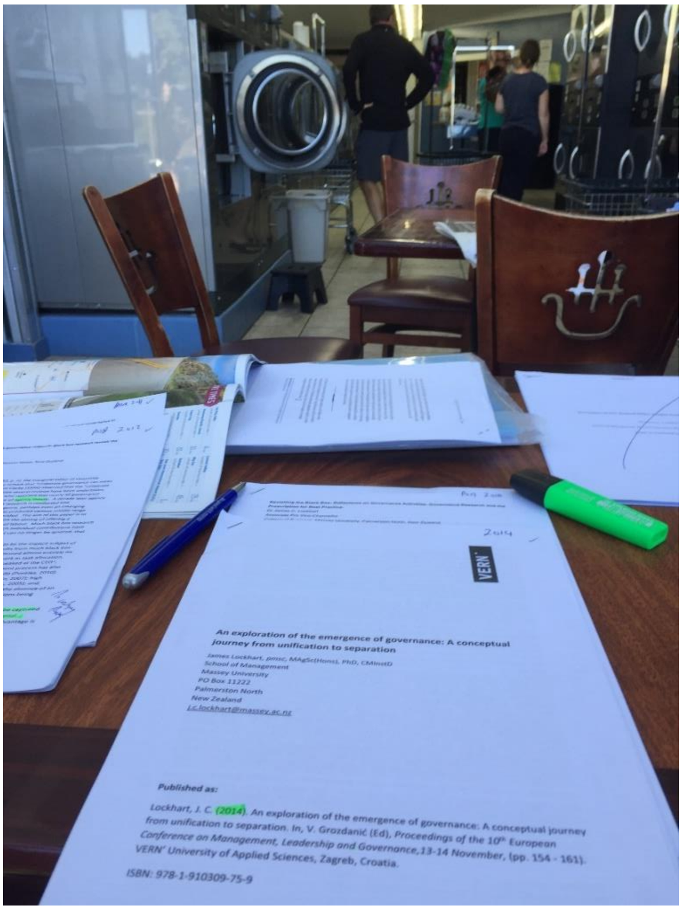
Mostly I was struck by the incredibly strong sense of values shared by primary producers and agribusinesses around the world. They are difficult to define but speak to the importance of honesty and curiosity, the rules of reciprocation, and a belief or faith in the value of the work they do.

No surprises then that these are also the values which make a Nuffield Scholarship the extraordinary experience that it is. I take this opportunity to thank all those who have contributed to my experience over the last 16 months. To the New Zealand Trustees and to Anne Hindson and Desley Tucker for their tireless support and organisation. To my fellow 2016 NZ Scholars, and the wider NZ Nuffield community. To those who have provided their honest (and sometimes brutal) feedback to the development of this report, especially to Hamish Gow, Patrick Aldwell, Juliett Maclean and to Julian Raine, I am grateful – but any errors and shortcomings remain stubbornly my own. To Nuffield Ireland for their clockwork hosting of the Contemporary Scholars Conference. To Nuffield Australia for managing the extraordinary Global Focus Program and in particular to our hosts Jamie McCoy (UK and Wales), Ed Kee (Washington DC), Brock Taylor (California) and the 2015 NZ Scholars who hosted the GFP group in NZ - all of whom put so much time and effort into our tour. Special thanks to Sally 'sowing-the-seed' Thompson who hosted our Brazil experience - relentlessly upbeat, challenging, worked 24/7, translator, motivator, Rio de Janeiro night-club extraction specialist. Kudos.

To the 150+ individuals and organisations who gave freely of their time to show us what they do and to everyone who hosted me during my individual travel – thank you all for your tremendous generosity.

To the Nuffield programme Partners and Sponsors for their investment in the program. It is a unique opportunity and I am very grateful for your individual and collective commitment to combatting New Zealand's tyranny of distance so that we can connect first hand with the issues affecting our industry.

Finally, to my family and especially my wife Trudy whom I abandoned for the CSC 2 days after our youngest left for his first year at University. I could not have done it without your support and encouragement.



Section 2: Setting the Scene

Governance: What is the fuss?

Shortly we will take a dive into the history and evolution of governance and look at a range of definitions of corporate governance before building a picture of what governance in your organisation might look like.

But first it is perhaps worthwhile addressing a more important question that you might be asking, 'Why should I even care?'

Let us, for the time being, take the most popular and commonly used definition for corporate governance, proposed by Lord Cadbury, author of the Cadbury Report: Corporate governance is "the systems by which companies are directed or controlled."[1]

Hopefully it is not controversial to suggest that organisations need to be directed and controlled to varying degrees. This definition implies two things. First, that the organisation in fact has a particular direction (either by choice or default), and second, that this direction is capable of being changed (or controlled) either internally or by external forces, for better or for worse.

In this section I want to discuss some of those external factors, and I want to reinforce how these external factors constantly challenge how we direct or control the organisations we are involved with. This notion is framed more bluntly by Professor Hamish Gow when he asks:

"Does the Past equal the Future?"

Because if the past doesn't equal the future, then you need to adapt – and the quality of your governance, how your organisation is directed and controlled, will be critical component of the success or failure of that adaptation.

Over the past 12 months, I have had the opportunity to secure a global perspective on numerous issues that will affect New Zealand agri-businesses in the decades to come. Here are a few.

Globalisation - Over the last 40 years, as western economies took on polices of economic neoliberalism involving a commitment to free trade, the privatisation of state enterprise, deregulation, and an increase in the role of the market, we have been handed more control over how we lead and manage our lives. New Zealand has embraced free-trade and open markets thereby increasing our reliance on the institutions that support the infrastructure of globalization. Events of 2016 have caused many to ask if we are seeing the end of the era of globalization. Prominent Trump advisor and ex-pat Kiwi, Chris Liddell, believes that the era of unbridled global free markets and trade agreements has halted.[2] What does this mean for your business, or your sector?

Environmental - Farmers are the largest natural resource managers on earth, shaping ecosystems, habitats and landscapes, and producing food to feed the globe, all of which has implications for the sustainability of agriculture.[3] To what extent will the impact of agriculture's environmental footprint be self-governed by producers, externally by regulators and NGO's, or downstream via the supply chain in the form of quality assurance programs? How will this 'metabolic rift' the between resource base of agriculture and between people and nature be resolved?

Disruption - "Ideas are having sex with other ideas from all over the planet with ever increasing promiscuity." – Matt Ridley, Author "The Rational Optimist"

- I met with tech-veteran Russell Fujioka, then CEO of Xero USA, in San Francisco. Russ shared the story of his time with the company Adobe Systems and how it destroyed the publishing industry's status quo – an industry launched by invention of the Guttenberg Press in the 1400's. I asked Russ what the incumbent industry players failed to ask. His response – "I feel like it was less about failure to ask, but failure to believe that they could be interrupted. I think tech companies for years have believed they are only as good as the last idea conceived in a garage. Non-tech industries believe the right to exist is built into the number of years their business or industry has existed. … Understand the speed of disruption happens so rapidly now that normal business models don't exist any more. The nice smooth bell curves of adoption are gone, first mover advantage led the way and innovation helps retain it."

- Jolene Brown, Iowa based farmer, professional speaker and farm business advisor does not agree that 'if you always do what you've always done, you'll always get what you've always gotten'. Instead, Jolene believes, you will be out of business. "The pace, people, process and products have changed."[4]

- In Denver, Colorado I spent time with renowned Futurist Thomas Frey who observed that despite many recent advances food production was still a relatively primitive and volatile endeavour compared to most industries. This meant he was extremely excited about what might be around the corner. Thomas noted that change tends to be iterative up to the point that parallel incremental advances link up to create single big changes. Right now moving onto digital platforms is proving to be the catalyst for accelerated change, and investment in on-farm data and digital platforms is exploding. How might a combination of Synthetic Food technology combined with distributed energy production (solar, wind) disrupt traditional food supply chains?

- Alibaba, the Chinese online e-commerce leviathan has opened offices in Australia and is coming to NZ. As the infrastructure of commerce has changed to narrow the distance between producer and consumer, the infrastructure of business, including governance, must also adapt.

Competiton:

- Much is made of the Food and Agriculture Organisation's 2006 research[5] declaring the world needs 70% more food by 2050. This fact invariably occupied the 2nd or 3rd slide of most presentations I saw in 2016. Let's dig into the numbers:
    - The 70% has been revised downwards to 50%.[6]
    - To reach the 50% target, agricultural production growth in developed countries for the next 40 years needed to be only a fraction of the previous 40 years actual growth.

- Greater success in tackling post-harvest losses (combining both supply chain and food waste) will further reduce the pressure to increase global food production.
- There are sufficient spare food production resources in the world waiting to be employed if circumstances allow.

- Premium consumers continue to breed like pandas not rabbits and global GDP continues to undershoot the long term projections driving current global food demand models. Advances in renewable energy technology "threatens" to repatriate huge volumes of cereal production from the bio-fuels industry back into the food supply chain.

- Colin Butterfield, Brazilian farm investor and entrepreneur, observed - if you are not in the value business you are in the cost of production business. Here the price is set at the level established by the top 25% of operators so you need to consider how you compete with (or emulate) them.
  - In Hong Kong I met with a senior advisor to the world's largest ag-input companies who estimates that up to 12million ha of corn/soy production will eventually move from USA to the more the cost-competitive farming regions in Sth America. What will USA farmers grow in its place?
  - In Brazil we learned about the Matopiba region which alone has the ability to significantly lift production across 35million ha, and the Cerrado region where there is potential to irrigate a further 10million ha. To put that in context, the entire Hawke's Bay region is 1.4million ha.

When I left for the Nuffield conference in Ireland in February 2016 the UK was firmly a part of the EU, the concept of President Trump hadn't even registered, there were nearly double the number of global giants dominating the agricultural input sector than today, and any idea of trade protectionism was patronisingly dismissed as a barbaric relic of yester-year. 2016 has proven the adage that history does not crawl, it leaps. New Zealand's agribusinesses need to adapt in an age of accelerating change and in an age where our past successes in productivity gains are translated into success in understanding and meeting the needs of the globe's elite consumers.

Corporate governance – where did it come from and what is it?

"The army of governance theorists is so disparate that one is led to think that the word, governance, itself is like a label placed on a whole batch of bottles which are then distributed amongst diverse producers each of whom fills them with the drink of his choice. The consumer has to look carefully." Baudin, 1944.

The word "Governance" is derived from the Greek verb "Kubernan" – to pilot or steer. Throughout history "governance was traditionally associated with government, with the exercise of power by political leaders. The concept was not widely used in the post-Second World War years, but during the 1980's it emerged with new meaning, now referring to something broader than government."[7]

The profile of governance has risen in prominence hand in hand with the social, political and economic changes that have accompanied the growth in democracy and globalisation witnessed since the 1950's. Put simply, as governments have progressively scaled-back their direct influence and control via de-regulation and neo-liberal reform society has collectively been handed the challenge and opportunity to govern itself. The traditional roles of government are now shared across a complex network of both complimentary and competing non-state interests including transnational supply chains, NGO's, public and private quality assurance agencies, the finance sector, regional and local authorities and so on. Note also the acquiescence of state authority to the jurisdiction of higher global institutions such as the World Trade Organisation. Sometimes it feels like everyone is in charge! Little wonder then that the tensions created by increased individualism and increased democratization are creating increasingly difficult challenges for families and family businesses.

Of course the current global context is that this system of global governance is under review. The forthcoming Brexit negotiations and the administration of president Trump, on the face of it, represent a fundamental test to the notion that neo-liberal economics and marketization are, on balance, delivering the benefits required. While this has come as a shock to many, The Economist magazine notes in its January 2017 edition that in reality global multinationals were already in retreat – in part a victim of their own success – putting us on a trajectory towards "a more fragmented and parochial kind of capitalism, and quite possibly a less efficient one – but also, perhaps, one with wider public support." For New Zealand's primary sector, with its tiny domestic market and heavy reliance on global free trade, the stakes could not be higher.

Corporate Governance developed rapidly as an area of focus and research following the 1987 market crash and the subsequent response which gave rise to the likes of the Cadbury Report and the Greenbury Code, followed by the Sarbanes-Oxley Act (2002) in response to accounting malpractice in the early 2000s, when public scandals such as Enron Corporation, Tyco International plc, and WorldCom shook investor confidence in financial statements and demanded an overhaul of regulatory standards.[8] New Zealand's own Financial Markets Authority updated its predecessors' (the Securities Commission) guidelines for corporate governance in the wake of the Global Financial Crisis.[9]

Awareness about the role of governance has reached the point whereby instances of significant organisational catastrophe and failure will almost inevitably see the blame for either the cause of the failure, or the inability to prevent it, laid at the feet of governance. This has led one commentator to dryly note that success is invariably associated with good management, while failure is the result of poor governance.

Dr Kevin Old notes, "over recent times there has been significant interest in corporate governance by the popular press, regulators and academics after strings of spectacular corporate failures."[10] Perhaps it is therefore not surprising that recently the notion that failure = poor governance has given rise to the automatic assumption that success = good governance.

Dr James Lockhart comments that "governance is now seen as a general panacea for business performance independent of the separation of ownership and control" and that "increasing awareness of governance and an emerging belief that governance is now central to business success" has in part been driven by banks, industry organisations, consulting firms and membership organisations.[11]

I have already referred to the definition of governance laid down by Lord Cadbury -"The systems by which companies are directed or controlled." During my research, I have come across many different definitions of corporate governance. Here is a selection:

"The structure and relationships which determine corporate direction and performance."

"The distribution of rights and responsibilities among the different actors involved in the corporate organisation."

"The allocation of power within a corporation between its stakeholders and its board of directors."

"The mechanisms and controls that are designed to reduce or eliminate the principal-agent problem."

"The set of mechanisms that influence the decisions made by managers when there is a separation of ownership and control."

"The manner in which boards or their like direct an organisation, and the rules applying to that direction."

"The process by which corporations are made responsive to the rights and wishes of stakeholders."

"The way rules, norms and actions are structured, sustained, regulated and held accountable."

And some expanded, or descriptive observations:

"Governance helps find the right balance between tyranny and anarchy."

"The objective of corporate governance is to enable investors to obtain an appropriate return on their investment in the firm."

"Corporate governance deals with the conflicts of interest between the providers of finance and the managers; the shareholders and the stakeholders; different types of shareholders; and the prevention or mitigation of these conflicts of interest."

"Corporate governance is what you do with something after you acquire it…When people own property they take care of it: corporate governance simply means caring for something in the corporate setting."

"How investors get managers to give them back their money."

Attempting to accurately define governance is no easy task. It has been observed that "[l]ike all maps the governance perspective applies a simplifying lens to a complex reality. The issue is not that it has simplified matters but whether that simplification has illuminated our understanding and enabled us to find an appropriate path or direction."[12]

Governance is not a "thing", it's a collection of things.

It is important to note that 'governance' is not confined to the role of 'governors'. The definitions above describe governance not as a single activity but rather as an ecosystem of internal and external factors that collectively operate to 'direct and control' an organisation. This ecosystem pulls together a wide variety of rules, tools, activities and influences, including:

- Legislation and regulation – for example the Companies Act – which define some of the limits of corporate authority and the respective rights of corporate stakeholders. The same goes for legislation for Co-operatives, Trusts, Partnerships and Limited Partnerships.
- Market and Consumer – increasingly we are observing the influence of a number of external stakeholders on the primary sector. These include communities and NGO's (think freshwater reform and the rise of collaborative governance models), the supply chain (quality assurance programs), and shifting market forces (organics, GMO's, local food movements, animal welfare).
- Contracts – binding agreements that impact the rights and roles of individuals within organisations, such as written constitutions, shareholder agreements and employment agreements (incentive arrangements) and the rules/contracts that govern external relationships outside the organisation.
- Policies – non-binding but instructive documents, including the scope of delegated authorities as well as compliance matters.
- People – via formal and informal Governance roles – undertaken by Boards of Directors, Trustees etc. and includes external advisors and confidants.

Reflection - Re-Regulating Regulation.

Note the presence of both external and internal factors affecting how an organisation is directed and controlled. Specific legislation and regulation have obvious impacts on the way we direct and control organisations i.e. compliance with the law. More difficult to quantify and understand is the impact a host of other non-government actors have on agri-business organisations via a mix of private and public regulation. I met with the University of Queensland's Professor Geoffrey Lawrence, co-editor of "Agricultural Governance: Globalisation and the new politics of regulation" who described the incredibly complex re-wiring of the way global agriculture is governed in the wake of globalisation. This has given rise to the competing influences of trans-world organisations (WTO, IMF, OECD), multilateral trade accords, transnational corporations, NGO's, activist groups and, of course primary producers themselves.

For our Agri-SME's the implications are straightforward: do not underestimate how many competing interests, by virtue of their advocacy and influence, have their hands on or near the levers of your business. It is the nature of interest groups to claim they speak on behalf of the consumer, the community or both. Whether or not that is in fact the case appears to be increasingly irrelevant. Either way, in terms of environmental regulations, staff welfare, quality assurance and animal welfare, the future most certainly does not look like the past.

Together, these activities form the tools of the governance workshop. But it is not enough to simply co-ordinate these things and call it governance. We have to ask: Why?

We pull these things together in order to c*ontrol our organisations*, in a manner aligned with our *strategy or values*, and marshalling the *resources necessary for long-term success* against a backdrop of an ever-changing external environment.

This is not new. There is already broad agreement that the key roles a board of directors undertakes are **Control**, **Strategy**, and **Service**. Beyond the Boards role, it is my belief that, for Agri-SME's, an analysis of these three roles provides the most useful framework for a critical assessment of the role governance should play, as well as the role it shouldn't.

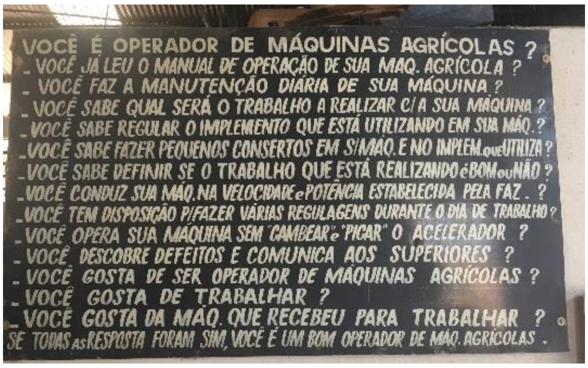
So what is meant by Control, Strategy and Service?

1. Control – protecting the business from errant management and "to safeguard the company's assets and resources, to ensure survival, and to avoid corporate trauma or consistent poor performance."[13]
2. Strategy – creating clarity about what you are doing, how you intend to do it, and why.
3. Service – securing external resources such as advice, counsel and knowledge, legitimacy and prestige and networks of contacts[14]

Let us now look at closer look at the first two.

Section 3: Taking a closer look at Control and Strategy

Control.



Welcome to the world of Agency Theory.

It is widely accepted that there is no integrated theory of corporate governance. Researchers and academics point to at least 8 separate theories that inform our understanding of corporate governance.

Of these, "[a]gency theory is regarded as the 'Bible' of corporate governance (Huse 2007); it dominates the academic literature and has a major influence on regulators in underpinning the majority of reform activity."[15]

Agency theory's dominance reflects its role in addressing the principal-agent problem, that is, the risks and challenges that arise from the separation of ownership of the business with the control of the business. While this separation is most obvious in legal structures such as companies and limited partnerships, it is just as much a factor in partnerships and trusts. Therefore, agency theory is primarily focussed on Control – ensuring that management is acting in the best interests of the organisation. The reasons are obvious because '[i]n organizations it is the leader, more than other participants, who has the possibility of making his or her fantasies a reality.' This is fine, right up to the moment that owners and leaders fantasies start to diverge.

This approach gives rise to popular governance phrases such as "Eyes in, hands out" and "A board's role is not management one step up, it is ownership one step down".[16]

The Institute of Director's in New Zealand identifies the 'four pillars' of best practice governance[17] as being:
1. Determining the Purpose,
2. Creating an effective governance culture,
3. Holding to account, and
4. Ensuring effective compliance.

Of these, pillars 1, 3 & 4 are predominantly concerned with Control. Of course, the Institute articulates the challenges of applying this approach to different types of organisations, including SME's and family businesses, but we can see that Agency Theory is the driving perspective behind what we might consider to be New Zealand's mainstream approach to corporate governance.

But is the agency focus appropriate for Agri-SME's? Recent research[18] has highlighted 4 separate conflicts of interest that make up the Agency problem requiring risk management in the types of businesses and organisations that are the focus of this report.

Conflict	Risk Management
Agency Problem I - The conflict between the interests of shareholders and managers: where the business is not managed directly by its owners there is ability for management to place its own interests and agendas ahead of the owners.	This problem is managed via the plethora of mechanisms that are widely promoted in best-practice governance - contracts, performance related tenure and incentive -based compensation, delegated authorities, Dividend policy (capturing free cash-flow for the benefit of owners ahead of management), Boards, removal of CEO/management.
Agency Problem II - The conflict between the interests of controlling shareholders and minority shareholders: where a large shareholder uses its controlling interest to appropriate private benefits of control at the expense of small shareholders.	Common tools to mitigate this risk include the use of independent directors, investor protection/shareholder agreements, dividend policy, and clear exit provisions (sunset clauses, drag-along and tag-along rights, shoot out provisions etc.), Estate planning, Insurance.
Agency Problem III - The conflict between the interests of shareholders and creditors:	Balancing the desire of owners to employ debt to minimise dilution with the risk of longer term survival of the business.
Agency Problem IV - The conflict between the interests of family shareholders and family outsiders.	This problem is more relevant to the very large family businesses found in the USA and Europe and which can see a great deal of formality around the management of wider family interests through family forums and councils, family project committees and written family constitutions.

Common sense suggests that for most Agri-SME's Agency Problems I, II and III either do not exist at all, or to the extent they do can be *self-managed* utilizing an ecosystem of agreements, policy documents and contracts. Beyond these examples of one-off and predominantly contractual mitigations, it is valid to challenge how additional layers of external control and oversight will add any value? Others put it more strongly. Lockhart[19] observed that 'family firm governance violates almost all of the underlying assumptions of traditional governance theories.' Others note that "Family governance is distinguished not by the separation but by the unification of ownership and control. "[20]

Quite simply, if *there is not a sufficient separation of ownership and management* can a governance structure founded on Agency theory be justified?

Significant energy is spent by industry, sector groups, financial institutions and the like to improve the performance, productivity and profitability of our agri-business sector. And research reveals that amongst NZ farming businesses there is ample room for improvement in the realm of formal management, planning and decision making processes. 'Formal planning typically included nothing more than an annual cash-flow (23% of participants), and or production forecast (11% of participants). Formal evaluation of financial performance was also rarely undertaken.'[21] But, to the extent that it has been felt that governance is seen as the missing activity from these businesses, "[i]n such occasions we are observing nothing more than management processes on steroids masquerading as governance, the fundamental tenents undermined, and expectations aplenty over these supposedly new found skills' and 'Sadly, governance is now at risk of becoming a ubiquitous panacea for effective risk management and business performance problems. This is a situation from which further crises of governance can only emerge.'[22]

This is not to suggest that *no* agribusiness should use an Agency theory approach as a mechanism for protecting the interests of owners. While on one hand a very large yet closely-held business may only require bespoke and infrequent governance systems, on the other hand a small operation with absentee owners (often seen in farming syndicates and Maori agribusinesses) would arguably be reckless to not have relatively formal agency-focussed governance systems in place. However, there is always a need to carefully consider exactly "what" is being governed, and upon whose behalf?

Case Study - Agency Theory at work - *Is the director adding value to the organisation, or is the organisation adding value to the director?*

We received a presentation from the CEO of a large agricultural co-operative (European). The constitution of this organisation established a board of 14 farmer-directors plus 1 non-executive independent director. The farmer directors could serve a maximum of two, four-year terms. While the CEO acknowledged that the director turnover was potentially disruptive and required significant director education, he expressed the view that the system worked very well "because the board had never turned a management project down."

Two weeks later, we had the opportunity to contrast this example with that of Superior Farms Inc, California's largest sheep meat processor and marketer. The Company is 100% employee owned under an ESOP – Employee Stock Ownership Plan. In an industry challenged by recruitment and retention of staff issues, the company has a significant proportion of employees who have been with the company for decades, as well as an enviable safety record– in fact one of their challenges is an under-reporting of Health and Safety incidents on account of the employees owning their workers' insurance company and being motivated to keep insurance costs down. The company has 6 directors, 2 of whom are appointed on the shareholder's behalf from the executive team, with 4 external appointments based on their industry and market expertise: currently a former CEO, a financial expert, a legal and regulatory expert and a senior executive with a significant meat retailer experience.

Both are examples of organisations of a size and structure for which Agency-based governance is appropriate - Which has access to the knowledge that provides the sort of advice and expertise management might need, or the insight and experience necessary to critically assess management's performance, or proposals?

In summary, I suggest that most Agri-SME's will not have a sufficient degree of separation of ownership and management to warrant a governance model that is overly preoccupied with Control. What risks there are can and should be dealt with by periodically reviewed risk-management documentation identified in the 4 Agency problems above. These are jobs for management with the support of accountants, lawyers and consultants in their professional capacity – not as directors.

Let us now turn our attention to Strategy.

Strategy

The second role for governance under a traditional approach is to ensure an organisation has (a) developed an appropriate strategy and (b) that it is executed faithfully in the best interests of that organisation. In this context, strategy means a story or description of why, when and how an organisation, in its own unique way, intends to get from Point A to Point B. Arguably, strategy is closely related to Control insofar as it seeks to ensure that the strategy developed is in the organisations best interests and that management's actions and incentives are aligned accordingly. However, it goes without saying that this is an area where external experts, in the form of directors or advisors, working in conjunction with management can certainly create wealth in the development and/revision of an organisations' overall strategy.

But for our Agri-SME's, is having a formal strategy a non-negotiable part of what might be considered good governance? There is no question there is widespread belief that having a formal and clearly articulated strategy is a necessary part of running a business. What's your Mission? What's your Vision? Certainly, in larger organisations, a formal strategy is one way of "letting the dog see the rabbit", by helping employees understand and align themselves with organisational ambitions.

Perhaps I should re-phrase the question. While I expect that a most people agree that having a formal strategy is a good thing, does this mean *the absence of a formal strategy is a bad thing?*

It is important to differentiate between a strategy and a goal, because I am of course not suggesting that having a goalless enterprise is a good idea. A goal is a broad primary outcome. A strategy is the approach you take to achieve a goal. A goal is an absolute, whereas a strategy is optional, dynamic and changeable and there will be multiple views on how to best achieve the goal. Most importantly, in the world of Agri-SME's – a territory dominated by benevolent dictators – the strategy will most likely be what the dictator dictates.

At the 2016 Contemporary Scholars conference in Cavan, Ireland renowned leadership consultant, Declan Coyle, challenged us with this statement: "Culture eats Strategy for Breakfast." In other words, no matter how inspirational or aspirational an organisations' stated mission, vision, or strategy might be, the culture of the organisation that was the most determining factor in the success or failure of that strategy.

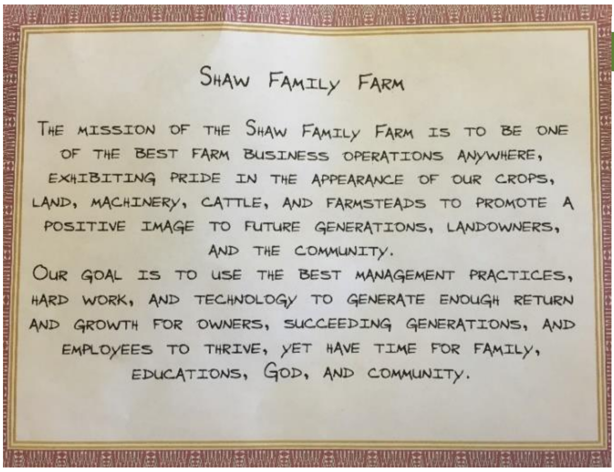
Reflection - Country Crest, Ireland.

Four days after Declan's presentation, we visited fourth-generation Country Crest Foods on the outskirts of Dublin, generously hosted by CEO Michael Hoey. As we toured the various business units, Michael commented that Country Crest's culture was a critical part of their success. I had the opportunity to delve into this one-on-one with him, and asked him to describe the culture. "Honesty" – was the one word reply. Interesting. How do you measure that?

"Easy – it's in the final product. If we cannot look at our produce and say we were honest in every aspect of how we made it, then we have a problem. We find that people who cannot understand that don't stay with us very long."

This was the first of many occasions during my subsequent travels where I was struck by the number of successful owner-operated businesses that appeared to rely on a strong culture rather than a clearly articulated strategy. Alternatively, I was intrigued by the number of large second and third generation businesses that could articulate their current strategy but, when asked about the founder's strategy, would immediately talk in terms of culture. Perhaps there were no consultants available 50 years ago?! Here are some other examples:

- Nearly all of the farmers I met with in Washington, Iowa and Nebraska articulated strong community and faith-based values.



- In USA – Marv Omdal, the Chairman of Skagit Bank and ex dairy farmer, believed America recognises that the nation benefits from the risks taken by individuals, which has in turn given rise to a culture that forgives mistakes so as not to supress the entrepreneurial culture.
- In a meeting with Californian executives from the Westchester Group, a multi-billion dollar owner of agricultural land, I was struck by the absolute emphasis they placed on securing alignment with the managers and lessees of their land holdings. Leases and contracts appeared to be remarkably short term but the key relationships were in fact incredibly enduring, which reflected their philosophy that the critical component of success was getting relationships right and being prepared to walk away if you cannot get it right.
- In Holland, it was hard to miss the importance of close-knit, integrated communities and the time-honoured principles of reciprocation.
- Amoungst Brazilian agribusinesses I observed consistent themes of faith, nationalism (they were impeaching a president at the time after all) and a real sense of pride in being an important part of the country's economic and social transformation.

In the same way that 'we are what we eat', perhaps our culture is staring us in the face in the form of our daily actions and behaviours, and that of our team? If we look around the people, what are they telling us? Nowhere is the saying that 'a fish rots from the head' more relevant than in an organisation's culture.

In summary, I suggest that many Agri-SME's can and do survive without a formal strategy sitting behind their goals. Furthermore, the success of the organisation is more likely to be a function of its culture, not strategy. This is not to reject outright the need for strategy in these organisations, but perhaps I have heard one too many times that a strategy or business plan is sitting in a bottom draw (or that the "next strategy' won't) to conclude that first building a winning culture is perhaps a better use of time and effort.

So far, we have discussed that governance operates to direct and control a business through mechanisms of Control, Strategy and Service. We have identified that (for Agri-SME's) Control is a most likely to be a management function, not a governance function, and that while Strategy is a 'nice to have', it is the development of the right organisational culture – again the role of management - is more important. So with 2 of the 3 roles of governance, in my view, severely diminished for our Agri-SME's, is there any place for an active governance function at all?

Absolutely.

Section 4: Finding the Green Zone

Service

Recall that the Service role of governance is described as – 'providing the organisation, particularly top management, with advice, counsel and knowledge, and providing legitimacy and prestige, as well as access to resources by utilising networks of contacts to assist the firm.'[23] Note how the ultimate focus is on the firm, not the individuals. The role of Service is not to simply provide back-up or support to the prevailing power-base, it is to utilise a greater collection of resources for the benefit of the firm.

Earlier we referred to the existence of differing theoretical foundations of governance and noted how one in particular, Agency Theory, has the major influence on governance practice and education. My view is that this framework is ultimately unhelpful, so let us turn our attention to another: Resource Theory.

Resource Theory describes how organisations secure scarce resources through an individual's external relationships or knowledge which in turn helps span the boundary between the organisation and the operating environment. Resource theory has both an external and internal focus.

Externally, an organisation can secure access to resources (either directly or via networks) such as advice and counsel, communication channels to external firms, assistance in obtaining resources (such as finance or influential groups) and legitimacy.

Internally, the resources provided are the support and guidance of management by individuals who are professionally and/or personally qualified and experienced through organisational, market and industry knowledge.

Straight away, we see that instead of operating as a mechanism of control a Resource Theory approach requires a highly collaborative relationship between the managers of the organisation and the provider of resources. Here the role of governance is to provide certain resources that are currently beyond the reach of business owner/managers by introducing specific skills that can help them develop their organisational capacity, (people management, for example), industry knowledge specific to the organisations market, access to important networks such as distribution channels or finance, or the derived benefits of an association with an individual.

Applying a Resource lens to the Service role of governance provides organisations with a tremendous opportunity to challenge and grow the capability of the owner-manager. That is: ***providing the <u>organisation</u>, particularly top management, with advice, counsel and knowledge.***

Reflection – Holding ourselves to task.

In a discussion that took place in Sao Paulo, Colin Butterfield, a Brazilian IT and agri-business entrepreneur, spoke about the challenges of running a business. When I asked Colin what was the most important question in business his response was emphatic – ***"Have you considered all the risks, the greatest of which is your own bias?"*** He went on to note that humans are the 2nd most dangerous animal on earth (gold medal to the mosquito) – and a failure to see our personal biases for what they are is the catalyst for many failures. For me this highlights the value and need for the Service role of governance when it is couched in terms of supporting and challenging an organisation's key decision makers.

"One family has a rule that half of the seats on the board should be occupied by outside CEO's who run businesses at least three times larger than the family business" Elstrodt, McKinsey & Co, 2003.

I believe that the starting point for an active approach to Agri-SME's governance is Service by bringing to the table the external resources necessary to increase effectiveness and capability and address the gap between the organisation's actual and potential performance.

Fairness. Really?

Of course, no discussion on the topic of Agri-SME governance can avoid the vexed challenges of governing a family enterprise.

Renowned international author and management consultant Manfred F.R. de Kets de Vries cautions that family enterprises require special consideration because "…in a family enterprise there is a coming together of two different systems – the business and the family" which in turn requires us to consider economic and psychological approaches in order to understand the workings of the business. "The business system becomes an extension of the family system, assuming its rules and behaviour patterns. If the family's pattern of functioning encourages clear boundaries and effective decision making, that will foster the same in the business." The complexity of the challenge is not to be underestimated. Professor de Vries notes that 3 out of 10 family businesses survive into the 2nd generation, and only 1 out of 10 to the 3rd. "No surprise that the average life-span of the family firm (after start up) is 24 years, which coincides with the average time a founder is associated with the business."[24]

Professor Belen Villalonga (and others) offer the following definition of family enterprise governance: "the collection of mechanisms that enable family decision-making and implementation of policies concerning the management of family affairs, its business and related entities."[25] In their paper the authors propose that the aim of family enterprise governance is to:

- Enable coordinated decision-making about common assets and their management.
- Enable orderly succession in ownership, management and control.
- Minimise interpersonal conflict within the family.
- Preserve and enhance family wealth.
- Ensure sustainability and prosperity of the family business.
- Enable long-term estate planning.

Jolene Brown states the issue in this way. Sometimes you have a **Family-First Business** where decisions are based on "emotions, feelings, personalities, genetics, wishes, avoidance, habits and assumptions", and sometimes you have a **Business-First Family** where decisions are based on 'an agreed mission, written goals, a code of conduct, discussion, clarifications, quality communication, legal and written documentation and carefully managed risk'. The latter 'does not sacrifice family for business, but values the family and has the family's best interest at heart...that's why they do business correctly.'[26]

Having discussed family business and succession throughout my Nuffield travels, sadly, but perhaps inevitably, I found no silver bullets, but plenty of spent cartridges. What I did conclude, however, is that a ***fairness perception is the core informal element in family governance*** and a governance approach focused on Service (adding resources) is preferable to one focused on Control (managing conflicts) because it is more likely to promote a fair process, which in turn should help avoid internal and external conflicts.

In a 2005 article in the Family Business Review, researchers noted "Family businesses link two societal institutions, family and firm, in co-operative ventures for mutual advantage. It is an area fraught with the potential for conflict, *with a key difficulty being the different perceptions of fairness and justice differ across family and firm* [emphasis added]." [27] The authors summarized the relevant literature as pointing to three types of Justice that impact the perception of fairness:

- Distributive Justice (outcomes).
- Procedural Justice (decision making process).
- Interactional Justice (fairness of treatments).

Fairness of outcome can be extraordinarily difficult to achieve – and not just for economic reasons – because in family systems there are varying drivers behind decisions. The authors note that family systems are largely organized around hierarchies based on parent-child relationships. This invariably leads to decisions based on the needs of individuals – which sit in stark contrast to a strictly commercial environment where equity is based on performance and merit. The same goes for shareholders – who require their interests to be based on principles of equality – in terms of dividend, rights, information (at least in accordance with their respective shareholding). Examples of the fairness issues that family businesses find more difficult to resolve than non-family businesses include:

- Capital – How are the businesses financial resources allocated among different business and family demands?
- Control - Who has decision making power in the family and the firm?
- Careers – How are individuals selected for senior leadership and governance positions?
- Conflict – How to stop conflict in one domain spilling over to the other?
- Culture - What values are fundamental to both the family and the business domains?

While this may come as no surprise to the ancient inventors of the principles of primogeniture, the research authors conclude that a single focus on achieving distributive justice is *inherently impossible* because individuals will employ separate criteria to assess fairness such as need, equality, merit - matters that lay bare the risks of assuming the family system and the business system are the same). Therefore, acknowledging the difficulty of achieving fair *outcomes*, in order to promote trust, commitment and (fingers crossed) harmony the focus must be **to establish a fair process**. The process they recommend is, in my view, surprisingly unremarkable. It is the fact of a process that counts.

1. Framing and Engaging - defining the issue, establishing the criteria for an optimal solution.
2. Exploring and Eliminating options.
3. Deciding and Explaining.
4. Implementing and executing.
5. Evaluating and learning.

What interests me about a commitment to process is the role that Service-oriented governance plays in supporting a fair process by bringing external experience and knowledge, testing internal biases, providing an alternative communication channel for stakeholders, and maintaining everyone's commitment to the agreed process.

Case Study – Harsh, but Fair.

It would be nice to think that a process would, of itself result in a seamless, harmonious outcome on every occasion. That would be to hope too much. A robust process should also establish boundaries and expectations lest an environment is created where the most stubborn or hard-nosed protagonist skews the debate. The CEO (and majority owner) of a very large vertically integrated business in Washington shared with me an unwritten rule applying to all shareholders. The company was represented by a lawyer who was available to give advice on the company's affairs. Any move by a shareholder to introduce an outside lawyer to address a company issue was deemed to be informal notice that the shareholder wished to exit the business, on the company's terms. While some questioned the ethics of this policy, no-one doubted its effectiveness.

"There is a time for succession, and a time to retire. You are very lucky if they're the same time." - Marv Omdal

The Project Perspective

When I told people my Nuffield research topic is SME-Agri Governance I was struck by the number of times the response was: "Oh. Succession – that's a tricky one."

To be clear, succession is not governance. It is an undertaking that will benefit from good governance. And while this is not a report on succession, the subject is a useful platform for a final closing discussion – Project Governance.

The essence of this report, ironically, is to recommend that Agri-SME's should narrow their governance focus. My recommendation is that the best entry point for governance is to secure the service of trusted or suitably qualified and experienced people who can *provide the organisation with advice, counsel and knowledge.*

One way to test whether this approach will add value to your organisation is to 'try before you buy', to conduct a one-off experiment that utilises an active approach to Governance. Perhaps your organisation is about to undertake an out-of the-ordinary project, such as acquiring new property, entering a joint venture, diversifying the business, or addressing issues relating to succession.

In a normal course of events, this process would predominantly involve the business owners and their advisors (Bank, Legal, Financial/Accounting, and Technical Advisor). My suggestion is that this is also an opportunity to experiment with the introduction of a governance role tasked with the following responsibilities[29]:

- Clarity around process and decision making,
- Clarity around authority and responsibility for decisions,
- Clarity around extent of delegated authority,
- Reporting appropriate to the scale of the project, and
- Awareness of and access to external resources for expertise, networks and stakeholder management.

Good project governance should encourage what US-based international forest manager, Ken Osborn, calls 'bright lines' where stakeholders understand roles and responsibilities, and everyone is clear about the extent of everyone's authority.

It may be that this approach leads to a more permanent and active governance approach within an organisation. It is equally appropriate that the engagement continues on a project-by-project basis, with the actors changing according to the requirement of the initiative. Alternatively, it may be that an organisation decides it is not ready or does not see the value in a more formal approach.

Nothing ventured, nothing gained.

"Risk equals opportunity, so which risks are you going to take?" - John Hopkins

Afterword.

Are you happy?

No, seriously. Are you happy?

Think about this the next time you are enjoying a Nespresso or Iily coffee – because the producer of those coffee beans (wearing the red hat) considers this to ***be the single most important question a business must ask itself***.

Marcello Balerini, owner of Montesa Farms, Brazil, runs a large-scale vertically integrated diversified cropping business. He is a workaholic. Everything he has, he has built from scratch – including the school that he needed in order to attract the staff that he wanted to make his business successful.

Green Zone Governance is an attempt to tackle the kind of business that Marcello operates - where he is clearly and totally in control of the organisation's destiny, and one where the his values strongly reflect the culture of the staff (are you happy?). And it is a business with a single and highly concentrated risk, Marcello himself.

Green Zone Governance seeks to add value to the organisation by stretching and testing both owners and senior management by providing them with access to resources they currently need but do not have. It offers a governance approach that can operate either continuously or on a project-by-project basis. Finally, it promotes an approach more conducive and empathetic to achieving a sense of fairness amongst family and non-family stakeholders as the business transitions from one generation to the next.

Appendix: Agri SME Governance Requirements Self–Assessment.

Category	Question	Comment
Ownership Structure and Control	What is the nature of the entity that forms the business?	Company, LP, Partnership, Trust, combination. What other related entities e.g landholding Trust, estate etc? Include shareholding/ownership percentages. Testing the need for formal directors, advisory directors, “Kitchen Cabinet” advisors.
	Does the business have a “CEO” and, if so, can s/he be sacked?	If the CEO is an immovable object then the business is not likely to require Agency-based governance systems. See Agency Problem I
	What modifications (if any) have been made in relation to minority ownership interests?	Test for shareholder agreement, partnership agreement, dividend policies, trust deed terms that operate to modify pro-forma ownership control rights. See Agency Problem II.
	What percentage of ownership is involved in the management of the business	Understanding if separation has occurred. Agency Problem I & III.
	What external (e.g. Family) interests are not represented in the ownership and control of the business entity but nonetheless impact or influence decision making within the business?	What formal and informal external stakeholder influences from estates, trusts, leases, matriarchs/patriarchs? Agency Problem IV.
	Has the business grown beyond the point where the founder or family members can effectively manage the firm?	Note Lord Cadbury’s recommendation is avoid a formal board of directors until this milestone is looming.
Future Focus	Does the business have an agreed view of: 1. The current business environment, and 2. The future business environment, and 3. The degree (if any) to which the business must change to be ‘future-fit’?	Yes/No in terms of a sense of direction. Does the future equal he past?
Goals	How important are the following issues for the business? 1. Succession planning for the business. 2. Succession planning for a related entity. 3. Growth by getting Better. 4. Growth by getting Bigger. 5. Growth by getting Branded. 6. Other?	Separate the need for *Systems of Governance* vs *Project Governance*. The latter can be a way of testing an organisation’s likelihood of actually getting value out of the former – try before you buy.
Culture	What is the culture of the organisation? What key values or value statements apply?	Does the organisation Have the culture to deliver on its ambitions? Does it have the Team?
Resource Constraints	List the key resource constraints within the organisation,	Capital, Infrastructure, Capability, Experience, Networks, Stakeholder Alignment, Profitability, Compliance/Planning, HR.

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* I met with Michael and John Lord, expat NZers and founders of Livwell, Colorado's biggest cannabis sector employer. Attracting millennial staff did not appear to be a problem.


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