

PRACTICAL PRINCIPALS OF ON FARM GOVERNANCE

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Overview

Implementing the principles and disciplines of governance brings many benefits to all farming businesses, large or small, from new sharemilkers to well-established farm owners. Improved governance gives better clarity of direction and purpose, and clearer roles and responsibilities, effectively utilising the skills of the family or team around you. Improved decision making and being on top of your business builds confidence, engagement and satisfaction, while family or team harmony levels rise. Stress, risk and uncertainty levels decrease.

Introduction

The word governance has become the “buzz-word” of the business arena over the past decade, but most particularly since the 2008 Global Financial Crisis. Governance is often seen as the domain of corporate businesses. However, we believe it applies to all farming businesses – large, medium or small, and at any stage of development – from new sharemilkers to well-established farm owners.

Definitions of governance

Sir Adrian Cadbury is recognised as the forefather of governance. He defined governance as:

“The system by which businesses are directed and controlled”

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DairyNZ have drawn on this definition to develop a definition used in DairyNZ's Farm Business Governance Programme:

"The process of leading, controlling and directing a business so that it delivers a desired set of outcomes for the owners."

Governance is the part of the business that:

- Knows what the big picture is:
 - why you are in business – purpose
 - where the business is headed
- Sets the goals, then monitors and reviews the performance – making changes at a strategic level when performance is not aligned with goals – ensuring accountability
- Sets clear boundaries of responsibility and accountability
- Ensures a broad range of skills and experience is brought to the table – a mix of creative and big picture thinking, good decision making and implementation. Independent and impartial thought is encouraged which provides a good environment for people to flourish
- Understands the broader issues the business has to deal with
- Identifies and manages risk and compliance requirements
- Plans the succession of the business.

Governance is different in a farming family situation:

- The family and business are intertwined
- You may play all the roles – governor, manager, staff - and may need to make an effort to wear a different hat for the different roles.

We need to create a 'safe space' for those tough conversations to happen. Farm business governance meetings are not the place to bring up personal issues. Families need to have the robust discussions but still be able to enjoy Christmas together.

The governance role differs to the management role. One analogy might be that governors must ensure the helicopter (business) is fit for flying, chart its path and ensure it stays on path, but they must keep their hands off the joy-stick. It is management's job to use the joy stick and navigate the helicopter each flight.

	Governance	Management
Is	Doing the right things Taking an overview of the business	Doing things right Ensuring things are implemented well
Focus	Discerning the purpose, vision and strategy of the business	Given the strategy, what needs to be done to deliver that strategy
Ask	Where are we heading? Where are we now? What will we do to get there?	Are we on track? How well are we delivering?

The benefits of improved governance

“Effective governance creates ‘the space’ to recognise opportunities and to act on them.”

Colin Armer, Dairy Holdings

Participants from DairyNZ’s Farm Business Governance Programme outlined benefits they have experienced as a result of increasing their focus on governance:

- Everyone working towards a common goal, with clarity of purpose and strategy
- Wider family and both generations included, with clearly defined roles allowing people to know where they fit
- Shared responsibility – the weight not just on one person’s shoulders
- Creating a ‘safe space’ for discussion
- Improved confidence, better decision-making
- Lower risk, stress and uncertainty
- Improved business performance and profits, with better longevity expected.

Formality increases as businesses become more complex

When DairyNZ began to focus on the topic of governance in dairy farming businesses, we found that many were already practising good governance, but generally informally and in small doses. Many businesses were at different stages of development. Diagram 1 shows a roadmap of various governance stages from informal through to more formal. As a business

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becomes more complex through size, debt levels, number and diversity of stakeholders, etc., levels of formality will rise.

Looking along this roadmap we can see that smaller businesses in an early stage of development or businesses with low debt may have quite informal processes

- The governors are often a sole operator or a farming couple
- Little formality around written plans, reporting, monitoring and benchmarking.

As businesses grow, and more people become involved, governance needs to address more complex issues:

- Progressing from husband and wife to an annual meeting with key advisors and a regular family meeting, or even further to advisory or formal boards
- Reporting and benchmarking requirements increase
- Agreements become more formalised.

Where do you place your business on this roadmap?

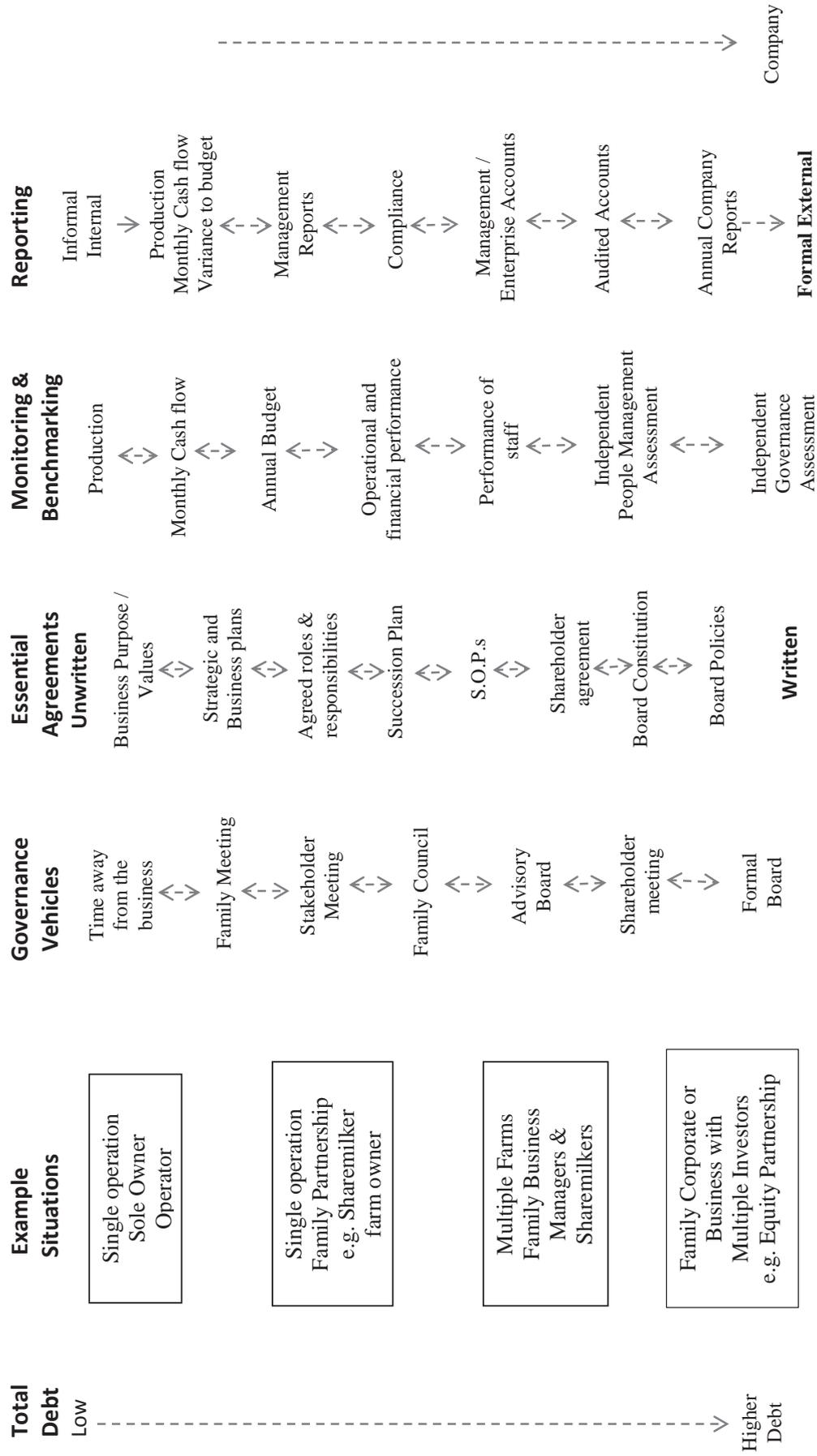


Diagram 1. Roadmap to more formal governance

Governance at Aratiatia

Southland dairy farmers Paul and Juanita Marshall attended DairyNZ's Farm Business Governance Programme in 2013 and share the following about their governance journey.

Paul was from Auckland, Juanita from Southland – both studied Agriculture (Economics and Science) at Massey University. We worked for four years in Wellington before moving to Southland in 1986 to the 600 hectare sheep farm owned and operated by Juanita's folks. The block had been bought, largely undeveloped, in 1966 and the last of the scrub and bush was put into pasture in 1980. At its peak the farm ran 5,000 ewes. From 2006, the ewe flock was progressively displaced by dairy support and the rate of pasture renewal was accelerated. In 2010 we sold the flock and converted the property to a self-contained dairy unit milking 900 cows.

Our farm business took a significant step forward after attending DairyNZ's Mark and Measure Business and Strategy seminars, but we were frustrated by how 'poor governance' had impacted on both the family farm and on our dairy equity partnership. We already had a Trust in place and with it a succession plan, but it all relied on us. We wanted a better work/life balance as well. With that background we entered the DairyNZ Governance Programme with high hopes, but with a degree of healthy scepticism.

The application of the key learnings from the programme has been life changing – they have already resulted in substantial change to our business.

Our children, who have their own professional careers off-farm, pointed out to us that our original business plan, with its focus on the farm and debt reduction, left no room for them. After a weekend of constructive dialogue with them, we're all **much clearer now about the nature of our business and our role in it**. Rather than a narrow focus on the farm as our family enterprise, our shared vision is now of an **"enterprising family"**. That simple juxtaposition gave "permission" to the children to contribute. The intergenerational alignment of the family's vision also **created space for us** to continue to contribute for as long as we want to. That neatly redefined planning around "succession" as planning for "business continuity".

We have established an advisory board with three external advisors and our adult children as members. The processes around running the advisory board:

- Happen in a transparent and timely fashion, so the advisory board is able to deliver value
- Remind us to strip out management (the daily imperative) from governance (strategic) considerations
- Provide the discipline of **holding to account**, and reinforcing **an effective governance culture**

- Lock in a **learning orientation** across all our endeavours – the advisory board is specifically charged with the business education of the children.

Key decisions are weighed against the purpose of the enterprising family and “**risk management**” is part of our review process. We wanted a structure that spread operational risk, and one that didn’t require us to be hands-on in the business. We’re in the process of restructuring the business to make that happen. Those governance changes have driven:

- an increase in cow numbers
- the construction of a second cowshed, and
- the employment of two contract milkers.

That separation also provides an opportunity to benchmark each contract and drive performance, lean efficiency and growth. The changes will also help shrink the farm’s environmental footprint and that process will be on-going as we look toward further wetland development. Continuous improvement is at the very heart of our enterprising family. Being environmentally savvy is one way of helping to ensure the business will continue to thrive with catchment nutrient limits on the horizon.

Our children are growing into the space the “enterprising family” concept created for them. As they become more familiar with the business their areas of interest are broadening. Their growing involvement in the governance has added another dimension to the relationship we have with our children.

We’ve only just begun ... but we see these first steps as useful progress towards capturing the economic benefits that stem from effective governance.

Key messages are:

- Start – the earlier the better – but start the process now
- Involve others – it’s not as scary as you might think
- Talk honestly with your family
- Have fun.

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Governance at Medbury Farm Limited

Medbury Farm Ltd attended DairyNZ's Farm Business Governance Programme in 2014 and share the following about their governance journey.

Medbury Farm Limited began in 2001 when we purchased and converted a property on the south side of the Hurunui River, near Hawarden, North Canterbury. At that stage it was 208 hectares. Now it is 408 hectares, with 2 dairies operating on it, milking 1350 cows.

The governance journey

For us, the governance journey started when we purchased the property. In the early days things ran along fairly informally, with regular discussions between Dave and Eric but few formal meetings. In 2010, when Mark came into the business, we created a shareholders' agreement and started to formalise a governance framework for the business.

Formalising governance has been an ongoing process, which has benefited significantly from the participation of all five directors in the DairyNZ Governance Programme. We have now created key documents to ensure that everyone is aware of what is happening and is involved in governance decisions. This includes an annual governance work plan, a business plan including policies and action points for the next three years, a five year financial plan and written delegated authorities. Formal board meetings are now held three times a year, usually off the farm and involving all directors; with monthly management committee meetings involving Dave, Eric and Mark.

What we have learnt from our journey

We all recognise that governance is not fixed in concrete. There is no right or wrong way to create the framework, and whatever is put in place must be amenable to ongoing review and adjustment. However, we now have clear processes in place that enable us to meet challenges and to take advantage of opportunities.

Discussion around the business plan required us to individually consider why we were involved in the business, and then collectively to agree the purpose of Medbury Farm Ltd. The purpose we developed is threefold:

1. To grow a sustainable dairy farming business that provides a low risk, long term wealth generating asset
2. To enable shareholders and staff members to be part of a business that they are proud of and enjoy
3. To provide opportunities for shareholders and their families to move into some form of agribusiness ownership.

Additionally, we have recognised the risks of ‘group think’ and therefore make sure that everyone is heard and contributes to board meetings. We are now more aware of the importance of personality type to board composition, and have procedures in place to review how well the board is performing. One of the significant benefits for Medbury Farm Ltd was identifying and acknowledging the strengths (and weaknesses) of each director based on personality tests carried out during one of the sessions. The result of this has been more structured board meetings which do not depart down irrelevant paths, and an expectation, led by the new chairperson, that when people agree to do something then it will be done in a timely manner. The board environment leaves the creative personalities free to think of strategies to grow the business, while the more organised personalities keep everyone grounded.

The formal board meetings are now structured around an agenda, which ensures that we cover the specific matters outlined on our annual governance work plan for the relevant time of the year; in May the focus is on setting the scene for the next financial year, in September it is on financial statements and governance appraisal, and in February it is on strategic review. Additionally, at each meeting we cover the regular agenda items such as the farm management report, compliance checks, finance and general business. Creating this more structured framework for our meetings gives the board assurance that environmental, human resources, occupational safety and health, animal welfare and banking covenants are all complied with, and ensures ongoing financial oversight of the business.

Governance 4 pillars and 7 practices

Diagram 2 outlines the Governance Framework used in DairyNZ’s Farm Business Governance Programme. Column one contains the Institute of Directors of NZ, 4 Pillars of Governance Best Practice. Column two shows the 7 Governance Practices developed by Peter Allen of Business Torques Systems, linking alongside the 4 Pillars. Next to each practice is a fuller description of that practice. Column three shows practical examples of what may be covered by that practice.

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4 Pillars		7 Governance Practices		The Governance Framework could record:	
Four Pillars of Governance Best Practice, Institute of Directors of NZ	I Determining Purpose	Seven Governance Practices, Business Torque Systems Ltd	1. Acting with a purpose in mind	<i>Aligning every governance decision and action with the predetermined purpose of the business</i>	The purpose or vision or mission Business values Business plan, strategic plans Annual governance work plan Succession plan (where applicable)
	II Effective Governance Culture		2. Holding effective governance meetings	<i>Sustaining a pattern for holding effective governance meetings</i>	Governance meeting agendas Annual governance meeting calendar Minute keeping How we run effective & time-efficient meetings Expectations of directors between meetings
			3. Working with other people	<i>Thoughtful challenging & non-personal debating in order to get consensus without groupthink</i>	The values that describe how the board behaves Description of board roles & responsibilities Strengths map, and possible future talent requirements Board member succession policy Consensus-gaining policy
			4. Making right decisions	<i>Exercising discernment through prudent stewardship; creativity; and, a stable but not static system of policies and parameters</i>	How to create policies and parameters within which decisions are made Financial decision-making & treasury policy Capital expenditure policy Investment policy Borrowing policy Dividend policy Interests Register Family decision-making policy (where applicable) Prudent decision-making checklist Process for getting board approval Delegations of authorities table
			5. Maintaining a learning orientation	<i>Assimilating new learning into current governance practices, bringing robustness to governance, and new life-giving decision-making skills to bear on challenges and opportunities</i>	Learning policy - how the Plan-Do-Review cycle is used Board performance review policy Policy on how we review past decisions Recording learnings that build and demonstrate progress in governance
			6. Knowing what's going on and what to do about it	<i>Taking responsibility for achieving the predetermined purpose of the business by understanding what's actually going on, and holding those responsible to account appropriately</i>	Reporting policy including reporting calendar KPIs policy Financial forecasts & budget creation policy Recorded critical success factors
	IV Effective Compliance		7. Managing risks effectively	<i>Proactively minimising the likelihood and severity of future events that could negatively affect the business, bringing grounded confidence</i>	Risk identification, prioritisation, & management policy Ethics policy Folder for the living Sustainability policy

Important Guideline:

The foremost component of governance is the practices, not the framework, which only serves as the system to record how the practice is actually conducted. Viewing governance as a framework could lead to two dangers; (i) excessive 'red tape', which is bureaucracy, and (ii) policies without practices, which is a pretence. Neither add value. A useful mantra is "everything that's needed. nothing that's not".

Diagram 2: Governance Framework

There are many things to consider when improving governance. The next section of this paper outlines Lynaire's top six picks of practical things which are easily introduced into a business to improve an aspect of governance.

Pick 1, Pillar I, Determining Purpose, Practice 1, Acting with a Purpose in Mind

Governors need to spend time determining the business vision, purpose and strategy. What is the purpose of this business? What are you trying to achieve? It is important to have extreme clarity about this, allowing the business to make decisions in line with its purpose, vision and strategy. One successful dairy farming business in Canterbury has determined its purpose as follows:

- Providing 15% return on equity
- Providing opportunity for others to grow
- Providing freedom for owners to spend time as they choose.

Make time to think and plan strategically and book in time each month to review your strategic plans. DairyNZ provides two different methods to begin the basics of developing a strategic plan. Attend a three-day Mark and Measure Strategy and Business seminar, offered in May or June each year, or use DairyNZ's QuickPlan booklet to develop the start of a basic strategic plan within two hours.

Pick 2, Pillar II, Effective Governance Culture, Practice 2, Holding Effective Governance Meetings

Many businesses already have an annual calendar of events outlining farming activities that occur throughout the year. Often these are mainly management and operational. An Annual Governance Work Plan would include a calendar of governance tasks to be completed at various times across the year. Medbury Farm provided a simple example of how, in May, the Board's focus is on setting the scene for the next financial year, in September it is on financial statements and governance appraisal, and in February it is on strategic review.

Pillar II, Effective Governance Culture, Practice 3, Working with Other People

This practice is based around ensuring you have a range of skill sets around the table, taking the time away from the busy-ness of farming to take a helicopter view, and ensuring there is room for independent thought in the business.

Two suggestions for improving this practice in your business:

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1. Evaluating the skill set of your team – have you got a range of skills around the table?
2. Holding annual meetings with your key advisors.

Pick 3, Evaluating the Skill Set of the Team

A business must evaluate the skill set of the team, identify strengths and weaknesses and then make a plan to plug the gaps. Each business needs a:

- Big picture and new opportunities person
- Great decision maker
- People person
- Details person.

One person may provide one or two of these attributes but is unlikely to provide three or four. Who provides these skills for your business? The importance of addressing this is demonstrated in the following two examples.

The first example is a family of a strong minded Dad, a peacemaker Mum and three opinionated sons. Mum and Dad had formed a successful business, and the sons were keen to form their own paths in life. There didn't appear to be the space or business size to work together, and lively discussions frequently resulted in a family blow-up. This family used the skills of an agribusiness professional to help them paddle their canoe together to grow the family business and accommodate all of their aspirations. The business has really leapt forward and room has been created for each person to use their strengths and exercise their skills set.

The second example is a family of four who are all detail people – great at analysing data, doing things correctly, but would need to improve their big picture thinking or bring in others to help them with this. They are missing the skills of innovation, thinking big and decision making. They are very thorough but probably take life a bit too seriously and miss opportunities. They will need to evaluate how they can bring these skills into their business.

Pick 4, Holding an Annual Meeting

Holding an annual meeting with your key advisors to discuss strategy and performance is an excellent method of harnessing the knowledge and skill set of those who support your business. These meetings should provide insight into possible business improvement while also providing key advisors the opportunity to learn more about the business. They can use this time to think on a strategic, rather than management or operational level.

Pick 5, Pillar 3, Holding to Account, Practice 6, Knowing What's Going On

It is important that the governors identify a small number of key performance indicators which allow them to monitor and evaluate business performance. One example is simply completing an annual budget and cashflow and monitoring this monthly. This is a basic core discipline of business, yet so few do this with purpose.

Pick 6, Pillar 4, Effective Compliance, Practice 7, Managing Risk Effectively

This area deals with risk management and would include areas such as:

- Addressing the new environmental challenges and conditions our industry is facing
- Effluent compliance
- Health and safety policies
- Financial policies eg., for debt levels and managing fixed and floating mortgages etc.

My top pick for this area: Planning for the replacement of the key people in your business – often that is you. My suggestion here comes from an accountant and business advisor, Deane Purdue, who encourages people to set up A Guide to the Living. This is a file where you put everything that is needed for your family should you depart life. This is a really practical idea, and something we each should have. An outline of what to include in this “Guide to the Living” is on DairyNZ’s website.

Summary

This paper attempts to demystify the principles of governance by demonstrating practical examples of improved governance gleaned from farmers. None of these principles are new or rocket science. They are just good disciplines of good business practice which could be exercised more regularly in dairy businesses. Your challenge now is to identify which one or two ideas you might like to action in your business within the next three to six months. And you might like to register to attend the 2016 DairyNZ Farm Business Governance Programme. Visit DairyNZ’s website for more details.

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