Corporate Social Responsibility in Aotearoa Dairy Farming

Current Situation and How We Win

Kellogg Rural Leadership Programme

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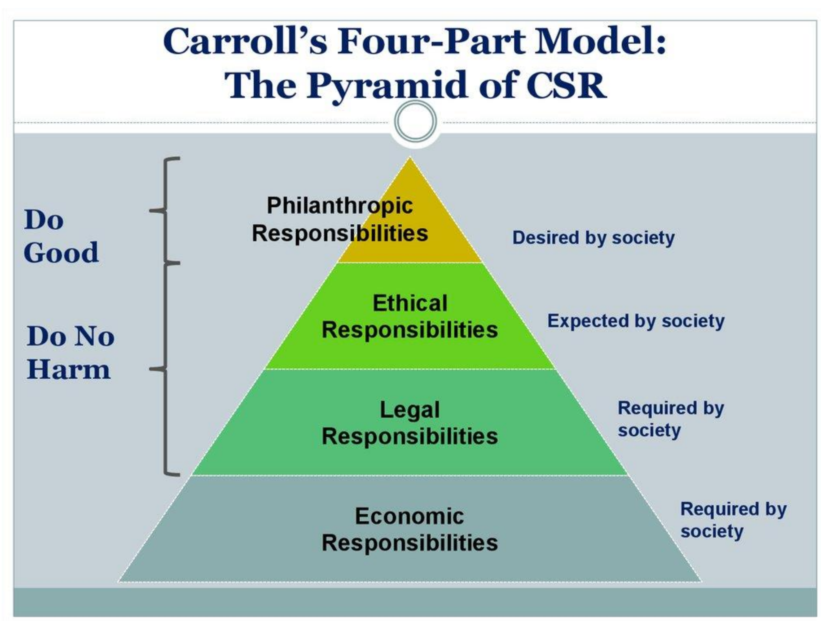
Graeme Peter



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EXECUTIVE SUMMARY

Corporate social responsibility (C.S.R.) is maturing rapidly in modern times as a way for companies to reflect the values of its customers, employees and investors. The United Nations (U.N) begun working alongside corporate organizations to encourage C.S.R. integrity in 1999 with the most ambitious development by the U.N being the 17 sustainable development goals agreed upon by 193 member states in 2015.

Much of this maturing of C.S.R has been in response to societal pressure and consumer demand. Perhaps no industry has felt the effects of this pressure more than dairy farming. Dairy is facing rising compliance as expectations of consumers and the public grow. Society is putting more emphasis on the impact of their food purchasing decisions resulting in rapid change for Aotearoa dairy farmers.

Dairy farming in Aotearoa is a unique business in that it is non-competitive at the supplier level. Farmers are not competing with their neighbour or any dairy farm, as they are all collected by a processor. Creating an environment where some low performing businesses have been able to survive that may have not in other more competitive industries, i.e. building firms; this will change. The impact potentially will have a positive effect on the standards within the industry as top-performing farmers who are more adaptable to change in compliance and ethical standards will rise.

The industry must prepare to exit a large number of farmers gracefully. With current debt levels and the stagnation or loss of land asset values, many farms will not have strong financial resilience for a drop in milk price (something history would suggest inevitable) while still holistically meeting their standards in C.S.R. Additionally; others will not adapt to changes in compliance and ethical responsibilities and exit the industry due to these changes. From this will be an immense opportunity for those farmers with healthy debt to asset ratios and who can operate in the top 20% of profitability.

Carroll's pyramid, a model for investigating a company's C.S.R. requirements, was used to analyze the Aotearoa dairy industry's current position. Dr Carroll, who was awarded a lifetime achievement award from Humboldt University, Berlin, Germany for services to corporate social responsibility has written a large amount of academic literature on C.S.R. Carroll broke the C.S.R. of a business into four pillars using a pyramid model. The four pillars are:

***Philanthropic Responsibilities**, voluntary or discretionary activities for the benefit of others or their environment*. Farmers participate in wide and varied philanthropic activities; these acts are not undertaken for strategic reasons. There is potential to leverage these acts to improve perception and build on social license to operate.

***Ethical Responsibilities**, standards and expectations that reflect the concern for what consumers, employees and stakeholders regard as fair.* Dairy farming has been slow to respond to ethical concerns of stakeholders, which has seen a loss of trust capital within relationships. As a result, in five years, positive perceptions of New Zealand dairy farming have slipped from 78% to 47% (U.M.R. Research, 2017). A social license to operate has become a vital topic in recent years regarding ethical

responsibilities. In response to this, milk processors, have implemented several ethical agreements with their suppliers setting standards above and beyond legal compliance standards, to meet public and consumer pressure.

Legal Responsibilities, *business is expected to comply with laws and responsibilities set by the Government; economic returns must be achieved within the framework of the law.* Compliance is rising, and the cost of this is high. Top farmers will rise to the challenge, and many low performers will fall out of the industry due to increasing compliance. The increase in specific laws is a result of the loss of trust in stakeholders' views towards dairy achieving its ethical responsibilities. Ethical trust must be rebuilt with stakeholders to reduce growing legislated compliance. The industry will be held to account of its worst producer, not its best. The bobby calf scandal (Max Towle December 6, 2015) highlights this and shows the media will portray most of the industry by the actions of a minority.

Economic Responsibilities*, It is essential that a successful firm be defined as one that is consistently profitable.* The average return on asset of 0.5% for 2018-19 season, with a breakeven milk price returning between a $9,000 and $48,000 per 100,000Kg of milk solids, is not a worthy reward for the effort and is unsustainable long term. Capital gain on land can no longer be anticipated, operating profit is all that can be relied on, and this is volatile due to milk price. To be resilient and last long term, farms need to target the profitability performance of the current top 20% and continually improve.

To win in the future of Corporate Social Responsibility, farmers and the industry will need to achieve the following:

i. Reinvent their business constantly, the end goal may be the same, but the tools and methods are constantly evolving. Embrace change.
ii. Removal of farmers that risk tarnishing the industry, one farmer is a danger to the reputation and acceptance of all. Milk processors and Government must take responsibility of this. This will increase ethical approval by the public.
iii. Invest with the head and not the heart to be sustainable and ensure a more acceptable return on assets and manageable debt to asset ratios. Purchasing a farm must be made as if investing in a commercial building or other investment utilizing similar financial models.
iv. Acquire greater financial skills and drive profitability. Farmers should target to perform at the level of the current top 20% of operating profit. Action by the wider industry, including milk processors, must occur around educating farmers on profitability. If they do not, farmers will struggle to meet ethical and legal expectations of the industry. These all work in harmony.
v. Understand the "why" behind compliance better, were compliance instigates from and what it enables. Conversely, the industry must explain the reasoning behind compliance clearer and more intentionally to farmers.
vi. Formulate successful plans and models to exit a large number of farms gracefully from the industry. Support in planning and strategic decision-making is lacking at the end of many farmers careers. Banks, milk processors and industry good organizations must take accountability to support in this.

PREFACE

I hope by introducing myself, I can establish from the outset of this report where I am coming from and any bias or motivation I may have and why I view the world the way I do.

Growing up in the Kapiti Coast, I was not brought up in a rural setting. I attended Scots College in Wellington City and was the first student in over 40 years to study agriculture by correspondence. My interest and love for agriculture came from a love of animals and my parents taking the opportunity to ship me off to my cousin's beef farm in Dovedale Marlborough one school summer holidays. Since that fateful summer, I have had experiences in beef, sheep, dairy and arable farming in New Zealand, Australia and Thailand.

I do not pretend that I am born and raised farmer. I am without a doubt a raised "townie". I am currently employed with Fonterra in Northland working with farmers to aid in animal welfare and food safety. My background includes a bachelor of agriculture degree from Lincoln and time as a consulting officer with DairyNZ. I am proud to say I am a farmer and that to date, I have spent my entire professional career in the dairy industry.

My occupation has raised many debates and constructive conversation with my "townie" friends. These conversations have increased in regularity in recent years, while this has happened, I have noted a growing frustration amongst farmers. Growing compliance, more recording and paperwork and feeling beat up by the media are common points of frustration. Public scrutiny appears to be at an all-time high for Agriculture, the term "farming in a fishbowl" has never been so accurate. Comments such as "it takes the fun out of farming" or "if this continues, I will sell up and get out of farming" are becoming all too common in my daily conversations with farmers.

Reducing these worries for farmers and ensuring the industry meets the expectations of my urban friends are both passions of mine. This is why I have chosen to explore Corporate Social Responsibility in the Aotearoa Dairy Industry. Having strong roots on either side of the rural and urban communities, I hope to offer a fresh perspective.

A.I.M.

Corporate Social Responsibility in Aotearoa Dairy Farming, The Current Situation and How We Win, aim was to investigate the current C.S.R. position of the dairy industry its risks and opportunities. Utilizing recognized global C.S.R. models including the United Nations sustainable development goals to measure this.

METHOD

A literature review was the primary tool utilized to find themes and evidence that are discussed in the report. Both domestic and international literature was reviewed with a focus on both an agricultural perspective as well as a diverse view of corporate social responsibility literature focusing on other industries. Many interviews and discussions were had with industry leaders and farmers to support and challenge views found in the literature. Social media was used to approach a broad audience of farmers for examples at points of the study.

INTRODUCTION

Corporate social responsibility (C.S.R.) is maturing rapidly in modern times as a way for companies to reflect the values of its customers, employees and investors. This shift has seen the United Nations (U.N) working with corporate organizations to encourage C.S.R. integrity since 1999 with the most ambitious development by the U.N being the 17 sustainable development goals agreed upon by 193 member states in 2015.

Much of this maturing of C.S.R has been in response to societal pressure and consumer demand. Perhaps no industry has felt the effects of this pressure more than dairy farming. Rising compliance, growing expectations of consumers and the public as they become more connected to the origins and impact of their food are leading to rapid change in C.S.R. landscape for Aotearoa dairy farms.

Dairy farming is under immense scrutiny by the public and consumers, with that perception becoming more hostile. In five years, positive perceptions of New Zealand dairy farming have slipped from 78% to 47% (U.M.R. Research, 2017).

Heraclitus, the Greek philosopher, said, "Change is the only constant in life" a statement that many New Zealand dairy farmers can relate. Dairy farmers of New Zealand are currently and have been for some time facing a period of unprecedented change in the expectations of their corporate social responsibilities and the drop in perception would suggest that expectation is not being met.

Farming has never been an easy job, but dairy farmers have for a long time been able to farm their farms and manage their businesses in New Zealand without a strong focus on the actions they take behind the farmgate. These days have changed compliance is growing, ethical requirements of farmers also are growing all while farmers are trying to make a profit in a volatile milk price era.

The importance of C.S.R. has never been more significant to the dairy industry and its future. Achieving and exceeding the C.S.R. expectation of consumers and the public is essential for the industry to thrive and progress in the modern world.

1. INTRODUCING CORPORATE SOCIAL RESPONSIBILITY

1.1. THE IMPORTANCE OF CORPORATE SOCIAL RESPONSIBILITY

The importance of corporate social responsibility has been deliberated amongst scholars and business leaders alike since its introduction.

Early literature such as economist Milton Friedman (1970) maintained a company's sole responsibility was to return a profit to its shareholders. Famously Friedman described a move to social responsibility by general motors as "pure unadulterated socialism". As noted below, this has become an outdated view with most modern academics, and business leaders are now in disagreement with Friedman.

"Corporate social responsibility has transformed from a minimal commitment to becoming a strategic necessity'. Chandler, D., & Werther, W. B. (2013).

Chandler (2016) went on to form the term strategic corporate social responsibility (S.C.S.R), suggesting a S.C.S.R perspective within a firm strategic plan would create added value over the medium to long term. S.C.S.R has it's roots in early research by Howard Bowen (1953), whose research suggests that C.S.R. should be used as a tool to assist businesses to create value. These definitions, in contrast to Milton Friedman, argue that when a business adopts a focus on C.S.R. or strategic C.S.R., it has the potential to extract more value in the medium to long term. The fact that most major corporations have a C.S.R program and often actively market these programs is testament to the change in focus and importance of C.S.R. for a modern firm or organization.

1.2. THE UNITED NATIONS IMPACT

In 1999 Kofi Annan who was the current Secretary-General of the United Nations delivered a speech at the World Economic Forum, "I propose that you, the business leaders gathered in Davos, and we, the United Nations, initiate a global compact of shared values and principles, which will give a human face to the global market" (United Nations Global Compact n.d.). The result was the establishment of the United Nations Global Compact (U.N.G.C.) in July 2000, assembling 44 global companies, 6 business associations, and 2 labour and 12 civil society organizations (United Nations Global Compact n.d). This was the first clear endeavour by the U.N to influence C.S.R. of commercial organizations.

Ten principles to guide corporate behaviour were established by the U.N.C.G. focused on human rights, labour, environment and anti-corruption with the aim members would incorporate the principles to guide their decision making with integrity and long-term wins (United Nations Global Compact n.d.).

Fast forward to September 2015, all 193 Member States of the U.N embraced the 17 sustainable development goals proposed originally at the United Nations Conference on Sustainable Development in Rio de Janeiro in 2012 *(*UNDP 2018).

*The Sustainable Development Goals (S.D.G.s), also known as the Global Goals, were adopted by all United Nations Member States in 2015 as a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030 (*UNDP 2018).

Figure 1 United Nations Sustainable Development Goals

Source: (United Nations Global Compact n.d.). http://www.undp.org/content/undp/en/home/sustainable-development-goals.html

The 17 goals are considered the most ambitious commitment by the U.N yet. All of the goals are interconnected, and many have a direct impact on Agriculture particularly eradicating poverty, zero hunger, clean water, life on land and tackling climate change.

Leslie (2018) when investigating the relationship between the U.N sustainable development goals and C.S.R. and their impact on Aotearoa primary sector concluded;

"In unison the S.D.G.s and C.S.R. create balance between economic interests, environmental needs and social expectations by integrating sustainable development into the business strategy" (Leslie, A. 2018).

"The S.D.G.'s and C.S.R can be used to grow and increase competitiveness despite, and sometimes because of, the global challenges businesses face. The S.D.G.s in conjunction with C.S.R. can create something much more powerful than individually implementing either one. Together they can create, Corporate Social Opportunity" (Leslie, A. 2018).

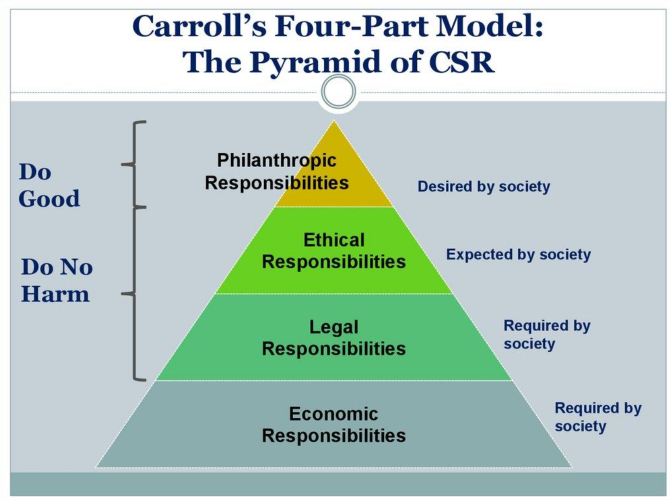
The U.N has impacted and influenced C.S.R. since 1999, the Sustainable Development Goals Agenda for 2030 provides a clear commitment by the 193 member states to improve many social and environmental issues. Highlighting the importance of the Sustainable Development Goals is critical to this report as these goals can be used to guide C.S.R. policies for firms and organizations globally. Leslie (2018) highlights the opportunities of using the Sustainable Development Goals in conjunction with C.S.R. strategies for the Aotearoa primary sector, whilst this report touches on the impact of the U.N goals Leslie's report is an excellent much more in-depth look into this topic.

1.3. DEFINING CORPORATE SOCIAL RESPONSIBILITY; CARROLLS PYRAMID

An exact definition of corporate social responsibility (C.S.R) has struggled to be agreed upon amongst scholars. One of the first primarily accepted definitions was that of Carroll's (1979). "The social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time".

Carroll's pyramid encompasses four sections to describe an organizations C.S.R obligations. The extracts below provide definitions sourced from Carroll's original literature "A three-dimensional conceptual model of corporate performance" Carroll, A. (1979).

Figure 2 Carroll's Four-Part Model: The Pyramid of C.S.R.



Source: **Carroll, A.B. (2016) Retrieved: *The CSR Journal Understanding the Four Levels of CSR***

Philanthropic*: Philanthropy encompasses those corporate actions that are in response to society's expectation that businesses be good corporate citizens. This includes actively engaging in acts or programs to promote human welfare or goodwill.*

Ethical: *Ethical responsibilities embody those standards, norms, or expectations that reflect a concern for what consumers, employees, shareholders, and the community regard as fair, just, or in keeping with the respect or protection of stakeholders' moral rights.*

Legal: *Business is expected to comply with the laws and regulations promulgated by federal, state, and local governments as the ground rules under which business must operate. As a partial fulfilment of the "social contract" between business and society, firms are expected to pursue their economic missions within the framework of the law.*

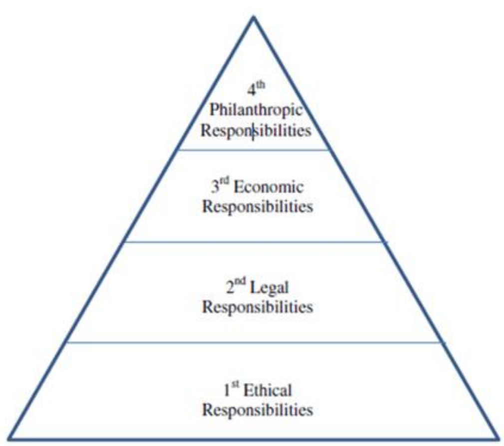
Economic: *All other business responsibilities are predicated upon the economic responsibility of the firm. It is important that a successful firm be defined as one that is consistently profitable.*

Whilst reviewing literature on C.S.R Carroll's pyramid is most often referenced. As it is still the foundation for most academic discussion the decision was made to focus this report on how dairy farming in Aotearoa fits within this model. Literature that critiques and offers improvements on the model is also included.

1.4. MODERN CRITIQUE OF CARROLL'S PYRAMID

Carroll, when explaining the pyramid of C.S.R., stated that all other business responsibilities are predicated upon the economic responsibilities of the firm because, without it, the others become moot considerations. This is the most disputed pillar in order of importance in the model. With critique from some scholars arguing that if a business cannot be profitable without breaking legal or ethical standards, then it would be in the best interests of society if it was not in business at all (Kang & Wood 1995). A further critique of the models argues a profit-first mentality puts businesses at risk of unethical and unlawful practice by justifying their behaviour through profit. Bennett et al. (2013) suggest it is this mentality that is the root of most corporate misbehaviour.

Figure 3 Baden's Remodeled C.S.R. Pyramid



Sourced: Baden, D. (2016). A reconstruction of Carroll's pyramid of corporate social responsibility for the 21st century

Baden (2016) in a modern review of Carroll's pyramid utilized surveys across four different continents and literature review of relevant scholars to remodel Carroll's pyramid to place ethical responsibilities as the most critical factor (diagram 2). Baden's explanation for the remodelled pyramid was that for a business to have the license to operate and to be trusted with the production and allocation of scarce natural resources and inherently valuable human resources. It needed to first and foremost accept its ethical responsibility to do no harm and conform to society's ethical norms and expectations. Carroll did not wholly disagree with this declaring "it is important to prevent ethical norms from being compromised in order to achieve corporate goals". Baden described ethical responsibilities as a social licence to operate.

A social licence, *according to Brohmer (2011), is what is earned as a result of meeting public concerns or when an industry can act in their best interest or protect the common good.*

Baden's model placed legal responsibilities second in its model, stating a business needs to be compliant with its legal responsibilities and only once it has accepted these responsibilities is it free to make a profit and pursue its economic objectives. Carroll, in a critique of his model, did say no metaphor is perfect, and the C.S.R. pyramid is no exception. It is intended to portray that the total C.S.R. of business comprises distinct components that, taken together, constitute the whole.

A consistent theme when researching modern literature that discusses Carroll's pyramid of C.S.R. was that little if no researchers contested that any of the four pillars should not be included in a model that represents C.S.R. The main disagreement found was the order of importance of those pillars.

When researching how the Aotearoa dairy industry fitted into Carroll's model, it was clear that without the three bottom pillars of Carroll's responsibilities legal, economic and ethical being meet, the industry was at risk.

Figure 4 Remodelled Pillars of C.S.R.

Source: Graeme Peter

Figure 4 represents that for the industry and a dairy farm business to be successful, it must meet its economic, legal and ethical requirements. The success of each area is reliant on the others also being achieved. When these three pillars are achieved together, then a business can meet its philanthropic responsibilities.

Now we understand Carroll's pyramid, however, appreciate the dispute of modern literature over the ranking of importance of these pillars. We can investigate how the Aotearoa dairy industry fits into these pillars, without a focus on the ranking of importance utilizing figure 4.

Conversely to meeting C.S.R. responsibilities, what would happen if the industry and farmers chose not to strive to be successful in these pillars of C.S.R?

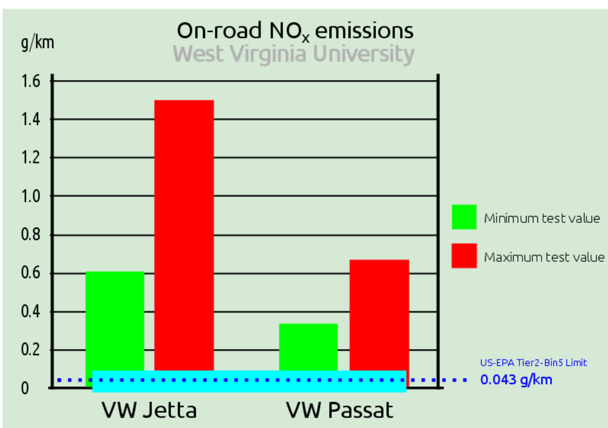
2. THE RISK TO NOT EMBRACING CORPORATE SOCIAL RESPONSIBILITY

2.1. VOLKSWAGEN SCANDAL

On September 18 2015, the US EPA served a Notice of Violation (N.O.V.) on Volkswagen Group alleging that approximately 480,000 Volkswagen and Audi automobiles equipped with 2-litre TDI engines, and sold in the U.S.A between 2009 and 2015, had an emissions-compliance "defeat device" installed. (Brooks, P. A. September 18 2015) Volkswagen later admitted up to 11 Million cars worldwide were affected. (Dreyfuss, E. September 22 2015).

Volkswagen was found and charged with deliberately engineering a means to circumvent emissions control with what was called a defeat device. The software sensed when the car was under testing and reduced emissions and performance, whilst the software allowed for increased torque and acceleration under everyday driving, which resulted in increased pollutants, particularly nitrogen oxide. Up to 40 times the US-EPA tier 2 limit was exceeded when placed under road testing (Brooks, P. A. September 18 2015). This was a deliberate decision that had a negative impact on the sustainable development goal of climate action set by the U.N.

Figure 5. On-Road NOx Emissions VW Jetta, VW Passat



Source: West Virginia University "In-Use Emissions Testing of Light-Duty Diesel Vehicles in the United States".

The Volkswagen diesel emissions scandal is an apparent failure of C.S.R. The impact of the company not embracing C.S.R. and abiding by its legal and ethical responsibilities to the environment, and people has had consequences for the business.

Volkswagen executives are claiming the effects of the scandal first found in September 2015 are still felt in the first financial quarter of 2021. The scandal Volkswagen states as of the first financial quarter of 2021, have cost the company 31.3 billion euros (Taylor, E. March 17 2020*).* This cost made up of legal fees, fines from federal governments, settlements with customers and loss of sales. Martin

Winterkorn chief executive at the time of the scandal said his company had "broken the trust of our customers and the public". Mr Winterkorn resigned as a direct result of the scandal. Whilst In November 2016, Volkswagen and its labour unions agreed to reduce the workforce by 30,000 people until 2021 as a direct loss of its sales to its diesel manufacturing business (Chapman, B. May 2 2019.)

2.2. BP DEEPWATER HORIZON OIL SPILL

The Deepwater Horizon oil spill was an industrial disaster that occurred on April 20, 2010, in the Gulf of Mexico. The tragedy happened when a high-pressure methane gas main exploded, killing 11 workers and starting an oil flow into the marine environment that would last for 87 days and result in 4.9 million barrels of oil entering the Gulf of Mexico (Henry, R. June 15 2010). In July 2011, over 790 kilometres of coastline were contaminated with oil. A significant negative impact on life under water one of the 17 sustainable development goals of the U.N.

A peer review study (Fabien B. et al. 2014) published in the Proceedings of National Academy of Sciences conducted by 17 scientists from the United States and Australia, found that tuna and amberjack had developed deformities of their heart amongst other organs that resulted in fatal or life-shortening outcomes. The scientists concluded this was likely to be the same results if the study was focused on other large predator fish or even to humans as their hearts are similar. B.P. disputed the trial claiming it did not relate to the "real world effects" however the scientists responded saying the trial assessed similar levels of contamination found during the spill (Sahagun, L. February 13 2014).

The White House commission held B.P. and its partners responsible for many cost-cutting choices which led to the disaster (Graham, B. K. Reilly, W. January 2011). A U.S District Court judge ruled that B.P. was primarily responsible for the oil spill due to gross negligence and reckless conduct. B.P. agreed to pay $18.7 billion in fines in July 2015 (Wade, T. Hays, K. July 2 2015) this was the largest corporate settlement in the history of the United States at that point.

B.P. failed to focus on its responsibilities holistically, focusing on cost-cutting measures to ensure maximum financial return without embracing its legal or ethical responsibilities. Ultimately this mindset cost B.P. severely in the area it was initially focussed on, its finances.

B.P. confirmed the total costs including fines, compensation payments and clean-up costs paid, was over USD 60 billion (Uhlmann, D. April 27, 2010). The B.P. funded cleanup efforts continued until April 15 2014. The B.P. share price fell by a maximum of 54% before recovering by 2013 following the environmental disaster B.P. had dropped from the 2nd largest oil company to the 4th (Tharp, P. June 25 2010).

2.3. RELATING THESE SCANDALS TO THE AOTEAROA DAIRY INDUSTRY

In both these case studies, the companies failed to embrace and implement a culture of C.S.R. In these circumstances the immoral behaviours resulted in extensive environmental impacts for which the companies received large financial penalties, both similarly in fines and stock/sales dives. Both also impacted negatively on the U.N sustainable development goals. What separated the scandals was where Volkswagen knowingly set out to deceive its stakeholders, B.P., in contrast, was liable for cost-cutting and not putting in place the correct measures to prevent a disaster.

Interestingly both these companies have established C.S.R. programs in place which they advertise to market. From the outside, it would appear there was a lack of buy-in throughout the business across all aspects. Suppliers and business must buy into the C.S.R. strategy, rather than it being a marketing tool, it must be culturally ingrained. These scandals have led customers and investors to doubt the C.S.R. integrity of the businesses leading to sizeable financial losses and impacts. It was highlighted by B.P falling from the 2nd largest oil company to the 4th with a share price loss of 54% and Volkswagen confirming a 31.3-billion-euro loss in 2021 attributed to the C.S.R. scandal first brought to light in 2015.

These case studies offer the Aotearoa dairy industry insight to the damage a C.S.R. scandal can have to a business or industry. The need for a business to be thorough in its processes and transparent in its approach to C.S.R. is clear.

The New Zealand dairy industry is formed of multiple dairy processors, each with a portion of New Zealand's 11,590 dairy farms (N.Z.I.E.R., New Zealand Dairy Statistics) supplying them. Some of these processors are corporations with shareholders, and some are co-operatives owned by farmers

When upstream suppliers are implementing management practices that are poor in terms of labour, environmental, health and safety standards etc., organizations who are purchasing their product risk the security and sustainability of their supply chain as well as their reputations (Eltantawy ET AL., 2009; Roberts, 2003).

Dairy processors in New Zealand purchasing milk face the risk of upstream suppliers (farmers) implementing management practices that put their reputation and security at risk. As each of these processors export milk leveraging the New Zealand provenance story, they all are at risk of causing a scandal that could tar all New Zealand dairy processors with the same brush globally. This is a risk to each dairy farmer in New Zealand. There is a case to say each New Zealand dairy farm poses a threat to its processor and its provenance story and therefore, a connected risk to every other dairy farm in New Zealand.

Transocean and Halliburton are two contactors/suppliers that were found as "negligent" in the B.P Horizons oil spill both ultimately had a part to play in B.P being found liable in court. This scandal has similarities to the risk profile in the Aotearoa dairy industry as each supplier poses a risk to their milk processors C.S.R. reputation.

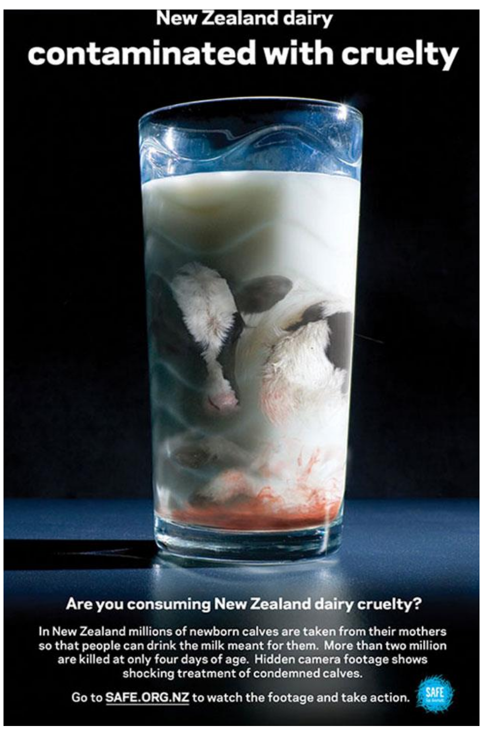
2.4. BOBBY CALF SCANDAL 2015

In November 2015 the Aotearoa dairy farming industry was hit with the bobby calf scandal, brought to light when an animal advocacy group Farmwatch released footage from hidden cameras showing calf mistreatment. As part of an investigation into bobby calf treatment. The footage showed animals beaten at the meat processors as well as calves thrown into crates and trailers on farms (Farmwatch. 2015).

The footage was used to condemn the Aotearoa dairy industry by animal rights organizations worldwide and made available to international media. While Belinda Grant's article "Shocking video footage of New Zealand dairy industry shows animals bashed and kicked, with four-day-old calves regarded as 'trash' thrown onto bloodied concrete floors" (2015) written for the Daily Mail Australia, featured globally.

The advocacy group Save Animals From Exploitation (SAFE) paid for a full-page advert in the United Kingdom's Guardian newspaper, "New Zealand dairy contaminated with cruelty" (2015) (Figure 6) following the scandal.

Figure 6. New Zealand Dairy. Contaminated with Cruelty



Source: Safe.Org.NZ

Federated Farmers spokesman Andrew Hoggard said the appalling behaviour was from a minority of farmers, transport companies and slaughterhouse workers and it was not something the industry would tolerate (Towle. M. December 6 2015).

Hoggard went on to say he was disappointed SAFE had drawn international attention to "what is only a very small number of individuals from within the New Zealand dairy industry and associated industries". Dairy N.Z. chief executive Tim Mackle said the footage of cruelty to bobby calves was unacceptable and did not represent the majority of farmers (Maxwell.J. December 6 2015).

The 2015 bobby calf scandal caused outrage amongst the farming industry and consumers alike. The industry strongly presented the idea that this was a minority of farmers tarnishing the reputation of the entire industry.

"While there is still work to do with a minority of farmers, it is important to remember that the vast majority of our dairy farmers are treating their animals with care and respect". Chief Executive DairyNZ Tim Mackle (December 2015)

Interestingly not one milk processor or individual was held to account in the media or by the public; instead, the entire industry was criticized for its practices. Supporting the philosophy that each dairy farm is a risk to its processor as well as a risk to every other farm's, corporate social responsibility reputation—this emphasizes the importance of the entire industry buying into their C.S.R. responsibilities.

Quantifying the economic cost to the industry has been challenging to measure. It is a limitation to quantifying the impact of this C.S.R scandal to the dairy industry.

Relating the scandal to the four pillars of corporate social responsibility the bobby calf scandal was a breach of the New Zealand Animal Welfare Code 1999, industry members breached a legal responsibility. The scandal raised many ethical concerns from the public and ultimately led to the ethical responsibilities of the industry and bobby calves entirely being questioned.

Following the scandal, new laws were introduced by the Ministry of Primary Industries (M.P.I) to strengthen the law around the management and treatment of bobby calves. These laws were a result of the breach of trust the public felt towards the industry and its ethical responsibilities.

3. PHILANTHROPIC RESPONSIBILITIES OF DAIRY FARMERS

3.1. COLLECTIVE AND MILK PROCESSORS PHILANTHROPIC ACTIONS

Corporate philanthropy embraces business's voluntary or discretionary activities. Philanthropy or business giving may not be a responsibility in a literal sense. However, it is normally expected by businesses today and is a part of the everyday expectations of the public. (Carrol. A 2016)

Fonterra "Milk In Schools" is an example of philanthropic activity undertaken by the industry, Fonterra and its farmers have supplied milk to up to 70% of New Zealand schools. Providing fridges to schools and delivering milk every school day. From 2021 this will transition to Kickstart Breakfast in conjunction with the Sanitarium and New

Zealand Government. To provide breakfasts to Over 1,100 schools in need across New Zealand.

Synlait's Whakapuāwai programme is a wide-reaching environmental program that incorporates the establishment of an industrial scale nursery to propagate native plants. The 15-hectare site at Synlait's headquarters in Dunsandel will be capable of growing more than one million native trees and shrubs annually, with the goal to plant four million native trees on farms and community land by 2028.

*Strategic philanthropy is an approach by which corporate or business giving and other philanthropic endeavours of a firm are designed in such a way that it best fits with the firm's overall mission, goals, and values. (*Carroll, A., 2018).

Both these examples of philanthropic programmes implemented by dairy processors and many other examples not discussed were found during this study. These examples can be classed as strategic philanthropy, and although they are not a requirement and are charitable, they are still utilised to promote positive marketing of the organisation.

3.2. INDIVIDUAL PHILANTHROPIC ACTS OF FARMERS

Through interviews and social media, farmers were quizzed on the philanthropic activities they engaged with; the following were examples found.

Examples of individual farmer philanthropic actions

> *"Volunteer at the local lions club. Our lions' club completes a slink calf run in which farmers provide slink calves, and the lions' club receives the profits. Which are then shared with schools and sports teams locally."*
>
> *"Donate firewood to the local school fundraiser every year."*
>
> *"Collect old batteries to recycle for the local daycare."*
>
> *"Started a club called the 'Cow Girl Club'. Wives of dairy farmers as well as urbanites wanting to know more about the industry come together. To learn and grow whilst keeping on top of our mental health".*
>
> *"Sponsor the local rugby club, have done for as long as I can remember."*
>
> *"Maungamahem is an event run and organized on a local dairy farm runoff in our town of Maungatapere. The event is a mini adventure race; all proceeds go back to the local school."*
>
> *"We have local schools come to our farm to participate in planting days of our rivers and waterways. Fonterra provides milk for the children, and we aim to provide an educational experience whilst the children experience farming and sustainability."*

> *"I run a men's group all over the northland region we facilitate for anything, and anyone. It has had great success turning lives around and giving them back their hope purpose and identity."*

> *"We raise steers on our property for free, which are then sold by the local school to fund projects. Have done since the 90s."*

The I.H.C. calf scheme is an example of individual farmers working as a collective. Through a registered process, farmers can donate a calf/s to the program. The profits of the calf/s are donated to the I.H.C. calf scheme. "The Rural Scheme is a longstanding fundraising program that is now in its 33rd year and generates more than $1 million annually for people with intellectual disabilities" (I.H.C. Calf and Rural Scheme 2018 Announcement. July 4 2018).

Schools and local sports teams were common recipients of farmers' time, goods and money. Many choose to stand on local sports and school boards or parent-teacher associations. Giving livestock or resources such as calves, steers or firewood was commonplace and often not considered a philanthropic act at all until pointed out, as one farmer interviewed stated: "it is just what farmers do". Many philanthropic actions were longstanding and had remained consistently delivered for many years.

Throughout researching and interviewing dairy farmers, it became conclusive philanthropic acts remained more genuine than discussed by Carroll (2016). Whilst milk processors and industry may participate in strategic philanthropy to return a positive image of the business or industry the philanthropic acts by dairy farmers are not driven due to public or community expectation; the acts were not undertaken strategically to market or provide any return to the farmer. Instead undertaken as it was considered the right thing to do. The theme of supporting the community, particularly rural communities was healthy.

There is potential to market or promote the philanthropic acts of farmers further; these acts may not be strategic but do stand out and help promote a positive image.

4. ETHICAL RESPONSIBILITIES OF DAIRY FARMERS

"In one sense, changing ethics or values precede the establishment of law because they become the driving force behind the very creation of laws or regulations" (Carroll. A, 1979).

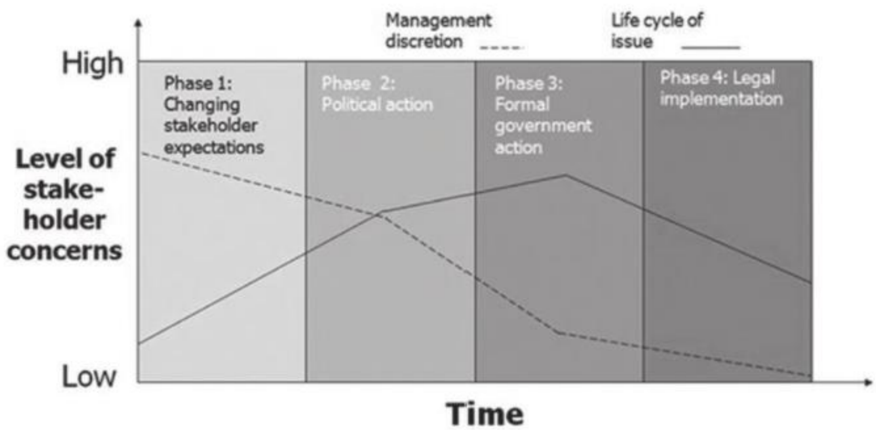
Farming is a minefield of ethical responsibilities, as legal responsibilities and compliance of dairy farming grow, so does the ethical expectation and focus on farmers by the public. Many new legislations in Aotearoa that affect dairy farmers can be traced back to starting as an ethical issue held by the broader public then turned into legislative law, i.e. changes in bobby calf legislation. These changes are often described as a social license to operate. The U.N sustainable development goals provide a strong foundation to view the ethical responsibilities of Aotearoa dairy farmers with a global perspective rather than local or consumer perspective.

4.1. SOCIAL LICENCE TO OPERATE

As our society's values have evolved and changed, so too have their perceptions of the industry. Unfortunately, the industry has not evolved at the same pace, and the qualities that build trust have suffered as the industry has struggled to respond. (Clark-Hall, P 2019)

Clark-Hall, when investigating the social license of agriculture in Aotearoa, discussed the farming industries slow response to changes in perceptions that affect the social license to operate. She pointed out the slow rate of evolution and responding to stakeholder expectations, something the dairy industry has been at fault of in the last decade.

Figure 7 Stakeholder Approach to Issues Management



Source: Boutilier, R., 2011, p. 36. Stakeholder Approach to Issue Management.

"The earlier a company identifies and acts on the issue, the more influence the company can have. In the later stages, management discretion is reduced to damage control and regulatory compliance. Phase 1 is a period when small groups of people share their complaints among themselves. As they discuss their dissatisfaction, their expectations and analysis of the situation become more articulated"…

"In plain language, the initial stakeholders (phase 1) develop a blame story. They often also create a shared identity, or victim identity, that facilitates the organization of public and justifies demands for changes." (Boutilier, 2011, p. 34-35).

Taking Boutilier's (2011) model (figure 7) of stakeholder approach to issue management, Hall stated the farming industry was at fault of often reacting in phase 3 or even phase 4. Only when Government intervened or implemented legal action did the farming industry respond. If we once again review the bobby calf issue, this would support Halls theory. The dairy industry, in that example, missed the opportunity to correct practices and influence stakeholders in the early phases, to help reduce the life cycle of the issue and potential negative impacts or bad press.

The earning of a social licence is really not that complicated. It all boils down to relationships and the trust capital within them. (Clark-Hall, P 2019)

In recent times the Aotearoa dairy industry has lost the trust capital referenced by Clark-Hall, with its critical stakeholders. The rebuilding phase has begun, particularly a phase of rebuilding trust to 'own' its ethical responsibilities. Without this trust, as we have seen with the bobby calf scandal, stakeholders can influence government intervention and legislation. Stakeholders having trust in farmers to own their ethical responsibilities is essential in reducing further on-farm compliance via legislation.

4.2. MILK PROCESSORS MOVES TO IMPROVE ETHICAL PERSPECTIVES

Ethical responsibilities have always affected the public reputation of farmers; this not only affects social license to operate but also affects consumers purchasing decisions. In recent years many milk processing companies have moved to either incentivizing or enforcing ethical responsibilities on-farm, as part of their supply agreements with farmers. These programs often go above and beyond the requirements of the law and require farmers to meet more aspirational targets. They are a move to counter the negative rhetoric pushed to remove dairy's social license to operate and to meet the expectations modern consumers hold of dairy.

The strength of the consumer has grown dramatically in recent years, with milk processors having to target their marketing beyond the initial customer, where the price is often the most significant sale point to targeting the final consumer.

Analysing a sample of four of the major milk processors in Aotearoa, similar themes appear in their incentive or ethical supply agreements although to different standards and levels. This research did not investigate the detail of these programs. Instead, the main areas addressed, and the reasoning provided.

Table: 1 Milk Processors Ethical Supply Agreements Aotearoa

Milk Processor	**Name of Programme**	**Aspirational Standards**
Fonterra	Co-Operative Difference	Animal Health Plan Farm Environment Plan (compulsory) Health and Safety Plan Food Safety/Quality Co-Operative and Prosperity
Miraka	Te Ara Miraka	Animal Health Plan Farm Environment Plan (encouraged) Health and Safety Plan Prosperity, Profit Economic Planning (Encouraged) Food Safety/Quality

Synlait	Lead With Pride *(accredited ISO/IEC 17065 dairy farm assurance system)*	Animal Welfare Standard Environmental Standard Human Resources Plan, including Health and Safety and recruitment Food Safety/Quality
Westland	FarmEx	People & Risk Management Animal welfare standard Environmental Standard Food Safety/Quality

Fonterra Chief Executive Miles Hurrell, "We've always paid our farmers based on the value that milk provides to the Co-operative. The reality is that the drivers of value are changing, and we need to reflect that. Our customers want to know that the products they are buying are not only safe, but also produced sustainably". (June 23 2020)

Miraka General Manager Milk Supply Grant Jackson "This is about more than just meeting regulations, it's to show what's possible and to become true leaders in the industry". …. farmers are incentivized to meet the new needs of consumers. "Miraka stays in close touch with its markets and food safety is now a given. However consumers are now looking closely at the environmental and social aspects of food production". (July 21 2020)

Synlait Director Business Development & Sales, Martijn Jager "Customers" expectations have changed. The customers and consumers that we target to work with are justified in demanding transparent and ethical supply chains. Synlait's purpose, values and business practices reflect these changes. We are delivering on that". (June 2020)

Westland Chief Executive Rod Quin says FarmEx is primarily about future-proofing the dairy industry and Westland Milk Products' ability to continue to sell into an increasingly demanding international market, where not only is food safety and quality paramount, but also the story behind the milk. Customers increasingly want transparency, traceability and accountability in all areas, this payment helps us meet the changing needs of our customers, so they continue to choose our milk and enjoy dairy as a sustainable and nutritious choice". (May 25 2015),

Themes from milk processors senior leaders' opinions;

- These programmes are above legal or food safety requirements, into ethical responsibilities
- Customers' requirements are changing driven by changes in end-consumer demands; this is resulting in new opportunities to gain value.
- Transparency and traceability in the supply chain are essential to consumers
- Sustainable and ethically produced milk is vital to consumers

- Value passed back down to the supplier from milk processor when suppliers can meet the desires and wants of the final consumer

These programs all reference the end consumer and meeting their ethical wants; this allows processors to pass on profits back to these farmers that achieve these. Four common themes appear in the aspirational programs' animal welfare, health and safety, environmental and food safety. All four commonalities have a legal compliance standard; however, these programs are implemented to go above this and meet ethical expectations consumers and the public hold of farmers.

These aspirational programs are an opportunity to earn the trust of the public/consumer regarding the ethical responsibilities of dairy farmers. Many of the senior leaders referenced these programs as ways of creating more value. This is an example of strategic corporate social responsibility, as explained in 1.1 The Importance of Corporate Social Responsibility.

Stevens et al. (2018) debate the success of C.S.R. programs like these in modern times. "Western agriculture shifts have seen a wide range of C.S.R. initiatives, initially seeking to reconnect agriculture and society, frequently provoke debate, conflict, and protests".

M.P.I.s research "New Zealander's view of the primary sector" (2017) showed only 47% of urban respondents held positive views towards dairy farming. Showing a gap in the social acceptance and social license of dairy. Boutilier's model demonstrates the need to act early to reduce stakeholder concern. Dairy has faced bad media and public backlash from media events such as the dirty dairying media campaign and bobby calf scandal in recent years. Which have all escalated to phase 3 and 4 of Boutilier's model requiring government intervention. All four examples of aspirational/ethical processor programs have been introduced post the dirty dairying campaign in 2002. Being introduced post issues surfacing publicly, they may have been viewed with scepticism by the public and would have had more significant influence if introduced at phase 1 of Boutilier's model.

5. LEGAL RESPONSIBILITIES OF DAIRY FARMERS

Aotearoa has over 750 primary Acts and over 3,000 statutory regulations with the Government creating and amending about 100 Acts and 400 regulations each year. Adding to this is local Government plans, policies and by-laws, which are all subject to change.

Dairy farming, as a business has many standard legal requirements that are similar to other businesses. These include:

- *Companies Act 1993, Operate as a legal entity, Central Government requirement*
- *Income Tax Act 2007, Work within the tax laws of the N.Z. Goods Service Tax, Fringe Benefits Tax, and Income Tax, Central Government requirement.*
- *Employment Relations Act 2004, Employee Agreements, Minimum Wage, paid Leave, Central Government Requirement.*

- *Health and Safety at Work Act 2000, Take all practical steps to provide a safe workplace. Central Government (Worksafe)*
- *Building Act 2004, All buildings in compliance with the act, Central Government*
- *Transport Act 1987, Correct licensing and correct transport of goods on public roads.*

Many legal requirements of farm businesses are unique to agriculture or dairy farming. Acts that have a significant impact include:

- The animal welfare act 1999: The act sets out how people should take care of and act towards animals, and is jointly enforced by S.P.C.A., the Ministry for Primary Industries (M.P.I.) and the Police. Failure to comply with the act has led to multiple prosecutions of farmers. *(Affects export)*

- Animal Products Act 1999: Is New Zealand's legal framework for processing animal material into food, such as meat and dairy products. It establishes a risk management system that requires all animal products traded and used to be 'fit for intended purpose' through meeting New Zealand animal product standards. *(Affects export)*

- Agricultural Compounds and Veterinary Medicines Act 1997: Its purpose is to manage the risks posed by the use of agricultural chemicals including; veterinary medicines, vertebrate toxic agents and other related compounds to an acceptable level to support the overall Government goal of growing and protecting New Zealand. *(Affects export)*

- NZCP1- Code for the design and operation of farm dairies / NZCP2 Code of practice for the assessment of farm dairies sets out the requirements and procedures for assessing farm dairies food safety suitability. The rules behind the annual farm dairy assessments completed of farm dairies. *(Affects export)*

- Waterway Fencing: All stock excluded from permanent flowing rivers, streams, drains and springs more than a metre wide and 30cm deep. Priority under the sustainable dairying water accord.

- Climate Change Response (Zero-Carbon) Amendment Act of 2019. The actual impact and cost of the act for farmers is yet to be confirmed. Each farm will, however, need to estimate its current emissions and, over time, develop a farm-specific plan to manage and reduce these emissions through farm management improvement.

- Effluent Compliance: Ensure the effluent treatment system and storage complies with Regional Council Rules. Enforced by Regional Councils.

- NAIT Animal Identification and Tracing (NAIT) ACT 2012 (Significant amendment 2019) legal obligation to register stock to a property and record any stock movements. Enforced by M.P.I. *(Affects export)*

- Resource Management Act 1991 (R.M.A.): The Resource Management Act 1991 sets out the law on the management of activities that impact the environment, including air, water, soil, biodiversity, the coastal environment, noise, subdivision and land use planning in general. Although the R.M.A. impacts many businesses outside of farming, its impact on dairy farming is unique. (Has been under recent review with no confirmed changes)

- Some other acts that affect dairy farmers specifically include the; Irrigation Schemes Act 1990, Crown Pastoral Land Act 1998, Dairy Industry Reforming Act 2001.

Dairy farming is affected by many acts. Common farmer opinion is that these regulations or compliance is growing and so with it are compliance cost. Supporting this theory is new legislation and significant amendments in recent years. Research to quantify the cost increase of compliance comparative to historic costs appears to be scarce.

A survey of Waikato Dairy farms found that the average initial capital cost of environmental compliance was $1.02 per kg M.S. or $403 a cow (Macdonald, TO 2014). For the average farm system surveyed, this placed the capital spend in the bracket of $130,000 to $170,000 dollars as an average compliance establishment cost. This research shows the significant environmental costs incurred by farmers to meet modern environmental compliance. Further potential costs such as the Zero Carbon Act will add to these environmental costs.

A theme throughout this study was the cross over between legal requirements and international customer requirements. Particularly of note is the climate change response act. Whilst there has been much media coverage of adverse farmer reaction to legal implications of the proposed acts. Many major dairy customers have also set significant reductions in their supply chain emission contribution, including;

Nestle's commitment to zero-emissions by 2050 (Nestle, Press Release September 2019)

McDonald's have a 31% reduction target in emission intensity across the supply chain by 2030 (Corporate McDonalds September 2019)

Starbucks with dairy as its most significant contributor has committed to a 50% total emissions reduction by 2030 (Eric Pfanner January 22 2020).

Zero Carbon is an example of where the law and customer requirements cross over. Many acts are solely or partly the result of export requirements to countries Aotearoa dairy products are exported to (These are noted in the act descriptions).

"The changes that were coming to farming were no longer on the horizon; they are on the doorstep. Those who can adjust to the new compliance rules will survive. Those who can adjust and be in the top 25 per cent, I think will thrive because opportunities will come quick and fast." AgFirst managing director James Allen (2019)

Dairy farmers face many legal responsibilities not necessarily faced by other businesses. Many of these acts are due to the unique export-focused nature of dairy (e.g. Animal Products Act 1999) or use of a natural resource (e.g. Waterway Fencing, Clean Streams Accord). At the same time, some laws are aligned with customer requirements. Clarity of what acts enable, such as the many acts affecting export is are not always explained well to farmers. With further education and explaining the necessity of many laws, the focus could shift to how to make compliance more efficient, and pain-free for farmers, rather than energy spent contesting in these areas.

Compliance costs, particularly environmental costs, are high at $403 per cow (Macdonald, TO 2014) to become compliant. Many farms will not adjust and will fall out of industry due to compliance (Allen, J 2019) in the coming years due to being unable to achieve the required compliance levels or absorb the related costs.

6. ECONOMIC RESPONSIBILITIES OF DAIRY FARMERS

The dairy industry has a significant economic responsibility to Aotearoa at both a national and regional level. The dairy industry contributed $17.6 billion to the economy in 2019 and was up a further $512 million for the June run report in 2020 (Ministry Primary Industries 2020).

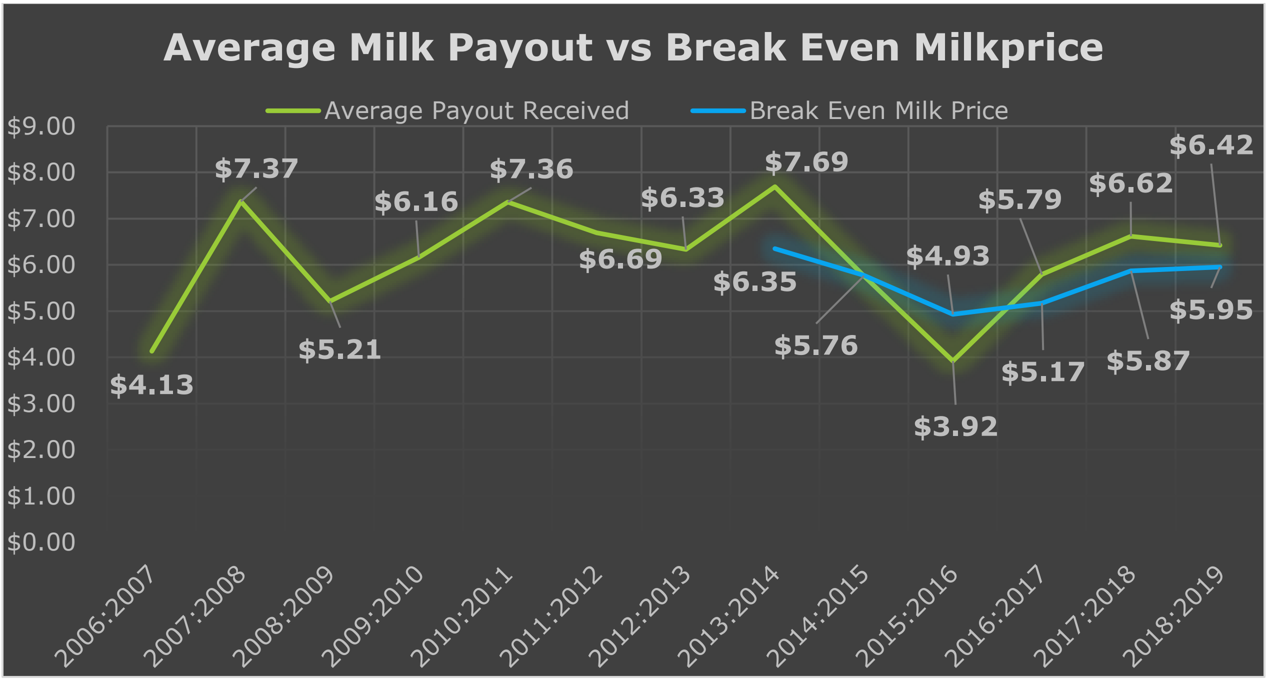
In Waikato, Southland, the West Coast and Taranaki dairy is the top income generator, delivering more than 10% of the regional G.D.P. While dairy provides the second-largest contribution to economic activity in Northland and the Manawatu, and in the Canterbury and Bay of Plenty region dairy is the third-largest contributor. Dairy is also a crucial part of the Maori economy, with an estimated 10% of industry assets being in Maori ownership. 40,000 people are employed in the New Zealand dairy industry (StatsNZ 2019) with over 35,000 of those employed directly on farms.

Within this macro view of the economic responsibility and contribution of dairy, each farm has its micro-level of economic responsibility. Carroll (1979) stated that one of the critical economic responsibilities of a firm is to remain consistently profitable. Being consistently profitable allows a farm to pay its employees, service and goods providers, repay debt and invest while contributing to the local economy. So, are New Zealand dairy farms consistently profitable?

6.1. THE ECONOMIC SITUATION ON FARM, THE GOOD, THE BAD AND THE UGLY

6.1.2. BREAK EVEN MILK PRICE AND THE PAYOUT

Figure 8 Average Milk Payout vs Break-Even Milk price



Source: DairyNZ Economic Survey, 2006/2007 through 2018/2019

Breakeven milk price is the milk income per kilogram of milk solids required to cover all costs or outgoings. The goal on a farm should not to just breakeven but have a low enough breakeven milk price, that money is available for debt reduction and or investment. (Source DairyNZ Economic Survey)

Average payout is the average farmgate milk price received per a kilogram of milk solids from farms surveyed by DairyNZ in their economic surveys.

The milk price data line in figure 8 identifies the volatility of the average dairy payout received, emphasized by the $7.69 payout received in the 2013-14 season only to drop by 51% in two seasons to $3.92 in 2015-16.

Dairy commodities are one of the most volatile commodities in the world. Whole Milk Powder prices have a volatility percentage of over 40% versus commodities such as oil (22%) and sugar (26%) (Fonterra, 2015). Global supply and demand for dairy are extremely sensitive to a wide range of external factors, including weather, geopolitical decisions, unprecedented demand from new markets, and food safety issues. (Sing, S.K 2016)

Reasons behind milk price volatility are not expanded in this study, however, are well covered by in the Nuffield report written by Sing, S.K. 2016, which argues further hedging or price risk management tools would reduce volatility at the farm gate.

Making a point of the volatility is vital, as sustainably achieving all areas of a strong C.S.R. model is difficult when budgeting is volatile. Budgeting the financial cost of medium to long term legal or ethical responsibilities is incredibly challenging when profitability can be so volatile, affecting the ability of all pillars to work in harmony.

A limitation in comparing payout to breakeven milk price is the DairyNZ economic survey has only included breakeven milk price since the 2013-14 season (Figure 8). Breakeven milk price saw a significant drop in the 2015-16 season before rising again. The consensus from several bankers interviewed put this drop to unsustainable items being removed to minimize the financial impact for that season with the low dairy payout. An example of this would be capital fertilizer applications withheld for one season. Many of these costs removed could not be sustainably withheld and have since been reintroduced, and with it, the cost of breakeven milk price has increased.

Table 2 Dairybase top 20% vs Average DairyNZ Economic Survey & Dairybase Benchmarks

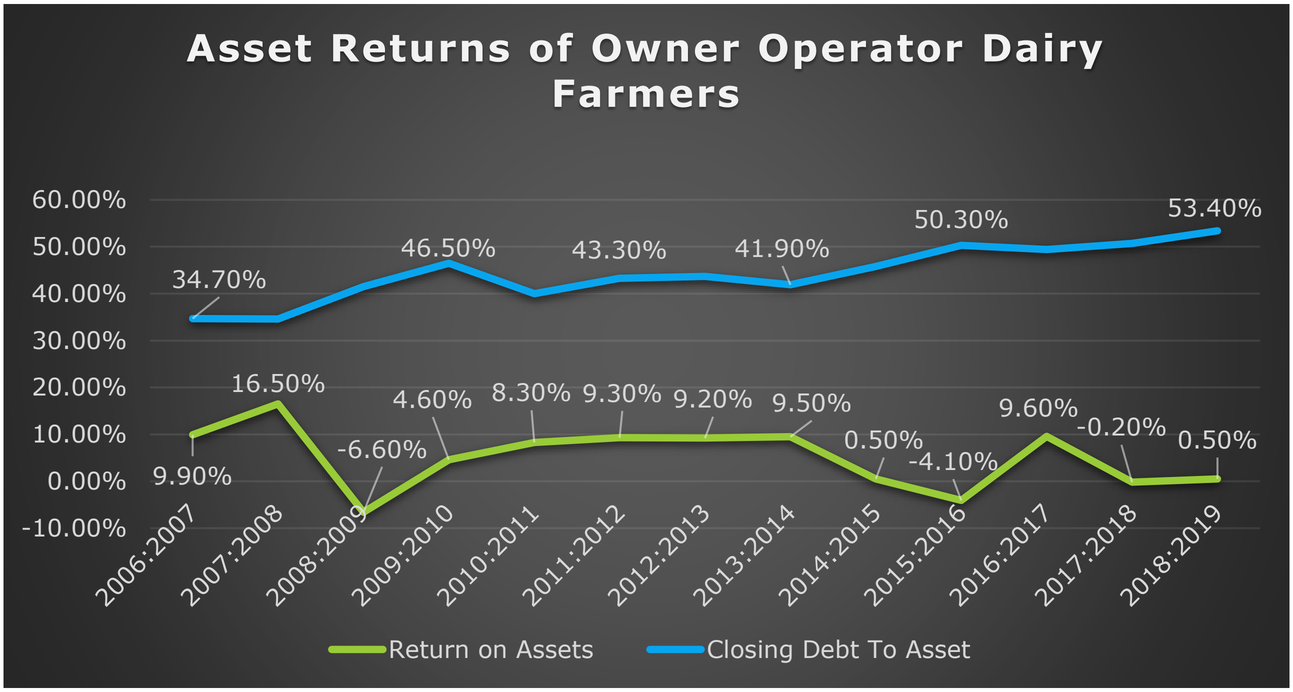
Source	Break-Even Milk price	Payout Average (Survey)	Profit Per Kg Milk Solid	Per 100,000 Kg of Milk Solids
DairyNZ Economic Survey	$5.95	$6.42	$0.47	$47,000
Dairybase Benchmark Average Data	$6.33	$6.42	$0.09	$9,000
Dairybase Top 20% (New Zealand)	$5.23	$6.42	$1.19	$119,000

Source: Dairybase 2018-19 benchmarks, DairyNZ Economic Survey 2018-19

Table 2 clearly shows the discrepancies in profit between the average and top producing farms, keeping in mind the gap between the top 20% and bottom 20% is even more significant than this. Many farms below the average would have a breakeven milk price higher than the payout resulting in an operating loss.

6.1.2 RETURN ON DAIRY ASSETS

Figure 9 Asset Returns of Owner Operator Dairy Farmers



Source: DairyNZ Economic Survey, 2006/2007 through 2018/2019

Return on assets: *Net Income /Assets (Value of capital adjusted annually)*

Debt to Asset Ratio: Total assets measured against total liabilities

For the past decade, the total average return on dairy assets has ranged between -4.1% and 9.5% (Figure 9), change has been driven by the change in land values and buildings, dairy company share values, livestock values and profits.

Figure 9 shows the climb in average debt to asset ratios since 2006-07, rising from 34.7% to 53.4% at the close of the 2018-19 season. Contributing to this has been asset values dropping. The dairy industry since 2003 has increased its total amount of debt by 263% to $41.4 billion (Ministry Primary Industries 2020).

Table 3 Return on Assets. Owner Operator Average vs Supreme Dairy Business of the Year Winner.

Year	Average DairyNZ Economic Survey	Supreme Dairy Business Of Year Winner
2018-19	0.5%	6.2%
2017-18	-2%	11.3%

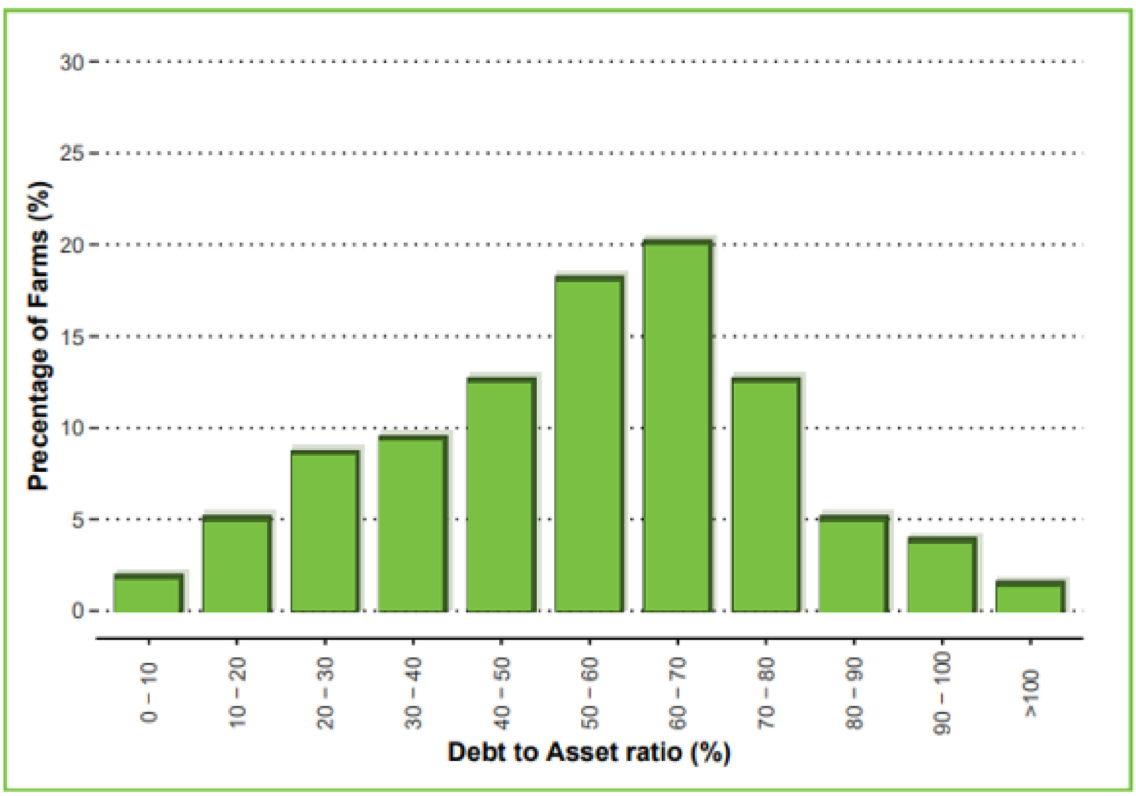
Source: DairyNZ Economic Survey 2017-19 and D.B.O.Y 2019 & 2020 Awards

Table 3 shows the large discrepancy in return on asset between a supreme dairy business of the year winner and the average result from the DairyNZ economic survey. Once again, the lowest performing farms would be operating with an even greater gap.

DairyNZ farm systems specialist Paul Bird noted that over ten years the top 20% of North Island farmers, ranked on return on assets (ROA), could grow their equity by more than $1.5 million. This is assuming a $6.25/kg milk solids (averaged over the prior five years) milk price and returning all profits to debt reduction. He went on to comment with the same assumptions; the average farm would make little to no headway, with potential to lose $150,000 unless milk prices remained above $6.25/kg milk solids or capital gains provided a return. (Anne Lee, Interviewing Paul Bird, 2020, February 14).

Table 3, emphasizes the variance between a top-performing farm and the average. A return on asset of 0.5% is unsustainable and places a business in stress. A business under this amount of stress cannot approach its C.S.R responsibilities holistically as it is focused on financial survival. Paul Birds comments support this, stating an average farm using recent data would stand to make little to no headway, potentially even losing $150,000 over the next ten years.

Figure 10 New Zealand Dairy Farm Debt to Asset Distribution 2018-19



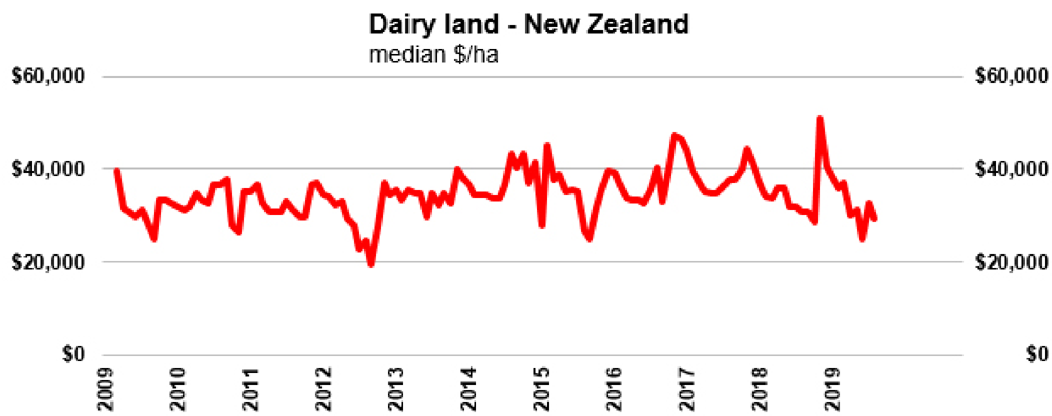
Source; DairyNZ 2018-19 Economic Survey

Debt in the industry is spread (figure 10) with more than a quarter of dairy farmers holding debt to asset ratios of more than 70%. Businesses this indebted are under immense pressure to repay principal, these farm businesses need to be efficient and return a substantial profit, ideally with a low breakeven milk price to allow for extra debt repayment.

"The current profile of dairy debt reflects a degree of poor decision-making by borrowers and lenders" ("Royal Reserve Bank Of New Zealand", Financial Stability Report, David Hargreaves November 2019 27.)

Capital value of Dairy land has not increased since 2009 (figure 11). Dairy land in 1978 cost, on average, $13,000 per hectare, and in 2014 the average 'value' was $51,000 per hectare (Reserve Bank of N.Z. 2016) resulting in a significant capital gain for the farmer, this growth has subsequently stopped. This halt in asset gain from land value increase, has not helped the debt to asset ratio of many farmers.

Figure 11 Dairy Land - New Zealand. Median $/ha



Source: David Chaston 22nd October 2019, Originally retrieved from The Real Estate Institute.

If farmers wish to make real capital gains, they will need to initially purchase at lower prices in keeping with conservative estimates of future product prices and increasing costs. It is possible, for example, the availability of the farm' next door' tempts farmers into paying too high a price to allow making an annual return on capital similar to urban-based fixed interest investments. (Grieg. B et al. 2018)

Poor decision enabling of banks is still the result of poor investment decisions by farmers. Farmers must start discussing the return on their asset as standard practice. The historic days of farming with capital gain have not occurred in the past decade, and there is no argument to say this will improve. Without a strong return on asset, farms will not survive. Investment decisions must be more accurate, and emotion needs to be removed from the "buy the neighbour" philosophy. If farmers are to make acceptable returns on assets, assets must be first valued appropriately.

Due to the nature of significant capital investment in the land with farming, it is often not compared to other businesses. When purchasing a dairy farm, goodwill is also not a factor. During the study, the idea of valuing a farm via the following method was raised by banking industry personnel.

Value = Net income / Rate of Return (I/R)

This method is employed by commercial property investors to evaluate new investments potential. This helps to exclude the emotion and provide another context to measure farm business rather than solely on land values.

6.2. ECONOMIC SITUATION SUMMARISED

In figure 4 the remodelled model of C.S.R. designed for this study, the economic pillar poses a risk to all other pillars working in harmony for the average farmer. Whilst in Carroll's model (figure 2) economic responsibilities is considered the most important responsibility. A return on asset of -0.5% and a $9,000 to $48,000 per 100,000kg milk solids profit paid after breakeven milk price does not provide a business resilience. Considering the importance of economic responsibilities in both these models there is significant reason for concern with the current 'average' results.

"It is important that a successful firm be defined as one that is consistently profitable" (Carroll. A 1979).

The volatility in milk price has not allowed for the average farm dairy businesses to be consistently profitable, shown in 2015-16 season when the average payout was $1 Kg milk solid below the average breakeven milk price. The result of this is farm businesses being stressed and unable to operate in a resilient manner whilst struggling to meet their other three areas of responsibilities. For all pillars to work in harmony the economic situation needs to provide more certainty and resilience in future years.

CONCLUSIONS

Consumers have become more connected to the origins and impact of their food. Consumers are dictating their requirements on dairy processors who will be forced to ensure farmers comply with the consumer's ethical expectations of the future. The industry will be held to account of its worst legal or ethical producer, not its best. The bobby calf scandal highlights this and shows the media will portray the majority of the industry by the actions of a minority. Investigating C.S.R scandals in other sectors proves the need to ensure we take all steps to prevent scandals in the sector

Farmers participate in wide and varied philanthropic activities; they do not undertake these acts for strategic reasons. There is potential to leverage these acts more to improve perception and build on social licence to operate.

The average return on asset and breakeven milk price is not a sustainable return and an unworthy reward for the effort farmers invest. Capital gain on land should not be anticipated, operating profit is all that can be relied on, and this is volatile. To be resilient and last long term, farmers should aim to operate in level with the current profitability of the top 20% of farmers.

Compliance is rising, and the cost of this is high (Macdonald, TO 2014). When combined with the average farm's financial performance, the industry is on the verge of a period of unrest. Top farmers will rise, and many low performers will fall out of the industry. This will occur either due to farmers failing to meet changing ethical or compliance requirements or not running a financially viable business (Allen, J. 2019).

If given the choice consumers would not select the 100th worst builder to work on their homes, however, are often drinking milk from the 100th worst supplier of milk in their region. A builder is unlikely to survive if they not one of the best operators in the town, the top businesses are likely to grow and expand and out-compete the low performing operators. Dairy farming is a unique business in that it is non-competitive at the supplier level. Contrary to a builder in town farmers do not compete with their neighbours as they each sell their milk to a processor who markets and sells the milk products and does this competition on behalf. I believe this has created an environment where some low performing businesses have been able to survive that may have not in other industries such as building; this will change, top operators will rise and poorer performers will fall out of the industry. The impact potentially will have a positive impact on the industry as top-performing farmers more adaptable to change in compliance and ethical standards will rise.

The wider industry must prepare to exit a large number of farmers gracefully. With current debt levels and the stagnation or loss of land asset values, many farms will not have strong resilience for a drop in milk price. Something the volatile history would suggest is inevitable. Additionally, others will not adapt to changes in compliance and ethical responsibilities. From this will be an immense opportunity for those farmers with healthy debt to asset ratios and who can operate in the top 20% of profitability.

RECOMMENDATIONS

To win in the future of Corporate Social Responsibility, farmers and the industry will need to achieve the following.

vii. Reinvent their business constantly, the end goal may be the same, but the tools and methods are constantly evolving. Embrace change.

viii. Removal of farmers that risk tarnishing the industry, one farmer is a danger to the reputation and acceptance of all. Milk processors and Government must take responsibility of this. This will increase ethical approval by the public.

ix. Invest with the head and not the heart to be sustainable and ensure a more acceptable return on assets and manageable debt to asset ratios. Purchasing a farm must be made as if investing in a commercial building or other investment utilizing similar financial models.

x. Acquire greater financial skills and drive profitability. Farmers should target to perform at the level of the current top 20% of operating profit. Action by the wider industry, including milk processors, must occur around educating farmers on profitability and prosperity. If they do not, farmers will struggle to meet ethical and legal expectations of the industry. These all work in harmony.

xi. Understand the "why" behind compliance better, were compliance instigates from and what it enables. Conversely, the industry must explain the reasoning behind compliance clearer and more intentionally to farmers.

xii. Formulate successful plans and models to exit a large number of farms gracefully from the industry. Support in planning and strategic decision-making is lacking at the end of many farmers careers. Banks, milk processors and industry good organizations must take accountability to support in this.

FURTHER STUDY

Potential for further study to expand on Corporate Social Responsibility in Aotearoa Dairy Farming could include.

- Quantify the rising cost of compliance across all aspects of a dairy farm business.
- Investigating if the top 20% of financially performing farmers are achieving their ethical and legal responsibilities?
- How does the industry better protect itself from the weakest performers tarnishing the reputation of all? How can these farms be exited from the industry?
- How to promote and leverage the philanthropic acts many farmers participate in, to help build trust capital within a social license.
- With the large number of farms that will exit the industry in the next decade, what measures can be taken to ensure this is achieved positively.
- Alternative means for valuing a dairy farm asset.

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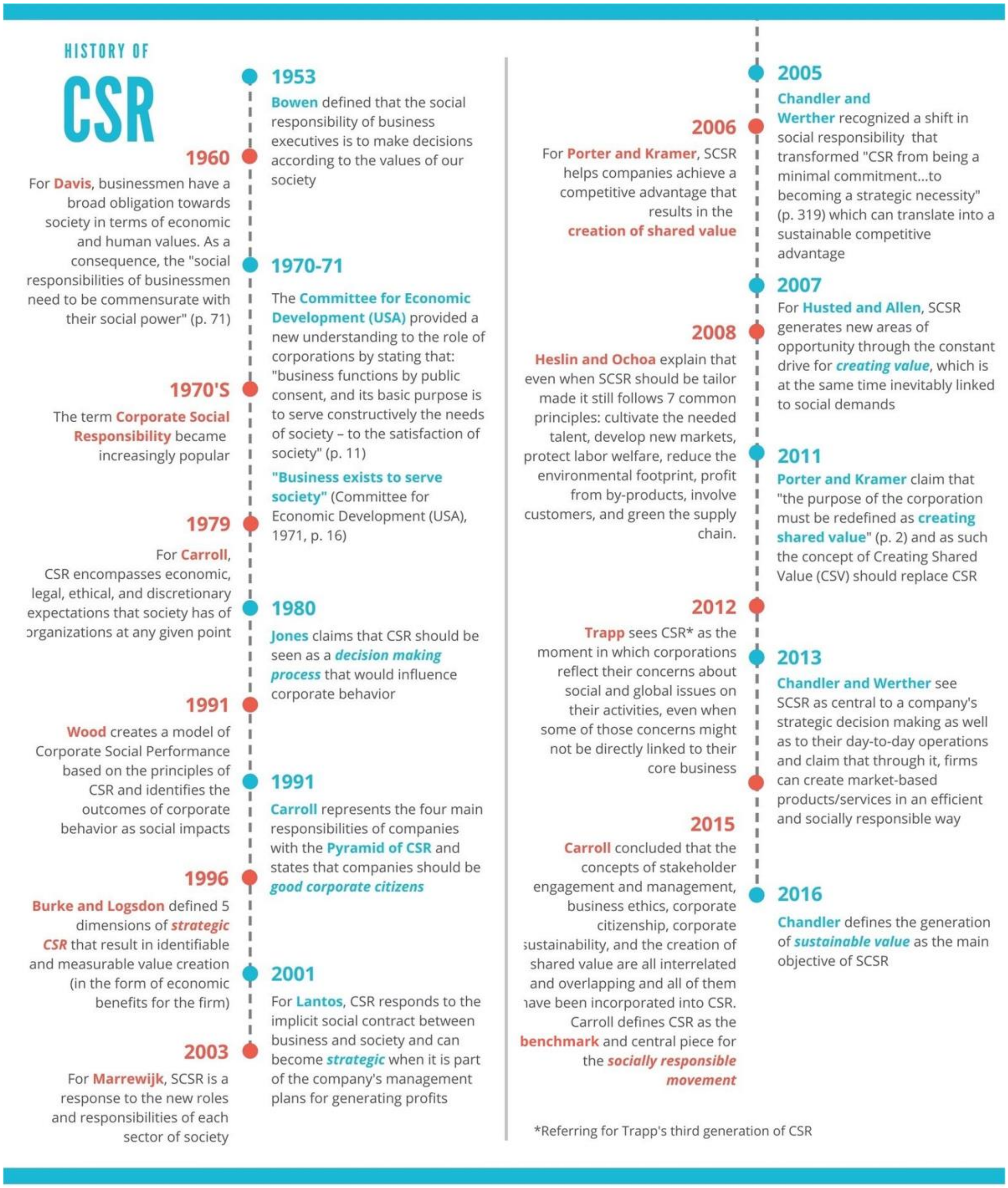
APPENDICES

Appendices 1. History of Corporate Social Responsibility.



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