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Title

‘Rethinking Corporate Governance (part 1): Structure of Governance at The Day Chocolate Company’

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Abstract

This paper offers a case study of the structural aspects of the corporate governance model operated by The Day Chocolate Company (DCC). This company is a fair trade start-up, operating in the UK confectionery sector with the aim of providing market access for the Ghanaian cocoa growers co-operative Kuapa Kokoo. In contrast to the Anglo-American governance model, centred on structural arrangements at the firm level, the case example presented here is a more inclusive stakeholder approach involving partners across the supply chain and external Fair Trade accreditation agencies. It is argued that effective governance, in this company, derives from relationships between stakeholders and the corporate credibility produced by independent external evaluation. The argument therefore prioritises social capital over structural checks and balances prescribed by formalised codes of practice associated with Anglo-American governance models. In so doing, the possibility of developing innovative and more socially oriented governance models in the context of prevailing Anglo-American financial and market institutions is highlighted.

Keywords

Fair trade; corporate governance; stakeholder governance; Stakeholder theory.
INTRODUCTION

This paper outlines the structural elements of the corporate governance model developed by the Day Chocolate Company (DCC). DCC is a UK fair trade organisation created to offer better exchange relations and UK market access to Ghanaian cocoa farmers. In contrast to the Anglo-American governance model centred on structural arrangements at the firm level, the case example presented here is more inclusive (in respect of stakeholders) and depends for its success on the existence of intangibles such as trust, respect, fairness and integrity within decision making processes. This contrasts with typical Western governance models with their strict adherence to codes of conduct (such as the UK Financial Services Authority Combined Code on Corporate Governance 2003) to ensure structural checks and balances via a tripartite division of powers between shareholders, managers and boards of directors.

In a companion paper (forthcoming), the authors argue that effective corporate governance requires an appropriate management culture to support the structural arrangements discussed here.

LITERATURE REVIEW – APPROACHES TO CORPORATE GOVERNANCE
Corporate governance is a concept developed over a number of centuries and has become a catch-all term for all types of organisational control structures. The Anglo-American conception of corporate governance has been variously defined as:

“… (T)he ways in which suppliers of finance to corporations assure themselves of getting a return of their investment” (Shleifer and Vishny 1997, 737).

Or,

“The relationship between various participants in determining the direction and performance of corporations.” (Monks and Minow 2001, 1).

According to this perspective, the main participants within corporate governance are seen as shareholders (owners), management and the ‘board of directors’ and is the product of legislative and economic changes, regarding the legal form and role of private corporations in general society spanning three hundred years (Grant 2003).

The concept of the corporation has evolved significantly since its emergence as a government chartered vehicle for provision of socially desirable public works in seventeenth century Britain. Corporations have evolved in tandem with economic and legal changes in (mainly) the United States and in the United Kingdom. Through the introduction of ‘limited liability’, via the Companies Act of 1856 in Britain and most US states by 1860 (Hickson and Turner 2005), corporations became a vehicle for a larger number of investors to pool their resources in order to maximise the return on their capital and limit responsibility for ensuing debts and losses to the sum invested. Development of capital markets in the USA and UK during the twentieth century saw
corporate ownership disperse from an easily-identifiable small pool of large investors to a much larger pool of small ones and back again to a small group of institutional investors.

As the above comments suggest, the theoretical standpoint from which Anglo-American conceptions of corporate governance emanate is that of the *shareholder* perspective. Such shareholder-oriented approaches are often grounded in the rubric of the proposed inalienable private property rights of owners/financiers. They posit a moral imperative for managers to control corporate assets toward maximising return to owners. Such theories have traditionally viewed the mechanisms of governance as means to increase efficiencies and reduce managerial discretion over privately owned assets (i.e. asserting structure over agency). The separation of ownership and control (Berle and Means 1932; Fama and Jensen 1983), the theory of the firm (Coase 1937), agency theory and the ‘agency problem’ (Jensen and Meckling 1976; Fama 1980), and the nexus of contracts concept (Williamson 1979) represent some of the significant developments in the academic literature within this tradition.

This shareholder approach contrasts with the *stakeholder* perspective:

“Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders…also (providing) the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.” (OECD 2004, 11).
This perspective stems from initial influential work of Dodd (1932) and, latterly, Freeman (1984) and Donaldson and Preston (1995). Such definitions recognise the variety of relevant constituencies “without whose support the organisation would cease to exist” Freeman (1984, 31).

In extending the scope of managerial discretion to address the interests of groups other than shareholders, the stakeholder approach is seen as problematic by proponents of free market economics who point to an unlawful diminution of the rights of private property owners to maximise the lawful returns on their capital (Friedman 1970; Sternberg 1997; and Jensen 2001).

The development of this broader conception of corporate governance is, in part, an expression of different institutional arrangements for the structuring of relations between capital markets, corporations and state regulators in different countries. For instance, in the Rhineland and Japanese models highlighted by Vinten (1998), stakeholder (especially workers) representation at board level is commonplace. Such differences draw attention to the sources of tension created by seeking to transfer governance structures from one national context to another.

As concerns over corporate governance have spread from the corporate sector of developed economies to less developed ones, the issue of transferability has become more prominent. Several authors have posited the issue of transferability as a tension between
globalising pressures for convergence, on the one hand, and path-dependencies deriving from national culture on the other (Licht 2001; Palepu et al. 2002).

In similar vein, Steane (2001) asserts that outside of the corporate sector the so-called not-for-profit or *third* sector exhibits greater diversity in board composition to divergent approaches to governance. He notes that though convergence is possible it “needs to be built upon a realistic assessment of the divergent dimensions of the ideologies and values that influence (these) organisations” (Steane 2001, 18).

That is not to say the Anglo-American approach to governance is unresponsive to endogenous shocks. Following stock market crashes (notably in 1929 and 2001), high profile corporate wrong-doing (e.g. Parmalat, Enron, WorldCom, etc.), the raised profile of corporate social responsibility and influential reports such as the UK’s Cadbury Report a more holistic approach to governance is emerging (Dunn and Riley 2004).

It is from this stakeholder perspective, more specifically, a multi-stakeholder ownership model that this paper develops an evaluation of the governance systems in place at DCC. Issues of accountability, transparency, the changing constitution of stakeholder groups and their role in strategic direction are materially different for these organisations as will be illustrated.
The success of fair trade organisations, such as the DCC and Cafédirect exemplify a stakeholder approach to governance. Their approach is more radical, relying less upon the triumvirate of owners, management and Board of Directors and so avoiding the insularity of governance structures (characteristic of many large private sector organisations) capable of producing abuses such as those of Enron... Instead they employ a system *inclusive* of stakeholders. The approach taken by DCC, in particular, emphasises how a successful profit-making organisation can be effectively and transparently governed by encompassing upstream and downstream actors in the supply chain. This holistic approach to governance addresses many of the perceived weaknesses of prevailing Anglo-American governance systems in terms of transparency and accountability as will be discussed below.

**THE DAY CHOCOLATE COMPANY: BACKGROUND**

The Day Chocolate Company (DCC), set-up in 1998, shares with its partners a mission to improve the livelihoods and opportunities for small-scale cocoa farmers in West Africa. It is the first fair trade company to have farmer ownership at the centre of its value proposition. This entails farmer representation on the board, active brand participation, influence over the product in the market and profit sharing. This governance structure, involving board level representation enables cocoa farmers to gain added value from the entire value network and not just from the selling of the primary commodity: profits follow ownership. These farmers are members of a co-operative called Kuapa Kokoo (KK), which means “Good cocoa farmer” in the local Twi language.
DCC’s 99 shares (its legal form is a company limited by shares) are owned by three parties as illustrated in Figure 1 (see end). The international NGO (Non-Governmental Organisation) Christian Aid also own preference shares and the leading UK charity Comic Relief enthusiastically support the company and are also partners in the Dubble Fairtrade chocolate bar (see Figure 1).

The board of directors includes two people from KK (Managing Director of KK Ltd and the Farmers Union President), two people from Twin Trading and one person each from the Body Shop, Christian Aid and Comic Relief (see Figure 1). In addition independent non-executive directors sit on the board. This governance structure is unique in both the UK fair trade and confectionery markets and is recognised as an innovative organisational model (Duncan 1999). Key to the initial set-up and launch of DCC was a loan guarantee facility provided by the UK Department for International Development (DfID) to a commercial bank (Ronchi 2001). This was felt necessary to overcome the perceived risk of entering this highly competitive UK chocolate sector. DCC have developed their own brands of Fairtrade chocolate, Divine and Dubble, and also supply own-label Fairtrade chocolate to both the Co-operative Retail Group (CRG) and Starbucks Coffee Company UK.

This coalition of shareholders was no accident. Twin Trading’s mission, to facilitate market access for disadvantaged producers, was already known and had seen them set up the successful fair trade hot beverage company Cafédirect. Similarly, The Body Shop buys cocoa from KK at the Fairtrade price to make cocoa butter which is used in more than twenty of its products. Christian Aid with a membership of over 250,000
people and Comic Relief, which has 96% brand awareness in the UK, both have
mission’s to alleviate poverty. These partners are strongly placed to assist DCC in
achieving its commercial and social objectives via high street retail distribution and brand
awareness. It is a specific objective of this partnership that all cocoa is purchased by the
internationally recognised Fairtrade standards that are a part of the Fairtrade supply
agreement and code of conduct.

Ghanaian cocoa producers in global commodity markets

In the last decade large companies have accelerated their control of basic
commodity markets such as cocoa. We have also witnessed the growing power of
distributors (retail supermarket chains). In addition, since the introduction of structural
adjustment programmes (SAP’s) in developing countries smallholder farmers have
received limited state support. This is in stark contrast to farmers in Europe, USA and
Japan. One of the consequences of these factors is persistent rural poverty in the
developing world (Tiffen 2002). By comparison salaried workers in industries like
clothing, shoes and technology are experiencing improvements in minimum standards
and conditions. Some large companies pressurised by both NGOs and consumer groups
have introduced voluntary codes of conduct, which do provide a point of entry for
improvement and dialogue between downstream and upstream actors. It must be
understood that smallholder farmers are self-employed, non-salaried and are still beyond
the reach of voluntary corporate codes of conduct. However these farmers are critically
dependent on a few large companies who operate far away. Chocolate companies, for
instance, are still deemed to be not directly responsible for the impact of their commodity
prices on these small-holder farmers (The Biscuit, Cake, Chocolate and Confectionery Association 2002).

An estimated 11 million small-holder farmers grow cocoa in West Africa (International Cocoa Organisation, 1999), but few cocoa farmers in this region are aware of the destination of their beans beyond the village. Few farmers have ever tasted chocolate or have any concept of what it is or who uses it for their products (Tiffen 2002). Smallholder participation in global food systems is restricted by barriers such as understanding of western markets, knowledge of consumer tastes and buyer preferences (Page and Slater 2003). Conversely, despite long track records in the countries where chocolate is manufactured the large chocolate companies have little or no connection with farmers who work mainly through middlemen. From a corporate governance perspective, if large companies cannot trace their primary raw materials then they cannot satisfy concerns about a range of issues as diverse as GM, social welfare, child and forced labour, sustainable farming practices and good quality raw materials. DCC’s inclusive stakeholder model of governance addresses these issues by taking a ‘bean to bar’ approach to its cocoa supply chain. The whole value network is addressed in ensuring ethical and equitable governance. It is to address market exclusion of cocoa producers and promote higher standards of corporate governance across the whole value chain that DCC has adopted a governance system and structures that departs markedly from the classic tripartite system of check and balances between owners, managers and board of directors. By contrast, voluntary practices by mainstream chocolate companies fall well short of the standards promoted by organisations such as the Fairtrade Foundation.
The structural elements of this model are discussed below (the culture and values based elements are the subject of a companion paper in preparation).

**CORPORATE GOVERNANCE MODEL OF THE DAY CHOCOLATE COMPANY**

Discussion of DCC’s approach to governance will be split into two sections. Firstly, the authors address the traditional distribution of powers within DCC’s management structure. Secondly, methods of achieving robust and ethical governance in the wider value chain are explained. It will quickly become apparent that this split is purely for purposes of exposition. In practice, these elements represent an integrated stakeholder model.

The key structural representation of corporate governance at DCC is reflected in the distribution of shares between the key stakeholder groups (explained above and depicted in Figure 1). However there are subtler operational aspects that serve to illustrate the real and direct representation of cocoa farmers in the production and sale of chocolate. Some of these will now be discussed.

At board level all parties actively participate in decision making on both policy and business strategy. Operational managers such as Head of Sales and Marketing regularly present at board meetings to discuss business/marketing strategy and provide information to aid discussion. The board then provide input to direct this strategy on key issues such as product development, pricing and promotional spend decisions. The board
also work together to solve problems relating to the business such as supply chain issues, finance issues and also sign off any salary changes for all employees etc. Furthermore, a number of board directors with specific expertise have worked voluntarily on certain projects to assist the objectives of DCC. Pauline Tiffen describes this as real “brand participation” (personal correspondence). Trust arising from these close working relationships is a key success factor in the governance model operating at DCC.

In building relationships with customers such as the multiple retailers DCC has encouraged participation of board members. For example, Mr Kwabena Ohemeng-Tinyase (Managing Director of KK & Board member of DCC) was involved in supporting the negotiations (2002-2003) with the Co-operative Retail group during the process of their complete switch over to 100% own-label Fairtrade chocolate sourced from DCC. There is also significant involvement of KK in the marketing communications strategy of DCC. This takes the form of media interviews, hosting media visits to Ghana (e.g. BBC News 24 and The Observer Newspaper). The unique ownership structure is both a central and consistent feature of all DCC’s external communications with the media and involves active participation of key owner/stakeholders. This is only possible because of a shared clarity of purpose and trust among stakeholders.

However, participation extends beyond involvement of key stakeholders in operational decisions and marketing communications to issues such as gender representation upstream in the value network. For example, KK has already achieved a key aim to ensure at least 30% female participation at all decision making levels. Women
Cocoa farmers (of which there are many due to a cultural tradition of females inheriting farms) now feel they have some dignity and do not feel powerless.

DCC works hard to manage the structure of relationships between internal and external stakeholders and is acutely aware of the positive impact of the resulting level of trust. The social capital produced by this focus on relationships yields many positive outcomes in terms of brand profile and teamwork within DCC’s operations. For example, in 2003 a large delegation from DCC (not only company employees but former employees and media supporters such as the editorial team from The New Consumer Magazine and the Co-operative Retail Group Strategy team) visited KK in 2003 for their Tenth Anniversary Annual general Meeting in Kumasi, Ghana.

Open communication is a quality of the Board and the resulting stakeholder dialogue has resulted in better understanding of the supply chain leading to increased knowledge by all parties. For example, being able to discuss the whole ‘bean to bar’ story with supermarket buyers, consumers and the media has been advantageous to DCC. Until very recently big chocolate brands had not featured the cocoa origins as part of their message. As with the beverage sector, the practice has been to reinforce the commoditisation of source products and concentrate value added in downstream activities controlled by the chocolate manufacturers.

**External verification and ethical governance in the wider value network**

DCC’s inclusive stakeholder approach to corporate governance extends to external groups within civil society. Openness and transparency are central to DCC’s
corporate culture and are seen as a generating trust and credibility across the supply chain. David Croft, former Head of Co-op Brand & Technical Affairs at Co-operative Retail Group (CRG), explains “without DCC the CRG Fair trade communications strategy would have been more piecemeal and more disparate, the partnership has resulted in greater Co-op brand equity. This has been achieved through a strong relationship with DCC and its amazing “story”. We have used this story in marketing messages, which screams credibility, which is an incredible asset.” (Doherty and Meehan 2004).

Apart from positive feedback from its trading partners, DCC also subjects itself to scrutiny by external bodies. For example, DCC has set up the educational charity Trading Visions which acts as an advisory body to DCC. The participants in Trading Visions include teachers, politicians, representatives from religious groups, journalists, customers, consumers of differing age groups and other NGO’s.

As a registered fair trade company DCC and KK are also subject to independent annual audit by the Fairtrade Foundation. The Fairtrade Foundation is the UK representative of the International body FLO (Fairtrade Labelling Organisation). All DCC’s products carry the Fairtrade Mark, which is a guarantee that they meet the internationally agreed trading criteria. Fairtrade standards stipulate that traders have to:

- Pay a guaranteed commodity price to producers that covers the costs of sustainable production and living;
- Pay a premium that producers can invest in developing their communities;
- Partially pay in advance, when producers make this request;
• Sign contracts that allow for long-term planning and sustainable production practices.

Furthermore, DCC has also chosen to participate in the self-assessment process as part of its membership of IFAT (International Federation of Alternative Trading). IFAT seeks to increase the opportunities of small scale producers marginalised by conventional international trade. The IFAT monitoring scheme is measured using the following criteria:

• Creating opportunities for economically disadvantaged producers
• Transparency and Accountability
• Promoting fair trade
• Payment of a fair price
• Gender equity
• Child labour
• The environment

This willingness to participate in external validation of its commercial practices in accordance with ethical and fair trade standards is critical in enhancing the legitimacy and credibility of DCC in the wider supply chain and society in general. The company has excellent relations with governments as a result of this activity. For example, DCC and KK are currently involved in a Twin Trading/DfID commissioned impact study. This study is ongoing and aims to evaluate: (1) The impact of activities on the economic well-
being and livelihood of cocoa farmers in Ghana; (2) The impact on the UK chocolate market (retailers and manufacturers).

CONCLUSIONS

DCC has a unique ownership structure which guarantees representation of its key commodity supplier (Kuapa Kokoo) at the very heart of the company’s strategic and operational decision making processes. The ownership of DCC shares is not a diffusion of shares among a disparate and financially oriented pool of shareholders but a focused and concentrated matching of committed like-minded stakeholders drawn from one end of the supply chain to the other (from ‘bean to bar’ as Day put it).

The structure of relationships between stakeholders is central to the success of DCC’s governance model. Both within the organisation and beyond, the emphasis on an equitable partnership of interests engenders the trust and credibility which underpin the operational and strategic development of the organisation’s effort to mainstream Fair Trade chocolate in order to provide market access for Ghanaian cocoa farmers. According to DCC’s business philosophy, the ‘means’ matter as much as the ‘ends’. Indeed, the stakeholders understand the two are mutually constitutive: a sharp distinction from ‘shareholder approaches’ to corporate governance which are often little more than lip service paid to weak codes of practice generated by those they purport to regulate.
Credibility in the wider value chain also derives partly from the willingness of DCC to subject itself to independent scrutiny. This credibility was a key factor in the UK’s Co-operative Retail Group selecting DCC to manufactures its fair trade chocolate (and DfID’s decision to support DCC). With consumers increasingly differentiating between organisation’s and their product brands, the value of this organisational credibility in the marketplace is critical to the success of socially oriented business models and their competitive strategies.

It is clear from our discussion above that the success of DCC’s governance model is dependent on both formal structures and a management culture which values all stakeholder input and shows itself to be transparent and ethical in its dealings with all stakeholders. The subject of DCC’s culture is the focus of a companion paper by the same authors that is currently in development.
Figure 1. The DCC/KKU Value network

Cocoa farmers Village Societies (900+ in 2004)

Kuapa Kokoo Farmer’s Union (KKFU)
Village societies elect a Society Executive from these 7 member Regional Executive Councils elected, and from these a 13 member National Executive Council (NEC) is elected.

Day Chocolate Company

Kuapa Kokoo Farmers’ Trust
Disburses FT premiums, DCC/KKL profits and other funds as decided by board of trustees:
- 4 NEC farmers
- 1 KKL manager
- 4 local professionals

Body Shop
(14% shares, 1 seat)
Comic relief
(1 seat)
Christian Aid
(1 seat)

Day Chocolate Company

33% shares, 2 seats

Twin Trading
(52% shares, 2 seats)

Chocolate Manufacturer

FLO approved Cocoa Processors

Sole European Importer

Cocoa Marketing Company (CMC)
Monopoly exporting Subsidiary of the Parastatal cocoa marketing board (COCOBOD)

Kuapa Kokoo Ltd (KKL)
- 97% of shares held by KFU (founders hold rest)
- Board of Directors:
  - 5 NEC farmers
  - 1 Managing Director
  - 4 Senior managers
- Staff of 26 Society Development Officers

Kuapa Kokoo Farmers’ Trust
Disburses FT premiums, DCC/KKL profits and other funds as decided by board of trustees:
- 4 NEC farmers
- 1 KKL manager
- 4 local professionals

Legend:
- Ownership
- Flow of goods and cash
- One way cash flow

Doherty and Meehan (2004)
REFERENCES


