DAIRY FARM OWNERSHIP AND MANAGEMENT STRUCTURES: FOCUS GROUP RESEARCH

T. Payne, N. Shadbolt, E. Dooley, D. Smeaton and J. Gardner

Tracy Payne, E. Dooley, D. Smeaton*
AgResearch Ltd, Ruakura Research Centre, Private Bag 3123, Hamilton
New Zealand
Email: tracy.payne@agresearch.co.nz

N. Shadbolt, J. Gardner
Massey University, Private Bag 11222, Palmerston North
New Zealand

Abstract

The traditional route for individuals in the New Zealand dairy industry is from farm worker to sharemilker to owner-operator. In recent years new routes have emerged. The purpose of this research is to gain a clearer understanding of the variety of ownership structures that now exist and how they are managed, their potential impact on the industry and what each has to offer present and future players in the industry. Four focus group meetings were held. The farmer participants included owner-operators, equity partners, sharemilkers and managers. Various rural professionals also attended. These meetings aimed to capture the participants' interpretation on the advantages and disadvantages of various structures, and the issues driving change. Participants' views on the ownership and management structures were influenced by the structures prevalent in each region, especially in the South Island where equity partnerships are prevalent.

Keywords: dairy farming, farm ownership, management structures, equity partnerships, sharemilking, focus groups.

Introduction

Dairy farm ownership and management structures impact on business and wealth creation, career structures and entry and exit of participants into the industry. The traditional pathway of career development and farm ownership moves from farm worker to sharemilker to owner operator.

Industry statistics identify that 63.7 percent of all dairy herds in New Zealand are run under an owner-operator system while 50:50 sharemilkers comprise of 23.6 percent of herd ownership (LIC, 2005).

Sharemilking is a traditional pathway to farm ownership in New Zealand. The land owner provides land and the fixed improvements (Shadbolt and Gardner, 2006). A 50:50 sharemilker provides the livestock and machinery, and the labour, and most of the management, for a 50 percent share of the milk income (Shadbolt and Gardner, 2006, p.3). Gardner and Shadbolt (2005) note that sharemilking owes its existence to the simple fact that few dairy farmers wish to spend their entire working lives milking cows twice daily. It enables a farm owner to discontinue milking cows while retaining a reasonable income and modest return on investment (Taylor, 1996). While the number of herds in New Zealand has decreased, both herd and farm sizes are increasing resulting in greater competition among sharemilkers for opportunities (Hall and Allen, 2004).

While the family farm is the most common ownership and management structure in New Zealand agriculture other forms are emerging in the industry (Hebling, 1996). Equity partnerships, the emergence of 'mega' farms, and sharemilkers holding multiple contracts, are now options. Shadbolt and Gardner (2006) found that the high equity capital required to purchase farm land has been a factor which has resulted in these new business mixes emerging. This results in implications for the division of land, labour and capital in the industry, potential career structures, farm succession, and attainability of farming and business goals.

An equity partnership provides farm ownership for a number of investors. The farm may be managed by one of these equity owners. Handford (2005) believes this collaborative approach to farming will be indicative of dairying in the future. An important advantage of an equity partnership is that it enables farming on a larger scale than would otherwise be possible (Shadbolt, 1998; Ormsby, 2005).

The purpose of this paper is to report on the initial findings on a study into the impacts of ownership and management structures in the New Zealand dairy industry. The paper includes a description of the current ownership and management structures, advantages and disadvantages of major structures and issues driving ownership structure change. Factors which participants thought would influence future structures are also documented.

Methods

Four farm focus groups were run in two North Island (Waikato and Manawatu) and two South Island (Canterbury and Southland) regions of New Zealand. Farmer participants included owner operators, equity partners and sharemilkers. Rural professionals, including rural bankers, industry representatives, lawyers, accountants and farm consultants, also attended. The participants were asked four key questions;

What are the current ownership and management structures?

What are the advantages and disadvantages of an owner operator, equity partnership and 50:50 sharemilking arrangements?

What issues are driving the change in preference towards the different structures?

Which factors may influence future structures?

All focus group meetings were taped and later transcribed to provide an accurate record for documentation.

Focus group participants defined owner operators as those operations not employing labour units and thus some of the advantages and disadvantages of this structure will not be applicable to those owners who employ labour.

Results

Different dairy farm ownership and management structures possess different asset ownership. Table 1 identifies the relationship between structure type and asset ownership. Based on the relative abundance of structure types it was decided that owner operators, equity partnerships and 50:50 sharemilking would be the focus of further investigation.

Table 1: Ownership and management structures in the New Zealand dairy industry identified by four focus groups

	Assets						
Structure Type	Cash	Plant & Machinery	Cows	Shares	Land	Human Resources	Off-farm Income
Owner operator	✓	✓	✓	✓	✓	✓	
Equity partner (passive)	✓	✓	✓	✓	✓	✓	✓
Equity partner (active)	✓	✓	✓	✓	✓	✓	✓
50:50 sharemilker	✓	✓	✓	✓ (some)		✓	
Lessor	✓	✓	✓			✓	
Owner operator with sharemilker	✓	✓ (some)	✓ (some)	✓	✓	✓	
Lower order sharemilker	✓	✓ (some)	✓ Non-milking			✓	
Contract milker	✓ (some)	✓ (some)				✓	

Advantages and disadvantages of the structures

There were a range of advantages and disadvantages mentioned by all participants. Table 2 identifies the advantages mentioned by participants in regards to owner operators, equity partnerships and 50:50 sharemilking structures. The most noted difference between the structures was the pride and emotional attachment which was seen as an advantage for only owner operators.

Table 2: Perceived advantages of the different structures

Advantages	Owner Operators	Equity Partnerships	50:50 Sharemilkers
Asset rich	✓		
Stable operation	✓		
Labour	✓		
Control	✓		
Simple decision making	✓		
Pride and attachment	✓		
Business approach		✓	
Spreading risk		✓	
Wider skill base		✓	
Scale		✓	
Access to capital		✓	
Cash flow			✓
Developing human resources			✓
Developing capital			✓
Easy to move assets			✓
Return on asset			✓
Free house			✓

Canterbury owner operators argued that being self employed meant you had a more flexible system which could be tailored to suit individual circumstances, simplifying decision making processes. Manawatu owner operators felt that avoiding employing labour resulted in a more reliable operation, as the owners themselves were doing the work. The lifestyle offered and the pride associated with owning and running your own farm was a huge benefit as opposed to working for someone else. Being your ‘own boss’ and receiving 100 percent of the reward for 100 percent of the effort was a common attribute.

The emotional attachment owner operators feel towards their property motivates success for personal reasons and was seen as an advantage by Southland owner operators. They did not believe that equity partnerships and sharemilking structures provide this. Most owner operators tend to live in the same area for a longer time than other ownership structures and Canterbury owner operators argued that the community benefits from this stability in the long term.

Equity partner and rural professional participants believed there were many advantages to operating an equity partnership. Having partners involved with a range of skills and approaches to dairy farming was thought to create a system which was more efficient. A more formal business approach, which leads to a separation of governance and management, was seen as a huge advantage by Manawatu and Canterbury participants.

Canterbury is a region known for its large farms and equity partnerships, and the equity partners and rural professionals attending the Canterbury meeting were very vocal in their opinions of the benefits of these arrangements. Becoming a member of an equity partnership allows an individual to benefit from increased land values, without necessarily investing all their equity. The minimum requirement for entry level is flexible and can be a stepping stone towards a larger equity share or farm ownership. It allows individuals to spread their risk, which can aid wealth creation. The scale to which equity partnerships can operate was seen as an advantage because of the leveraging opportunities created.

Sharemilking was still considered to be a stepping stone towards farm ownership, or career progression by all focus groups. Manawatu sharemilkers saw this management structure as a vehicle for wealth creation which has been proven over time. Furthermore, if a sharemilkers working situation changes, it is easy to move their assets (cows, machinery) onto another job. As sharemilkers run their own business they are accountable to both themselves and the landowner, and there was the belief that they were willing to work that extra bit harder because of this.

Canterbury sharemilker participants believed they were the strength of the New Zealand dairy industry because they have the passion and drive to succeed and work hard. This passion and enthusiasm compensated for the lack of capital they bring to a property. This form of structure has proved successful over time, because productivity, they believed, increased under a sharemilking structure. This group had high job satisfaction, which provided motivation to progress quickly from a small herd to a larger one. Rural professionals saw sharemilking as a way for individuals to enter the industry with little or no capital. As the earning capacity is good, sharemilkers have the potential to grow their equity by increasing their number of livestock. They believed that sharemilking provides a good return on assets and this is further enhanced by access to free housing for the duration of the contract.

However, participants also mentioned a number of disadvantages (table 3). An owner operator relies on their labour only and therefore having time off the farm can be problematic. Participants mentioned that the heavy workload not only impacted on the individual, but also their families who tended to assist when extra labour is required. An increase in financial risk and result in a lack of resources to expand was perceived to occur to the small size of these properties.

Rural professionals questioned the level of expertise and the narrow focus on the operation, which tends to be more operational focused than strategic. While this structure is perceived as being ‘asset rich’, a perceived disadvantage is that this group are ‘cash poor’. Participants argued that it is better to be able to spread your equity over a number of investments, to reduce vulnerability, than to have all your ‘eggs in one basket’.

Table 3: Perceived disadvantages of the structures

	Owner Operators	Equity Partnerships	50:50 Sharemilkers
Limited time off-farm	✓		
Smaller farms	✓		
Over capitalised	✓		
Narrow focus	✓		
Cash poor	✓		
‘Eggs in one basket’	✓		
Not treated as an economic unit	✓		
Needs the right mix of people		✓	
More people in charge		✓	
Cash yield low		✓	
Governance process		✓	
Lack of emotional attachment		✓	
Lack of control		✓	
Jobs becoming fewer and larger			✓
Staff			✓
Declining profit margins			✓
High risk			✓
Nomadic lifestyle			✓

While the emotional attachment owner operators feel towards their property was seen as an advantage by some, especially owner operators themselves, others argued that this could be considered a disadvantage. Canterbury and Waikato owner operators recognised that having an emotional attachment to your property makes it harder to take a 'step back' and look at the 'whole picture'. Yet, for many owner operators, the emotional attachment to their property is what 'gets them up in the morning' and while making a profit is important it is not their only reason for farming.

Participants believed getting the right people to form an equity partnership initially is a challenge as this can 'make or break' the business. Furthermore, the number of individuals in the partnership will impact on the ease of running with some owner operators believing that the more people in charge the harder it is to achieve anything. Therefore, deciding on the number of individuals is essential for success. The partnership must initially establish their goals and whether they want a regular cash yield or capital gain. If goals are not shared this can lead to conflict. Highlighted potential problems were a lack of initial planning and a lack of negotiability during the entry and exit process. Factors that need to be considered are potential forced exiting, or where members may exit at times which are unsuitable for other members. Other tensions may include where some partners may want to be involved with the day-to-day running of a dairy farm, while others may want a more passive role and be involved for the returns. Also, the cash yield may be low if profit is reinvested back into the property and investors will require alternative income sources. Broaching these subjects early-on will assist in partnerships being successful for all members.

Equity partner participants in Canterbury and Southland argued that the governance process can be both an advantage and a disadvantage. Making decisions can be a slow process depending on the number of partners and how often they meet, which can create added inconvenience to farm workers, especially if a decision needs to be made fast. This was seen by many, especially owner operators, as an added complication to the ownership structure. This form of ownership structure is very dependant on the relationships between partners. If a partnership turns sour, then the whole business could be placed in jeopardy. The Southland focus group believed one of the greatest disadvantages was that an individual's sense of ownership was limited as the property is never 'your own'. They believed this sense of ownership is a key ingredient to a successful business.

Waikato sharemilkers believed that sharemilking jobs were becoming fewer and larger, and they needed more equity and had less job certainty than in the past. Others believed that landowners have too low a return on capital when employing 50:50 sharemilkers and so are choosing other options for their farms creating less demand for sharemilkers. Failure to find employment for a sharemilker means potentially selling the equity they have in their cows. Since cows fluctuate in value regularly, sharemilkers cannot be confident that they will make a profit if they have to sell.

Attracting and retaining staff was seen as a disadvantage, especially with jobs increasing in size. They believed there is a declining margin between kilograms of milksolids produced and hours worked which is making sharemilking a less attractive economic option. Manawatu sharemilkers saw sharemilking as a high risk enterprise due to environmental issues, contract terms and supply and demand variability. The renewal of contracts and finding employment creates a nomadic lifestyle. This can be a disadvantage for couples with school age children who do not wish to change schools regularly and also relates to very loose community ties developing.

Issues driving change in preferences towards different structures

Factors identified in the literature as having an impact on both the number of herds run by each operating structure and their relative profitability include, milk price which has been volatile over the last 30 years;

land prices which have experienced substantial increases; the fluctuating cow price; and the lifestyle expectations of the younger generation (Rabobank, 2002; LIC, 2005).

All participants believed there were many common issues driving the move towards or away from the different structures. The labour shortage was a problem for all structures. Participants argued that there was more competition to find people for jobs today as opposed to 20 years ago and the farming lifestyle turns many young people away. The social expectations of the younger generation have also changed. Many young people now do not want to be tied to milking cows twice a day everyday, and farmers have reacted by adapting their practices to allow for time off.

The cost of land and increasing farm size was seen as a major driver of change. While many believed that owning your own farm was still possible, most people recognised that achieving this has become more difficult over the last ten years. This has lead to an increase of land ownership, such as equity partnerships.

Some believed there was a shift away from owner operating due to the amount of equity needed because of farm sizes and increasing costs per hectare. The price of land has meant fewer young people purchasing farms. While these sentiments were discussed they still believed farm ownership was achievable, although the pathway was less clear.

Succession was still seen as a driver of change for owner operators, as individuals changed their farming ownership and management structures to accommodate the future generations. Employing their child as a sharemilker and allowing the child to pay the stock off gradually was one possibility.

There is a drive towards equity partnerships as the size of farms and the amount of capital needed increases. There is still a strong desire to own land and some individuals will enter equity partnerships as a means of achieving this. However, it is important to recognise that we have not seen the “full circle” with few people exiting from equity partnerships. Therefore, participants felt they could not comment on the drivers discouraging people from this ownership structure.

The Future

Nearly all participants believed that people are the biggest challenge facing the industry. The dairy industry has grown on the backbone of passionate people and that passion needs to continue. Yet there was a perception by some that people entering the industry now lack this vital ingredient. Others disagreed and felt that the industry still has passionate young people entering it.

Many participants believed that management structures in the dairy industry will change. A business approach will be adopted for future farming with the farm system being run from an office not a cowshed. Technology will have a huge impact on the way farms are run. Labour will continue to be an issue for farmers, and procedures will be put into place, such as robotic machinery, and once-a-day milking as a result of the difficulty in obtaining good labour. They believed there would be a trend away from sharemilking to equity partnerships and this would be market driven because of the large amounts of equity required to purchase farms. However, participants believed that land ownership will still be the number one priority for most people and that becoming involved in an equity partnership will only be a stepping stone towards this. Therefore, there will still be a drive for people to own their own farms, or at least own land.

Participants felt there will be a demand for highly skilled individuals to run the business operation and the human resource side and this will be reflected in their salaries. Equity managers would be on high salaries due to their expertise. Participants commented that within the next five to ten years there would be an increase in family trusts and large family farm companies. Public companies will not have a large share of the market as it is perceived that they cannot handle the 'ups and downs' of farming like families can. Owner operators will still be asset rich and cash poor. Small farms will slowly disappear and the average size of farms will increase. Many argued that in the future top dairy farmers will grow their businesses. The rich will continue to get richer, and will demand, and pay top dollar, for highly skilled staff. In contrast, some participants argued that there could be a turn back to small farms which can be run by one person to eliminate labour issues.

Environmental legislation, such as waste water disposal, fertilizer use, water restrictions, and land use change will impact on the future direction of the dairy industry. Some believed there would be an increase in the number of small factories throughout the country, due to an increase in energy costs. Others foresaw on-farm processing being adopted in the near future to decrease energy costs. The supply of milk in New Zealand will drop because of environmental legislation, and therefore individuals argued that *Fonterra*, New Zealand's main milk company, will source milk from outside the country to keep up with demand. Individuals will be able to supply milk but will not necessarily be required to own shares in the company which is the current situation. *Fonterra* will play a large role in the direction of the dairy industry and may seek capital outside of shareholders for example from banks.

Conclusion

Views on current ownership and management structures identified by each focus group were influenced by the structures in their particular region. Opinions of the advantages and disadvantages of these common structures varied depending on a participant's involvement in the industry. However, a number of advantages and disadvantages were identified for each structure. Key drivers in changing structures included labour shortages and the increasing land prices. In general, equity partnerships were predicted to increase because of land price. However, the shortage of labour may encourage more owner operators. Looking to the future of ownership and management structures in the dairy industry, there were a number of directions mentioned, including a more business approach adopted, with the farm system being run from an office, not a cowshed, and that highly skilled individuals will be in demand. Most participants believed that the biggest challenge facing the industry was people.

Acknowledgements

The authors thank focus group participants and Dairy Insight for funding this project.

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