People of future agriculture

Managing farm business

Business models for farming

KITCHEN TABLE, PILLOW AND PADDOCK

A practitioner's observation on farm business succession

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ABSTRACT

In Australia there are 52,140 broadacre (sheep, beef cattle and crop) farms. Few of these farms have been retained in the ownership of the same family for three or more generations. The majority are small and only thirty percent or 15,000 have any real chance of succession from a financial perspective.

Following a literature review it became apparent that whilst there have been many studies on succession and farm business management, few if any, had compared the competencies, attributes, attitudes, skill of the owners of the businesses which have remained in the same family with those which have not

The aim of the study was to contrast farm businesses which are continuing to and beyond the third generation with farm businesses which have not been retained by the family or have been retained but are no longer viable.The case study method was chosen to conduct the research because it offered the opportunity to contrast and compare businesses of a similar size operation in a similar climatic and the same economic environment.

The key attributes and actions of the people in the continuing businesses include; planning for succession long before they developed a succession plan, team work, a shared belief that the dual aims of succession and the satisfaction of self-interest of non-farming family members is possible and agreement on the end game.

INTRODUCTION

This paper addresses three of the themes of the Congress. In considering how farm families have approached succession in farm businesses the paper is relevant to the People of future agriculture, Managing farm business and Business models for farming. The major emphasis is on comparing the actions, skill, attitudes and attributes of the people in farm businesses which will continue to the third or fourth generation with those which will not. It is important to recognise that there are many new businesses emerging and, as was always the case, landowners do not need to farm and farmers do not need to own land. While recognising the opportunity to develop models which allow new entrants to farm this paper concentrates on within family farm succession.

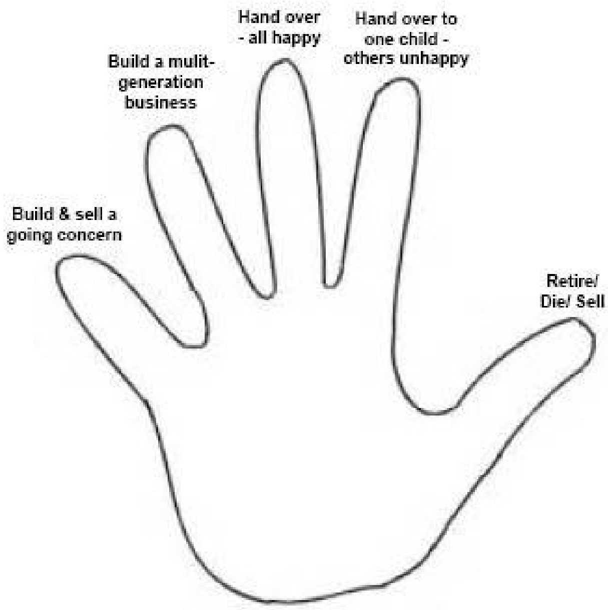
The paper draws heavily on a study, funded by Meridian Agriculture and the Meat and Livestock Australia Donor Company (MDC), which included sixteen in depth farm business case studies. These studies looked at the human, financial, political and environmental risks and examined the decisions and strategies that directed the growth which enabled succession, or that rendered that business un-viable. The studies included eight case studies which featured businesses which have successfully grown and evolved over three or more generations and are set to carry on to a fourth generation, while the other eight studies feature businesses that have not survived through the generations or are no longer viable.

Further it draws on a series of surveys of farmers and their advisors and one hundred minor case studies. The formal research is complemented by countless kitchen table and paddock conversations. The pillow conversations which were shared second hand with the researcher although unreliable can be a major factor in within family succession discussions.

The case studies, in depth and minor, highlight differing approaches to farm management and to funding the transition to the next generation. In Australia, as in most developed countries, few farm businesses stay in the hands of one family for several generations. In most families the farm business is too small, while in others there is no successor. In some cases there is no one who has an interest in farming. In others because where there was an interest by a possible successor the interest has been destroyed because of inappropriate employment arrangements or difficult parent child relationships. They don’t want to be in business together.

Figure 1 below highlights that families have five choices in relation to the future of the farm.

Figure 1: Five possible farming future



The underlying assumption in considering farm succession is that farmers have three main aims:

1. Funds to enable retirement:
    - Farmer may not want to retire;
    - Sufficient funds means choices.
2. A viable farm for the child or children who want to farm:
    - If any want to farm;
    - Viable may mean the next generation taking on considerable debt.
3. Sufficient resources for the non-farming children to be happy:
    - Often a good plan is one where nobody is overjoyed but nobody is harbouring resentment;
    - A 'Happy Family' ensures the satisfaction of self-interest.

MATERIAL STUDIED AND METHOD

ABARES reported in 2017 that there were 52,130 broadacre farm businesses in Australia.

- The most significant blockage to succession of a viable farm business is scale.
- Of these the 52,130 farm businesses there were:
  - 19,770 (38%) with annual cash receipts of under $170,000.
  - 33,980 (65%) with annual cash receipts under $400,000
  - 18,345 (35%) with annual cash receipts over $400,000
  - 3000 (5.8%) with annual cash receipts of $500,000 or greater (ABARES)

Because of the size of farms succession of a viable business is a reality for only a few (maybe 30% or 15,000) businesses. Before deciding to use the case study method surveys were conducted through lawyers, accountants, bankers, rural financial councillors and consultants. As a result of these surveys a total of 6,500 farm business, or 12% of all broadacre farm businesses, were examined. In addition, surveys were conducted directly with farmers.

The case study method was chosen after discussions with academics at the University of Melbourne. Thirty family owned farm businesses were considered for the Case Studies project. Nineteen of these farm businesses were approached, with sixteen studied in significant detail. In addition to these Case Studies, 100 succession cases were also examined.

In selecting the sixteen businesses it was recognised that some farming families manage to keep a viable farm in the family for generations and keep the non-farmers in the family happy. Other families do not. The studies consider the approaches to succession throughout successive generations. They contrast the attitudes, attributes and actions of people within each business. Eight businesses will continue, while the other eight businesses have been sold, have remained in the family but are no longer viable, or have had significant changes in direction. To protect the privacy of the participants and ensure anonymity, a letter of the Greek alphabet has been used for the name of each family.

Interview Process

Preliminary interviews were held by phone. These were followed up by a minimum of two, and in some cases up to four, face to face interviews.

Following each interview the researcher sent a draft of the case study to the participants for review / edit / correction.

The final version of both the full and summary case studies was sent to each participant for approval. When approval was granted the summary case studies were uploaded to the Meridian Agriculture website and notification was given to all participants that the summaries are available on the website and the full case studies are available upon request.

In order to ensure relevance to a wide range of farmers the sixteen case studies were chosen because of different circumstances which could be described by a tag line as follows:

- They determined that they weren't going to live like peasants and used their combined skills to follow their passion.
- Being an only child helped, but with his father he built the business from a small farm to a truly viable one and the eventual division of family assets amongst his three children will be 40/30/30
- The farm was split in three successive generations. For it to remain viable it needed to avoid further size reduction. There are four children. The family confronted the issues and the split is 79/7/7/7.
- The start was modest, we share farmed, worked off farm, invested off farm. The seven children were brought up to expect no handouts. They play together and they have stayed together. The two who farm own the business and some of the land. Most of the others still share in the landownership and want to keep it.
- Without a succession plan the farm would have been sold. Who would invest in a business with no future?
- After the lean years after wool crashed the shareholders threw down the gauntlet to the directors. Perform or we sell. The business was turned around, several off farm investments were made (unsuccessfully at first) and family members were encouraged to spend time on and enjoy the properties.
- The farm was halved, then again and then again. The current owner and his brother revered the trend and have now split with a viable business each. Over a 20 year period the Mu family has achieved a 14% return to capital.

- Their Grandfather set up the two brothers. The brothers just kept buying more land. Their sons this generation then had to pay for it. More expansion, poor prices and some droughts didn't help. But they were nothing compared to the Swill Franc loan. They borrowed one point five million and paid back three.
- A strong history of succession done well and brothers, with complementary skills, working well together to build the business, under pins this business well.
- They inherited a farm which had been successively cut up through five generations. The business wasn't viable but as stewards they handed it on to the next generation.
- He was given no choice and was burdened with the family expectation that he should carry on. But he wanted to give his children room to do what they want. So he and his wife decided to sell the entire seed stock operation.
- His grandfather, in order to uphold his position in the community, funded his lifestyle by selling a part of the farm whenever he was short of cash. In addition the old man was dictatorial and pushed his family away only to recall one member when in old age he couldn't manage the place.
- The company battled drought, government, price crashes and each time got back to profit. But when the family lost interest and then lost control of the board, they lost the company.
- They wanted to keep farming but it was unrealistic. There were too many shareholders as the shares were handed on from generation to generation. The sale was clever and the business was sold with the value paid for the intangible assets. A family member has remained as manager for the new owners.
- The three brothers took the business from 3000 to 13,000 in one working lifetime. But they spent 20 years and hundreds of thousands of dollars arguing about whether to break it up. The legal and accounting costs were enormous.
- They thought they had succession sorted. The family member who wanted to farm is smart, industrious, works hard, was suitably experienced and educated so he got the job and some of the land. Then he changed his mind.

RESULTS

Business success was measured against the stated aims of each family. In most of the case studies the family aims were to; ensure sufficient funds to retire, to hand over a viable farm, and to ensure that all members of the family are happy. The aim has been to share the family wealth as near to equally as possible whilst achieving the three previously mentioned aims. In one case, the Rho family, the viability of the farm took precedence over the near equal distribution, and that has been accepted by the family concerned. From the research, the following characteristics of successful farm business managers VS unsuccessful were identified:

- Intelligent leadership VS Autocratic, patriarchal behaviour.
- An absolute commitment and determination to achieve the three aims, Succession is at the core, not an add-on. VS A belief that the big three isn't achievable.
- A history of well thought out succession VS Poor history of succession.
- Progressive farm management VS Doing things the way we always did.
- A focus on the customer VS What customer?
- The intelligent use of capital VS Using capital to support the lifestyle.
- Preparedness to go into debt and maintain low equity VS Totally debt adverse and maintaining lazy capital in the business.
- Deliberate strategies to woo stakeholders VS A strategy of keeping them off farm and disengaged.
- Managing with humility and quietly going about your business VS Maintaining your position in the family and society as somebody very important.
- A determination not to live like peasants VS A determination not to look like peasants.
- A common end game goal VS No agreement about the end game.
- Respectfully challenging advisors VS Threatening advisors.

The Lambda study demonstrates a successful business growth strategy, with growth achieved while maintaining the enterprise mix. The business is now jointly owned and managed by two brothers, and most of their siblings are joint owners in a portion of the land. There are mechanisms in place to ensure that, if in future, any do want to sell, both a valuation and the timing can be agreed.

Other businesses have growth strategies which have included the development of a bull breeding business (the Iota family), significant off farm investment (the Mu family), brothers working together and building on their individual strengths (the Epsilon family).

In the Sigma family brothers aggressively bought land and left it up to the next generation to pay for it. It nearly ended in failure when they borrowed heavily off shore.

Delta and Epsilon had similar histories. In the Delta family, which is continuing, the brothers agreed on the end game and the family split was easy, however in the Epsilon family it was hostile and led to business failure.

In addition to the findings listed above major findings include:

1. Most farmers don't have an up to date succession plan;
2. Most farmers are reluctant to become involved in the succession planning process;
3. Many plans are incomplete or fail;
4. Conventional wisdom is that scale is a prerequisite to succession but the studies show that scale is built to enable succession;
5. Only 22% of the minor study families achieved the three main aims;
6. Only 11% of the minor study families achieved the three main aims and an equal assett split.

DISCUSSION

First it is useful to examine some important contrasts of continuing and non-continuing businesses within the case study series:

Control of the Board and Shareholder engagement: The case studies highlight the importance of keeping control of the Board and ensuring shareholders are engaged. Two families, in the farming business since the 1800's, employed people from outside the family at a senior level. The Beta family relied heavily on external advice and consequently lost control of the Board, the family became disenchanted and the business was sold. In contrast, the Pi family kept control of the Board, and ensured family members had a keen interest in the business. The Pi family business is thriving.

Team work & involving the next generation: The case studies serve to highlight the importance of working together as a family unit to grow the business, and involving the next generation early on to ensure smooth succession. The Iota family business started as a small business and now supports eight people including four members of the founding family. In contrast, the Zeta business started as a large business, but has shrunk and is now requires off farm income to rebuild infrastructure and support the family. The principle in the Zeta family was autocratic in his leadership style, and the next generation were chased away.

Agreement on the end game: In succession, it is important that all family members agree on the end game, and are happy with the outcomes of succession. Contrast two sets of brothers who farmed together from an early age and their approach to succession. The Epsilon brothers used their combined talents so the inevitable split would be orderly and advantageous to all. ‘It took about an hour to agree’ and each member of the family got what they wanted. In contrast, the Delta brothers took twenty years of argument to eventually agree to appoint a liquidator to sell and distribute the assets. The family lost about 40% of its wealth in the split, and no one got what they wanted.

With the stated aims for each family identified previously, the case studies have helped to debunk some common truisms within the industry. Some of these include:

- **Get big or get out** – could be replaced with ‘get efficient or get out’. The Sigma and Tau family studies identified that an undercapitalised small business will not become more inefficient simply by increasing scale before it has achieved efficient use of capital. Similarly the Iota and Lambda family studies showed that the efficient use of capital can fuel expansion.
- **You cannot fund retirement, pass on a viable farm and treat your children equally (the three aims)** – as identified in the case studies of the Mu, Upsilon, and Epsilon families, the three aims of the family can be achieved by: starting at an early age to build the business; handing over to the next generation early; encouraging family members to earn off farm income; and using all the relevant skills and talents of family members to achieve agreed goals.
- **Keep the family capital in a block** - The Theta study shows that whilst maintaining the capital in a block may give growth if the family grows (in number) faster than the capital grows (in value in real terms), eventually the asset will have to be sold or some of the shareholders bought out.
- **Maintain 80% equity** – As was demonstrated with the Mu family study, 80% equity is an indication of ‘lazy capital’. The equity has mostly been between 60% and 70%, and an average return on capital of 14% per year has been achieved over the last 20 years.

Case study participant survey

At the conclusion of the project, all 16 major case study participants were asked to complete a survey which highlighted how their participation in the studies changed their understanding and knowledge of succession planning.

Sixty four percent of respondents noted that their understanding of succession planning had changed since taking part in the case study series. Some of the details on how their understanding has changed are included below:

- *Act earlier rather than later, involve everyone where possible.*
- *There is no 1 template to follow, it must be worked through for each family and they will be different.*
- *Share the decision making early.*
- *Don't leave out the 'daughter in law'.*
- *There are a number of influential external issues that constrain the boxes above, i.e. drought, debt, management style, etc.*
- *I think all of the above have relevance in succession planning procedures.*
- *Leadership from a family member that oversights and owns the process and takes responsibility for its progress.*

Figure 2 (below) highlights the attributes, attitudes and skills that have enabled some businesses to continue and present a successful succession plan.

Figure 2: Attributes, attitudes and skills enabling succession

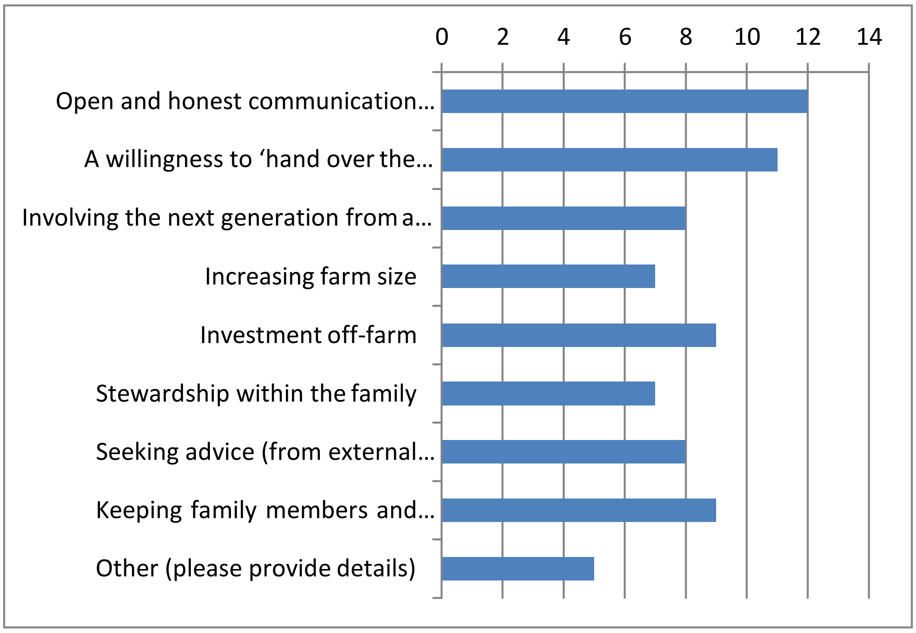
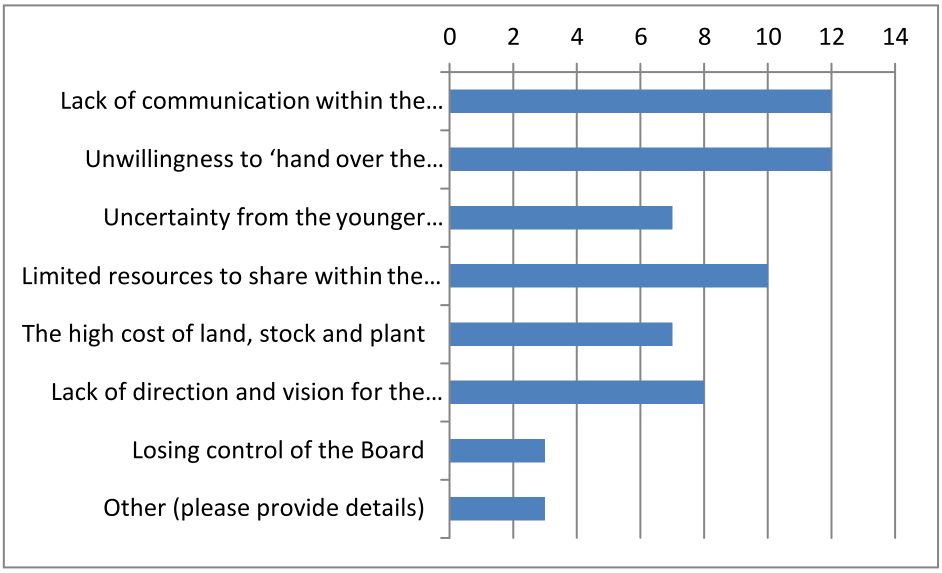


Figure 3 (below) highlights the major road blocks to succession as ranked by the 16 participating case study businesses. In addition to these, the following suggestions were also made:

- *Lack of leadership from senior generation – what do the parents need?*
- *Inward looking management. Some of the worst cases we see are farming families that don't understand the wider context. Stick to long cherished views without the ability to challenge and change.*
- *Personal relationships within the family. Not all families can get on or trust each other.*

Figure 3: Major road blocks to succession - participants



Comments from participants include:

- *The information in the case studies can be used, not only in farm succession planning, but in dealing with setting up inheritances within non-farming families.*
- *We shared the findings with our clients through a written newsletter to 2,300 people. We had significant feedback on the usefulness of the information. For families that are 'stuck' this can be quite confronting.*
- *Our involvement in this case study allowed our family to review the past, plan for the future, and find a way to implement the plan, which looks like been in a successful way.*

The following described changes to the succession plans since their involvement in the case study series:

- *Starting succession conversations earlier. We have also restructured the Trust structure to better facilitate the next generation.*
- *Asset and ownership of property has changed.*
- *Clearer about the steps, e.g. removing one member of the family from the trading company. Separation of the issues of the trading company (livestock and plant and equipment) versus the ownership of land. Schedule of steps clear.*

Case study audience survey

The following includes some key messages that the survey participants learned from the case study series and/or attending webinars presented by the author.

- *Not always fair, must keep pushing hard*
- *Every succession plan is different and they be changed - they are not set in concrete.*
- *Start early. Being fair might not mean being equal*
- *Involve all key stakeholders in the decision making*
- *Input is required from a variety of professionals.*
- *Invest off-farm, have shareholder agreements with buy-sell agreements, fair is not necessarily equitable if everyone is happy.*
- *Plan early*
- *Start churning ideas to match our needs*
- *A caveat on seeking advice - the key is finding an advisor that can work with the personalities in the business and listen rather than tell.*
- *Possibly invest off farm.*

In figure 4 is shown what respondents believe are the attributes, attitudes and skills that have enabled some businesses to continue and present a successful plan. Other attributes, attitudes and skills that were mentioned are also included below:

Figure 4: Attributes, attitudes and skills that have enabled some businesses to continue and present a successful plan

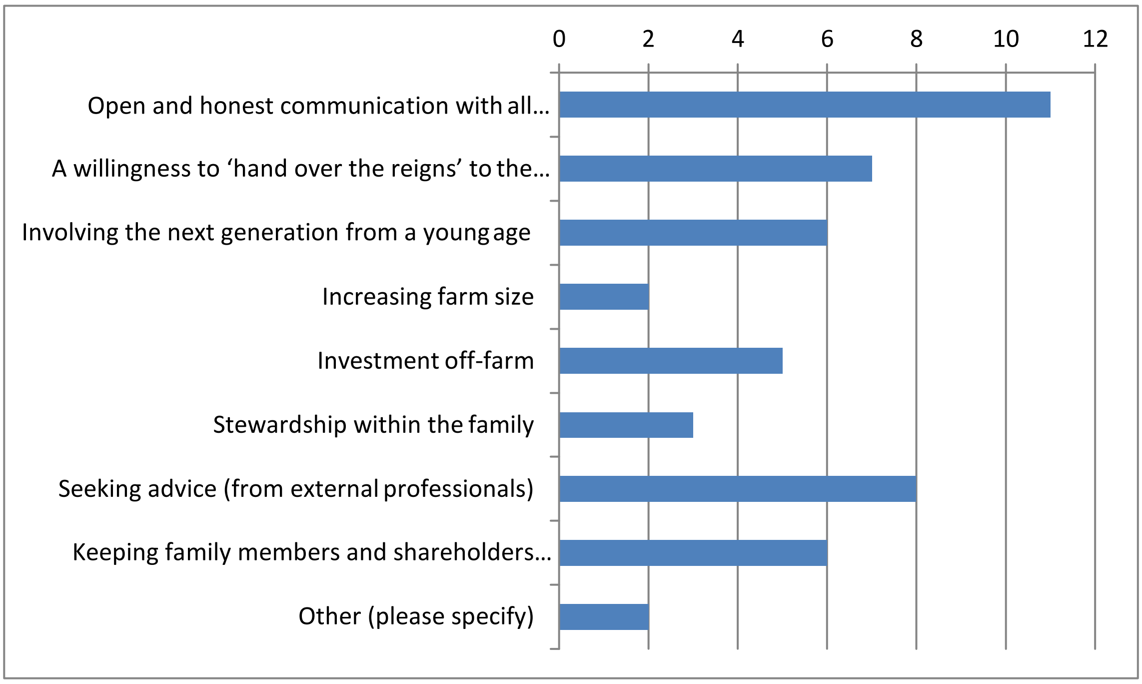
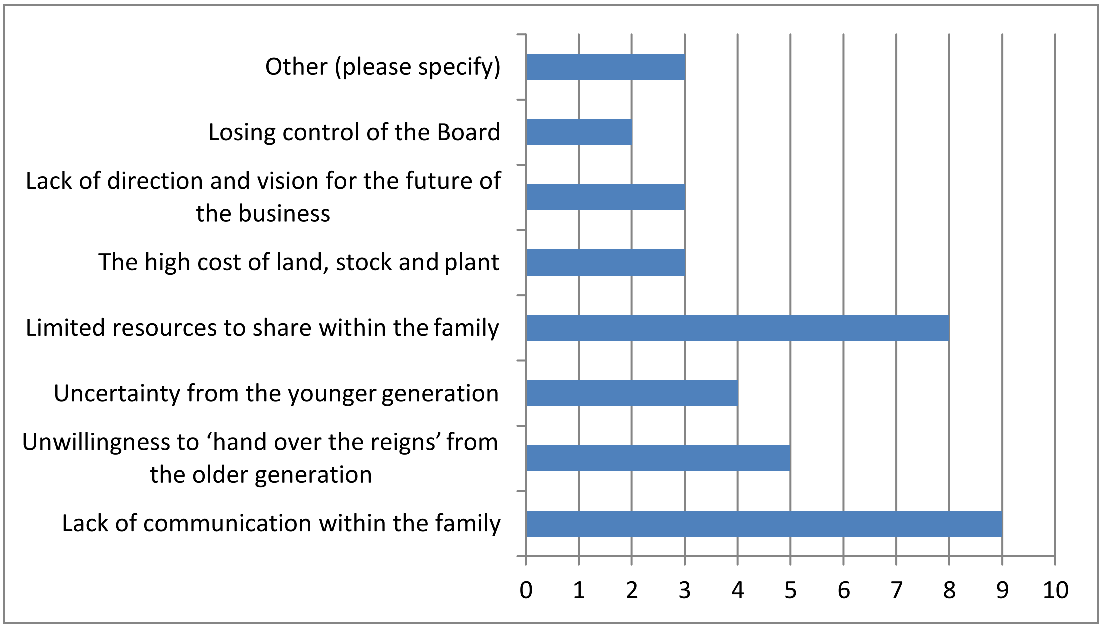


Figure 5 is a graph of what respondents believe are the major road blocks to succession. Other road blocks that were mentioned by participants include:

- *Fair does not mean equal!*
- *Family politics, distribution of assets in wills to numerous siblings and uncertainty around their intentions (i.e. communication).*
- *The unknown of the swags future.*

Figure 5: Major road blocks to succession webinar- audience



Since reading the case study series and / or joining one or more of the webinars, the 61% of respondents have changed their approach to succession

The following describes the changes participants have made in their approach succession planning:

- *Broad advice, open dialogue and communication, take time, look forward, consider non binary options.*
- *have not yet approached it*
- *The need to engage all parties early in the discussion. Open communication.*
- *Getting in expert help earlier in the process.*
- *Mainly more determined to progress succession planning. Proposing to family use of a facilitator. More involvement and respect for views of upcoming generation.*
- *My thoughts have cleared somewhat.*
- *Given higher priority.*
- *Asked them to watch the webinar and think about what has to be done.*

CONCLUSIONS

Inferences and insights from the data relative to previous research:

The pre case study work confirmed that most farmers do not have a succession plan and most broadacre farm businesses do not have sufficient scale for succession of a viable business to be a reality. The case studies contrasted the attributes of the successful (continuing) businesses with those of the businesses which are not continuing or are no longer viable. The case studies and the subsequent minor case studies clarified some ‘conventional wisdom’ including the notion that scale is necessary for succession. The case studies showed that the aim of succession drove the determination to build scale. The end of study surveys with case study and webinars confirmed that the majority had paid insufficient attention to succession planning. They also confirmed the need to start building the business and planning early.

Practical implications for industry:

The first practical implication for industry is that building a business to have the scale to enable succession is a long process which takes considerable time, effort, skill, dedication, energy and commitment from all family members involved.

The second is that although it may be too early to plan succession for unborn or very young children, it is never too early to build the business to allow succession planning.

Other practical applications include using a team of professions to assist with succession, involving the whole family with the process and accepting that there will be hurdles or obstructions which create difficulties in turning the plan into action.

Unanswered questions and recommendations:

The recommendations fall into the province of (the Australian) Government rather than industry.

These include:

- Increasing the financial literacy of farmers by increasing the Farm Management Accounting literacy of accountants. This has been attempted before in Australia and other countries with varying success
- Lifting the turnover and net asset limits for Small Business CGT Concessions.
- Allowing Farm Management Deposits (FMD's) to be held by Trusts and Companies.
- Allowing family members working off farm to direct their salary through the farm accounts and into FMD's provided the money was used as part of a succession plan.
- Developing a register of Succession Planning Accredited professionals.
- Providing tax incentives for farmers to use Accredited Succession Planning professionals.

Future R&D:

Future R & D to increase the number of farmers who build their business to plan for succession and develop a succession plan could investigate sociological aspects of the family in business and generational interaction. In cases where there is no successor, investigations could be centred on the relative importance of family relationships, the image of farming, the social isolation, and the capital constraints.

At the extension end of the R D and E continuum initiatives could include:

- Enhancing the financial literacy of farmers:
  - One approach is to enhance the understanding of the requirements of Farm Management Accounting. Many accountants provide taxation accounts which are useless in supporting farm management decision making. In most cases with minor additions, new calculations at a slight increase in fees tax accounts could become useful.
  - A second approach is to deliver the Young Farmer Business Boot Camps, which have been very successful in Victoria, across all States.
- Understanding the blockages which inhibit farm business growth.
- Understanding the blockages to farm succession which include:
  - The scale of the business;

        - Many are too small.
    - The belief by the business owners that succession of a viable business is possible.
    - The lack of a successor:
        - In some cases the next generation has no interest in farming.
        - In other cases the possible successor or successors have left the farm because of difficult personal relationships or an unsatisfactory employment relationship while they were on farm.
    - The desire of the business owner:
        - Some people see the farm as their superannuation to be sold to provide funds for retirement.
    - The threat of legal action.
    - The threat of legal action is very real in some families but the structures which need to be put in place to mitigate against it are often complicated and expensive.

Some areas of government policy, if changed, could assist farmers in building their businesses. These include:

1. Accept that high quality analysis and advice about farm succession decisions is in short supply and:
    - Develop a register of succession professionals (as with Whole Farm Planning);
    - Appoint part time succession expert Rural Financial Councillors;
    - Provide a better than 1 for 1 tax incentive for approved plans;
        - For the plan to be approved the farmer would need to meet agreed criteria.
    - Encourage accountants to become literate in farm management accounting
2. Remove the restrictions on FMD’s to allow family companies to hold them and;
    - Further lift the individual limit of FMD’s;
    - Allow off farm income, used in succession to be included as part of the farm income.
3. Support programs which improve financial literacy including:

- Programs which encourage accountants to provide farm management accounts
- Programs such as the Young Farmer Finance Boot Camp.

4. Actively support community debate around the meanings of fair, equal and equitable.

NOTE: Foreign/sovereign/domestic fund investment is a two edged sword in relation to succession and any policies which interfere with/control the free market will have negative consequences for some family farmers and positive consequences for others.

Key Messages

In order to increase the percentage of properties which remain in the ownership of a family for several generations farmers will need to:

- Believe that succession is possible.
- Have a successor.
- Work with the family to build the business to enable succession.
- Develop a succession planning team
- Develop a succession plan.
- Be prepared to adapt and modify the plan.

The likely social benefits will be derived from family members having certainty about the future. The likely economic benefits include arresting asset decline which occurs during a rundown phase in a farm where no succession is planned.

While many families and professional who advise them will declare that the farm is a business and decisions need to be made from a business perspective in reality there will be compromises where family issues and individual needs and objectives take precedence over business objectives. This phenomenon is not peculiar to farming businesses. The same issues arise in non-farming family businesses around the world.

The model below (Figure 6) which places family vision and values at the core is an attempt to depict the issues which require attention.

Figure 6: Major road blocks to succession webinar- audience