KELLOGG
Rural Leadership
PROGRAMME

‘What Should Wal Footrot Do?’

An investigation into ‘Potential’ exit strategies for owners in the Sheep and Beef Sector

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Kellogg Rural Leadership Programme

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PROGRAMME PARTNERS

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- The Strategic Partners and Programme Partners of the Kellogg programme.
- My wife Heidi and the family. Cheers for the time on the Phases of the programme away from home and the time when I have been staring at the laptop in the last month.

Many books are recommended to someone who goes through this process and two have stood out. They may not have had a direct effect on the project, but they certainly did influence the personal development journey. They are;
Rebecca Macfie Tragedy at Pike River Mine – How and why 29 men died.
James Kerr Legacy - What can the All Blacks teach us about the business of life.

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TABLE OF CONTENTS

1. EXECUTIVE SUMMARY

- The purpose of this study is to look at what options exist for owners of farm businesses in the sheep/beef sector to 'exit' either; their role or ownership in the business. This is not an investigation into the overall succession topic, more a look at one of the key parts of the process.

- Where are we today
  The ownership base of the farming businesses in the New Zealand Red Meat sector are getting older. They say with age comes experience, but in this case, it is not a good thing.
  As the owners get older that are not planning any better, and making it harder for the next generation to get a step on the management and ownership rungs of the ladder.
  At the same time, we are seeing only small improvements in profits when compared to value of the land that those profits are generated from.

- Navigation is not easy
  The family business is complicated, especially as it gets larger and intergenerational. This does not include the increasing pressure that gets applied for the cost of compliance and larger variations in climate.
  Every business owner is in a different position, but they are getting older and need to act to drive our industry forward.

- It is possible
  Families and owners have navigated, and are navigating their ways through this exit and succession road. It can be done, there are options. Everyone is different and often big decisions must be made.

- The options exist, whether it be:
  Change the existing model, or
  Lease out, or
  Sell or
  Equity partnerships.
  There are options that are all better than Status Quo. Follow the suggestions and take some advice.

- There are people to help – it may cost, but what is the cost of doing nothing? Use the family, friends, mentors, professionals like valuers, advisors, lawyers and accountants to help by discussing the issues and determining the best way forward.

- Use a 'Mantra' or guidelines to assist in the journey.
  OODA may be suit - Observe, Orient, Decide, Act.
  Or the 3 questions - 1. Where are you and how did you get here?
  2. Where are you heading, do you want to go there?
  If not, then where?
  3. What must you do different or better and learn,
  to get there?

2. INTRODUCTION – THE WHY

- **An Ageing Industry**

Farmers are an ageing demographic

PAT DEAVOLL
Last updated 16:19, August 31 2015

www.stuff.co.nz/business/farming/agribusiness/71539606/Farmers-are-an-ageing-demographic

There has been plenty written and talked about in the New Zealand Red Meat sector over the years, and this article published by Pat Deavoll from Stuff has summed it up nicely. According to Statistics New Zealand the average age of a New Zealand Sheep and Beef farmer has lifted from 53.5 years in 2006 to 56 years in 2013. We have a workforce and farm ownership age that is on the increase and, as this age increases, the pressure increases to consider what is there for the next generation.

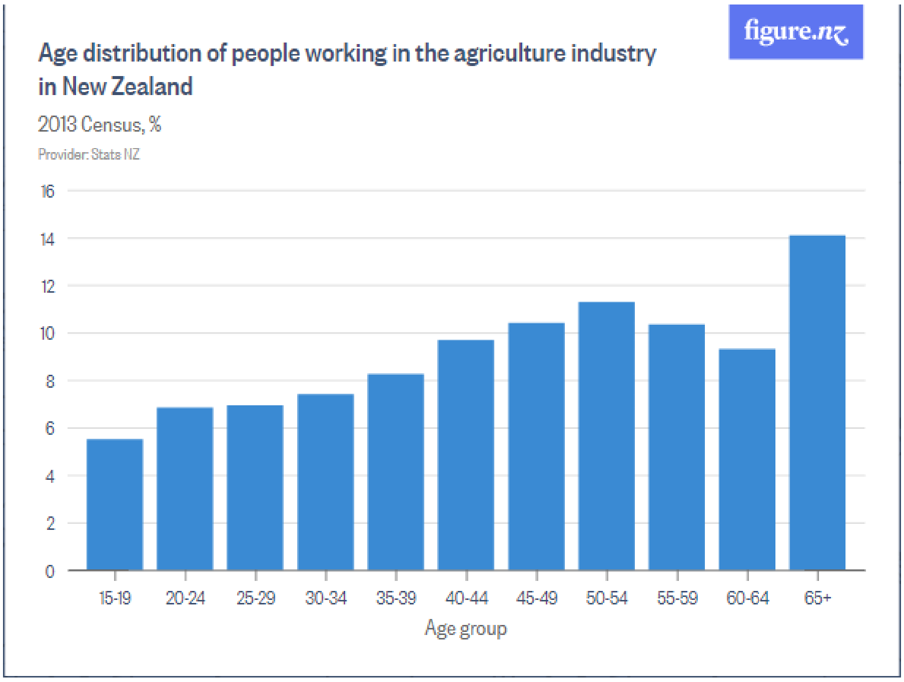


Figure 1: Age of people working in the agriculturesector
www.figure.nz

As part of the Beef + Lamb Economic Service an annual farm survey is carried out to measure sheep and beef farm performance and profitability. This surveyed group is a cross section of red meat farmers across the sector and significant effort is put in to ensure it is an ‘across the board’ group. Over time the average age of the surveyed farmers is getting older.

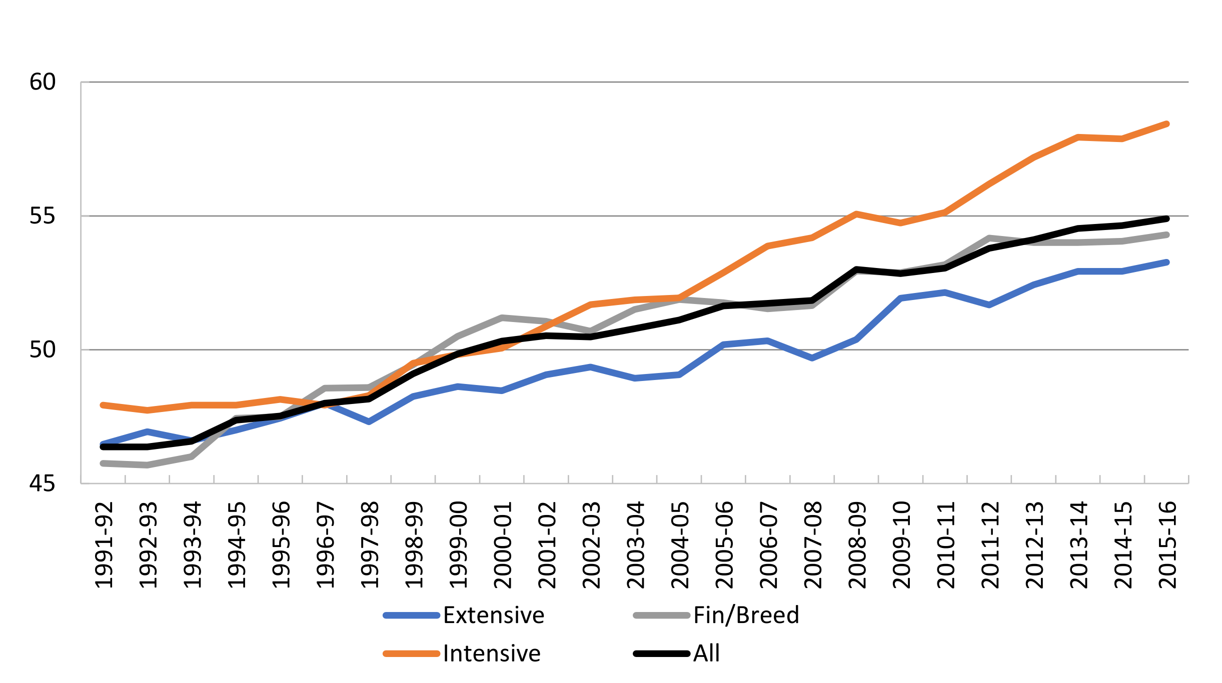


Figure 2: Age of farmers in the Beef + Lamb Economic Service Survey

- **Age + Lack of Planning / Confusion = Poor Outcomes**

At the same time as the average age is increasing there is also a potential retirement issue in the industry. An important piece of research was carried out in 2013, based on a survey of over 800 farmers. Old and Nuthall (2013) from Lincoln University found that while some farmers were working on succession planning a considerable number – 46.3% - had indicated that they did not intend to leave their farm before retirement.

Intention	%
Sell up and invest off farm	12.3
Sell up and purchase another farm	3.0
Sell up and gift some or all to heirs	6.5
Pass farm to heirs	31.9
Do not expect to leave farm	46.3

Figure 3: Farmers’ Intentions (if leaving the farm before retirement)

There has also be recent research completed by the Red Meat Profit Partnership in December 2015. RMPP is a Primary Growth Partnership programme that is working to help the red meat sector increase productivity and profitability. Funded by industry and The Ministry for Primary Industries, they have carried out research in 2014 to understand barriers to and motivations for on-farm practice change, and what channels would assist this change.

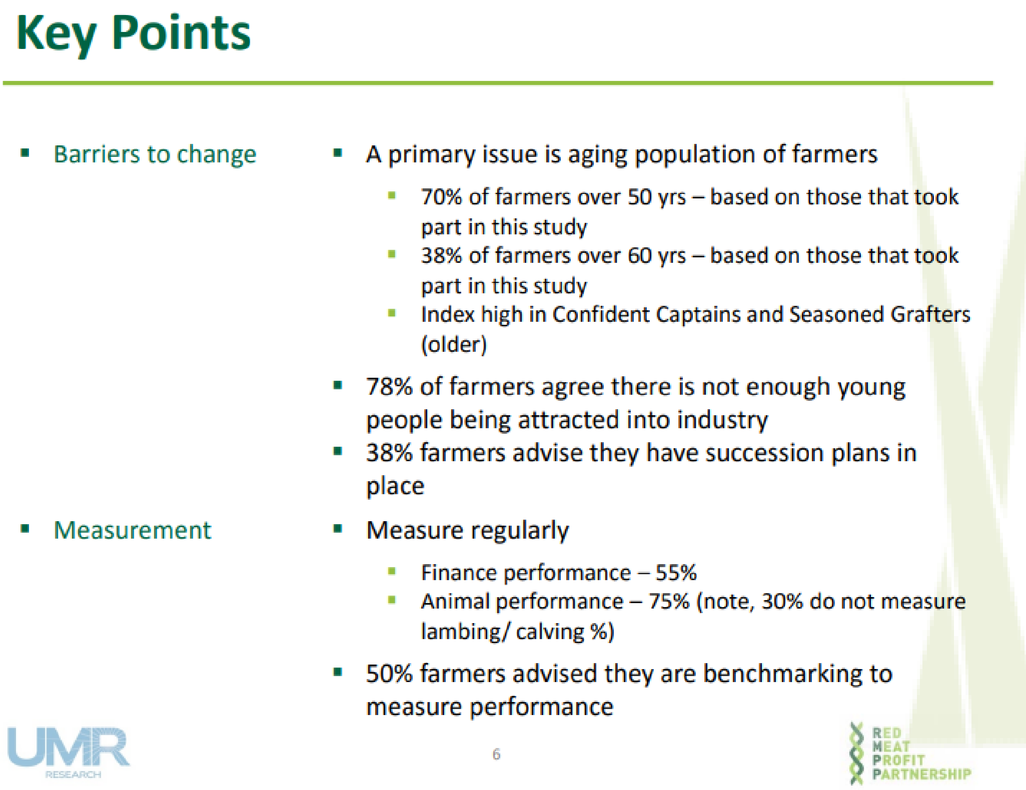


Figure 4: Key Points from the RMPP Research December 2015

- **Profitability**

The typical sheep and beef farm has been battling a profitability challenge since the late 1980's which has meant that, for the average farm business, the return on investment and profitability has reduced options for growth, succession and progress. One of the key factors in a successful exit or succession process is having a business that is profitable and has a healthy balance sheet that allows for options.

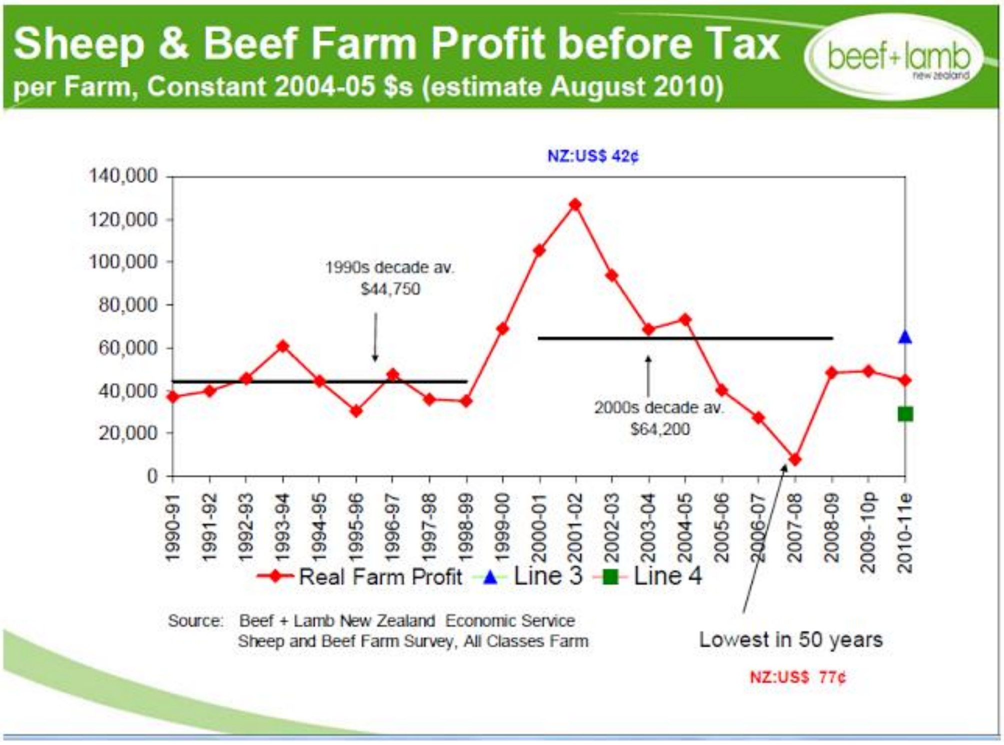


Figure 5: Beef + Lamb Economic Survey 2011/12

From 1990/91 to 2010/11 the average Farm Profit before tax was just over $50,000 per farm business. In the last decade this profitability has increased; $109,955 in 2014/15 and $86,600 in 2015/16. This still only equates to returns on investments below 5% of the asset base.

All the succession literature talks about the importance of a having profitable business to enable the planning process to begin. The average farm profit before tax of $50,000 to pay tax and principle does not leave much for growth and options for the future.

- **What else is being done and What is 'Exit'**

There is limited existing support, however there is progress with the recent inception of RMPP toward providing the sector to lift this profitability.

However, one key thing that could assist the overall industry is giving the next generation the ability to get 'into' a farm.

But how do these farms become available? By managing a comfortable transition or exit for the current owner these farms can become available.

Exit is defined as 'a way out of…' or 'an act of leaving a place' (Dictionary.com, 2017). This sounds very final when it comes to the farm business, but it also could be an exit from the management or ownership role whilst still be involved physically or financially.

- **The Family Business is Complicated**

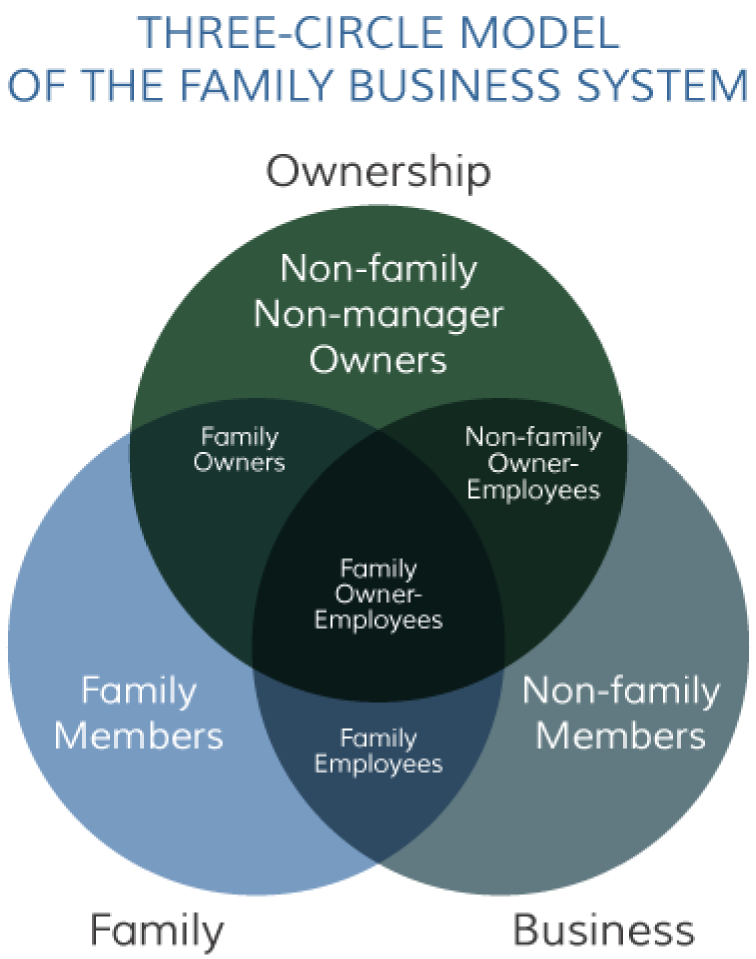


Figure 6: Taguiri and Davis – Family Business System - Allen P 2015

Family businesses are complicated structures with several players that wear different hats and at times multiple hats. This diagram by Taguiri and Davis (1992) shows this complication in a simple diagram. Right in the centre are the Family Owner - Employees who are the key to the whole business. They wear the most hats and have most of the control.

It is possible for a Family Owner - Employee to step out or exit out of the centre to the outside, i.e. still be an owner but not an employee.

3. METHODOLOGY OF THE RESEARCH

There are farm business owners who have managed to carry out a succession or exit plan successfully. There are also some that have had issues and not been so successful, and there are some in the middle of the process. The object of the research was to find out and answer several questions including;

what has worked?
what has not worked?
what else are we not thinking about?
and who do we need to listen to?

A series of confidential interviews and discussions (approximately 50) have been carried out with farm business owners in the Manawatu/Wanganui region. Some of these discussions were part of the typical day of an Agribusiness Consultant and other focused interviews.

This combined information is included in the next section of this report. It is included in the stories of our heroes which summarises the research and what has worked and not worked in the industry.

This is put into three examples of farm business that have gone through some of the 'exit' stages already from either ownership and/or management. These three examples will be our heroes and whilst they do not reflect any single experience, they are a combination of findings and examples.

Our Heroes;

1. Wal Footrot and Cheeky Hobson
2. Cooch Windgrass
3. The Murphy Family

It is not only the owner/manager of the farm business that is involved in this process but also the extended family, business advisors and professionals too. Interviews have been carried out to add their side of the story and offer something to our heroes as words of advice.

Reading and research into previous Kellogg projects and industry research also formed part on the information for this project. This research included;

Passing the Baton – ANZ 2012
RMPP Research Summary Overview – 2015
Effective Family Succession Planning and Governance – Dylan Barrett Kellogg 2016
Farming Families and Succession – Mark Stevenson Kellogg
Your Last Fencepost – Joan Baker 2008

4. OUR HEROES

1. Wal Footrot and Cheeky Hobson

'Pass the Ball – Leaders Create Leaders' (Legacy, James Kerr 2013)

Update on their story
Wal and Cheeky's relationship has continued, they are now married with grown up children, that have moved off farm. Cheeky is back working part time back at the Raupo Salon she owned a share in. Her interest in the farm had only increased slightly.

Wal and Cheeky have continued farming sheep, cattle and deer. The business has successful grown over the years, generated some profits and repaid debt. Cheeky's off farm income has assisted the business growth.

Wal had taken some advice years ago to farm as a company with two shareholders in the company – him and Cheeky, this took over from the sole trader that he ran before Wal and Cheeky got married.

Wal has been coaching rugby at the local rugby club and some rep rugby for the local union which has given him some time off the farm each week

The recent changes in environment policy and health & safety legislation and along with the realisation that Wal is not keeping up with technology changes is bothering him. In the last few years Wal had lost his energy and come to the realisation he isn't invincible.

Realisation Moment
A few years ago Wal was out the back on Windy Ridge and after saving a cast ewe in a swamp he had an epiphany. He could hardly get back on the motorbike, his back was no good and his knee was worse. It took him a few hours to get back to the woolshed on the bike and he was thinking 'my days as farming the hills of the Raupo are done'. He needed to do something about this.

Learning Process
After spending a few months thinking about this he finally got the courage to talk to Cheeky about what he was thinking. She was worried about Wal but struggled to talk to him about it. She told him about this bloke that comes into her hairdressing salon, some townie that helps farm business and families in navigating their way through the issues that they had.
Wal told Cheeky to get this bloke to give them a ring, and this started a series of events and decisions that Wal and Cheeky have never looked back on.

Family Discussions

After Wal and Cheeky spent some time thinking about what they wanted, they spent some time talking this over with their kids. What resulted was a list of goals that they all agreed on;

- Everyone felt some attachment to the farm and wanted to keep it in the family, but Wal can't stay in a day to day management position forever.
- Wal had something to offer to pass on to the next generation about farming.
- Wal and Cheeky wanted to spend some time off farm, and Wal wanted to see the All Blacks live in England within 2 years.
- There was work needed on wills and memorandum of wishes to get these right and aligned to business structures.
- Leasing the farm out was a good option for all.

Rangi and Pongo

Remember these young guys, well they are a bit older now. Married with a few smaller Rangi's and Pongo's running around. They had been up in Gisborne for several years where Rangi had been managing a large station. Pongo wanted to get their family back closer to her family down near Raupo. They met up with Wal and Cheeky during a school holiday and shared their thoughts about what they wanted. This conversation crystallised the thinking of Wal and Cheeky, but they knew they needed to get this right.

Leasing Process

Wal and Cheeky employed a rural professional to advise them on what to do next. This advisor went over the recent succession planning that took place and agreed that a lease to Rangi and Pongo would be an ideal option to all. The terms and conditions of the lease were agreed after some meetings. The price of lease was independently assessed to ensure this was fair to all and in line with the market.

Wal and Cheeky engaged their lawyer to draw up a lease agreement which included all the relevant information" Right of renewal, key dates, fertiliser, soil testing, capital and maintenance of improvements were all included. An ongoing reporting requirement by a third party included in the lease.

They looked at an Equity Partnership, but questions arose about whether the goals aligned, and it was too soon in the business relationship to commit to this.

Wal and Cheeky were able to borrow against the farm asset and purchase a lifestyle block closer to town. Cheeky had kept her ownership in the Salon. They put both assets in a Trust as a separate entity for the family succession process. They shifted off farm, which was a significant move for Wal, but he was able to come back to the farm to help and show Rangi he was still handy with a handpiece.

Capital Works

During the first term of the lease Rangi and Pongo wanted to extend the deer fencing and they had done some investigation into the costs. They sat down with Wal and they came up with a plan. It was agreed that Wal and Cheeky would supply all the materials and Rangi and Pongo would install the fences. Wal wanted to make sure it was done to his standard, so he helped on some of the work.

Other Documentation

Wal and Cheeky were asked about their wills by advisors during the lease process and they noted that one of the Trustees of their estate had passed away since this was set up. The other Trustee Cooch Windgrass had no idea of the lease process that they were going though, so they met with him and explained it all to him. Wal and Cheeky also shared this with their children.

Key Learnings from Wal and Cheeky regarding the process

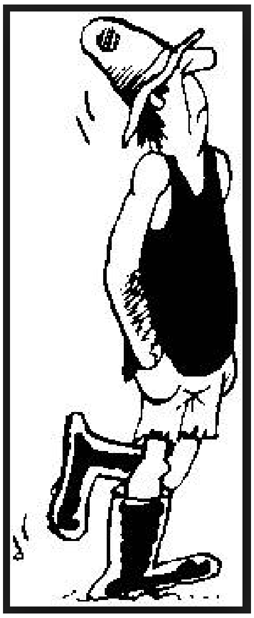
- Important to assess the situation and look at the options.
- Use advisors from outside the business and family to assist with the process. Take on the feedback.
- Communicate with everybody involved, family, trustees etc. Share goals and wishes, have them recorded.
- Time is critical, don’t do anything too fast, but stick to some time frames
- Spend some time off farm and talk to others. Both Wal and Cheeky did this. It wasn’t just about the farm.
- Wal sums this up with the talking about the OODA loop which he learnt from reading the Legacy book by James Kerr (2013).

  Observe
  Orient
  Decide
  Act

  It doesn’t matter whether it is a decision to drench sheep or lease the farm out; this decision cycle is very useful.

2. Socrates 'Cooch' Windgrass

'Vision without action is a dream. Action without vision is a nightmare' (Legacy, James Kerr 2013)



Update on what Cooch has been up to

Cooch has gone through a similar age issue to Wal and Cheeky. The farm was ticking over well, he had won some environmental awards in the past for his river protection and planting work. He had some grand plans for the farm and ongoing environmental work.

He was realising that he could not carry on forever and that his beloved wool was not worth the effort anymore. He had a fantastic line of Romney ewes that were well known for their high-quality wool (and getting over the fence into Wal's!), but recent drops in wool prices were making things tough.

Long term thinking was something that he had never put much thought into and he had spent no time planning, thinking or talking to anyone about what he would do. When asked about this Cooch would always say it was too hard, he had no kids, some extended family that maybe keen to farm, but no real idea. There was no regular interaction with the bank manager or accountant, and the last time he used a lawyer was years ago.

He ran his business as a Sole Trader that leased the farm off his Trust. This structure was recommended by his accountant, but he wasn't too sure about what this structure meant. There was an old family loan owed by the Sole Trader to his Dad's estate when he bought the farm off his parents year ago.

Wal and Cheeky had informed him about their change with Rangi and Pongo's lease and his role as a trustee. He was approached by a friend of a friend who was keen to lease the farm from Cooch, and Cooch's first thought was – 'great, this will work'.

Lease Process

They had a look around the farm a few times and this guy had told Cooch he had leased blocks in the past and he knew what he was doing. Cooch had dealt with him in the past, he drove tractors for Cooch's cropping contractor a few years back and he did a respectable job then so had some confidence in him.

Cooch wanted to keep a bit of land for himself and the house, so he could stay on the farm and keep an eye on things, plus still run a few cattle.

The Leasee presented Cooch with a lease agreement that had come from the Lessee's lawyer; 4-year term plus right of renewal and right of purchase. Cooch was not happy about the right to purchase and crossed this out when they signed his copy. They had verbally agreed that the Leasee would buy Cooch's MA ewe flock and that if the lease was not renewed in the future Cooch would buy the flock back.

A Few Issues

After a few years things started to go downhill in the relationship with the Leasee.

Bulls Cooch and the leasee talked about no bulls to be run (apart from mating bulls), but in the second year of the lease Friesian bulls turned up. Cooch mentioned it and was told ‘they are only here for a short time’. Well they were gone and more came. Cooch was not happy, so he looked over the lease agreement and there was no mention of bulls in the agreement.

MA Ewes After a couple of years Cooch noticed something different about the ewes that he had sold to the leasee. He realised that the hoggets and 2ths coming into the flock were cross bred with composite rams. The leasee was not as passionate about the Romney breed as Cooch was.

Stock Health and management

Things were not being run well on the lease block. At times Cooch had to shift stock to make sure they were being fed and the leasee was slow at picking up dead stock. Then Cooch found out that the leasee was putting drench capsules into all the sheep as a blanket treatment.

Fertiliser The leasee had been putting fertiliser on every year. Cooch was happy that he was doing this, but then he found out that the fertiliser was mostly lime with some fertiliser and trace elements. There was very little phosphate and sulphur being applied. When Cooch approach the leasee he produced a plan from a fertiliser company that stated this was all the farm required as an ‘annual fertiliser dressing’. When he checked over the lease agreement it stated, ‘the leasee was required to apply an annual dressing of fertiliser to the farm’.

Fencing The standard of the fencing on the farm was never ideal with Cooch. He was known around the district for his ‘baler twine’ solutions and things had got worse. At least the farm was stock proof before, but now it was almost unmanageable. There wass no maintenance being carried out and the farm requires a capital programme to bring the fencing up to standard.

Trees There had been severe damage to his trees by the lessees’ stock.

Health and Safety

Cooch had not considered this when the lease was set up but there have been a few issues including near misses and accidents.
Cooch had a visit from Workplace safety recently.

Family Loan

In the third year of the lease Cooch’s brother had got into some financial trouble and their mother wanted to bail him out. She told Cooch he had to help. The loan Cooch had had with his father’s estate was always a verbal agreement. It would disappear when his mother passed away, but now he had to pay some back to help his brother out. The only option Cooch had was to approach the bank and borrow the money from them.

Decision to Sell
Between the issues with the lease and the new bank loan Cooch decided enough was enough. He was not going to be able to achieve his vision for the farm and work was required to get the farm back to where it was prior to the lease. He had looked at some smaller blocks on the market and was keen on one.
He approached a couple of local real estate agents about selling his home farm. The local rumours got around, and the next thing Cooch got a letter from the lessee's lawyer regarding a potential sale and his right to purchase. Cooch was forced to seek his own legal advice and he found out he was in his rights to advertise the property and would just have a settlement date for the conclusion of the first lease term.
Things got a bit out of hand for a while. The leasee stated that he wanted to enforce his right of renewal and investigate a right of purchase. After many meetings between lawyer's things were settled;

The leasee had no right of purchase because it was not agreed to
He had no right or lease renewal. It was Cooch's right to renew, not the lessees.

This complete process had taken almost the last year of the lease to settle and in the meantime the farm had got even worse, and Cooch had spent thousands on legal bills.

Sale Process
At the conclusion to the lease Cooch bought the now composite ewes back off the leasee and farmed the entire property again for a year to tidy things up and sell the farm. He was able to purchase a block close to town to retire. This block had a short take over date. Things moved fast.
Cooch choose one of the agents to market the farm, but he never wanted his neighbours the Murphy's to own it in his lifetime, so it went up for Tender and sold to another farmer in the district who bought their third farm.
Did it sell for its potential value? We will never know, but it was not the way Cooch wanted to end his farming career.

Key Learnings from Cooch regarding the process
- Spend some time off farm, (not in an operational role) to think about the options, talk to neighbours, family and independent people about what he could do.
- Have a list of goals or bucket list of items written down to use as a guide and driver of decision making.
- Find out what the family think. When it comes to family agreements get them documented and have everybody aware of them.

- Get your own employed third party to draw up the Lease Agreement and make sure it covers all aspects of the lease, including the stock sale and purchase. Recommend a lawyer does the lease and get someone who knows about fertiliser and stock to check those clauses.

- He thought staying on farm to keep an eye on things was a clever idea, but in hindsight he didn't know what he was doing overseeing the lease and it only caused problems.
- Outline the difference between capital and maintenance work in the lease.

- When it comes to selling, time is your friend, not your enemy. Again, take the advice of the agents and advisors.
- Off farm financial investments and time is very important and gives options and time to think.

3. The Murphy Family

'Society grows great when old men plant trees whose shade they will never see' (Legacy James Kerr 2013)

<u>Family Structure</u>
The Murphy's had a structure that is common in the rural sector and was the way things had been done for years. What did this common structure look like;

Mum and Dad – owners and employers
Children – employees
No contracts or job descriptions, and the children paid below the industry wage with one day the hope to inherit the asset.

They managed to go through a process to change this and set up an intergenerational business, but this did happen too late in some people eyes.

<u>How it was</u>
Stewart 'Irish' Murphy is the father. He still held the 'cheque book', he was the only one that was in the centre of the Taguiri and Davis' family business model (section 3). He took drawings out of the partnership he had with his wife. The boys got paid a wage that was under the market rate, but that suited Irish – he wanted the boys to do exactly what he wanted. He had continued to grow the farming business by buying more land and taking on more debt.
Elvis 'Spit' Murphy, Irish's oldest son, managed to make it all the way through school and once he left school spent some time in the helicopter industry. He returned to the family farm shortly after gaining his commercial helicopter pilot's licence. He had plenty of ideas about how the farm could be run better and got frustrated about the way his father was holding him back. The only thing he had managed to achieve is get a loan through the farm to buy a helicopter and did some contracting applying fertiliser, spraying and hunting with the machine. He did hill country cropping for some of the neighbours, but nothing at home. Irish thought hill country cropping was not for his farm.
Ronald 'Hunk' Murphy, the youngest son, left school at an early age and had worked for Irish ever since. Like Spit, he was frustrated by Irish and felt he was being held back. He wanted to work smarter and better for the farm. He had wondered about how much debt there was and what position the business was in. he would always ask Spit, 'is that helicopter paying its way?'
The boys worked very long hours for what they felt was poor wages. They wanted to farm the farms for the rest of their lives, but do things better than Dad. They were both involved with a local discussion groups, read things and had plenty of ideas, but Irish said their latest ideas either wouldn't work, or they couldn't afford them. Family social get togethers are not events that the family always looked forward to.

Growth the old-fashioned way

Irish Murphy had continued to do business the way he always done, and it had worked in the past, so why change it he thought. Hard work, more work and debt. He worked out early on ‘I have two boys that are keen on farming plus me, so I need to triple my land holdings to make it work’. Give each son a farm and have my one to retire on. Simple solution he thought. The business he thought was in an acceptable position, the bank liked him because he was a big client with debt. He was getting on a bit, earning government super, but plenty of farming life still in him.

Sudden Change Happened

Everything suddenly changed one day when Irish was in the cattle yards. He was kicked by a big bullock which caused a heart attack. Luckily Spit was heading to the cattle yards to help Irish and he found him. Ambulance, then hospital, then an operation. It all happened so fast.

The boys weren’t too sure what was happening. Were the bullocks going to the sale, or the works? Was the contractor booked to put the fertiliser on? What about the bills had they been paid this month?

After the dust had settled and Irish came home the Bank Manager contacted Irish. They wanted a meeting with all the family and the Regional Manager was coming too. The bank laid their cards on the table;

> The business was not in an acceptable position, too reliant on Irish.
>
> The overdraft was over the limit again and the bank were still waiting on the budget to be done.
>
> They would support the business and were not concerned about the balance sheet, but
>
> Things HAD to change.

Irish asked the bank ‘what can I do and what do I need to do’?

A Process Followed

Irish’s wife had put her foot down. Irish had to step back from the business and slow down. She wanted him to spend time off the farm. This was a familiar story to many. The bank helped them by getting an advisor in to assist the family with change.

This advisor followed a similar path to the OODA decision cycle that Wal Footrot used, this time the **‘Three Questions of Governing’** mode was used**:**

> **1. Where are you and how did you get here?**
>
> **2. Where are you heading, do you want to go there? If not, then where?**
>
> **3. What must you do different or better and learn, to get there?**
>
> (Business Torque Systems, Peter Allen 2015)

The advisor worked out quickly that Irish wanted the same that his wife did: get off the farm and pass the baton to the boys. But he had no idea how to do this.

The key steps in this process;

Meetings

> At the start everybody felt like their life was dominated by meetings. But this allowed for all to share their thoughts, and Irish and his wife were able to think and share about what they wanted.
>
> The Bank Manager, Accountant and Lawyer were also involved in some of the meetings to assist in the decision making process.

Reports

After each meeting summary notes and reports were taken and shared where appropriate.

Analysis

Structural and ownership options were presented, discussed and considered.
Financial benchmarking the business performance also showed everyone where improvements could be made.

Feedback

This was encouraged and given by everybody.

Decisions and the space for the ‘boys’

Irish found out the business could, and needed to survive without him. This realisation was a big step in the journey. In his case he knew he had to let go, but this is not always the case. Some hold on until it is too late, which almost happened here.
Moving from the main house.
The was no way he was going to live in town, but he had to move out of the main farm house where all the other buildings were. So, they decided to renovate one of the smaller houses at the other end of the farm and move there. This caused what Irish called a vacuum. He was no longer the first to the yards or had all reps and business support people knocking on his door.
Another key step was that Irish found out he liked golf and started playing regularly.

Structural Change

A company was set up where all the family were shareholders.
The partnership sold the land, stock and plant to the company.
Regular monthly meetings with an independent advisor held. Irish does not even go to all of them, especially on golf days.

Business Administration Advancement

CashManager started to be used for the accounts and GST. A budget was completed and monitored by Spit and Hunk.
Enterprise coded to measure the performance of the helicopter contracting.
Everybody meet with the Bank Manager and Accountant on a regular basis.
All meetings were minuted and action points supplied.

<u>Key Learnings and Mistakes from the Murphy family regarding the process</u>

- Irish started the process too late, although the outcome was ideal. You can’t start the process too early: i.e. talking to family members and changing ownership structures to allow divesting of assets.
- Patience is an essential ingredient. People need time to adjust to new realities and understand the process.

- Open communication to all the family about what everybody wants is essential Record this formally.
- Getting out of the Family/Owner/Manager part of the circle early, not when you are too old. Move off farm and allowing others to take your place.
- The importance of a healthy balance sheet coupled with ongoing financial analysis and reporting.
- Set the business up into an entity that allows for change. Often a company is the best option due to the tradability of shares. Having a separate entity like a trust may work for protection.
- This is not something that can be done by yourself, use outside assistance to facilitate the process and the process must be led by the parents
- Irish now looks forward to getting the family together - The ultimate sign of success. Everybody gets so well, which does not always happen.

5. OPTIONS FOR THE HEROES

Section 5 has presented some of the options that exist for the 'retiring' famer. There are some other options that can be used in the process for the change in ownership and management roles different to those our heroes choose. This is a summary of the other options and some other points for consideration.

- **Status Quo**

Nobody has to do anything – status quo could be an option, we could just carry on. Well in reality something will happen, and it won't be of our design and it won't mean a good outcome for most. As we get older we lose the energy and enthusiasm to achieve potential, the status quo is not an option.

- **Selling**

It is a big step making this decision. There is advice in section 7 about this process.

Selling takes place more often than people realise, often farms are sold to the next generation through estate settlement and succession. In these cases, it can be as simple as getting a registered valuation completed and agreeing on the price. Depending on the situation all of the family need to be involved in the decision-making process.

Sometimes the outcome of the succession process is that the best option is to sell, especially if there is no way to hold to the asset and bring in the next generation to the business.

- **Leasing**

This form of business arrangement does have somewhat of a bad name, although as we know bad news always spreads faster and wider than good news. There are plenty of successful leases that take place in the market. The principles that Wal, Cheeky, Pongo and Rangi followed shows it can be done well.
Leasing is more common in the market than people think. There is a whole lot of leasing happening with multi ownership business. i.e. a Farming Company leasing of the Family Trust.

- **Equity Partnerships or Companies**

These business structures are a way of assisting someone else into the business without having to take the big step of 100% ownership, which can be step too far for some. They are 'coming of age' in the sector and people are becoming more comfortable with the concept of being in business with together.

Often a trading company that has a minority shareholder/ manager and majority shareholder. The land can be in the EP, or in a sperate entity.

They are commonly formed in three ways;

1. Land owner seeks equity partner/manager from the start
2. A manger employed with the intention of moving to an EP
3. Similar to either above, except EP wasn't the intention

Possible motivation for Business Owner

Secure a good operator in the business long-term
Improve accountability in the business
Create more time and space for himself/herself to pursue interests off-farm.
Looking to grow the business with additional capital and expertise.
Motivated to give someone worthy a go.

Possible motivation for an Equity Manager

Leverage into business ownership with limited capital.
Grow equity through profit are share purchase and job security
Opportunity to leverage off scale.

Getting Good Advice

Both parties need to seek independent advice, and some recommend this independent advice is ongoing.
Be prepared to go into the business and have a defined term.
Needs some significant paperwork including Shareholding, Lease, Employment Agreements and Business Plans.

- **Role of a Family Trust**

There have been considerable number of these set up in the recent years. They have been more common as a vehicle for tax planning, succession and estate planning. But beware once set up it can be difficult to change this. Don't just agree to the one adviser about this, seek a second opinion

If you have one are you carry out your legal obligations as a trustee; holding trust meetings and being fully understanding of the settlors wishes.
Ensure the Memorandum of Wishes and Wills all line up to the Trust deed.

- **Multi-Generational Business**

Family business are complex, there are a whole lot of things at play. Taguiri and Davis have summed up how this looks in their Family Business System diagram. If you are involved in a family business use this diagram to see where everybody sits and ask the question – 'is this right'.
They can be a great vehicle for business continuance if run well, but also can be the end of some families, if not.

6. WHAT DO THE INDEPENDENT EXPERTS THINK

In the rural sector there are many people involved with rural businesses and families assisting in the 'exit' and succession process. They have experience and knowledge but are not always used by the business owners to smooth the process. What do they know that could have helped our heroes throughout the process? This section introduces four of these sectors and their advice.

6.1 Fergus Rutherford – Registered Valuer BakerAg Feilding

Fergus is a valuer with nearly 20 years of experience in the valuation sector including rural, residential, commercial and industrial sectors. He is involved in rural valuation and also works in the management and overseeing of lease properties in the Manawatu, Wairarapa and Wellington regions.

Leasing

Rural land leasing does work well, but needs to follow some principles to ensure both lessor and leasee gain from the arrangement. In the rural sector there is more connection between the lessor and leasee in terms of the lease price and profitability than compared to other sectors.

Recommended practice to follow;

1. Ensure a legal document is drawn up and agreed and understood by both parties. Use a third party to assist with this process.
2. At the start of the lease take a record of the condition of the improvements. There is no need to record every fence line and gateway, but there is a need to focus on two areas; what is new or in good condition, and what is in poor condition. Check over the property and record this formally with a report including photos.
3. Agree on capital work required and who is liable to pay for these.
4. Use someone to monitor the lease and carry out regular inspections informing both parties of what is happening.
5. Ensure that fertiliser applications are well recorded and, where possible, proof of placement maps kept.
6. At the conclusion of the lease use the initial and monitoring reports to ensure both parties end the lease amicably.

Capital improvements need to be fully agreed on by all parties. A system that works well is either, setting aside a proportion of the lease to be spent on capital works/ materials by the lessor, or a discounted lease price and a requirement by the lessee to carry out the work at their cost. Both are win/win situations.

Farm houses can be a unique aspect to rural leasing. Sometimes houses are included in the lease and sometimes they are run as separate tenancies. This is not as consistent as it should be and can influence profit.

Valuation

The process of carrying out a Registered Valuation uses the principles of analysing comparable sales and the income potential from the property in question. A potential market value is derived. Searches on Certificates of Titles, Regional and Local Authority plans, and soils map are included in the research.
If the property is in a poor condition when compared to the comparable sales then it will be discounted, like the market would likely do in a purchase process. Poor condition would also affect the income approach.

Registered valuations are carried out for many reasons, but most are done for property purchases, estate settling or business changes. The reason for the valuation does not change the methodology used or the outcome. The principles are the same.

6.2 Lawyers

The following are comments that have been gathered from various meetings and discussions with clients and lawyers in the Manawatu.

A legal agreement is a must for any business arrangement - whether that be succession, leases, sales, wills or trusts.
There have been many documents produced and signed over the years where people have not had a good understanding of what they were signing because of the trust and good faith shown in the legal profession. This is not ideal – everybody needs to have a full understanding of what they are getting themselves into. They need to invest time reading, talking and asking questions.

A lawyer can be involved early in the discussion and planning process or just be involved as an overseer to ensure the right documents are completed. It is important for clients to tell the lawyers what you want, and they will ensure it is put into the correct documents and language to cover all parties.
There will be times when different parties should use different lawyers in setting up agreements to ensure independence.
They are very happy to work with all the parties whether that be the family, Accountant, Valuer, Consultant; the more input the better the process.

This process all costs money. However, the outlay is minimal when compared to the cost of getting it wrong. Legal disputes like Arbitration or Courts can cost in the hundreds of thousands. Another aspect to rural legal disputes (especially family and lease), they often end up being settled in Mediation or Arbitration which are legal private agreements not public court cases, and cannot be used as ‘case law’ for legal precedence.

6.3 Martin Boyle – Agribusiness Consultant

Martin has over 30 years experience in consulting to dairy farming business of all scales, particularly those who have a focus on growth, and providing management and strategic business advice.

One of the key aspects according the Martin is that the business needs to be in a position where it can be 'taken forward'. This is applies equally whether it be a decision to sell or grow; the business always needs to be 'Succession Ready'. A lot of businesses and families that begin the process are not succession ready when they get to the start line.

To be ready, there needs to be a solid plan and the right attitude to be ready to go through the process'. For this to happen the owner needs to spend time not being distracted by the day to day operations, taking time to think, interact, use advice and plan to process to ensure a good outcome. There is a big question encompassing here – do they have the best support available to assist them go through the process?

The current owners need to know all aspects of the business and the family exaptation's;

- Where is their business at? The balance sheet, the profit and loss, resource consents, staff.
- Know what everyone wants.
- Be able to communicate what they want and what needs to happen to family, advisors, trustees etc.
- 'Get a life' – a hobby or another interest outside the property
- Be prepared to be in business with somebody else, family, business partner, leasee.
- Able to the ask for advice.

6.4 Peter Barnett – NZ Real Estate Feilding

Peter is a rural Real Estate Agent with 16 years experience, based in Feilding and an owner of NZ Real Estate. Prior to real estate he was a rural banker.
He is involved later in the overall process when people have made a 'decision'.

An interesting factor to consider that Peter has to work with is that most of the people he deals with have bought a farm at some stage in their farming career, but not many have ever sold one. This means that the level of knowledge of the overall process is often low. There is an understanding of the big picture, but very little of the specifics of the process and their requirements.

<u>How does the process work?</u>
Peter's experience is that in about 2/3rds of cases he is called in by people who are happy to use him and his company only and they commit early on. In the other 1/3 of

cases the vendors will call in 2 - 3 agents or companies to assess what they offer. Referrals are a big part of agents getting clients.
The most crucial factors in a successful process are that the vendors are mentally ready for sale and that they understand the process and what needs to be done. This can take some time.
Often, they may be mentally ready, but the farm is not physically ready for sale with some work is required. This work is often superficial involving tidying up and presentation.
The state of the property will affect the sale price. If capital works or even tidying up is required the price is lower, or the farm harder to sell.
Once a vendor is ready a contract is signed with the agent for both a fixed period and an agreed selling process.
The overall process of listing a property for sale can take over 40 hours of work with preparation of the property report, setting terms and conditions and setting up the marketing process.

Sales Types

This will depend on three aspects: the property, the circumstances and the people. Other considerations include how do they want to go very public? Is this a property that will be in high demand?

Tender This is where the property is marketed with a final date when offers must be in by. The offers are presented in sealed envelopes, including price and conditions. These offers are kept confidential from other buyers. The Vendors open these envelopes in their own time and then either accept, or negotiate (often with the highest tender) to get a sale.
It is becoming a more common sale process and is also used in situation where there are multiple owners, multiple titles or an estate. It is considered a more private process. More often than not the highest tender will win this process.
Variations also include Final Treaty and Deadline Sale.

Auction

This process is often used where the property has a high profile or there are several potential purchasers that could push the price up with open competition. The auction dates set a deadline for the process, although purchases will be required to be ready for purchase if finance is involved. Some auction marketed properties can sell prior to auction; this is at the vendor’s discretion.

Open Sales or Fixed Price

This method is not so common now. This is where a property is advertised with a fixed price and no specific sale date.

About 5% of farms are advertised and sold under the open sale or fixed price and 95% under auction or tender.

Property Report

Like everything this will vary across the agents, but Peter believes that a good property report provides the potential purchases with a good amount of information and gives them some confidence about the property and its potential. It is important to include as much as possible and the agent has legal obligations of disclosure to provide whatever information is relevant to the property and surrounds.

Typical the information included in a report would include:

Farm policy
Soil tests and Fertiliser history
Farm Maps and legal map and descriptions
Chattels and what is included in the sale and what is not
Consents
Description of the farm improvements

Marketing Costs

To market a farm there is a range in what the owner could spend on the campaign. This will vary across agents and vendors, but could be in the range from $5,000 to $20,000. Technology has significantly changed this process in the last 5 – 10 years. The internet and lately drones have improved the ‘showcasing’ of the farm to potential purchasers and it is now easy to find out more information on a property and view it online.

Properties are marketed via;

Internet adverts
Adds in the media and publications
Email to databases and connections

7. ANOTHER VIEW ON LEASING

The leasing of rural land is one of the options in the land owner's toolbox that could be used as part of making decions like Wal, but this does not always work well in the sector. It fails for many reasons, as shown in Section 5, but what about the Commercial Property Sector? Can the industry learn something here?

7.1 Ian Steele – Commercial Sales Consultant Property Brokers Feilding

Ian has spent many years in Real Estate in the district and works mainly in the commercial space involved in sales and leasing.

Owner Objectives
There is one key difference with leasing of commercial verses the rural sector, but this difference could be where we could learn something. In the commercial sector building ownership and leasing is purely the reason for ownership and involvement, whereas, in rural, it is often the transition of succession or supplementary income. This business focus does drive the rural sector in different behaviours, some positive and some negative.

Return on Investment
A commercial land owner would be expecting or targeting a return of 10% from the lease (rental income / property value), although this does range from 6 – 15% depending on the market, location and size.

In the rural sector this return is less, but also will depend on location, size and use. Three examples in the Manawatu region;

Hill Country Sheep/beef	3.5%
Intensive finishing	2.8%
Dairy support	1.9%

The returns in the rural sector are lower than those in the commercial sector because rural property is often overvalued compared to its earning capacity. Another report could be devoted to this topic!

It is not uncommon for a property to be bought and sold with tenants in place. Longer-term tenants would increase the price and saleability of a commercial property. It is very unusual for a farm to be sold with a tenant in place.

Vacancy and Demand
Commercial property can run the risk of being vacant for periods and the owner receiving no income, whereas in the rural sector demand typically outstrips the supply for land, and it is very rare for land to be vacant.

Capital, Maintenance or 'Fitout' costs
With commercial property a tenant will often require a fitout to the building or land to make it fit for purpose. This cost is more often paid by the tenant and is linked to the term.
The maintenance costs for commercial properties are seen as in the tenant's best interest, keeping the 'image' of the business up. This is especially relevant to a retail

or service business, so the tenant will be happy to carry out the required maintenance and, at time, capital to keep the asset in good condition.

Fencing and Fertiliser, as covered in section 6, is unique to the rural sector.

Lease set – up

The real estate industry charges 15% of the annual rental to set up the commercial lease. For the 15% they will supply a 'Head to Lease' document. A Deed of Lease may also be completed by a Lawyer. Not all commercial leases are fully documented, but the failure rate of leasing is lower than the rural sector.
When rural leases are set up by third parties the cost could be less than half that of the commercial sector. This is a factor of the demand vs supply model.

Lease Terms

There is no difference between the lease periods across the sector, driven by the same metrics. The only difference will be with 'big box' or multinational retailers that will sign for longer periods.

Property Manager

In larger or multi-tenancy commercial sector properties, managers are common place. They oversee the period of the lease and ensure correct process is followed. This is a vital role that is not done well in the rural sector. The number of leases that have issues because lack of ongoing management and communication is significant to the extent that it is seen as a negative towards the process. Another key learning area for the rural sector to consider in the ongoing property management is that to ensure that all correct steps are in place.

Summary

There are aspects of the commercial sector that the rural sector could learn from;

Why does the rural sector expect the lower rates of return?

Are there enough leases that are being overseen by and property manager?

8. RECOMMENDATIONS

‘Go for the Gap – When you’re on top of your game, change the game. The All Blacks – (Legacy James Kerr 2013).

1. Plan early, think about the business without the current owner in place. Run through the options and scenario’s that may happen. Ask yourself ‘what if I meet the stock truck on the road’.

2. Communicate with everybody that matters. Partners, family, advisors, trustees. Formalise this communication.

3. Gain some advice from family, peers, advisors and professionals. Make sure you take that advise.

4. Analyse where is the business at. The balance sheet, the profit and loss, consents, staff.

5. When selling, time is your friend to be mentally and physically ready.

6. When leasing, use a third party to be involved at the start, during and at the end of the lease. Let’s learn from the commercial sector and ensure we follow what Wal and Cheeky did, not Cooch.

7. The use of a mantra like the Observe Orient Decide Act loop, or the Three Questions can help with decision making

8. Get a ‘life’. Time outside the business is as vital for the time inside the business. It’s the old mantra – ‘Yes you are working in the business, but when do you work on the business?’

9\. Be prepared to be in business with somebody else. That could be a family member, an equity partner or a leasee.

9\. Think of the internal energy, what time of the day do you work better and think better. What time of your life do you have the most energy.

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