

Business Partner Compatibility Testing:

Dan Billing.

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Daniel Billing.

15 November 2006.

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Introduction:

With equity partnerships becoming a more common form of ownership for people without the initial capital needed for sole ownership, the reliance on other people becomes an increasingly important issue. If the people that you become involved with aren't compatible with yourself then problems will arise and the partnership may dissolve or become inefficient

If at the beginning when choosing your partners you could all sit down and complete a test to show how compatible all the partners are going to be with each other, then the confidence that is gained going into the partnership will improve the relationship and efficiency within the group.

By combining commonly asked questions from initial start-up and inserting a level of tolerance, then the level of compatibility can be established and compared with other members in the group.

Although there are a number of experts within the field of Equity Partnership establishment, I have found no evidence of there being a system available to rank participants together.

How the project is set out:

Part 1: Understanding Equity partnerships.

Part 2: The Test and how it Works.

Including, copy of test.

Also included: CD-ROM containing

- Working copy of test with initial set of test questions.
- Copy of research paper.
- Copy of Power Point presentation.

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Aim:

From this research the author aims to develop an equity business partner compatibility test, which aids in the process of establishing partners in an equity sense. To be used in the initial stage to allow each member to have the confidence in themselves and the other people involved when investing together.

The test is intended to be simple, manual and quick but at the same time no less accurate than a standard personality test.

As the research progresses knowledge of Equity Partnerships, how they work, things to avoid and people that need to be included will be revealed, but more importantly:

- The way people think when faced with investment challenges.
- How people react to different situations.
- The challenge of establishing trust within a group of strangers.
- Being impartial and objective enough understand each individual, but at the same time also being able to have enough confidence to stand alone as an individual.

PART 1:

Understanding Equity Partnerships (EP):

Defining an Equity Partnership:

In simple terms an equity partnership means a group of people investing into the same business venture.

In more detailed terms an equity partnership is a joint venture between investors with the goal and vision to grow their own equity along with the added advantages of having

- Shared capital, shared risk
- The ability to leverage specialist skills and or capital assets
- Achieve high performance efficiencies of scale.

The equity partnership is usually based on or around a Ltd Liability company structure with shares being issued to each member according to the amount of equity that each member has invested.

To operate an efficient and profitable EP there needs to be a minimum outline of communication, and structure.

- A clear and concise business plan.
- A clear investment period along with a clear process that allows the shareholders to exit the EP.

- A shareholders agreement. Outlining the process for decision making, share sales, valuation process and dispute settlement process.
- Clear contracts along with job description.

Who is investing into EP's?

The cross section of people that are entering into EP's ranges from the first time agricultural investors, looking for diversification within their existing investment portfolio, through to the established Agricultural specialists.

Within the later group there a number of sub-groups, involving

- Existing Equity managers. Again expanding their investment portfolios. As the capital in the existing EP grows the ability to expand the number of shares that are held or to invest off farmer easier and more realistic.
- Passive investors looking for a return within a relatively safe industry. These investors seem to be from outside of the agricultural industry, looking to spread the investment risk by becoming involved into an EP. Generally silent when it comes to the farming policy side of business, but will have their say when it comes to the investment as a whole i.e. further investment or increasing debt.
- Retiring investors looking for a return to allow them to retire safe in the knowledge that they will be financially independent and financially safe. As the average age of the farmer increases coupled with the lack of interest from the children, older farmers are allowing themselves to "pass on the farm" through means of keeping a amount of equity held in a business and allowing younger people to buy into their business.
- Families looking to help out members of their family to allow them a start within the industry. Family succession is also becoming a big issue when deciding the fate of the "family farm". As land prices increase the need for family to retain their capital in the business brings about the formation of Equity Partnerships by default.

The Evolution of the Equity Partnership:

EP's are not a new investment option, a number were started in the late 1970's within the kiwifruit and Sheep/ Beef industry. These were established to take advantage of government incentive schemes and the taxation policy of that era.

Investors took on large financial risks and policy risks which went against them when economic reform was announced in Dec 1984.

After this set back EP's as an ownership/ investment structure subsequently lessened in popularity until the late 1990's as the growth and restructuring of the dairy industry gained momentum.

EP's have evolved because of

- Limited capital from young and first time investors.
- As a tool to spread investment risk.
- As an alternative investment option.
- Strong balance sheets within the agricultural industry.
- The increasing cost of land.

The long held image of agricultural for the purpose of investment is of a business of low returns coupled with high risk.

Contrary to this, the agriculture industry has grown from 12% to more than 17% of New Zealand's GDP, showing returns that outperform those from the New Zealand Stock Market. While the investment is an appreciating asset – land, profits from farming have increased from better farming practices and better business management.

The key to a successful EP

As stated above good relationships and a common goal are vital, this all starts at the beginning of the partner selection process.

These key factors are crucial in all facets of our career, so the need to get to know and understand other people and how they are to react or respond to different situations needs to be addressed by all parties involved.

The compatibility test that is described allows the partners to do just that get to know their peers.

By using the above mentioned, intentional investors and partners can eliminate people who will not work well and integrate within the intended group. By doing this, the dynamics of the group will be positive and confident allowing the EP to advance into the next stage.

A combination of reviews, checks and balances keep the EP communication lines and business operation in line with initial outlined guidelines.

Failures within an EP:

Failures within EP's are generally not caused by the land, buildings or the stock but by the people that are involved.

Some common causes of EP failures are:

- The mix of people within an EP is wrong, with conflicting personalities. People becoming over controlling, aren't team players, different partners having different ideas and goals for the business. Some may be happy with what others are not.
- Mistrust, poor communication.
- A lack of forward planning.
- Poor advice or advice from the wrong people or poor interpretation of the advice given. Having clear and easily understood advice from a team of professionals who know the business of farming and how EP's are to work.
- The reporting and accountability systems that are used are weak.
- Unrealistic expectations in regards to production, profit and growth.
- The manager of the farm failed.
- Poor governance structure/ documentation. There are fewer disputes if at the start better supporting documents are completed and implemented.
- Interference from the share holders.

PART 2:

The Test and how it Works:

The Need for a Test:

What makes an EP work?

These are all obvious, but it is the obvious that can sometimes be overlooked. This test is based on or around these simple things that are thought of, or sometimes not thought of.

- Good balanced people and good business skills.
- Good structures of governance.
- An above average manager dealing with the day to day running of the operation.
- Having the cash and growth of the EP well managed. Including good debt structure.
- Having a property that is suited to the intended use and policy. This includes having the scope for profitable production increases.
- Is simple. A simple ownership structure and a simple farming policy.
- A shareholders agreement that is clear, defined and well thought out.
- Shareholders with realistic goals and timeframes that are common to the partnership.
- Family that supports and encourages the EP and investors/ shareholders.

“Good relationships between partners and a common goal for the EP are vital to the success of the EP”.

THE PROCESS OF CREATING THE TEST:

When initially having the idea I began contacting people that were, are or are involved in or with setting up EP's.

The purpose of all this was to allow them to say whether or not the idea had merit and was worth proceeding with, secondly to informally interview them with regards as to what they did, who they involved (professional consultants) and the due diligence processes that they followed to create their EP.

Questions were asked along the lines of

- What were your initial thoughts going into this venture, with regards to who is involved, what are your aims and goals out of this, what sort of professional advice did you receive or require, what family issues were taken into consideration and finally asking them if there was anything that they thought that I might need to know and allowing them to talk freely to me about each individual operation that they are involved in.
- Once all interview information had been collected and collated the process of creating a template on which the test was to be built. Then creating an initial set of test questions.

This was done to allow me the chance to create questions from the information gathered, along with the help from experts specializing in the wording of documents. The single biggest problem was how to ask a question so that took away all selection bias, allowing the test participant to work freely and uninhibited mentally.

Also creating a document that was simple and easy to follow allowing clear, concise definition of what was wanted from each test participant.

- The now completed template along with questions was then returned to all people involved to allow them comment on relevant question topics, the wording of these questions and comment on the format of test template, process of scoring each individual and the mental strain involved in answering the test (how hard was the test to read, follow or understand).
- Again changes had to be made according to the relevant feed back, bringing us to this current working model of the intended test.

.A Basic understanding of how the test works:

In the initial stages of deciding to invest into an EP, people need to know about the other people that are involved. Unless there has been some sort of previous history, then there is only a limited knowledge.

It is this initial confidence that allows anyone to proceed, onto not just this first step but onto each consecutive phase of the EP.

This test is designed to be quick, simple and to be able to be done manually while everyone is present.

This test is only a tool to aid in the decision making process, not a tool to make any decision for you.

The test consists of commonly asked questions that business advisors, successful equity partnership operators, bank managers along with employment psychologists and anyone that takes an interest in this, asks themselves when entering into a partnership.

The first step involves “test setter” to sit down with potential candidates/ investors and discuss with them what they would like from the EP in regard to investment goals, personal goals or timeframes that they would like implemented. The questions for the test are then written and set according to the group discussion.

By answering the questions in the form of a importance ranking (1-10. 1 being least important, 10 being most important), then ranking the level of tolerance (0-10. 0 being no tolerance at all, 10 being most tolerant) that they would be willing to accommodate the test builds up a profile of each person according to the question that are being asked. This gives us the ability to see whether they are or aren't compatible with other people that have completed the same test.

Each persons individual test answers are ranked against the group importance rankings and the average tolerance levels. If individual scores are outside the tolerance level then they are deemed to be incompatible in this question. The numbers of compatible and incompatible questions are then added up to give a percentage score. This number is what the decision to include or exclude a particular person is then made on.

Understanding each page of the test:

- Comparative Test: This page holds the information regarding.
 - ◆ Topic's, headings and questions relating to the individual EP investor discussions. The designated "Test Setter" will create and insert the relevant questions into the yellow marked area.
 - ◆ Calculates the average rankings for the Importance and Tolerance, along with the Test Summary section.
- Test Summary section (within Comparative Test page): compares each individual score against average score and calculates them accordingly. Giving a final percentage score to be used to make final decision.
- Individual Test: All questions within the individual tests are automatically transferred through into individual sheets from comparative test at time of question setting. Each intending investor then proceeds to complete test by ranking questions as explained. For the test to be marked the individual completing test needs to trigger the test by writing name or initials into yellow marked area in individual test. If this isn't done then the Test Summary page will not recognize or calculate scores.

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References:

- Westpac NZ Ltd, Equity Partnerships guide.
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- National bank of New Zealand. Rural report Sept 2006.
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- Rubus Group website.
- Aginvest website.

Summary:

With the completion of this research and Test it has brought to the author's attention the differences between different investors.

Initial thoughts that all investors could be compared together were wrong, as different groups can be compatible under different circumstances. The fact still remains that even then there is an exception to the rule with regards to success within investment groups and the different thoughts, ideas and opinions that each individual has.

As a whole the research undertaken has allowed the author to make a more informed and professional decision when becoming involved into an Equity Partnership.

Authors note:

This research paper has sought to create a tool for the use in the aid of decision making within EP's of the Agricultural Primary Industry.

As to whether this test becomes implemented into an EP set up situation is irrelevant, it has allowed the author look into aspects of initializing EP's that could have been previously overlooked. This has caused the author to "take his head out of the sand" and re-evaluate how he is go about becoming involved in potential EP's.

Readers should take note that although every effort has been taken to provide true and accurate information, this test should not be allowed to make decisions for you. Any decisions that need to be made should be made with as much relevant information as possible.

Finally the author wishes to thank anybody that has taken the time to help in the research and development of this test and paper.

Cheers

Dan Billing
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