THE AGRICULTURE SCENE AND THE HUMAN DIMENSION

PASSING ON THE FAMILY FARM

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Background

My experience of farm succession planning is principally related to the rural sector and has grown from my previous involvement with farmers as a farm consultant.

The information that I will work through in this paper includes:

- Previous research studies on farm succession
- NZ agriculture today
- Trends in agriculture
- Succession processes and the human dimension

My background with farm succession has mainly involved sheep and beef businesses and a few dairy farming businesses. Many of my clients are second and third generation farmers and there is often a strong emotional attachment to the farm business which is being succeeded.

Our average sheep and beef farming client is approximately 8,000 stock units. Profitability is a challenge but capital growth has been significant in recent years. We are currently experiencing a significant increase in farm syndication, particularly with respect to dairy farm clients (50:50 sharemilkers and new entrants to the dairy industry).

Research studies – farm succession

There has been limited research undertaken on farm and business succession and the processes involved. The two research studies undertaken are detailed below.

1. "*Issues of NZ Farm Succession; The Study of the Intergenerational Transfer of Farm Business*", MAF Policy technical paper 1171-4662; 97/4A (June 1998).

Background

This study involved 30 interviews with retiring couples, succeeding couples and single male successors.

The key findings of this study included:

- Average age of retirement was 59 years old
- Average age when succession completed was 42 years old
- Transition period of succession 18 years
- All children thought their parents had done much more planning with advisers than they actually had
- Meetings with professionals usually only involved individual successors and the retiring male
- Although each generation advocated open communication was the key to a successful and less stressful succession, families appeared reluctant to meet to discuss the future of the farm. Such meetings were often irregular and informal and often put off or delayed
- Family harmony with and between siblings is a strong goal for successors
- Only 20% of the families interviewed included all their children and their spouse in family meetings for farm succession.

Important outcomes of the farm succession process

- Secure retirement income for the parents is of paramount importance
- Expectation that all children will be treated fairly and with respect (not necessarily equally)
- Ensure ongoing viability of the continuing farming business
- Non-farming siblings will retain emotional ownership of the property
- Important to include non-farming siblings in the process to achieve a successful succession process and retain the highest possible level of family harmony.

(See Appendix II for conclusions from this research)

2. '*Living the Dream; Exploring Governance in Exemplary Family Businesses*'

This is a research report presented in partial fulfillment of requirements for a degree in Batchelor of Business Studies with Honours at Massey University by Desiree J Reid, 2004.

Background

Fifteen New Zealand family businesses were explored by way of a case study method. Case study businesses were selected on the basis of three criteria, these included:

- Growth – to the point where they are substantial businesses in their own right today
- Leadership ability through influence of their respective industries
- Succession through at least two generations of family

Of the fifteen businesses that were analysed, eight of them had indepth analysis undertaken including interviews involving open ended questioning.

Results

This research paper reported the growing recognition of the importance of the family dream, the acceptance that the performance of the family business requires convergence between the family and business goals, and lastly that the succession is a protracted process beginning with the young children and simultaneously extending through multiple generations.

Conclusions

The three strongest pre-requisites for enduring family businesses included:

- A clear vision and purpose for the business, ie a family dream
- Motivation beyond money, a real perseverance and passion
- A willingness to trust and support the successors

Other Findings for Enduring Family Businesses:

- Very strong work ethic
- Very strong re-investment and growth philosophy
- Opportunity takers
- Fair treatment of family offspring
- Long term enduring working partnerships
- Business structures used fitted the circumstances

New Zealand agriculture today

Table one below indicates the average and top 20% by area (sheep and beef) and herd size (dairy). These figures relate to the 2006/07 year.

Table 1: NZ agriculture; sheep and beef (average by area)

	Average	**Top 20% (by land area)**
Area (hectares)	564	976
Stock units	4,400	8,500
Farm assets	$4,350,000	$8,300,000
Debt	$600,000	$1,100,000
Equity	$3,850,000	$7,200,000
Number of farms	13,560	2,300
Gross income	$301,000	$576,000
Profitability pre family/owner distribution	($45,400)	-
Cash Surplus after drawings/tax	($24,800)	-
Source: Meat & Wool New Zealand – Economic Service		

Table 2: NZ agriculture; dairy (by herd size)

	Average	**Top 20% (by herd size)**
Area (hectares	110	215
Cows	300	610
Farm assets	$3,820,000	$7,575,000
Debt	$1,180,000	$2,345,000
Equity	$2,640,000	$5,230,000
Number of farms	11,900	2,400
Gross income 2006/07	$429,000	$870,000
Gross income 2007/08	$650,000	$1,320,000
Profitability pre family/owner distribution 2006/07	$57,000	-
Profitability pre family/owner distribution 2007/08	$222,000	-
Cash surplus after drawings/tax 06/07	($31,000)	-
Cash surplus after drawings/tax 07/08	$90,000	-

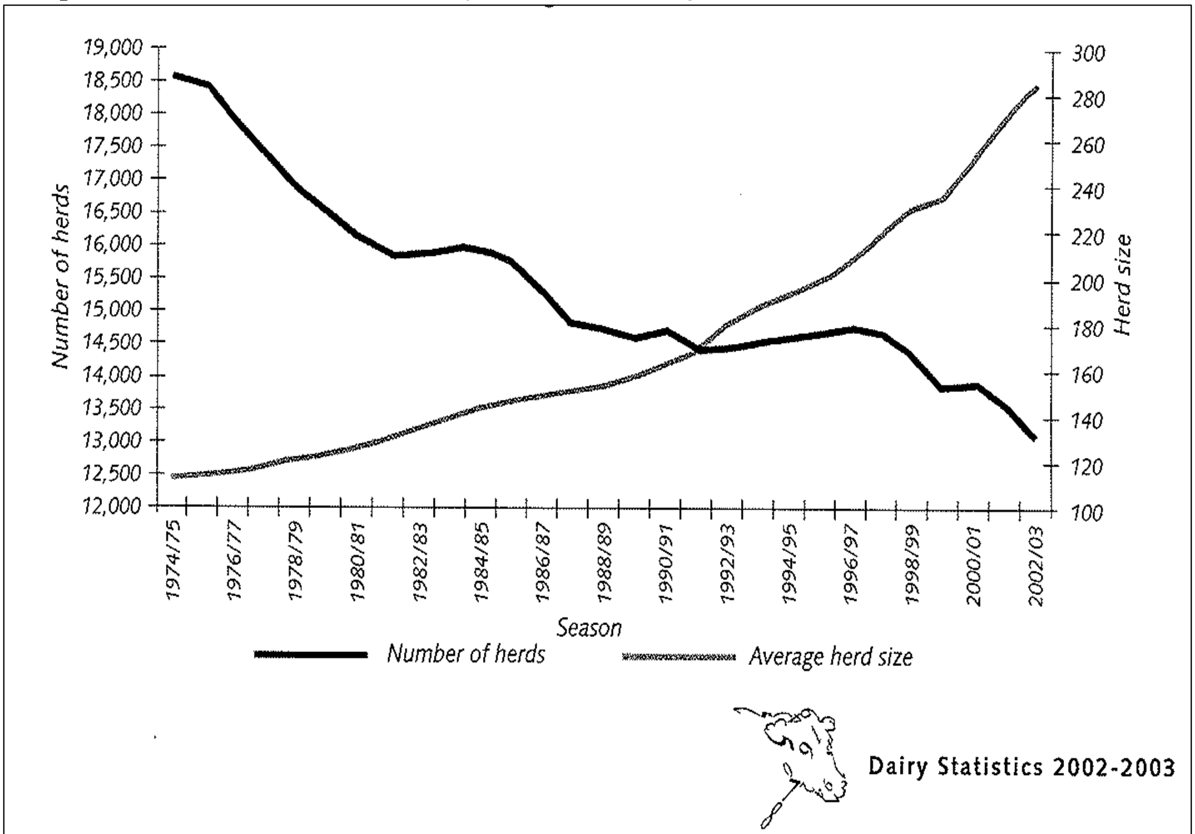
Source: Livestock Improvement Corporation, Dairybase

It is clear from this information that the average sheep, beef and dairy farm operator has struggled to generate sufficient profit or achieve a cash surplus under previous financial returns.

This will of course improve significantly for the average dairy farm with the payout in excess of $6.40 per kilogram of milk solids for the coming season. Projected cash surplus for this year is $90,000 for the average dairy farmer.

Farm profitability is perhaps one of the most important considerations in developing a viable farm succession plan. Farm profitability provides both the opportunity for a desired standard of living during retirement for the parents and also the opportunity for viable farm succession to the next generation. This is an enormous challenge facing the current average sheep and beef farmer.

Graph 1: *Trend in the number of herds and average herd size since 1974/75*



Average herd size is increasing and the number of herds are decreasing (11,900 in 2006/07). Sheep and beef farms have reduced from 22,000 in 1984/85 to 1`3,700 in 2007/07. Average stock units per farm over this period have increased from 3,400 to 4,350.

Rural Land as an Investment

There are fundamentally two parts to most farmer's businesses.

i. The farming (trading) business
ii. The land ownership (rental) business

Typically these are bundled together so it is difficult to determine the returns from each of these businesses separately.

Land price has typically been a reflection of the farming business returns with land price being driven up until farm returns are driven down to < 4%. Any improvements in returns will typically increase land price.

Land values have however been rising much faster than farm profitability over the last several years. Chart 1 indicates some of the sheep and beef land price trends since 1960.

Chart1

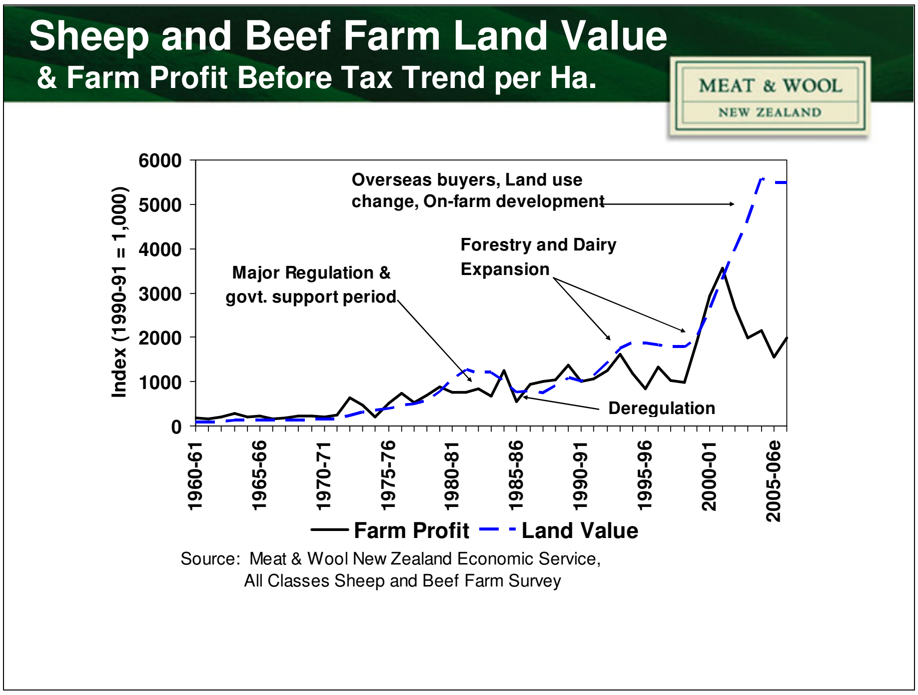
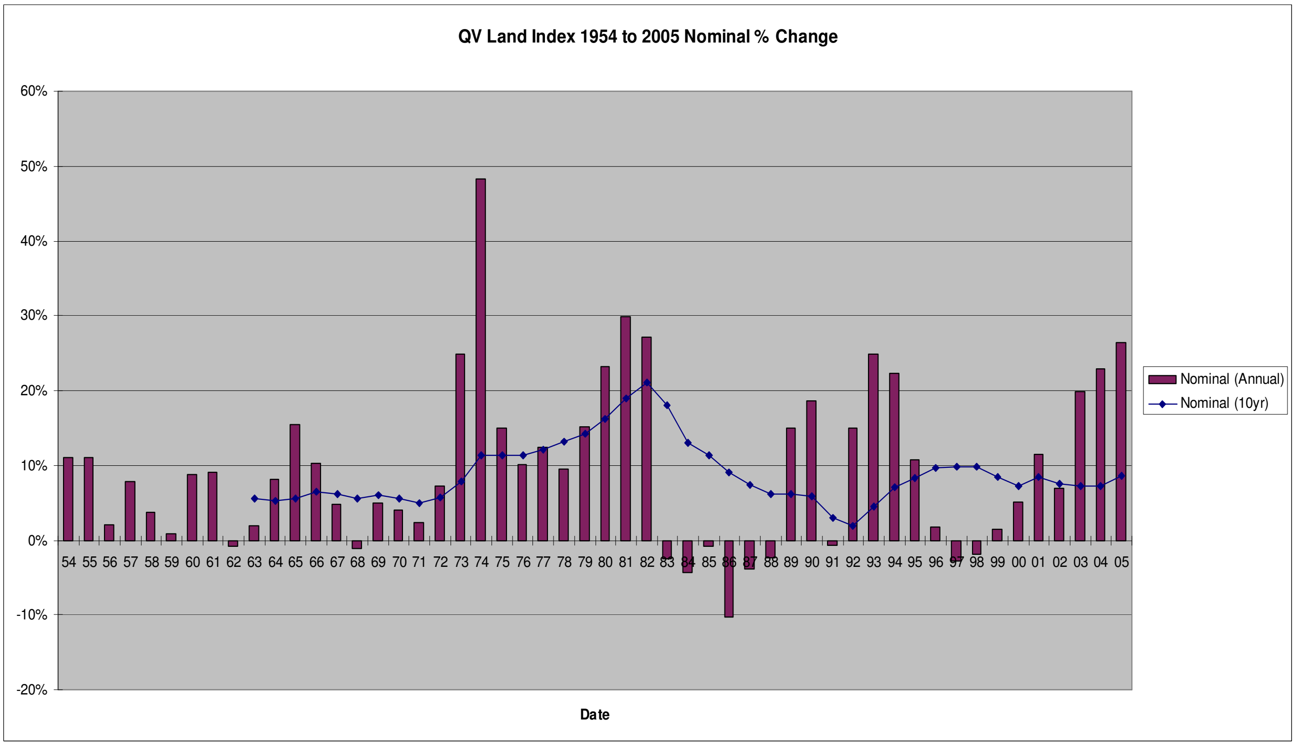


Chart 2



(Source: ANZ National Bank of New Zealand)

Chart 2 indicates the nominal percentage change in land price since 1954

Chart 3

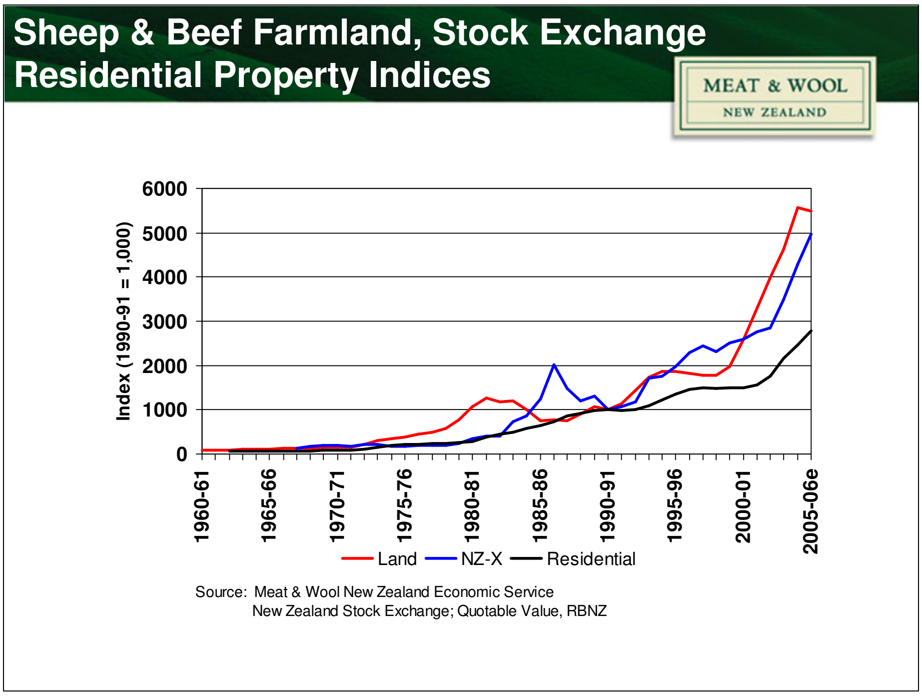


Chart 3 indicates the price indices for sheep and beef farmland, stock exchange and residential property indices.

Viable Farm Succession

The trends of fewer famly farming businesses being succeeded to the next generation, ongoing farm amalgamation, increasing scale and land use changes, will continue.

There are a number of reasons why family farming businesses are not succeeded to the next generation including children not being interested in farming or better off-farm career opportunities, higher retirement expectations for the parents, an inability to create a sense of fairness for all children and the inability to remain viable post succession.

The reality is that when all these factors are taken into account, for up to 50% of today’s farming businesses (particularly sheep and beef properties) viable farm succession is a financial impossibility.

As advisors it is so important to deal with the feelings and the facts of each individual situation.

Every circumstance is different and the most important difference is the individuals and family involved. What is workable for one family may be totally unworkable for another family.

For the average sheep and beef farm business of 4,400 stock units with $600,000 debt loading, remaining viable is real struggle today without even contemplating farm succession. This does not mean however that there will be no 4,400 stock unit sheep and beef farms which can achieve viable farm succession. It really all depends on the individuals and family involved, the amount of debt, everyone’s aspirations and the options/opportunities available.

The situation is quite the reverse for the average dairy farmer.

It would be quite difficult to justify any form of viable farm succession on a sheep and beef farm of less than 2,500 stock units or on a dairy farm with less than 100 dairy cows as there is simply not enough gross or nett income available to be able to support two or more families going forward.

In some situations viable farm succession can be a financial impossibility for even large scale operations given the individual circumstances involved, eg, the issue of equality and fairness. Every situation is totally different.

The key with viable farm succession is to be very clear about the numbers involved; it is a disaster to give false hope when in reality the whole exercise was never going to work.

The input of the accountants and farm consultants cannot be underestimated in assessing the viability aspects of a farm succession plan.

Trends in agriculture

- Increasing size of a farming business (graph 1)
- Decreasing number of commercial farmers (graph 1) ie, less farm succession
- Viability is a real struggle for the average sheep and beef farmer.
- Increase in equity syndicates, joint ventures, corporate farmers and outside equity funding available to farming businesses
- Contributed cash by the incoming successor makes up a lower component of the total equity involved
- Land values are continuing to rise (8% to 10% per annum). This rise may not be directly related to returns.
- The asset values and equity involved now are significantly larger.
- There is typically a much lower return on investment than traditionally achieved.
- Average equity is approximately $3.3 million.

The Human Dimension of developing a succession plan

There are three key areas involved. These include:

1. **Discovery process (D)**
2. **Planning process (P)**
3. **Actions and accountability (A)**

The "DPA" process is an approach that the ANZ National Bank have used for some time with their clients in the rural sector.

Discovery process

Typically as Professionals we can be very good at the planning and action parts of the process or in other words providing the "solutions", but are often weak or remiss in the Discovery process.

There are two key areas that need to be well understood as part of the Discovery process in order to develop a plan that our clients have ownership of. These include:

a. **The Human Dimension**

   This is about discovering where our clients have come from, where they are at now, and what their aspirations and dreams for the future are. By identifying this information we are providing one of the greatest human needs, the need to be understood.

   The human dimension should involve the decision makers as many of the children as possible.

b. Factual Dimension

This involves having a clear understanding of all the facts involved. This will require developing a clear understanding of the current farm business performance and future farm business viability.

Often it is also important to understand some of the bigger trends and issues of the agricultural industry to be able to make informed decisions. For example, the trend of land price increases over time.

Planning process

An effective plan can really only be developed once the discovery process has been completed. Very often as Professionals we start the plan without understanding the human and factual dimensions (Discovery process).

The Plan will be different for every single family and farming business, depending on the outcomes of the human and factual discovery process.

The Plan will involve trying to meet the common successional goals which could include:

Preservation of family relationships

Family harmony with and between siblings is often a successional goal. The achievement of this is very dependent on how involved all family members are in the process.

Financial security for the parents

Todays life expectancy for a female is 81.8 years, life expectancy for a male is 76.3 years. Many parents are living for 20-30 years after they have succeeded the farming business to the next generation. Retirement expectations have increased significantly and this will continue as the baby boomers (1946 – 1964) start entering retirement. Financial requirements can often be higher than initially anticipated, hence the need to create financial flexibility through having a living succession plan which would typically involve the gradual divestment of equity and control during the remaining life of the parents.

Ensuring all children are treated fairly (not necessarily equally)

For many parents this is a very important outcome of a successful succession process. This may involve making provision for the non-farming children throughout their lifetime including provision for education, deposits on first houses, helping them into a business, providing guarantees and utilizing equity within the farm for off-farm investment to achieve a sense of fairness for the non-farming children.

Transparency and certainty for the incoming successors

There is nothing more de-motivating than being unclear and uncertain as to how the plan will eventually unfold for the incoming successors. Transparency can be achieved through open communication, clarity and certainty around Memorandum of Wishes and the outcome of the will.

Viable farm succession

The farming business must be viable and have the ability to grow post succession. Business growth is essential for ongoing viability and to provide for the next generation.

Protecting the family wealth

This is an important part of the succession process and can be achieved through good, sound, legal structures and advice. This is particularly important with respect to relationship breakdown of both farm successors and non-farming siblings.

Actions and Accountability

This is simply the implementation of the overall succession plan. The key with actions is that there is some form of accountability to ensure that the succession plan is implemented and is regularly reviewed.

The actions can be broken into two main areas:

a. **Business & family decisions**

   This may involve implementing some significant decisions that meet everyone's needs and aspirations

b. **Legal and accounting actions**

   This will involve putting together the relevant legal structures, valuation, transfers of ownership and control, redrafting wills and memorandum of wishes, enduring powers of attorney, reviewing life insurances and contracting out agreements.

Outcomes of the Discovery, Action, Planning Process include:

- Clients are happy that they have been involved in a process that has allowed them to be understood
- Clients understand the factual information involved and take full ownership of the decisions made
- There is a very real deepening of the relationship between the Professional and the client which leads to more long term client relationships
- There is a disciplined process in which clients have had to make some hard decisions

- Instead of Professionals being order takers and cleaning up some of the situations afterwards, this is a process that allows Professionals to display leadership and be order makers in terms of client work
- This process adds very high value to our client's affairs

Information Gathering – The Discovery Process

Feelings before Facts

From my experience one of the most important outcomes of the farm succession process come from the emotional drivers or the need for our clients to be understood. It is critical that all decision makers are involved in the overall information gathering and planning process. This would certainly include the husband and wife but in many cases this should also include some if not all of the family members, so that everyone's emotions and aspirations can be taken into account so that there is the highest possible chance of preserving excellent family relationships going forward.

Very often farming businesses are second or third generational properties which have an incredibly high emotional attachment and in which the non-farming siblings will retain a very high degree of emotional ownership. For this reason it is very important for the non-farming siblings to understand and justify in their own minds why a decision has been made and agreed upon. If they are involved in the process then there is a much higher degree of ownership in the outcomes.

There are a number of steps which are important in helping to develop a successful succession plan. These steps could include:

1. Farm succession meetings with a professional

This may initially involve a separate meeting with the parents and then further followup meeting(s) with all the other family members. It is very important that both decision makers (parents) are present at these meetings.

It is important everyone has put some quality thinking into the issues before coming to the meeting. To aid this process it can be helpful to send out a request for information from all attendees prior to a meeting. (See Appendix 1) Questions need to be open questions.

2. The Human Dimension – information required

Information requested could include:

- Everyone's future goals and aspirations (short & long term)
- Issues the family need to consider with respect to farm and family succession
- Actions required

(see Appendix 4 – Checklist)

The better the understanding of everyone's needs and aspirations, the easier it is to make a succession plan. "If you do not know with crystal clarity what it is you want then you are hardly likely to achieve it." *Deane Purdue, McCullochs, Gisborne*

Often a whole host of non-farming issues emerge out of these meetings for which part of the overall succession plan can be adapted in order to cater for non-farming children's aspirations in particular.

3. Financial information required

Financial information which is presented in an understandable format needs to be available at these meetings to indicate the current situation with respect to:

- Farm Business
  - Current cash surpluses (deficits) being generated from the business
  - Current business performance
  - Current assets, debt and equity
  - Insurance policies, their value and purpose
  - Existing structures
- Off-farm Investments
- Any other relevant financial information

Often going through the financial information with all family members allows a comprehensive understanding of the overall financial situation and can provide a reality check in terms of developing plans going forward.

4. Big picture information

The information may relate to some of the wider issues associated with agriculture or the economy (almost like a SWOT analysis for farm succession)

- The opportunities available for a change in farming practice to significantly boost farm business profitability, eg dairy conversion.
- Trends in land prices over time.
- Subdivision opportunities to create capital.
- Off-farm investment opportunities
- Anything that will materially influence the outcome and actions of the farm succession plan.

Leadership with our clients

As Professionals we have a very real obligation and responsibility to lead, facilitate and educate our clients in the farm succession process.

It is very important that the whole family can understand why a particular agreement and legal structure has been decided upon and as business owners and family members that they have been involved in developing the solution so they "own" the solution.

This may require specialist input and advice from legal, accounting, farm consultancy, banking and other respected non-professionals. There is a need for professionals to work together more.

“People do not trust experts whom they do not understand and who make no effort to be understood and accepted.” This is a quote by William Reilly, in a book that he wrote called “How to Get What You Want Out Of life”.

For example when it comes to the planning part of the process we will often spend a significant amount of time working through the mechanics of a family trust with a client, and recommend that the client reads a book by Ross Holmes, called “Success with Trusts”. This is an excellent book in that it provides real life examples of where trusts have been used successfully, where they have not been used at all, and some of the outcomes of these situations.

We provide a complimentary copy of this book to any of our clients who are considering setting up a trust.

Summary

- Viable farm succession is harder than ever before. The successor needs to have a clear vision, a deep level of passion for the business, and a trusting relationship with the successors.
- There is a very real need to continue to grow the farming business over time to ensure ongoing viability and to enable future enduring succession.
- The MAF Policy study of 1998 indicated that children thought that their parents had done much more planning on succession with their advisors than they actually had. There is perhaps an opportunity for advisors to be more proactive with their clients with respect to succession planning.
- We need to develop a strong capacity for handling the human relationships involved. The important aspects of the process begin with the feelings and then the facts. The emotional drivers are the strongest drivers of any decision making process. They are the most powerful for those involved in the process. Our clients want to be understood.
- The discovery process is the key to developing a robust succession plan.
- As professionals we need to work together a lot more closely with other advisors so that all aspects of the plan are tied together including the emotional, financial and legal aspects.
- The financial aspects of the overall succession plan must be very clear to all parties.
- As professionals we have a deep obligation to continuously lead and educate our clients in all aspects of their business but particularly where we have provided specialist advice that relates to technical issues such as legal structures and financial arrangements. Clients need to be fully informed and involved in these processes.
- The average equity within a farm business is approximately $3.3 million. Some of this equity could potentially be available for off-farm investment opportunities and could

provide an opportunity for non-farming children to be treated more fairly in the succession process.

- Commercial reality will mean that there will be less family farm succession going forward.
- The issue of equality and fairness is perhaps one of the hardest issues to deal with in the farm succession process but is made significantly easier when the emotional drivers are taken into account during the process. There would be very few examples in New Zealand agriculture where equality between all siblings and viable farm succession has been achieved. In most situations this is simply not a commercial reality.

- We will see the continuance of the existing trend of less commercial farms but an increase in equity syndicates and corporates as a model for commercial farming.
- The financial reality of a farm business today with an average equity of $3.3 million is that if they sold the property, the average farmer could comfortably retire, have significantly more disposable cash than they generate from their current farm business; not something that we would want to dwell on for too long!

Appendix I

Family succession

Information required for the family meeting from all family members.

What are your future goals and aspirations, personal and business (1 - 5 years)?

What are your future goals and aspirations, personal and business (5 to 20 years)?

What issues do the family need to consider with respect to farm family succession?

Actions Required

Appendix II

"Issues of NZ Farm Succession; The Study of the Intergenerational Transfer of Farm Business", MAF Policy technical paper 1171-4662; 97/4A (June 1998).

Conclusions from this research

Farm succession is a fundamental part of the transference of the farm business. No matter the state of the agricultural economy, many farm families will endeavour to ensure the continuity of their family on the land. For some families, particularly those with a history of intergenerational transfer and an appreciation of the need for planning and management, or those with a secure financial base, succession will be achieved relatively smoothly. For others it will continue to be difficult or even impossible. Planning and management will come too late and as a consequence succession may not be achieved successfully resulting in a weakened business operation facing ultimate sale.

Early in the research it became obvious that the respondents themselves had 'the answers' to successful succession. They had arrived at these answers' either through their own successful experiences or through being aware of the shortcomings within their own families that were blocking successful succession strategies. The 'answers' comprised three universal observations made across the two generations. They were:

- Open communication between the generations
- Begin planning and preparation for retirement and succession early
- Be open to ideas, be flexible, be prepared to change, to adapt, to exercise options

The research shows the critical importance of early planning and management of the succession process. Succession management should be automatically considered within the orbit of farm management and as regularly reviewed and monitored as are farm management plans. Without this management rigour succession is likely to be a 'hit and miss affair' damaging both the business operation and family and kinship relations.

Succession is an evolutionary process as the successor gains ownership step by step beginning first in partnership with his father over stock and plant. As father withdraws his interest the young farmer is likely to be joined by his spouse and together they hold ownership over total stock and plant. The withdrawal of the father's or the retiring couple's interest is critical for the entry into the farm business of the female spouse. In her case there can be no entry without exit.

Succession and retirement is a process of change and change is stressful. The greatest stress comes for the succeeding generation at the beginning of the process as they wait, uncertain about their eventual succession. For the retiring generation stress is attached to each of the major decisions that must be made if the process is to progress.

Uncertainty about ultimate succession is the greatest stress the successor farmer faces. Delayed succession impacts negatively on the farm business as ageing successors come to succession too late to carry out their own farm business strategies. When the retirement generation were asked to recall their own experiences they also identified the negative impact of slow or delayed retirement. A reluctance to retire can be the result of several factors, the prospect of a restricted income being one and being awed by the perceived legal complexities of succession being another.

Some farm businesses will not be in a position to be transferred to the next generation because they are unable to remain viable through the succession process. They may not be viable for any number of reasons. In these circumstances successors need to be told at the earliest that there will be no succession so that they don't remain 'in limbo' with unfulfilled expectations.

Appendix III

Bibliography:

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Appendix IV

NZLS Rural Property Transactions Conference 2007

Passing on the family farm – check List

The following checklists are designed to assist you in providing advice to farming clients who wish to discuss their succession planning issues.

Often one of the best ways to encourage involvement by all parties is to use a whiteboard so that ideas and figures are able to be captured.

Some of the following issues will be worth exploring in more depth:

Emotional considerations

- Has there been a clear articulation of the personal goals, needs and aspirations from all members of the family in the succession process?
- Is there a clear plan for preserving family relationships going forward?
- Has the entire family been involved and/or consulted about the process?
- How would you go about involving them in the process?
- Does everyone fully understand the outcomes and proposed strategies?
- Who is reviewing the plan from a family perspective and a professional perspective?
- How will the parents be involved going forward, once the succession plan has been enacted, eg, working on the farm?

Financial considerations

- Is viable farm succession a reality? (sometimes the best succession is no succession)
- The parents' retirement income requirements are clear and there is a built in allowance for inflation and the other essential considerations such as new cars, world trips and any health issues.
- The financial aspects of the business are clearly understood by all parties involved, including the spouse and children, with respect to present profitability, cash surpluses being generated, assets, debt and equity.
- The overall succession plan is workable on paper

– Have all opportunities been considered that are available including subdivision, off farm investment etc

- Does the farming business, once succeeded, have the capacity to continue to generate profits and cash surpluses and have the ongoing ability to continue to grow.
- Is the equity that is held within the farm able to be utilised off farm to build off-farm wealth for the non-farming siblings?
- Is the financial control passed on or retained at the appropriate stages?
- Is there any key person insurance required?

- What is the financial plan for non-farming children, particularly with respect to education, provision for first home purchases and starting their own businesses?

Meetings and the discovery process – the facilitators role

- The first meeting often involves setting the scene with the parents and exploring what the issues and possible options are.
- The next stage may involve an analysis of current business performance, cash surplus available for either re-investment into the existing business or for retirement requirements or off-farm investment, and how much equity is available within the business for off-farm investment. This often involves an analysis by the Accountant or Farm Advisor involved with the farming business.
- The next meeting may involve other members of the family and this is where it is important to ensure that feelings and emotional issues are explored before factual issues such as the financial situation are discussed.
- Ensure that there is a clear purpose for the meeting and an agenda which begins with “feelings before facts” then move into the financial information. When dealing with the financial issues make sure the information is very clear and understandable (use of a white board can be helpful).
- Make sure that everyone has an opportunity to participate in the meeting and put their views forward.
- Summarise the achievements and actions from the meeting.
- From an administration perspective it is important that there is a written record of the main points or actions from the meeting. This would be distributed to the family after it has been reviewed by the parents.

Advisory team

There can be a number of choices as to the source of advice to include in an advisory team.

Lawyers – are an essential component of the professional advisory team in the farm succession process. Appropriate legal structures are critical. Knowledge of the workings and set up of the trust, drafting wills and Memorandum of Wishes is essential.

Accountants – can provide advice on farm business performance and taxation issues, particularly when there is a change of structure, and the process for changing legal structures.

Farm consultants – Many farmers today have a farm consultant and they can often provide a very objective opinion on the financial robustness of a farm business and a potential farm succession plan.

Bank managers – Rural bank managers typically have good experience with farming businesses and can provide an independent and wide view on the overall succession process and its viability going forward.

Non-professional Advisors - These people may include friends or relations of the family who are involved with the farming business, trustees of an existing family trust who may be able to add value to the overall succession process.

There is a clear need for professionals to work more closely together in the farm succession process. No professional is an island unto themselves and all professionals are able to add value to a successful succession plan.

Farm succession needs sustainable profits

Gerard Hall

Rampant land prices seen in recent years appear to be quickly moving land purchase out of the reach of many aspiring farmers and the younger generation wishing to purchase the family farm through succession.

Increasing land and asset values coupled with average farm incomes relative to prices now being paid for land assets means the incoming farming generation faces an uphill battle accumulating the necessary cash and tax paid savings for future farm purchase.

Adding even more pressure to the family farm structure and the first farm purchaser, is the prospect that in the current environment, a farm business needs to grow by at least two and half times within the next 20 years for the successive generation to purchase and operate a business that will continue to be viable.

Country-Wide asked George Collier, an Alexandra-based chartered accountant and farm consultant, how best farming families might meet the many challenges they now face in providing for farm succession.

Collier is quick to acknowledge that he does not have all the answers but points to a number of well proven business principles.

He says, many of the challenges associated with farm business succession are similar to those that are faced by most businesses.

"For it to be achievable, succession requires strong underlying profitability, a focus on business growth and a well thought out action plan."

Collier believes an efficient and profitable farm business is the foundation for successfully implementing any farm succession plan. Without sustainable farming profits it is difficult to make the whole exercise work going forward.

"Profitability and growth are the two cornerstones of long-term success in any business venture, not merely reducing debt. As in any business, continual growth is critically important but more so in farming if the continuing decline in real terms of trade continues."

The dilemmas that make the process challenging include adequate retirement income, being fair to all children, managing succession so that the successors and the farm business is not burdened with debt, and ensuring that everyone retains a sense of family cohesion at the end of the process. Regardless of equity arrangements or ownership stakes, many non-successor siblings will retain emotional ownership of the farm throughout their lives.

"There aren't necessarily any recipes sitting on the shelf but there is certainly a number of important principles including open and honest communication, so everyone knows what is happening; beginning succession management early enough in the generational business cycle, and making provision for the non-farming children."

Being clear about the whole family's objectives and having in place the correct trading structure to make it work are also pivotal, he says.

However in some instances farm succession can easily get so bogged down in some of the issues so much so that the capital and income needs of the retiring parents are forgotten about.

All to often it is easy to lose sight of the fact the parents' wishes and financial requirements are paramount. Good succession planning involves fitting around the parents wishes and requirements, not, as Collier says, remaking their wishes and requirements to meet the needs of others.

The first action of any successful farm succession plan is protecting the capital and income of retiring parents, particularly when some will live for another 30 or 40 years after retirement.

"Open communication and early planning is important. Family members and advisors are certainly not mind readers. Full family meetings early on are usually well worthwhile so that all involved have the chance to air their views and feelings. Involving all members of the family from the outset also provides the opportunity for all the family to be involved in putting the plan together."

Quite apart from the money involved it is important that nothing is agreed to unless it's completely understood by all parties.

Collier says like any business plan a succession plan needs to be flexible so that changes in strategy can be quickly made. There also needs to be the flexibility in terms of the type of structure that will allow for the succession to take place.

"We are tending to find that the most preferred succession planning structure is often a limited liability company that has as its major shareholders' family trusts. This structure works well as it allows flexibility for changing shareholders at any stage without selling the underlying assets."

Collier also points out that having trusts as shareholders means that ongoing growth in share value is captured in the trust and not in individuals' names.

He suggests that succeeding children and non-farming family members should be building their wealth through trusts and not in their individual names to provide for protection from matrimonial and property relationship implications.

Turning his attention to children who may not be involved in the farming business going forward, Collier says having a plan for them is critical. Treating all children equally and ensuring viable farm succession is a financial impossibility for the majority of farming families.

The key is to strive to be "fair" rather than "equal" in the provision of non-successor children. This is why it is important to involve non-successor siblings in family meetings when discussing the future of the farming business.

"This may involve making provision for educational expenses after leaving secondary school; or aggressively developing an off-farm investment portfolio when debt servicing is at a manageable level; or planting an area of the farm in forestry to provide a source of cash to the non-farming family members when they could really need it."

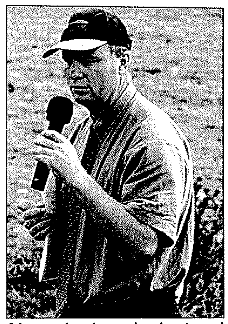
Collier says in some instances a farm business with little or no debt may be under utilising one of its most important resources for farm succession.

"Low debt loading on farm provides the opportunity to pursue off-farm investment options which can provide cash returns and capital growth for non-farming children. It can be a very tax effective and can provide the opportunity for further farm expansion if that is desired."

"Moving even relatively small amounts of cash to the non-farming family member at 25-35 years of age can be enormously helpful in assisting in the establishment of a business, buying or building a house, etc and is certainly appreciated."

"For this concept to be achievable it is very dependent upon reasonable levels of farm profit," Collier says.

"It can work extremely well and more importantly, reduce friction amongst children at a later date. In many respects it is about the time value of money, he adds.



Alexandra-based chartered accountant and farm consultant George Collier says successful farm succession requires strong underlying profitability, a focus on business growth and a well thought out action plan.

Children want family estate preserved

A study of issues relating to New Zealand farm succession highlights that a large number of farming children feel that while the family farm should not necessarily be preserved at all costs the estate certainly should be.

The study was carried out by Heather McCrostie Little in 1998 for MAF Policy.

Among the key outcomes highlighted in a survey on farm succession in New Zealand was that children thought their parents had done much more planning than they had reported especially in relation to updating wills and discussing with their consultants and professional advisers the topic of farm succession.

Also seen as important outcomes of any successful farm succession plan was the provision of a secure retirement income for parents, and the expectation that all children be treated fairly as well as ensuring the ongoing viability of the continuing business.

With land values now reaching levels that few successors could take on the farming business at market terms unless a farm estate is large, it is becoming increasingly more difficult to accomplish farm succession, treat all children equally and provide for retirees without major compromises.

Noting that the farm succession process is a very long transition period, about 18 years, the survey also found that the average retirement age of New Zealand farmers was 59 years and the average age when succession was complete was around 42 years of age.

After retiring and handing over responsibility many parents continue to provide a mentoring role and labour to the farming operation.

Crostie's study can be found in MAF Policy Technical Paper 1171-4662; 97/4a-www.maf.govt.nz

Decision critical

One of the most critical decisions that the farming family can ever make is having the right team of professional advisers involved.

Farm accountant and consultant George Collier says it is vital that the ownership, trading arrangements and wills are well set up to allow for a smooth and seamless farm succession process.

Collier says in many cases businesses outside of farming do not pass on to the next generation.

"Sometimes we can get all to emotional and lose sight of the realities of the situation. In some situations the best farm succession plan is no succession. If this is the case the best decision may be to sell and invest the capital elsewhere, or help family members in other ways."

While acknowledging the value family ownership offers the industry, Collier says growth in farm syndication and equity partnerships business structures will continue.

"These create opportunities for younger farmers aspiring to higher levels of management and also other another form of farm business ownership but on a larger scale basis, often with a greater commercial focus. Equity partnerships have predominated in the dairy industry but will become more common in all farming systems including sheep, beef, deer and arable systems going forward."

"Just as important as the equity that financial partners might bring to a business, is the outside expertise, lateral thinking, inspiration, accountability and planning that comes with this whole exercise," Collier says.