

Paper

Multi-family Business Models

A presentation for the Canadian Farm
Business Management Council
The Farm Succession Conference
Quebec 2009

The Need for Research

- Very little work done on farmer to farmer collaboration in UK
- Farmers require know-how on restructuring options.
- Most co-operation in UK with inappropriate agreements
- Sector expertise not acquainted with appropriate legal structures for horizontal co-operation



Well – That’s NOT what we agreed!!

The concept

Most family farms have one profit centre (e.g. with livestock where milk is sold) and perhaps two cost centres (forage production and raising of young-stock)

Co-operation between two or more family farms produces:

- (A) Economy of scale
- (B) Shared skills
- (C) A new business structure

Partnerships

It is essential that the parties do not see themselves as partners. The consequences could be damaging to one or both of them:

If you are deemed to share profit then you are also deemed to share Losses, and

Both parties are jointly and severally liable for all debts incurred by either of them in carrying out the partnership activity.

Co-operation between family farms

A situation where two or more families carry on an activity together for their mutual benefit.

Co-operation achieves desirable objectives, e.g. economies of scale, the downside is that participants have to accept, and acknowledge, a degree of loss of control over the activity.

This can create tensions in decision making. For this reason, co-operation can only last as long as the parties are in total agreement with what they are doing.

The objectives for co-operation

- To capture value for the farming family in the supply chain
- To keep the assets of the participants' farming businesses independent
- To allow **interdependent** farm management
- To create a better style of life for stakeholders

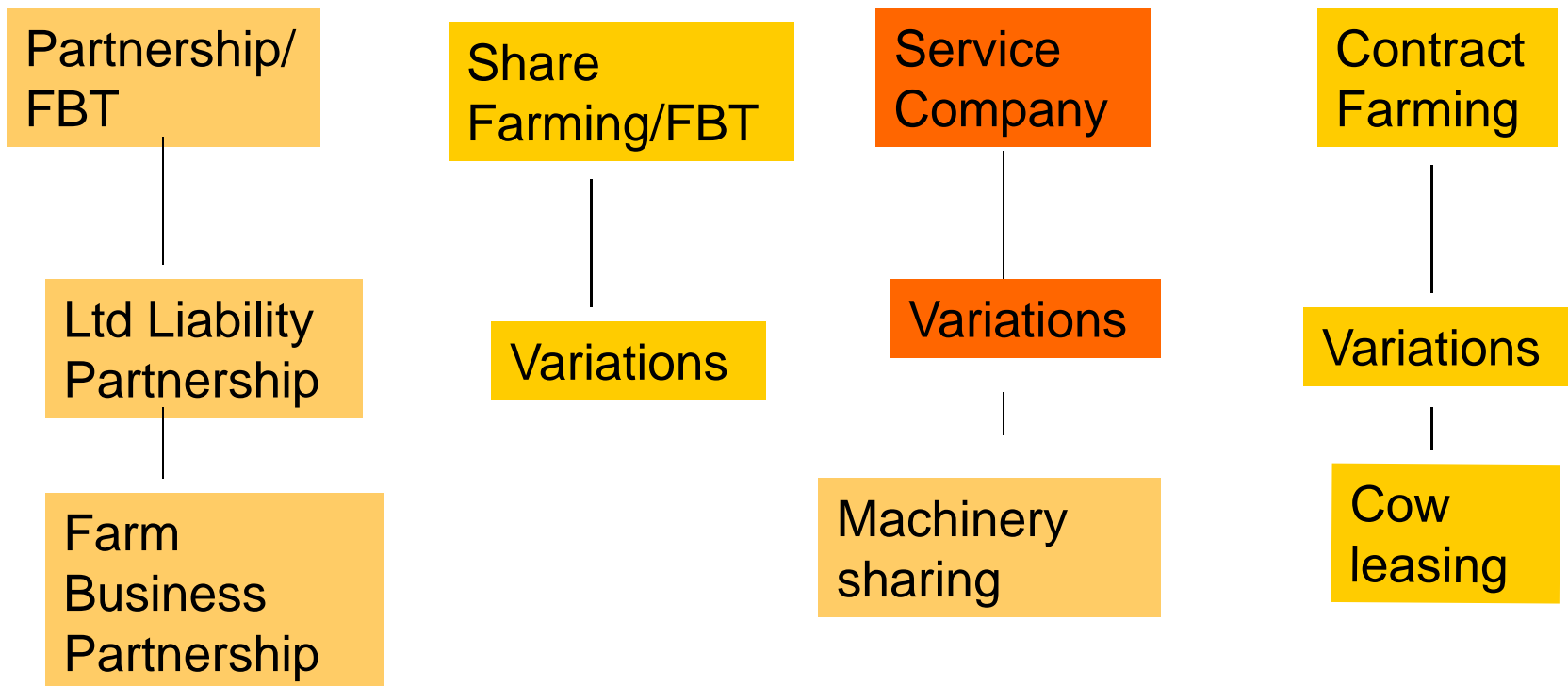
Some reasons for co-operation

- Lower costs of production
- Large units more profitable
- Need to diversify into other activities
- Income Tax reasons
- Rid duplication of equipment
- Mitigate against risk
- Families working too long hours
- Cut need for outside labour
- Policy of increasing yields or livestock numbers no longer the answer
- Using another person's skills

Principles

- Economies of scale; high productivity per person
- A new business infrastructure created which retains independence of existing family businesses.
- One 'herd number' enables flexibility over cattle movements
- Skills specialisation, e.g. Forage or corn production separated from milking and livestock rearing
- Participants don't count pennies

Types of models-depending on circumstances-for co-operation



Target Families

- Entrepreneurial, young, expansionist on medium sized holdings – constrained by current physical and social infrastructure.
- Families on an exit strategy. Transfer of stock, land and buildings to co-operate with expanding families.

Service Company

What is a Service company?

A company is termed a Service Company when the main function:

- (a) does not involve acquiring assets
- (b) Is to provide a contracting vehicle for the shareholders.

The establishment and legal implications are the same as for any limited liability company.

Service Company

1. Two or more farmers decide to work together
2. Set up a company – takes on debt
3. Move various overheads to Company
4. Company becomes new profit centre
5. Company plans work schedule
6. Company contracts services to farmers
7. Farmers concentrate on their income

Benefits & Pitfalls of a Service Company

Benefits:

- Easy to disband
- Reduces labour
- Capital released from machinery duplication
- Management synergies
- Big Expansion potential

Pitfalls:

- Setting up costs:
 - Extra set of accounts
 - Extra Admin costs
- Operating Agreement
- Potential for disputes

Hypothetical example of a Service Company Model combining two farm businesses (JHA and Aubourn)

For advice on tax efficiency – consult an accountant

Specifications	Farm A	Service Co.	Farm B	Comments	Benefits
Milk Price	18	18	18		
Acres	200	400	200		
Herd Size	150	300	150		
Yield (l/cow)	6,500	7,125	7,750		
Total Milk Sales	975,000	2,137,500	1,162,500		
% Leased Quota	10%	10%	10%		
Owned Quota	877,500	1,923,750	1,046,250		
Leased Quota	97,500	213,750	116,250		

	Farm A	SC	Farm B	Comments	Benefits
--	--------	----	--------	----------	----------

Budget					
Milk Sales	175,500	384,750	209,250		
Cull Sales	10,000	20,000	10,000	25% replacement	
Calf Sales*	9,500	19,000	9,500		
Replacements	-30,500	-61,000	-30,500	25% replacement	
Total Income	164,500	362,750	198,250		
Purchased Feed	39,060	76,860	41,800	0.3kg	
Other	15,750	31,500	15,750	£105/cow inc. VM	
Quota Leasing	7,800	17,100	9,300	Quota lease @8ppl	
Forage Costs	10,750	23,500	12,750	1.1ppl	
Total Var Costs	69,360	148,960	79,600		
Family Labour		37,500			
Herdsman	25,000	25,000	25,000		25,000
Power & Mach	26,325	41,941	31,388		15,772
Property Costs	15,250	31,950	20,250		3,550
Admin	7,500	10,000	7,500		5,000
Rent/leasing		0			
Total Fix Costs	74,075	146,391	84,138		49,322
Total Costs	143,435	295,351	163,738		
Profit	21,065	67,399	34,513		

	Farm A	SC	Farm B	Comments	Benefits
--	--------	----	--------	----------	----------

Profit	21,065	67,399	34,513		
SFP	16,783		18,453		
Less private drawings	18,750		18,750		
Net cash flow	19,098		34,216		
Income Summary from JV:					
Salary	18,750		18,750		
50% dividend	33,699		33,699		
SFP	16,783		18,453		
Total JV Income	69,232		70,902		

Service Company financial tools

- The buy-back agreement. SC invests on one of the farms. Owner buys back over 20 years.
- Rent. The SC pays rent on farms.
- Salaries. Paid by SC for 50 hrs/week
- Dividends. Paid to Farmer/shareholders
- Leasing. Quota, Cows, Tractors leased by SC

Share Farming

Share farming model?

Co-operation using a standard share farming agreement **but** between a dairy farmer on an exit strategy and a farmer on an expanding path.

The **Gross Returns** are shared, not profits

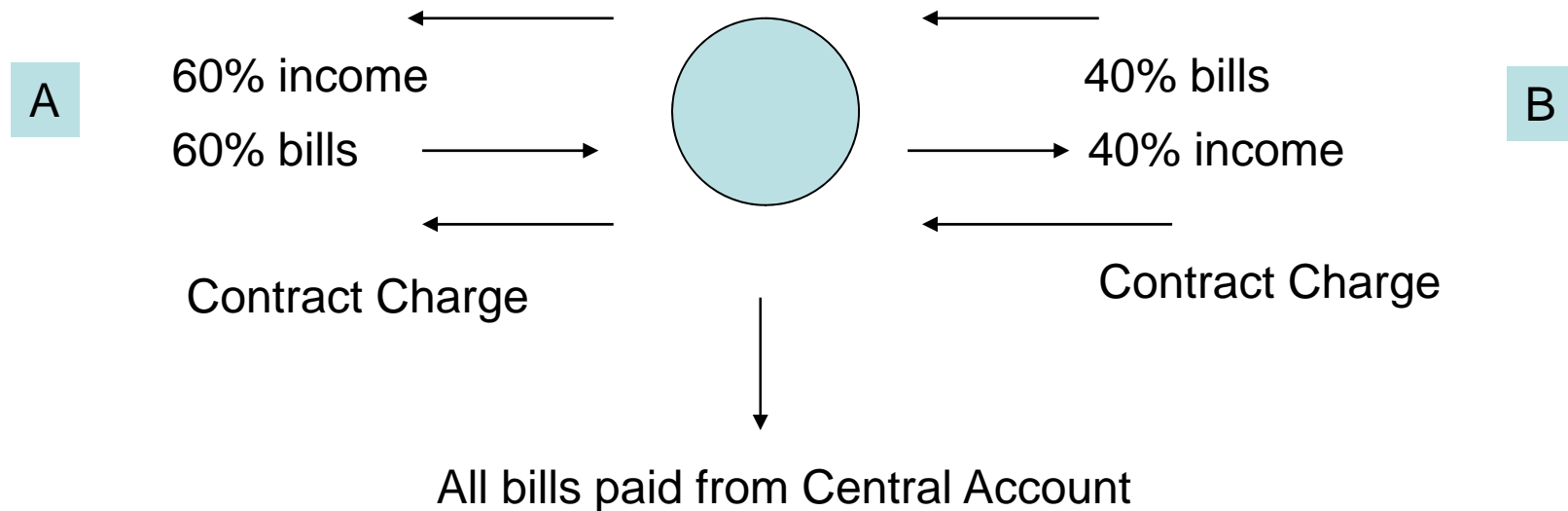
Parties to the JV carry on separate businesses and make **separate** IR returns.

Share farming Model

Objectives: Neighbour A wants to farm bigger unit, neighbour B wants to concentrate on off-farm income



All income to Central Bank Account



Benefits accruing from a Share farming model

- A receives profit after 60% income & exp'd.
- A receives 40% of management fee
- Remains two separate businesses
- A has bigger and more viable business

- B receives profit after 40% income & exp'd
- B pays income tax as schedule D case 1 (not schedule A as for letting his farm)
- B concentrates on his off farm income and lives in farmhouse

Contract Farming

Outline model of a Contract Agreement



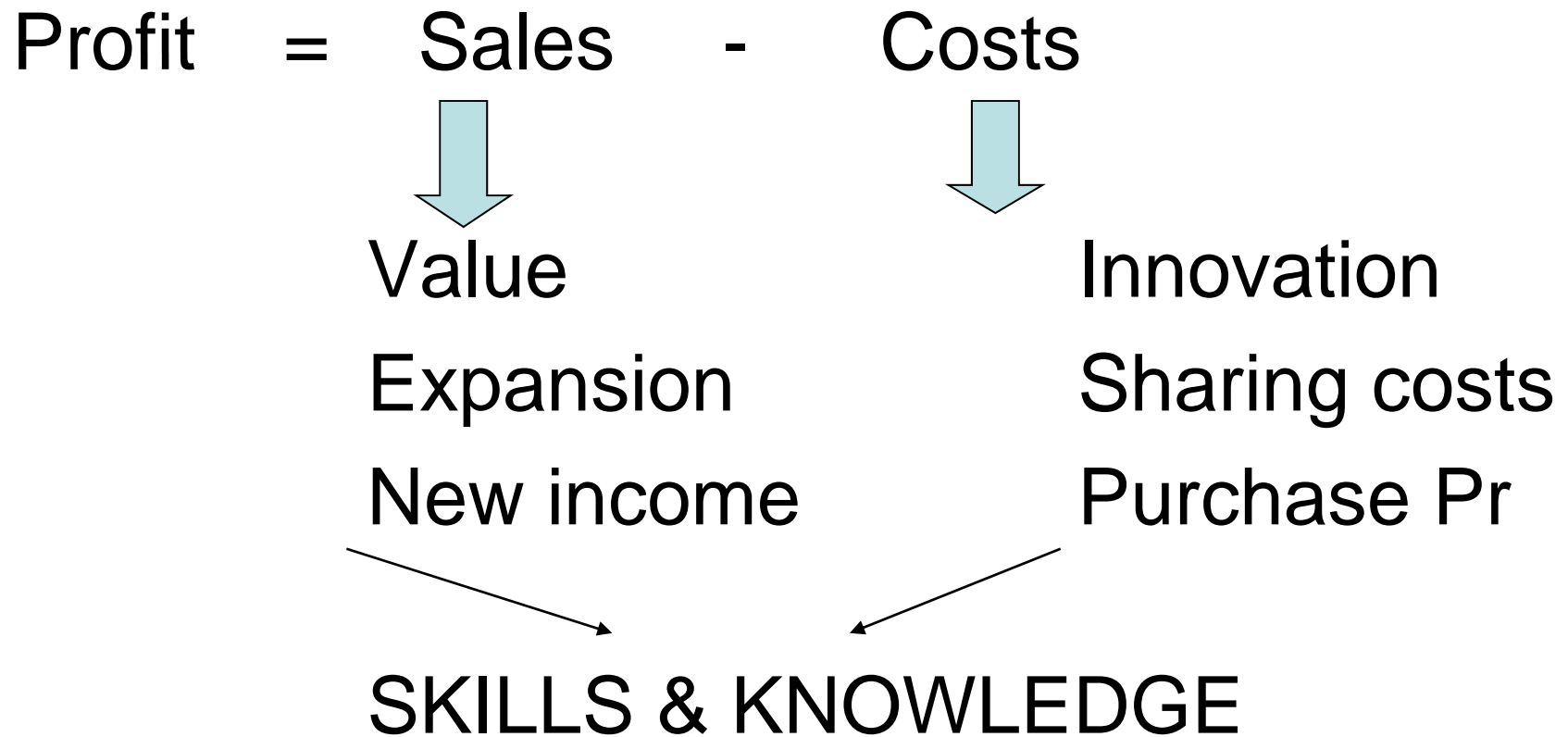
- Farmer LEFT has 150 cows
- Farmer RIGHT has 100 cows and sends them to farmer LEFT
- Farmer LEFT gets 40% and Farmer RIGHT 60% of the milk price on 100 cows.
- Both benefit - assets (fixed costs) better utilised

Getting an Agreement

The principles of binding businesses:

- What if planning, plan for 5 years, make sure an exit strategy exists
- Tailor agreement to requirements
- Build agreement – verbal - agreed infrastructure – written Agreement
- Parties go through an Agreement Check List (Done by an Agricultural Consultant)
- Once 'Heads of Terms' done then Legal Agreement drawn up by a Solicitor.

Finding a common vision



Layered Agreements

- Shareholders Agreement (rules)
- Management Agreement (between farmers and Company)
- Good accounting - records of transactions

Conclusion

- There is a genuine place for more horizontal cooperation between families
- Restructuring must be genuine: i.e. to obtain economies of scale.
- Farmers who succeed have a 'dependent management style' which requires a legal framework
- Farmers need professional guidance to succeed