

IFMA 22 Cover Page

Sub-theme: People of Future Agriculture

THE EVOLUTION OF SUCCESSION AND GOVERNANCE ON A MEDIUM SIZE DAIRY FARM. A CASE STUDY FROM CANTERBURY, NEW ZEALAND

M.C Pangborn

Faculty of Agribusiness and Commerce, Lincoln University, Lincoln 7647, New Zealand

Corresponding author: Marvin.Pangborn@lincoln.ac.nz, 643 302 7460, Marvin Pangborn, 48 Headworks Rd, RD 13, Rakaia, 7783, New Zealand

Acknowledgments: no financial support

Words: 1970 (abstract 174)

Applied paper

THE EVOLUTION OF SUCCESSION AND GOVERNANCE ON A MEDIUM SIZE DAIRY FARM. A CASE STUDY FROM CANTERBURY, NEW ZEALAND

M.C. Pangborn

Faculty of Agribusiness and Commerce
Lincoln University, New Zealand

Abstract

Alderbrook Farm Ltd. (AFL) was established as a 50-50 sharemilking partnership in 1987. Since the initiation of operations, the business has grown to be a self-contained business of two farms and support blocks milking 1,200 cows on a farming area of 550 hectares near Christchurch, New Zealand (NZ). Previous publications have described the growth in dairying in Canterbury (Pangborn et al. 2015) and the growth of this business (Pangborn 2012).

The process through which the farm established a succession plan and further developed a governance structure to oversee the operation is explored. It was clear that involving a facilitator at the onset to improve communication and give all family members a 'voice' was critical. After establishment, it was equally important to establish a plan that developed a purpose, mission and goals for the business. Further, a governance structure was adopted to oversee the plan. To date, the process has allowed the pursuit of the purpose of the plan; however, succession has come at a cost to the financial stability of the existing farm business.

Key words: *New Zealand dairy, governance, succession.*

Introduction

Land used for dairy production in Canterbury (New Zealand) increased from 20,000 ha in 1980-81 to 271,102 ha in 2016-17. Overall dairy production in Canterbury increased during this time from 14.5 million kilograms of milksolids (fat plus protein) in 1980-81 to 385.6 million kilograms milksolids (kg ms) in 2016-17. Alderbrook Farm Ltd. was part of this growth progressing from milking 500 cows as 50-50 sharemilkers¹ to owning 1,200 cows and owning/leasing over 550 hectares for the milking herd and support of the dairy farming system. Total milksolids production has increased to 576,300 (kg ms) – with per cow production of 480 kg ms and per hectare production of 1,773 kg ms in 2017-18.

The land involved in the business transferred from the company to a Family Trust in 2003. The holding of land by trusts is common in NZ for several reasons including the protection of family assets, tax planning and to address the NZ Property Relationships Act. The founders and their two children are beneficiaries. The assets employed on the farm (cattle, machinery, feed, dairy company shares) remain in the ownership of the company (AFL). As the founders of the operation entered their 60s, the future of the farm was considered – but no action was taken, as they were happy with their present situation. However, the impetus to start the process was a health problem for one of the founders in 2014.

In this paper, the process and results to date of the process are outlined. As with any discussion of the 'human side' of farming, the results will be highly influenced by the context of the family, industry and country. The theoretical framework is that of a case study

¹ 50-50 Sharemilking is a system where a farm owner (land) and a farm operator (cows/machinery) share the revenue and some expenses from the farming business.

undertaken within the qualitative genre (Yin 2009). As such, the aim is to establish insights relating to what happened and why it happened.

Sensitization

The purpose of this paper is to document the succession and governance experience of one farming family, rather than to produce an academic paper on succession and governance. Therefore, the sensitization process focussed on literature obtained from extension and commercial entities over several years.

Succession:

Nuthall and Old (2016) suggest that NZ farmers resist succession planning despite proof that early planning leads to success. Factors such as a reluctance to accept ageing, a concern over the risks involved and inappropriate objectives may all lead to procrastination.

Van der Hoeven (pers. comm., 2005) sowed the first seeds for succession planning in a seminar at Lincoln University. In that presentation, Van der Hoeven made the following observations regarding successful succession:

- Clear vision and purpose for the business – the farm must be profitable.
- Strive to be fair rather than equal with non-farming family.
- Motivation may be other than money, such as keeping the farm in the family.
- A willingness to trust and support the farming successors.
- A growth philosophy.
- Good communication and working partnership between generations.
- Consideration of the needs of the retiring generation.
- The structure used reflects the circumstances.

A further influence for the founders in clarifying their motives for pursuing succession were questions asked by Redpath² (pers. comm., 2014). These included:

What do you want to be doing in five years' time?

What do you live for? What is your purpose in life? What do you stand for?

What have you done so far about succession planning? What is the next step?

What 'courageous' discussions do you need to have, about what and with whom?

What keeps you awake at night around family succession?

If you died today, what would happen?

What do your children want?

What is the value of a sustainable family in the future?

Governance:

Concurrently family members studied governance through attending New Zealand Institute of Director courses. Key learnings from these programmes were:

- Good governance is about 'insight, oversight and foresight'.
- A key problem for farmers is that often the governors are the managers and nearly always, the farm is their home.
- It is important to separate management and governance activities.

² John Redpath is a principal in Coach Approach Rural, a NZ company involved in succession planning.

- Due to director liability laws in NZ, an advisory board may be a more appropriate vehicle.

Further exposure to governance from attending the Business Torque governance course³, expanded the list of governance objectives for this entity. These include:

- The governance body must work in the best interest of the company, not individuals.
- The ‘management dilemma’ is driving the business forward while maintaining prudent control.
- Meetings must be a safe zone, where members can speak without the fear of repercussion.
- An independent advisor to the management group is appropriate – probably someone from outside of agriculture.
- The group needed to establish a purpose, mission, family and farm values, develop strategies for the next five years and adopt the appropriate structures to achieve the strategies.
- A commitment by management to produce an annual report and updates before each management committee meeting to all family members.

Most importantly, it was realized that the development of governance is never finished. To quote Nuthall and Old (2017), “For every family situation there will be at least one ownership/governance system that suits their characteristics. Maintaining flexibility is important to allow for changing situations and goals. An optimal system in each case will depend on personalities, goals, knowledge, abilities and managerial skill, training, family structure and ownership, size of business, and succession requirement”.

Results

Facilitation:

The first task was finding an appropriate facilitator and then achieve ‘buy in’ from family members. Finding a facilitator whose personality fit with family members was important. The initial meeting between one of the founders and the facilitator discussed the business in its present state and the makeup of the family. The first decision was that all family (including partners) were to be involved and there would not be any prescribed outcomes presented throughout the process.

Over the next four months, all family members met with the facilitator to gain an understanding of the process and to complete surveys on their values. The initial components of the succession plan included (Redpath pers. comm., 2014) the preparation of a business overview and learning what was important to the parents as well as discovering what was important to the family members. A family meeting was held to discuss the values uncovered (some members have mentioned that they were uncomfortable with this aspect) and to gain an understanding of the asset base and farm profitability. Several alternatives discussed included: selling some assets, selling all or part of the farms or keeping the business intact. Most of the family favoured maintaining the present farming system, but using the financial strength of the business to allow the next generation to build their own businesses. However, it was recognized that without the realization of assets, the cash flow from the farming business would need to support the founders in their retirement.

³ Business Torque is a governance course operated by Peter Allen

Purpose, Mission and Strategic goals:

The next step involved developing a plan. A chart (Figure 1) was created that outlined the purpose, mission ‘pillars’, strategies and KPI’s to measure progress. It was agreed that any proposed changes to any section would be considered in light of the purpose.

Purpose

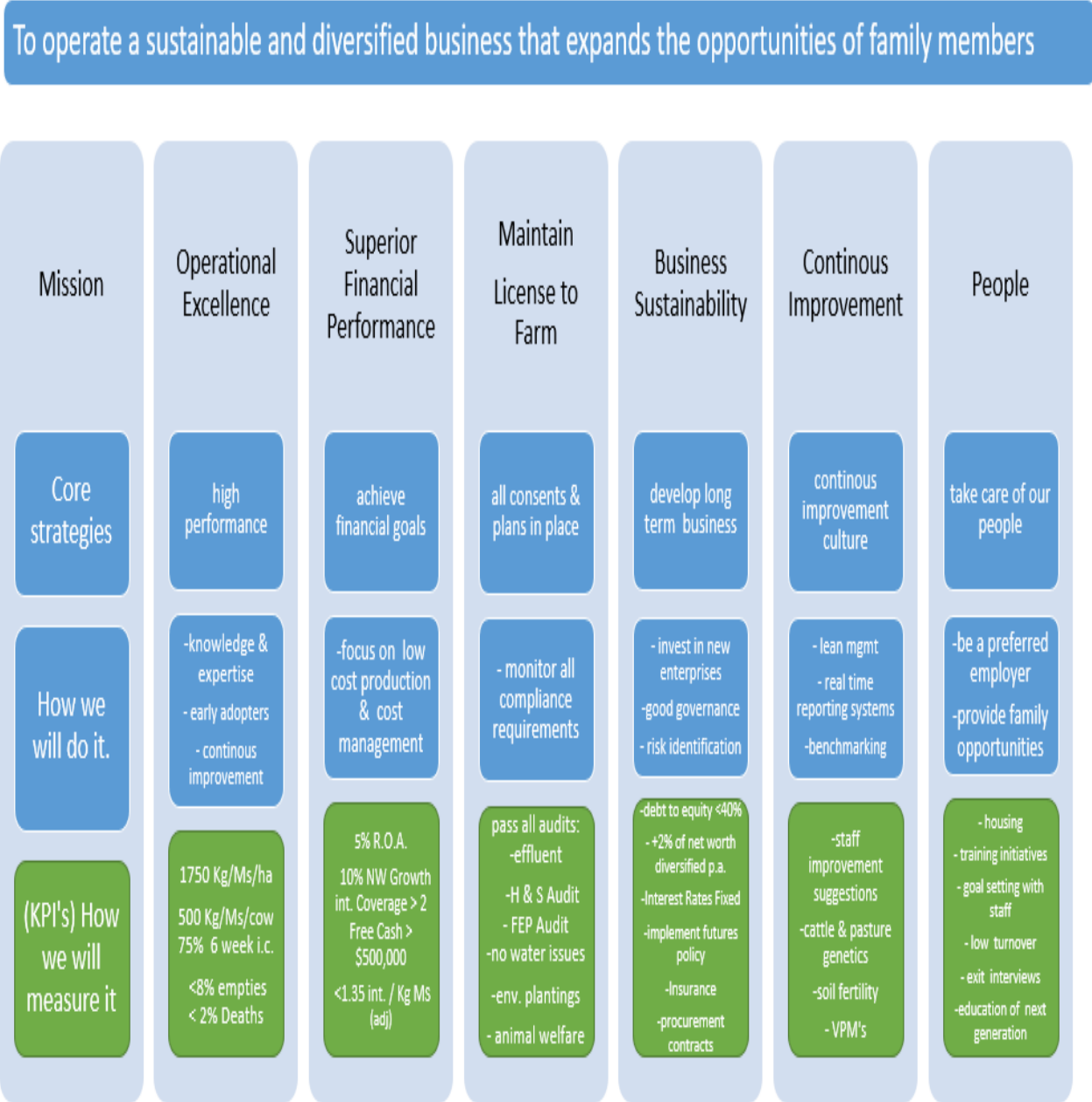


Figure 1. Plan for Alderbrook Farm Ltd.

Development of Governance structure:

An advisory board including all family members was established to meet three times per year. One of the founders would provide operational and financial reports on a regular basis. Early meetings concentrated on bringing the next generation ‘up to speed’ on the business. The family to date has resisted adopting a formal board of directors. This is partially due to

liability issues for directors under recently introduced liability laws and a desire to maintain family control. For the first few years, all six family members attended three meetings per year. However, babies started arriving three years ago, and in the past year, the structure has evolved to a 'Management Group' of the three males and the company accountant. The women will return when time allows. A search for an independent advisor is in place.

Outcomes

Since the succession process began, family members have been assisted into their own businesses. One couple has returned home to 50-50 share milk one farm and contract milk the other. This involved intensive budgeting and negotiations, concessions on cow prices, a commitment to re-developing one of the farms, a concession to a variable rate by the new 'family sharemilkers', loan guarantees and acceptance by all members that a 50-50 situation reduces the profitability of the dairy business.

The other couple are horticulturalists and have worked in the Kiwifruit industry for 11 years. They wished to become self-employed and have developed a business managing orchards, providing research assistance to the industry body and have purchased a 'crop loss' insurance assessment business. Recently, they secured an existing orchard and raised private capital to convert the orchard to a more profitable variety. The use of the present dairy farm's equity has helped through providing them with a short-term loan to purchase the insurance assessment business and the farm has purchased a shareholding in the orchard. These have increased the farm's debt. The horticulturalists have mentioned that a lack of passion for the family's core business can be a detriment to their involvement – although they make significant contributions to governance.

From a 'profit maximization' point of view for the existing dairy farming system, these moves have been detrimental. The move to a 50-50 sharemilker is estimated to reduce free cash⁴ by approximately \$100,000 per year. In addition, the farm has acquired debt and provided guarantees to finance the succeeding generation's businesses. Key financial measurements (debt per kg milksolids, debt to asset ratio, and debt service per kg milksolids) have been negatively affected, although still within industry-accepted ranges.

Conclusions

Every family and every situation are different. Although it is too early to predict success for the succession and governance programme at Alderbrook Farm Ltd., family members are pleased with the progress. Aspects considered important in the process are:

- An understanding of van der Hoeven's succession principals.
- A willingness to learn about succession and governance from several sources.
- The importance of the involvement of a facilitator.
- Committing a plan to paper.
- Constantly reviewing the plan.
- Establishing a governance structure helps to ensure progress of the plan.
- The establishment of a 'culture of further learning'.
- Not expecting instant results and being aware that family dynamics will change.
- Some family members must be passionate about the core business.

⁴ Freecash is defined as ebit less interest and tax

Challenges have included:

- Costs involved in the process.
- Conflicting goals of growing the existing dairy farm business while providing opportunities for the succeeding generation to establish their own businesses.
- Cash flow effects and increased debt levels
- Changes to key metrics for measuring financial position of the existing business.
- Determining who drives the process?

References

- Garratt, B. (2010). *The Fish Rots from the Head* (3rd ed.), London, Profile Books Ltd.
- Nuthall, P.L., Old, K.M. (2016). Farm owner's reluctance to embrace family succession and the implications for extension: the case study of family farms in New Zealand. *Journal of Agricultural Education and Extension* 23(39-60).
- Nuthall, P.L., Old, K.M. (2017). Will future land based food and fibre production be in family or corporate hands? An analysis of farmland ownership and governance considering farmer characteristics as choice drivers. The New Zealand case. *Land Use Policy* 63(98-110).
- Pangborn, M.C. (2012). Growth and innovation in the development of the Canterbury dairy industry. Unpublished Ph.D. thesis. Lincoln University.
- Pangborn, M.C., Woodford, K.B., Nuthall, P.L. (2015). Development of a dairy industry in a new area – land use change in Canterbury, New Zealand. *International Journal of Agricultural Management* 5(1-2), 20-25.
- Yin, R.K. (2009). *Case Study Research: design and methods*. (4th ed.). Thousand Oaks, California. Sage Productions.

Acknowledgments

The author thanks the following for reviewing and offering comments on this paper:

Guido van der Hoeven, Peter Nuthall, John Redpath, Peter Allen, Anthony Pangborn.