Discussion Paper - Farm Equity Partnerships

With reference to the stakeholder proposals in the recently released Agricultural Competitiveness Green Paper, attention needs to be given to educating Australian farmers and investors on the benefits and risks of alternative farm ownership models that have been successful in other similar agricultural focused countries, such as New Zealand.

Farms in Australia have typically been owned and operated as family businesses. The traditional path to ownership has been either through inheritance or bank debt funding. However, as land prices continue to increase and foreign investors circle, farm ownership by an individual is becoming increasingly difficult and unaffordable.

The family farm is arguably the most robust small business in Australia. However, with a lack of access to different forms of capital to fund its continued growth and productivity improvements it is in danger of becoming extinct. New structures for owning and operating farms need to be encouraged in order to attract investment from domestic and foreign investors as well as capital markets. According to the *Greener Pastures* report by Port Jackson Partners (commissioned by ANZ Bank), agricultural growth cannot be achieved without the support of both domestic and foreign investors. Between now and 2050, approximately $600 billion in additional capital will be needed to generate growth and profitability in Australian agriculture. A further $400 billion will be needed to support farm turnover, as ageing farmers make way for the next generation.

One such structure is farmer equity partnerships which attempt to harness the experience and capabilities of Australian farmers and combine them with fresh capital from investors, most likely foreign. Equity partnerships are a form of joint venture between individuals who have come together to pool their capital and possibly skills to maximise revenue and capital growth, consider new opportunities and ensure maximum productivity and efficiency from the business.

This frequently involves retaining existing management or recruiting local resources to control the production process, so both the investor and farmer have ‘skin in the game’. Generally one of the partners is employed as the farm manager. It also provides farmers with an alternative to the traditional single financing option, which is based on their equity and reliance on bank-supplied debt finance.

For many, equity partnerships are a viable alternative ownership structure that provides an opportunity to achieve business and personal goals that could not be achieved alone. The partnerships are also a good way for older farmers to maintain some stake in an asset but allow new management to become involved in the farm to continue delivering an income. For some families, equity partnerships have helped solve many succession planning issues by allowing non-active shareholders in a farm to divest their stake to a new investor without the farm necessarily having to be sold off.

Equity partnerships are usually structured as a private company with shares issued to each member according to the amount of money each investor subscribes. The equity partnership owns the land, plant and any stock. For an equity partnership to be successful it should have:

- A clear business plan which includes realistic budgets and projections;
- An indicative investment period and a clear exit process for shareholders;
- A shareholders agreement that addresses decision making, share sales, a share valuation process and how disputes are to be addressed;
- Clear job descriptions and work contracts for all staff; and
- A clear communication plan regarding a farm report as well as budget versus actual financial reports.

In New Zealand, equity partnerships have become a very popular investment model in farming, especially in dairying, due to the help they have given younger farmers, in particular, get the start they need. They have provided fresh opportunities for young farmers, family businesses and older farmers trying to scale back.
Equity partnerships have helped overcome the hurdles that higher land prices have traditionally thrown at farmers wanting to expand or improve their efficiency through scale. With increased profitability associated with larger farms and improved production techniques, equity partnerships enable investors to buy into another farm without the high debt / risk levels and consequently achieve the benefits of scale associated with large farm ownership without the major issues. In turn, new thinking, ideas and business practices are introduced.

A new partner can accelerate a company's growth in ways that are otherwise unlikely. The funds that an equity partnership brings have enabled businesses to launch new products, hire new employees, add facilities and increase their infrastructure. It can also benefit a business by helping to sustain it financially and advising the decision making process during periods of uncertainty such as drought and floods.

However, despite all of the advantages associated with establishing an equity partnership in the agricultural industry there are still many risks, especially those concerning control, scrutiny and expectations that need to be weighed up just as much as the benefits.
The decision making process within such partnerships involves more than one person. Regardless of whether one partner retains a majority shareholding the other partners have the right to challenge certain business decisions. This point may mean that the decision making is slower but may result in a better decision being made. Decisions may be a compromise and may not meet all shareholders' expectations which could result in a partner being voted out should the company not produce the targeted growth rate.
Partnerships also attract greater financial scrutiny by the partners. Income and expense items that were taken for granted under a sole owner are now questioned and analysed to ensure maximum return.

The most common disadvantage of taking on equity partners is loss of total control of the business by the original owner. As mentioned above most investors expect a significant return on their investment (30-35%). If the company is unable to produce the results expected, the business's original owner could realistically be voted out of his / her own company.

The equity partnership model never really took off in Australia primarily due to lack of liquidity in the farm land leasing market. In New Zealand farm land does not attract capital gains tax when it is sold, meaning stakeholders of farm businesses involved in land ownership can buy-in and sell-out of equity partnerships relatively easily. This is not the case In Australia where the sale of business assets attracts capital gains tax.

This, however, does not appear to be a deterrent for foreign investors who wish to invest in Australian agriculture. Foreign investment has the potential to help Australian farmers inject much needed capital into their farming operations and hence, revitalise the agricultural industry.
Australian agribusiness has a very long history of foreign investment with many foreign-owned companies already controlling significant players within the dairy (Lion, Fonterra and Parmalat), sugar (Finascure, Wilmar and COFCO), grain (Viterra and Cargill) and vegetable (McCain and Simplot) industries. Investment activity to date, however, has focused past the farm-gate within food processing assets. These assets are appealing as investors are familiar with their business drivers. Investors are increasingly seeing value in harnessing the management strengths of the existing family operation on the farm, which can be achieved through equity partnership models.

By encouraging equity partnerships to flourish Australia could potentially be attracting a sufficient amount of capital that will ensure the long term viability of the agricultural industry. As a nation of approximately 23 million people, raising the necessary capital ($600 billion) to support agricultural growth and longevity over the next 35 years at least is close to an impossible task. Australia must do all it can to attract this capital, regardless of its source as without it the Australian agricultural industry will either stagnate, fall further behind the rest of the world in terms of competitiveness, or potentially become irrelevant on the world stage.