EQUITY PARTNERSHIPS (EP)

DEFINITION

An equity partnership (EP) is an agreement between individuals who pool their capital, skills and resources together. Doing this, 'the Partnership' have the potential to achieve greater revenue and business growth than the partners could achieve as individuals. Further, it can free up time and/or capital for one or both parties to invest in family and activities off-farm.

An EP can be created through an existing legal structure, or by setting up a new entity. In a new entity, the individuals have a share of the business based on what they have invested. Profit is split based on an agreed percentage (post any owner salaries).

BENEFITS

Some of the benefits to partners entering an equity partnership are:

- They gain ownership in a farm business, (which may otherwise have been out of reach).
- Pooled resources and skills can improve profitability and enable each owner to purchase or lease other blocks or opportunities.
- The ownership percentage (%) by either/all parties is flexible.
- They have the ability to increase their ownership percentage (%) over time.
- The ability to increase entering party's equity over a period of time – provides an incentive to improve business performance.
- Gain scale and grow your business faster than perhaps going it alone.
- Reduce individual capital requirements and spread the risk involved with investing in the rural sector.
- Access capital to fund development projects to improve business performance and/or achieving personal/family goals.
- Release equity tied up in your farm for succession and retirement planning purposes.

ELEMENTS NEEDED FOR SUCCESS

- The right mix of personalities, skills, cash, stock, and equipment from the various parties.
- The parties need to have similar values and beliefs, particularly around farm systems, environmental and people management etc
- Regular formal and informal communication between the parties.
- Clear legal agreements which define each party's role.
- A documented Business Plan.
- The combinations of skills and additional capital will enable changes to be made to the farm business. These changes need to result in higher levels of productivity and profitability to justify the change in business structure.
- Have a clear exit strategy right from the start – start with the end in mind!

MODEL DIAGRAM

WHO COULD USE THIS OPTION

- Families looking to bring in the next generation.
- Employers who have a good staff member they would like to keep in the business for a longer term.
- Someone with excess cash who is interested in investing in a farm, but not necessarily getting involved in the day to day operations.
- A farm manager who may have the skills to take the business forward and a small amount of capital.

Further resources:

www.knowledgehub.co.nz – Farm Ownership and Transition Workshop Resource Booklet

www.anz.co.nz/rural/rural-news-insights/research-reports/

RED MEAT PROFIT PARTNERSHIP

CASE STUDY

Paul and Janet Pearce are looking to cut back their involvement in the day to day operations of their farm. The farm has been in the family for 3 generations, but the Pearce's children have made it clear they are not interested in working on the farm.

Paul knows that his Farm Manager (Matt) has taken a keen interest in the business, however Matt has mentioned he is looking to own his own farm at some point in the future, but doesn't know how this is possible as land is so expensive. (Step 1)

Paul raises the idea of an EP with Matt who indicates he is interested. The next week Paul gives Matt a list of things to think about. They organise to meet a week later to discuss things further.

At the meeting they discuss each parties goals and what interests them about working together. They discuss a 12 month trial period and, all going well, entering a 3 year agreement after that. This period could be extended thereafter. They also discussed the farm and Matt's ideas for how he would like to change a few aspects of farm operations to improve productivity. Paul outlined what he saw his role on the farm to be and how much control would be passed on to Matt (Step 2).

Finally Matt shared how much cash he had saved and what he was willing to put into the farm.

They agreed to meet again in a month's time once:

- Matt had prepared a draft Annual Plan for the farm which included budgets relating to financial and feed requirements, as well as production for the next 3 years;
- Paul had talked to his accountant/lawyer/farm consultant about the proposal and what steps they would recommend;
- They had both thought through what they wanted to achieve from the first 3 years of the equity partnership and also longer term;
- They had thought about a potential split of profit.

After their next meeting they took a template equity partnership agreement to their local rural lawyer to adjust it to meet their requirements (Step 3). They also agreed on job description for all partners to ensure each was clear on their responsibilities.

CHALLENGES

Some of the challenges in using an equity partnership are:

1. The risks that apply to the rest of the industry are likely to still apply to equity partnerships. For example, health and safety, market supply, animal health, drought etc.
2. Lack of good communication systems and/or variance in goals between the partners will cause friction.
3. Selecting the right partner.
4. If this is a partnership between an existing owner joining with a new partner, the owner's potential resistance to change can be an issue.
5. Lack of profitability or lack of financial management is a serious risk. Strong financial management skills and systems must be in place within the business.
6. If the expected length of the partnership is too short the true benefits may not be realised. The cost of establishment could outweigh the benefits.
7. Entering and exiting an equity partnership can be time consuming and can cause issues. Start with the end in mind. Ensure your establishment documentation outlines entry and exit strategies clearly.

WHERE TO FIND AN EQUITY PARTNER

The best place to start to find a potential equity partner/s is often through your local rural bank manager, rural accountant or farm consultants.

Rabobank and ANZ have specialist teams that work with new entrants and farmers on their farm ownership options.

Attending industry workshops and field days on farm business transition also attract 'like minded' people and hence can be a good place to build contacts for potential Partnerships.

NZ Young Farmers has a large membership of young farmers looking to get ahead. Contacting your local branch may also produce some good leads.

EQUITY PARTNERSHIPS (EP)

STEPS

1

- Identify a potential partner. This could be:
- A child/parent
- Current employee/employer
- Through asking your network for suggestions (e.g. other farmers, banker, consultant, accountant)

2

Potential partners need to discuss and understand:

- Goals and aspirations of each other (both short and long term).
- Timeframes (how long are they expecting to be involved).
- What each partner has available to contribute (e.g. skills, cash, stock, equipment etc.).
- Expectations around
  - Profit and splitting that profit
  - Salaries / Bonuses
  - Capital expenditure (e.g. tracks, equipment etc.)
  - Overtime
  - Staff performance
  - Productivity on farm
  - Involvement of spouses/partners on farm
  - Health and Safety
  - Staff (e.g. recruitment of new staff)
  - Communication system

Once partners are confirmed, identify:

- Are there any skills which the parties do not have, where it may be useful to bring in a third party advisor?
- Develop budgets showing potential profit.
- A business plan – this may include some key metrics you are hoping to meet.
- Role/job descriptions

3

Look at the various options structures for achieving the outcomes to the questions above. Understand whether an equity partnership is the best option – consider what other options are available. You may need to talk to an advisor at this point.