Equity Partnerships (EP)

Definition

An equity partnership (EP) is an agreement between individuals who pool their capital, skills and resources together. By doing this, 'the partnership' has the potential to achieve greater revenue and business growth than they could achieve as individuals. Furthermore, it can free up time and/or capital for one or both parties to invest in other areas.

An EP can be created through an existing legal structure, or by setting up a new entity. In an EP, 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

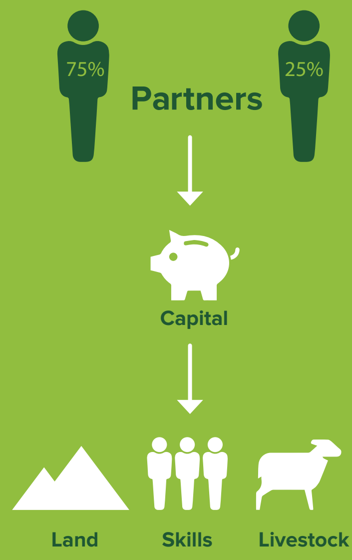
Some of the benefits to individuals entering an equity partnership are:

- 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 also consider other opportunities
- The ownership percentage (%) is flexible and can be varied over time to meet investor needs
- Investment in the business provides reward for an equity manager over and above their management wage and therefore an incentive to achieve high performance
- A well-capitalised business can achieve greater scale and often grow faster than a business that is capital-constrained
- They reduce individual capital requirements and spread the risk involved with investing in the rural sector
- Improved access to capital to fund development projects and improve business performance
- Release equity tied up in your farm business for succession and retirement planning purposes.

Elements needed for success

- The right mix of personalities, skills, cash, stock, and equipment from the parties involved
- The parties need to have similar values and beliefs
- Regular formal and informal communication between the parties
- Investment objectives that are mutually beneficial
- Agreements tailored to the situation which define how the partnership will function (shareholders agreement), each party's role (job descriptions)
- A documented business plan
- 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 Resource Book

www.beeflambnz.com

Where to find an equity partner

A good place to start to find a potential equity partner/s is 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.

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.

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.

Equity partnerships (EP)

Step 1

Identify a potential partner. This could be:

- A family member
- Current employee/employer
- Through asking your network for suggestions (e.g. other farmers, banker, consultant, accountant).

Step 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
- Roles and job descriptions.

Step 3

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

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 three 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 five-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 three 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 three years of the equity partnership and 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 descriptions for all partners to ensure each was clear on their responsibilities.

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