Equity Partnerships – The Keys to Success

The 5 Key Elements to Success

1) People
2) People
3) People
4) Governance
5) Management
6) Other Considerations

People People People

Choosing the right people to go into business with should all be based on values.

What are Values?

- Values are things that each person puts a strong value on.
- They represent an individual's idea on what is right, good or desirable.
- We all have a hierarchy of values.

There is no one set of perfect values and they are formed deep within us, almost subconsciously. Our values come about through our:

- upbringing
- experiences
- culture
- friends

Your values are important because:

- Your Values influence your behaviour.
- Your behaviour influences your actions.
- Your actions influence your results.

Your values dictate your "default action or reaction", particularly when you are under pressure. Someone who places no value on honesty will revert to lying under pressure. Someone who places high value on hard work will work harder under pressure.

Having aligned values, or at least complimentary values, is the most important consideration before agreeing to go into business with someone. It will be virtually impossible to realign values after the fact. Different values are okay, and can add synergy. BUT they must be Complimentary not Adversarial. Some examples of differing values. Are they complimentary or adversarial?

Examples of opposing values – Complimentary or Adversarial?		
Wealth Creation	vs	Lifestyle
Independence	vs	Teamwork
Perfection	vs	Efficiency
Hard work	vs	Effectiveness
Developing	vs	Finishing
Saving	vs	Investment
Equality	vs	Self fulfilment
Big picture	vs	Detail

What are your values? Are your values suitable to help an Equity Partnership succeed?
What are the values of the other investors? Are their values suitable?

What Values are suited to an Equity Partnership		
Teamwork	Interdependence	Communication
Integrity	Trust	Empathy
Thoroughness	Success	Honesty
Abundance	Fun	Respect
Continuous Improvement		Empathy
What values are not suited to an Equity Partnership		
Independence	Winning	Self Importance
Developing	Spending	Confrontation
Conflict	Stubbiness	

Get alignment of values at the beginning, by selecting the right people with the right values. (Including YOU)
The single biggest cause of failure, is failure to get an alignment of values at the start.

<u>First test yourself.</u>

- What are your values?
- Are you the right person to be investing into an Equity Partnership?
- What does win/win mean to you?
- Can you work within a team, when you only have 1 vote?
- Do you have a dominating personality?
- Can you accept being outvoted?
- How do you react to surprises?
- Are you independent vs being interdependent?
- What is your purpose for investing?
- Can you leave your ego at home?
- Do you understand your own risk profile?
- Do you naturally trust people?

<u>Then test the others.</u>

- Are they the right people to be going into business with?
- Do they share your values and objectives?
- Could you become friends with them and or have some fun with them?
- Can they work as a team, or are their personalities dominating?
- Do they have a similar risk profile to you?

Governance

The second biggest reason for Equity Partnership failure is either a lack of good governance or at least a lack of understanding of governance.

- The Company is governed by a board of directors, appointed by the shareholders.
- The directors must act in the best interests of the Company. Not themselves.
- Governance must not interfere with Management. This is difficult to achieve when the Management team are also part of the Governing team.
- The directors should not get involved with management except at the board table.
- Just as important, management must not govern, unless they are at the board table. That is to say that the management team cannot make governance decisions in the act of managing. This point is very difficult to understand and implement.

The directors are responsible for the Company's:

- Core values.
- Purpose.
- Vision.
- Strategic plan to achieve the vision.
- Employing the Management team.
- Approval of Management plan.
- Approval of budgets.
- Review Management's performance against agreed KPIs.
- Accountable for the Company's compliance. Financially, legally, environmentally, health & safety.
- Not interfering with management.
- Dividend vs Re-investment policy.

Part of governance is having a shared set of values, purpose and vision under which the Company will conduct its business.

- Under what core values will the partnership operate under?
- Other than making money, what is the purpose of the EP?
- Other than making money, why are you investing in the EP?
- Dividends vs re investing
- Capital growth vs debt reduction
- Similar risk profile
- Similar investment terms. May have different time horizons but you must all agree to a minimum investment term.

- Is quality and pride in your investment more or less important than financial returns?
- Could you become emotionally attached to your investment?
- Do you want to grow or decrease your share over time? Do the other investors know this?
- Is this the right opportunity for you?

Governance can be particularly challenging. One of the biggest challenges is separating governance from management, particularly if there is a small group of investors and the one of the directors is also responsible for management.

Having the right governance structure and culture is vital, but should be no more complicated than necessary. Having said that, this does not mean taking a lax approach to governance. Keep it simple but keep it effective.

Management

Poor management will probably not be the reason for the failure of the Equity Partnership, unless the Board fail to act as appropriate. The management though, will make a key difference in the operational and therefore financial performance of the Equity Partnership.

The Management team must be given the scope to manage, and should not be badgered on an adhoc basis by the Governance team. The Management team must manage in accordance to an approved management plan. Any deviation from the plan needs to be agreed to by the Board. Deviations may be induced by climatic changes, financial outlook, budget changes, and capital expenditure etc.

The Management's performance needs to be judged against an agreed set of Key Performance Indicators (KPIs). Any "please explains", particularly outside of the KPIs must be handled under the guise of a Board meeting, and not an "in the paddock confrontation".

The management team may be made up of several people, including the manager (who may or may not be a shareholder), a farm supervisor, farm consultant and maybe even a fellow director.

The management team is responsible for:

- Setting the management plan in conjunction with the Board.
- Carrying out the plan.
- Accountable for the operational performance.
- Responsible for the operational risk management policy of the Company.
- Must report breaches, failures and remedial requirements to the Board.
- Complete monthly management reports to the Board.
- The difference between a good investment or a great investment.

The Management must be employed by a seperate Management Employment contract. Even if the Management are also directors of the Company, they must be employed under a contract, which will be seperate to the Shareholders Agreement.

In effect, if the Management is not performing, disciplinary procedures need to be taken, regardless of whether they are shareholders or not.

Legal Considerations

Seek good legal and accounting advice from advisors who are experienced in the field of Equity Partnerships.

The key document is the Shareholder's agreement, which will sit alongside the Company's constitution. The important points to look for in a Shareholder's agreement are:

- The term of the "joint venture". Maybe more so the minimum lock in term. This is sometimes referred to as the Sunset clause.
- Pre-emptive rights. This covers off the transfer of shares between shareholders, the rights of all parties and the process to be followed. This also covers off the exit clause.
- Dispute resolution.
- Makeup of the Board.
- Voting rights, and in particular "major transactions"

The lock in period is important to protect all investors against a change in circumstances of other shareholders, which may encourage them to want to withdraw their equity. Their circumstances may change due to:

- Death
- Illness
- Marital split
- Other opportunities

The lock in period mitigates the risk for the remaining shareholders having to find funds to buyout the shareholder who wants to exit during the lock in term. Having said that, good old fashioned communication and empathy can still be employed, and should always be the first port of call, rather than just automatically defaulting to the Shareholder's Agreement.

Other legal considerations of an Equity Partnership include

- Ownership structure. Either a Company or a Limited Liability Partnership.
- Taxation implications.
- Management must be employed under a seperate Employment Contract.
- Constitution.

Other Considerations

Apart from the key factors identifies above, there are other considerations, which are bullet pointed below

- No surprises.
- Honest and effective communication.
- People react more on <u>how</u> you say something rather than <u>what</u> you say.
- People respond to coaching rather than telling.
- The partnership needs to have clear and achievable objectives and goals.

- The partnership will need a clear and realistic plan as to how to achieve its goals and objectives.
- Accept that investing has downside as well as upside.
- Understand your investment.
- Do your homework.
- No hidden agendas.
- What contingencies exist?
- Reporting standards.
- Budgeting and variance reporting. Who is going to do it?
- Who is going to pay the bills, and run the cashbook?
- GST returns.
- Annual accounts.
- Frequency of shareholders and directors meetings.

What is the appropriate number of investors?

Advantages of more:

- More democratic.
- Conflict easier managed?
- Easier to soak up surplus shares
- More access to capital?
- More access to specialist skills?
- More balanced decision making?

Advantages of Less:

- Fewer egos.
- Less potential for conflict.
- Decision making easier.
- More control over governance.

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