The Four Pillars
of
Family Succession

Introduction

What to do about the succession of family owned farming businesses has become a much discussed topic. The scale, complexity and the capital invested within farming operations has increased significantly over the last 25 years in particular. Coupled with this, society in general has become more enlightened with regards to fairness.

Farm succession is not an easy issue to resolve. The average age of farmers continues to increase, and a recent ANZ survey showed the following:

- 10% of businesses have a formal succession plan.
- 17% have an informal plan.
- 24% are developing a plan.
- 50% have no plan at all.

Why is it so difficult?

Conquering family succession is not an easy task. This is not surprising when you consider:

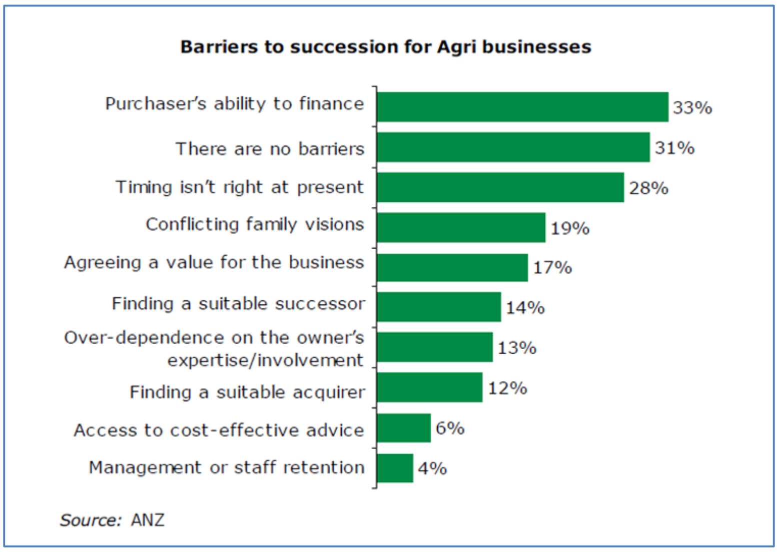
- The family farm normally has a huge amount of heritage, and is considered "home" for not only those that live there, but also for other children who have long since moved away. There are huge emotional ties.
- The amount of capital tied up within a farming business can be eye wateringly significant.
- The bulk of that capital has come about through capital appreciation as opposed to retained profits.
- Profitability has historically been less than the cost of capital. Therefore the ability to remove capital from the business is difficult to achieve.
- Parents are having to consider the future sharing of capital with those they most love.
- Not all brothers and sisters share the love, particularly when there is significant wealth at stake.
- In-laws come with their own set of values, which in my experience can be very complimentary, but are sometimes viewed with suspicion.
- People are living longer. Mum and Dad in their 60s see there is still a bit of "kick in the old horse yet". Meanwhile the successor(s) in their early 30s may be married with their own successor already born, and are keen to make their own mark.
- Every family is different and there is no off the shelf solution.

Generally there are two paths to take regarding succession. The first and least common is to run the business intergenerationally. The whole family retains at least a financial interest in the business, and the business is run as a large corporate, with a formalised board and business structure.

The advantage of this is the synergy gained from family members working interdependently together for the benefit of all. Sadly the examples of this system working successfully and sustainably in New Zealand agriculture are few and far between. Those families who have achieved this have gained much more together than they would have independently of each other. Succession in these families is an ever evolving and ongoing process.

The vast majority of families though, either don't understand the concept of interdependence or place a higher value on independence. As a result they are immediately faced with barriers.

There are many legitimate barriers as to why only a quarter of all family farming businesses have a succession plan. A recent survey completed by the ANZ highlighted the barriers as shown in the table opposite.



I suspect another of the barriers is the fear of the unknown. There are no guarantees as to where you will end up once the planning starts. Some of the barriers above may not be able to be overcome, but they certainly won't be overcome if a start is not made.

The risk of creating conflict

One of the fears that has been mentioned to me is the risk of "opening a can of worms" and the potential to create conflict. To me, nothing is more certain to create conflict than a lack of leadership, clarity and certainty. Suspicion and jealously often arise out of a lack of understanding. Suspicion and jealousy are great fire lighters for conflict. One thing I do know for certain is that conflict will not be sustainably resolved by neglect. If you ignore it long enough, it will not go away.

Conflict that was always going to start from within the can of worms will not start, simply because you took the lid off. If the can was not opened it would have exploded anyway. The sooner conflict, or potential conflict is dealt to, the sooner the fall out can be managed.

Where to start

Like many things in life, starting is the hardest thing to do. Not knowing how to start, or what process to follow prevents many from starting. I am sure the lack of a deadline does not motivate people to start either.

Presumably, succession planning is perceived by at least 50% of farming families as being important but not urgent. Why start today when you can start tomorrow. The trouble with this concept is that when it does move from important to urgent, the effectiveness of the plan will most probably be compromised.

An important consideration right at the start is that a family succession plan must be written by the family for the family. A plan cannot be bought off the shelf, and cannot be written by someone else.

Whatever the reason, sooner rather than later a start must be made. Whilst there is no off the shelf solution to a family's particular situation, there are some guiding principles and a best practice process to follow, which will increase the probability of a successful outcome.

To my mind there are four pillars upon which to build a plan. These are:

- Build a strong business first.
- Communication.
- Fair comes before equal.
- Understand the difference between ownership and control.

Within those four pillars, a process has been developed based around strong communication and letting everyone have their say.

Pillar One - Build a strong business first

This may sound rather obvious, or even defeatist. The brutal truth though is that if the existing business is only strong enough to support the current owners (Mum and Dad), or lacks productive and financial performance, then trying to pass the Business onto the next generation will result in one of two things:

- A millstone will be placed around the neck of the successor. This will result in disillusionment with the successor and possibly resentment from the rest of the family if the farm is "lost".

Or

- The terms of the plan will have to be so favourable it will result in Mum and Dad not having sufficient capital or income to have the retirement they deserve. Other siblings will also most likely "miss out". Naturally this will lead to interfamily resentment.

The smaller the pie, and the more mouths there are to feed, the fewer option there will be. The reverse holds true.

In all cases, regardless of the scale of the Business, the succeeding Business owner must bring something to the table. This may be in the form of:

- capital,
- off farm income or at the very least,
- youthful enthusiasm, motivation and commitment matched with an ability to continually improve the Business.

If the Business lacks scale or profitability, and the successor cannot bring enough to the table to sustainably make a difference, there is only one option. That is to sell the assets, Mum and Dad to look after themselves, in the first instance, and surplus capital to be distributed as and when appropriate.

Pillar Two - Communication

Communication must be at the heart of any plan. The purpose of the communication is to "flesh out" the underlying needs of the entire family. Unless there is a strong understanding of everyone's thoughts, needs and vision for themselves, the family and the family business, decisions will be made on assumptions. Assumptions lead to misunderstandings. Misunderstandings leads to conflict.

The sooner the communication starts the better. Children are never too young to be schooled in the "way of the family". So whilst you cannot set goals for your children, you can mould their values. A strong family influence will help mould values that reflect the family's values. The better this is done, the lower the probability of having a few black sheep running round the back paddock!

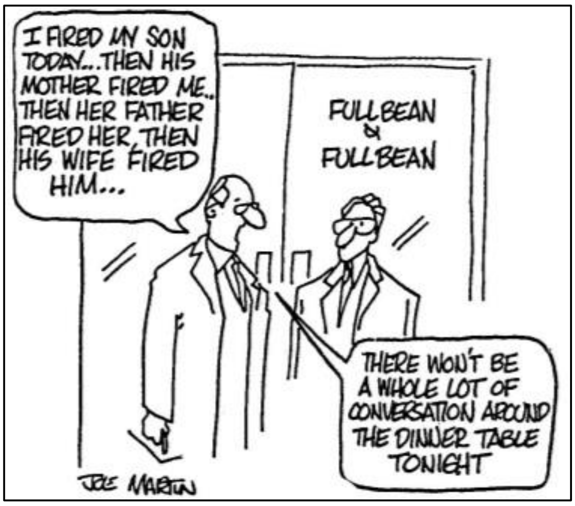
The younger the children the less formal the communication should be, and as they mature the communication should become more formal and structured. For many families there has been little or no communication regarding business succession.

> *"The vacuum created by a failure to communicate will quickly be filled with rumour, misrepresentation, drivel and poison".*
>
> *Cyril Northcote Parkinson, British historian, sociologist and publicist*

This creates a vacuum of knowledge and understanding. It is a scientific fact that a vacuum will not stay empty for long. If a vacuum cannot be filled with facts, it will be filled with assumptions masquerading as fact. Perception is reality.

For example if I am the likely successor, who has spent the last 5 years helping build the business, and I have no knowledge of what Mum, Dad and my siblings are thinking, and vice versa, we will all fill our heads with our own thoughts of what others may be thinking. The danger is this will lead to misunderstanding, suspicion, jealousy and ultimately conflict. If this goes on unchecked the situation will become untenable.

Most advisors have dealt with families in this situation. Conflict has arisen, most probably through poor communication. By the time the advisor arrives on the scene all that remains is for the advisor to shut the stable door because the "horse of reason" has long since bolted and can be seen disappearing over the horizon. Shut the door, he won't be back.



Once perceptions become entrenched, they turn into reality and can be incredibly difficult to turn around.

By the time a natural successor (or two) in waiting, has put down their own roots, with a partner and family, the need to start communicating is becoming increasingly urgent.

You don't necessarily need an advisor or independent to be part of the communication process. However the later the start the greater the value an independent can add. They will help remove the fear of starting and can filter and manage any unrealistic viewpoints.

The process I follow is to interview Mum and Dad, to uncover their values, needs and vision for:

- themselves,
- their family and
- the family business.

I then separately interview all family members and their spouse to uncover exactly the same thing for:

- themselves,
- their wider family (wider family means Mum & Dad, brothers, sisters, spouse and children)
- the family business.

The benefit of doing it this way is:

- They can find it easier to speak more openly away from other family members.
- They are forced to consider what everyone else's needs and views maybe.
- They are able to voice their own vision for themselves in a way that can be communicated with the wider family.

Once everyone has been interviewed, a one page matrix table for each member of the family, along the lines of the table opposite, is used to record everyone's responses and all responses are circulated to all family members.

	Yourself	The Family	The Business
Values	What are your values?	What values do you think the family unit should have?	What values do you think the business should have?
Purpose	What is your purpose?	What do you see as the purpose of the family?	What do you see as the purpose of the business?
Vision	What is your vision for yourself?	What vision do you have for the individual members of the family?	What vision do you see for the business?

I then bring the family together to discuss the full range of values, needs and vision. This is the starting point of understanding the barriers to a successful outcome, and then the plan can be designed to try to overcome these barriers.

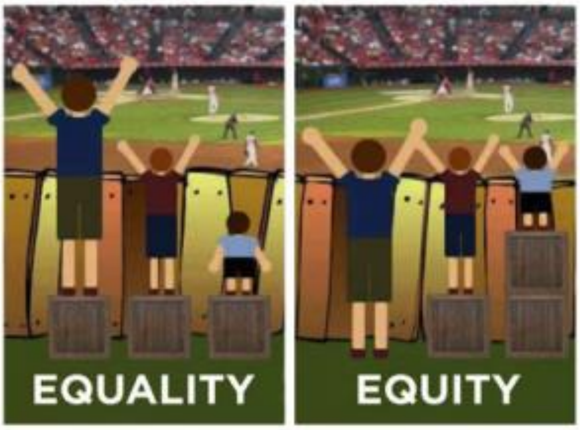
This is often the first time the family has had these discussions. It is not uncommon for these meetings to enhance inter-family relationships. They gain a deeper understanding of each other's needs and opinions and this can often garner a greater level of respect for each other.

Pillar Three - Fair comes before equal

There is a difference between being fair and being equal. Just because a succession plan is equal does not necessarily mean to say it is fair. The basis of any succession plan must be built on the pillar that it is fair to all parties. This may or not differ from being equal. Not only should a plan be fair, it must also be seen to be fair. This is why communication and understanding everyone else's point of view is so crucial.

The definition of what is fair will differ with every family. Going through a communication process as discussed above will help define and reach agreement on what is fair. Many factors will influence what is fair.

Consider the following:



- A lump sum payment to non-farming family members now, is more valuable to the recipient than say 30 years' later on the death of a parent.
- If there are no business successors, fair and equal will most probably be the same thing.
- If, during a period of capital growth in land values, family ownership of the farm has been retained, purely due to the farming efforts of a successor, is it fair for the successor to have to financially settle the other siblings equally?
- If a successor has taken financial risk in growing the business, should the returns of that gain be shared equally with the rest of the family?
- How should a successor who has committed themselves and worked within the business for a lengthy period time be fairly treated compared to others who have made their own way in life outside of the business?
- How should a successor who has worked for less than a market wage for a number of years be fairly treated?
- If, over a number of years, a successor has contributed their own capital towards increasing the productive capacity of the farming business, how should they be fairly compensated?

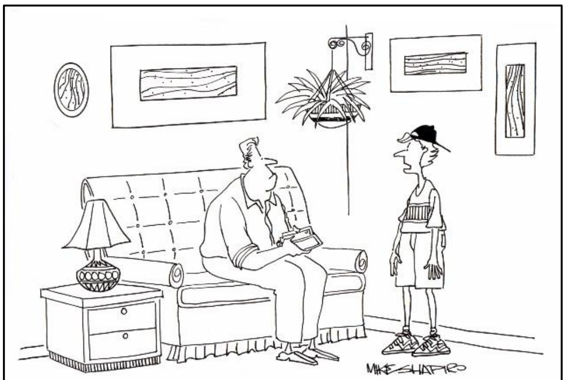
The difficulty is, every family's situation is different. Equality can very objective. It is easy to calculate an equal split. However, fairness is very subjective and is much harder to determine.

This is why communication and understanding everyone else's point of view and needs is so crucial. I can't stress this point enough.

Pillar Four - Understand the difference between ownership and control

There is a big difference between the two, and there needs to be a strong understanding of both. It can also be difficult to get the balance right.

I can relate my experiences with two different families. Prior to my involvement, a significant proportion of ownership had been handed to a son at a relatively early stage and on very favourable terms. In both these two examples, the father struggled to relinquish any control to the son. In both instances it wasn't because of a lack of trust, it's just that the father was used to making the calls and held firmly onto to the rudder.



"A raise in my allowance is fine, dad. But what I'm really after is power of attorney."

In both cases, this created tension between father and son. In both cases the sons were married and had started their own families, but were treated as "the boy". In the end, both situations deteriorated to a relationship with no trust and respect. It was easy to point to the son and think, "spoilt little brat". Equally though you could look at the father and say "stubborn old bugger". Thought had been given to allow the son to get "skin in the game", but no thought had been given to shifting some of the responsibility to the son.

"Someday, Tompkins, this will all be yours for about 90 days until you undoubtedly run it into the ground."

Another situation I became involved with, involved a son and daughter-in-law who had assumed full control, mainly through evolution rather than any one big decision. Dad still helped out on the farm from time to time, but all decisions were made by the son. There had been no discussion around the succession plan, and this started to create tension. Because of a communication vacuum, the son and daughter-in-law started wondering if they were ever going to get an opportunity for ownership – "slogging our guts out so others can benefit". Meanwhile the other siblings were thinking the son and daughter-in-law are going to "get the lot". It wasn't until we had a full family meeting that suspicion was replaced with fact, the plan was formed, and any likelihood of conflict was nipped in the bud.

Therefore, ownership without control and control without ownership can be as equally damaging to a family relationship. Balance and expectations need to be carefully managed. The only way this can be done is through strong communication.

Putting the plan into action

There is no point having a plan and then not acting on it. Part of the action will be to bring in the family accountants and lawyers to advise on taxation and asset protection issues. One of the mistakes that are made, I believe, is that some mistakenly believe that by simply having the farm in a Trust, they have their succession issues sorted. Ownership structures, taxation and asset protection are very important parts of a succession plan, but they should not be the starting point.

Finally a plan is just a plan. It is not an outcome. People's needs and vision change over time. Whether it be births and deaths or marriages and divorces or simply just the passing of time, needs will change. Therefore the plan needs to be frequently reviewed. How often will depend on the individual family dynamics.

Summary

Family succession is a difficult situation to fairly conquer. The fear of the unknown or just not knowing how to, may be putting people off from starting. However nothing was ever achieved without starting. There are many different ways to approach the subject, however not all of these will be effective.

There are however some guiding principles and a best practice process to follow, which will increase the probability of a successful outcome.

To my mind there are four pillars upon which to build a plan. These are:

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- Understand the difference between ownership and control.

Within those four pillars, a process has been developed based around strong communication and letting everyone have their say. Having an independent to lead the family through the process can add significant value. They will help remove the fear of starting and can filter and manage any unrealistic viewpoints. However they and the family must understand it is not the independent's role to "write the plan". The independent's role is one of facilitation.

Having an understanding of values needs and vision, and how this can be fairly achieved is the starting point of the plan. Ownerships structures, tax advice and asset protection come later. Finally a plan is just a plan, it is not an outcome. People's needs and vision change over time. Whether it be births and deaths or marriages and divorces or simply just the passing of time, needs will change. Therefore the plan needs to be frequently reviewed. How often will depend on the individual family dynamics.

More information on succession can be found on our website, www.farm-plan.co.nz or by giving Peter Flannery a ring on 027 615 4500.

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