AUGUST 2015

BUSINESS MANAGEMENT FACT SHEET

GRDC
Grains Research & Development Corporation
Your GRDC working with you

SOUTHERN REGION

IS MACHINERY SYNDICATION A GOOD FIT FOR YOUR BUSINESS?

Access to machinery for use in your farm business can be secured by either owning, hiring, contracting or syndication. Each approach has its own pros and cons that make it best suited to a particular financial and production situation. What do you need to consider to determine if machinery syndication is right for your farm business?

KEY POINTS

- Machinery syndication is not for everyone, nor right for every financial and/or production situation.
- Even relatively simple syndicates can benefit from a formal agreement documenting rules from financing to maintenance and winding up the syndicate.
- A partnership agreement provides a set of rules that serve as a reference point in the event of a dispute.
- Economic and practical issues of syndication need to be considered relative to you and your farm business.

PHOTO: EMMA LEONARD

Enterprises may enter into a syndicate for shared access to farming machinery such as no-till seeders (above).

Investment in modern farm machinery has significantly improved productivity for many grain growers. However, large investments in increasingly expensive machinery can cause businesses to become over-capitalised, which limits their liquidity and profitability and makes them financially vulnerable. This is illustrated by an increase in the machinery value to income ratio from 0.7:1 to 1.2:1 over the last 20 years, according to Ag Profit industry data.

Conversely, under-investment in machinery can lead to poor timeliness and high maintenance costs, which together can reduce crop performance and limit profitability.

Machinery syndication is likely to have little impact on operating costs, such as fuel, but can reduce maintenance costs. Syndication can also reduce capital costs such as depreciation, the opportunity cost of capital invested in machinery and insurance, registration and shedding costs, which increases profitability and frees up capital for other uses. It can also be an affordable way of accessing new technology that can improve operating efficiency.

These practicalities include the scale of the farming enterprise and the capacity of the machine; essentially how much work it can do in a given time, such as the area sown in the optimum seeding window.

What items of machinery should I syndicate?

Ready candidates for syndication could be specialist equipment such as a precision seeder for seeding only one crop in the rotation and could be shared by several growers with the same crop. Equipment such as balers or slashers used for stubble management would also seem appropriate for syndication, although the relatively low capital cost of a slasher, for example, means syndication would have limited impact on 'the bottom line'.

If machinery is being used to full capacity there is no potential for syndication

unless the machine to be syndicated has significantly greater capacity that is sufficient to meet the needs of all syndicate participants in the time available.

Identifying the realistic capacity of machinery is an important early step in the process of deciding whether or not syndication will work in the situation being considered.

Making the decision: is syndication for you?

Issues to consider when assessing the pros and cons of syndication include:

Economics

- Will there be an economic benefit from syndicating one or more machines or pieces of farm equipment?

Practicalities

- What management and paddock benefits could flow from syndication of one or more machines?
- What machines could you share without compromising your farming enterprise?
- Who will be your syndication partners?
- How will you find other growers interested in syndication?

Syndicates can be structured in a variety of ways, with the two most common being hire syndicates and group ownership syndicates.

Hire syndicates

Members of a hire syndicate hire the machinery at an agreed rate from an external business entity or from each other. Either way there is a formal agreement required.

In the external model the syndicate participants set up a separate business to buy the equipment they need. The participants then hire from the owner business when they need it, at a rate and on conditions determined by the syndicate.

With the individual ownership model, each syndicate member buys one item of plant that is used in their operation. Items are then hired to other members of the group, with the process governed by agreed syndicate rules.

The individual ownership model can work well for machines that are used only occasionally because it avoids having capital tied up in multiple pieces of plant with low usage rates.

Group ownership syndicates

In a group ownership syndicate the machinery is bought jointly by a group of farmers who each contribute a proportion of the purchase price, usually based on the area of land cropped annually by each member.

Options for financial structures of syndicates include unit trusts, companies and partnerships, with the right structure for a particular syndicate determined by the financial circumstances and structures of the members' enterprises.

Is it for me?

A discussion with your accountant or business adviser, and benchmarking production costs from recent years, should show whether an enterprise would benefit from involvement in a machinery syndicate.

If the financials suggest that syndication would improve liquidity and profitability there are more questions to be asked and answered.

One of the first is who you might syndicate with. If there are no obvious candidates, such as neighbours you feel comfortable working with, a local farm group could be a source of potential syndicate participants.

It makes sense to have the potential syndication model explored in a formal feasibility study, ideally by a trusted adviser.

Some practical operating aspects to address include:

Syndicate structure

- How will it be financed? How will decisions be made? How will it operate and who will manage or run it?
- What is the life of the syndication agreement?
- What is the life of the machinery and how is change-over at the end of the agreed life to be managed?
- Access to the machinery. Who can use it when? For how long? Make sure the rules are established and set out in detail when the syndicate is initiated and ensure the machine has the capacity to complete the planned work load in the required time and meet members' performance expectations. Be sure to include a realistic allowance for lost time.
- How are machinery modifications to be handled? Who decides whether or not a modification is needed? How are the costs covered?
- Insurance can be taken out by the syndicate as a whole and apportioned according to ownership of the equipment by syndicate members. Alternatively, individual syndicate members can be responsible for insuring their portion of the machinery as part of their farm insurance policy.
- Shedding of syndicated machinery is considered an overhead cost. As a rule of thumb, the annual cost of shedding machinery is around one per cent of the value of the shed.

The cell of optimum efficiency

For collaborative farming advocate John Gladigau, the reference point for machinery efficiency is a 'cell of optimum efficiency'; the area of land that can be farmed efficiently with a specific set of machinery, labour and infrastructure. For John's farming system in the South Australian Mallee his cell of optimum efficiency is 4000 hectares of crop, a 12-metre seeder and harvester, a 300-horsepower (223 kW) tractor, a 36m boomspray, a chaser bin, mother bin, three labour units and two utes.

Work any more or less than 4,000ha with that machinery plant and efficiency is reduced, with **less** meaning the machinery is under-used, and **more** meaning the resources are over-extended so there are penalties in sowing timeliness, increased harvest-time risk and lack of timeliness in weed and disease control.

The cell of optimum efficiency specifics will vary with the region, farming system and enterprise scale, but the principle remains constant.

Alternatively, allow 0.3 per cent of the purchase price of the machinery item as the annual shedding cost.

- Shedding costs should be apportioned according to the ownership of the equipment by syndicate members.
- Operating costs are usually best apportioned according to the number of hectares sown by each syndicate member. This requires accurate records of expenditure and hectares sown.

Fuel

- The simplest approach for a powered machine requiring fuel is for each user to supply their own fuel and fill the tank before the machine leaves the property for the next.

Repairs and maintenance

- Ensure the syndication agreement specifies periodic formal inspection of the machine or machines by a qualified engineer or mechanic.
- The cost of routine repairs and maintenance should be apportioned according to the area sown by each syndicate member.
- Decide how routine repairs or maintenance are to be authorised. A practical option is for each member to organise and pay for repairs or maintenance required while the machinery is on their property, with the amount spent recorded and the total cost apportioned as provided for in the syndicate rules.

Labour

- User driver or does the syndicate employ an operator to run and maintain the machine?

Operating rules

- Who has access to the machinery – when and for how long?
- How and who to notify about wear and tear and changes to machinery?
- The type and content of records to be kept.
- Hygiene requirements. Decide on hygiene procedures given the critical issues with herbicide-resistant weeds.
- Procedures for hand-over from member to member.

PHOTO: EVAN COLLIS

Successful syndication involves communication and cooperation among members. One area that is particularly important is machinery repair and maintenance. Not all members may have the same passion for machinery, so it is a good idea to discuss and then document how routine repairs will be authorised and how the costs will be shared.

Personalities and attitudes

It is important that syndicate members work together effectively and harmoniously. To help achieve this:

- Ensure good communication. Members need to be open and up-front.
- Aim for like-minded syndicate members. Having similar farming styles or goals makes it easier to agree on the type of machinery purchased. Having partners with a similar work ethic and care factor for machinery is also an advantage.
- Members must be committed to working together and thinking collectively rather than as individuals.
- Attitude is important. Focus on the positives and consider the big picture and broad advantages.
- There must be give and take. Recognise that everyone makes mistakes.

SOURCE: SYNDICATING SEEDING EQUIPMENT, COMMUNITY FARMLINKX PROJECT.

- Agree on rules, including costs, for any contract work done by the machine or machines.
- Schedule an annual review of the syndicate operation with the aim of addressing issues that arose or were identified in the previous 12 months.

Other issues to consider include:

- **Member compatibility.** Aim for syndicate members with similar personalities and attitudes to minimise the risk of stress and disagreements.
- **Attitude to machinery.** What happens if one member has a passion for machinery and another sees it purely as a tool and treats it like that? Having the machine operated and maintained by the one person could minimise the risk of conflict arising from such a scenario.
- **Dispute resolution.** Ensure the syndication agreement includes a clear set of rules to enable quick resolution of any issues that arise.
- **Exit policies.** What happens if the syndicate fails or a member needs to leave?

Getting started

The first step is to ensure you have a clear and accurate understanding of the business finances including the amount of capital tied up in machinery, the real operating costs and its true profitability.

It is also important to accurately establish whether or not the current machinery plant is being used to maximum capacity and exactly what plant capacity is needed to sow, manage and harvest the area cropped each year.

This fact sheet provides the base from which to consider the potential of machinery syndication for the enterprise; an exercise that will need to involve financial or business advisers. Seek accounting and legal advice on the proposal, and then include discussion with potential financiers, including your current bank.

If this exercise suggests the enterprise would benefit from being part of a syndicate, the next step is to identify other potential syndicate members and open discussion with them about the issues and processes.

TABLE 1 Machinery syndication benefits and issues

Potential benefit	Issue
Improved liquidity and profitability	Personalities
More efficient use of machinery and infrastructure	Communication
Improved economies of scale	Trust
Affordable access to new technology	Workable rules and guidelines
New machinery with lower maintenance costs	Group decision making
Better use of labour	Timeliness and access to machinery
Lower per-hectare costs	Perceived loss of independence
Time saving – from larger, newer machines	
Better use of members' individual expertise	
Social benefits, particularly for single-unit growers	

USEFUL RESOURCES

GRDC Farm business management: machinery investment and costs fact sheet
www.grdc.com.au/FBM-MachineryInvestmentAndCosts

Farming the business, sowing for your future
www.grdc.com.au/Resources/Publications/2015/01/Farming-the-Business-Manual

Syndicating seeding equipment
www.santfa.com.au/articles/syndicating-seeding-equipment

PROJECT CODE

ORM00011

MORE INFORMATION

ORM Pty Ltd
www.orm.com.au
admin@orm.com.au
03 5441 6176

Ag Profit
www.agprofit.com.au
admin@agprofit.com.au
03 5444 2600

This Fact Sheet is produced as part of the GRDC's Farm Business Management initiative.

Content prepared and edited by ORM Pty Ltd.

PRODUCED BY **WWW.CORETEXT.COM.AU** CONTENT PREPARED AND EDITED BY **ORM PTY LTD.**