FARM BUSINESS FACT SHEET

FARM BUSINESS MODELS

SOUTHERN

May 2017

Assessing your personal and business needs

Assessing farm resources, including assets and operations, is a form of 'stocktake'.

PHOTO: EVAN COLLIS

Key points

- Successful farm businesses have two important components: they are profitable and, perhaps more importantly, they meet the needs of the people who own and operate them. Having the right farm business model in place is the first step to achieving success in both
- Alternative farm business models cannot be selected 'off the shelf'. They need to be developed to suit specific personal and business needs, focusing on people, finances and resources

The following steps can be used to better understand your current personal and business situation. By progressing through each step, any required changes may be identified and subsequently addressed through an alternative farm business model.

- Step 1 – Why change the current business model?
- Step 2 – What do the key people in your business need?
- Step 3 – What stage of the business 'cycle' are you in?
- Step 4 – What is your financial position?
- Step 5 – What farm resources do you have available?

STEP 1 – WHY CHANGE THE CURRENT BUSINESS MODEL?

For existing farm businesses, it is important to understand what is driving the need to explore other business models. Are you looking for:

- increased profitability?
- better risk management?
- support for business succession?
- increased access to capital?

These drivers are the most common reasons for seeking an alternative business model and will help you develop the most suitable model for your situation, or even help you assess if a change is warranted.

Increased profitability

Profitability is underpinned by productivity, managing costs and access to sufficient resources. Alternative farm business models offer an opportunity to improve profitability through:

- increased farm business scale, resulting in stronger bargaining and purchasing power and economies to decrease costs;
- business relationships with other parties that can provide access to resources and technology not currently available; and
- matching resources to the scale of operations for greatest economic efficiency.

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Better matching of resources to scale can benefit businesses of all sizes. For every scale of operations, there is a level of resources that delivers the greatest economic efficiency. It should be noted that farm performance data indicates only a weak relationship between operating scale, measured by gross income, and profitability.

Options to increase the farm business scale of operations include:

- larger area operated through land purchase, lease, share farm, contracting or joint venture; or
- greater productivity of the current operation by investing in the business.

Better risk management

Traditional farm business models can leave growers bearing the responsibility for managing risks and liabilities, except for those covered by insurance. The scope for managing risk is relatively limited, with options generally based on risk avoidance or mitigation.

Alternative farm business models provide an opportunity to share risk with other parties that are involved in the ownership and operation of the business.

Supporting business succession

Understanding the needs of the key people in the farm business and designing a business model to suit can simplify the steps for succession to proceed. A suitable model can enable growers to exit farming in a manner and timing of their choosing. It can also enable growers to continue their involvement in the business without relying on their physical capacity.

PHOTO: EMMA LEONARD

Ed Cay (left) and Bill Trengove: Roles and responsibilities of all family members working on or in the business need to be defined.

Access to capital

There are few alternatives available for farm businesses to access capital[1,2], with most Australian family farms funded by a combination of 'internal' equity and debt finance[3]. Where there is sufficient internal equity, this approach is generally the simplest to establish and manage on an ongoing basis and often provides a cost-effective source of capital. However, opportunities do exist through alternative farm business models to access non-traditional sources of capital.

STEP 2 – WHAT DO THE KEY PEOPLE IN YOUR FARM BUSINESS NEED?

When developing a farm business model, it is essential to include the needs of all key people involved.

Alternative farm business models offer the opportunity to better match the business to the needs of the key people involved in the business. The needs will be diverse, but are likely to be based on:

- stage of life;
- aspirations for lifestyle and associated level of involvement in the business; and
- attitude to risk.

STEP 3 – WHAT STAGE OF THE BUSINESS CYCLE ARE YOU IN?

Family farm businesses commonly progress through a business 'life cycle', with identifiable stages and duration that span the working life of a generation[4]. Most often, the primary goal is growing the business to accommodate the next generation.

As the family farm business model has evolved, it is now common to find more than one generation involved in the business at any one time. A recent GRDC-funded farm business study of the eastern wheat belt of Western Australia found that 50 per cent of farm businesses had two generations actively involved in the farming operation[5].

Where overlapping generations occur, the business life cycle is not as easy to track and the link between the stages and business equity is not as strong. However, there can be strong relationships between the stage in the business cycle and the scale of the business, measured either as total value of assets, gross income or area operated.

While the business as a whole may not be mapped easily, individuals will identify with key stages in relation to their own involvement in the business.

Each stage in the life cycle has implications for appropriate business goals and financial performance targets and benchmarks.[6]

STEP 4 – WHAT IS YOUR FINANCIAL POSITION?

While the needs and aspirations of the key people are critical when developing a farm business model, they do not always match the financial capacity of the business. Alternative farm business models may offer pathways to overcome financial constraints, depending on the business's financial position or stage in the business life cycle.

The financial position of the business will influence the ability to:

- access capital; and
- manage fluctuations in financial performance.

Where the financial position of the business is weak, with low equity and/or cash flow, the ability to access capital is limited. Alternative farm business models can:

- reduce capital requirements, accessing capital from other parties for growth, development and operations; and
- share costs and risks.

STEP 5 – WHAT FARM RESOURCES DO YOU HAVE AVAILABLE?

Assessing current farm resources, including assets and operations, is a form of 'stocktake'. The assessment is an effective process for developing a business model that can address capacity issues associated with over or under-utilisation.

Each resource, including land, water, livestock, machinery and labour, should be described in terms of:

- current condition;
- current capacity;
- suitability to the current farm business; and
- improvements or maintenance required.

For example, in a cropping business, machinery is a resource that may be over-utilised, resulting in poor timing of key operations. An alternative model may involve the use of machinery contractors. Or, where existing machinery is under-utilised, excess capacity presents an opportunity to expand by contracting out machinery or accessing additional land through purchasing, leasing or share farming.

South Australian grower Robin Schaefer: profitability is underpinned by productivity, managing costs and access to sufficient resources.

PHOTO: NIGEL PARSONS

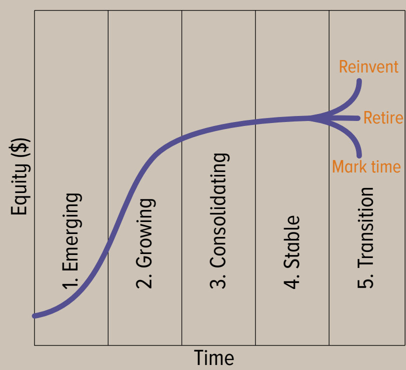
STAGE OF BUSINESS CYCLE AND IMPLICATIONS FOR BUSINESS MANAGEMENT

Business 'life cycle' stages (Figure 1) are commonly linked to business equity and can be described as:

- **Emerging** – The start-up phase, low asset value and low equity;
- **Growing** – Focusing on scale expansion often by leveraging the equity of others. Typically high debt due to asset purchases of land, machinery or livestock;
- **Consolidation** – Balancing debt reduction with investment in the business;
- **Stable** – Appropriate scale, debt is well secured and profits are sufficient to meet business and family goals;
- **Transition** – Point where the business reaches the 'cross roads', with the next option including:
  - Re-inventing, for a dynamic business ready to take on expansion. Introduction of the next generation often triggers new enthusiasm and the need for growth;
  - Retirement, or continuing in farming by using business models that allow reduced involvement while retaining the preferred roles and investments;
  - Mark time or windup, shifting investment and time out of the industry.

Emerging and growing businesses are typically highly efficient in their use of machinery and labour. Profits are directed to capital purchase of land and machinery. Growth in scale is often achieved using business models that leverage family or investor equity, through leasing, share farming or joint ventures.

FIGURE 1 Different stages of the business life cycle and the associated level of equity.



SOURCE: CLARK & O'CALLAGHAN (2013)[4]

Consolidated and stable businesses have choices for profit allocation and equity growth. Many will continue to focus on increasing scale through investment in land; however, debt reduction is also a priority and will be balanced with business reinvestment needs, such as machinery upgrades or lifestyle choices.

Transition to retirement businesses have sufficient equity to meet their retirement needs, choosing to remain in farming or shift their investment elsewhere. They may support the next generation to enter the industry in conjunction with their business through a joint venture, or by assisting to establish them in their own right through the use of land, machinery or livestock. Asset transfer to the next generation can be considered separately to the use of assets for business operation.

ESTABLISHING AN EQUITABLE FAMILY FARM AGREEMENT

Family farm businesses have traditionally operated without formal business structures and agreements. This was often seen as a strength, due to flexibility in management and business operations.

However, when dealing with multiple family members and generations, the lack of a formal agreement can result in the benefits of flexibility being outweighed by the uncertainty and risks. Without a clear plan and shared understanding of the day-to-day and longer term strategic business direction, inefficiencies can creep into business operations. The incentives of business ownership can be eroded if family members do not feel valued, or do not have recognised roles and rewards within the business.

For family farms, it is important to establish an equitable agreement within the family business first, before creating agreements with external parties.

Following are some of the key areas that need to be addressed in family farm business agreements.

- **Roles and responsibilities** of all family members working on or in the business need to be defined. This should include 'off-farm' family members who take an active interest in the business and its strategic management.

In addition to farm tasks, roles and responsibilities also need to account for time, or expectations for hours of work and arrangements for leave. This is one of the most common sources of frustration between generations in a family farm business.

- **Rewards** for contributions of resources to the farm business need to be determined, typically using market values.
- **Timeframes –** No item of farm machinery lasts forever and neither does a business agreement. Business agreements need to have a defined period of operation to allow for the changing needs of the business and key people involved.
- **Review** – The agreement should include arrangements for its review, including the 'when and how'.
- **Exit** arrangements need to be defined at the commencement of an agreement.

FREQUENTLY ASKED QUESTIONS

Who should be involved?

While the priority will naturally be to focus on people who own and/or manage the business, alternative farm business models involve other parties whose requirements also need to be considered to ensure a successful partnership. Other parties may include:

- investors;
- land owners;
- contractors;
- lessees;
- share farmers;
- employees; and
- advisers.

What is the right model for our business?

Farm business management is based on decision-making; choosing a path for your business that has acceptable rewards, both financial and non-financial, for acceptable effort with an acceptable level of risk[7]. What is 'acceptable' will vary from business to business and person to person. It is essential that farm decision-making includes all key people in the farm business.

PHOTO: EVAN COLLIS

Damen Maddock (with hat), a grain grower from Mukinbuddin, WA, during harvest with his father Reg, son Charlie and wife Ellen. When developing a farm business model, it is essential to include the needs of all key people involved.

Useful resources

GRDC Fact Sheets:
Farm business models – why consider a change? https://grdc.com.au/Resources/Factsheets/2017/02/Farm-business-models-why-consider-a-change
Farm Business Risk Profiles: https://grdc.com.au/Resources/Factsheets/2013/09/Farm-Business-Risk-Profiles

More information

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