Improving the Welsh Dairy Supply Chain

Partnerships in Dairy Farming

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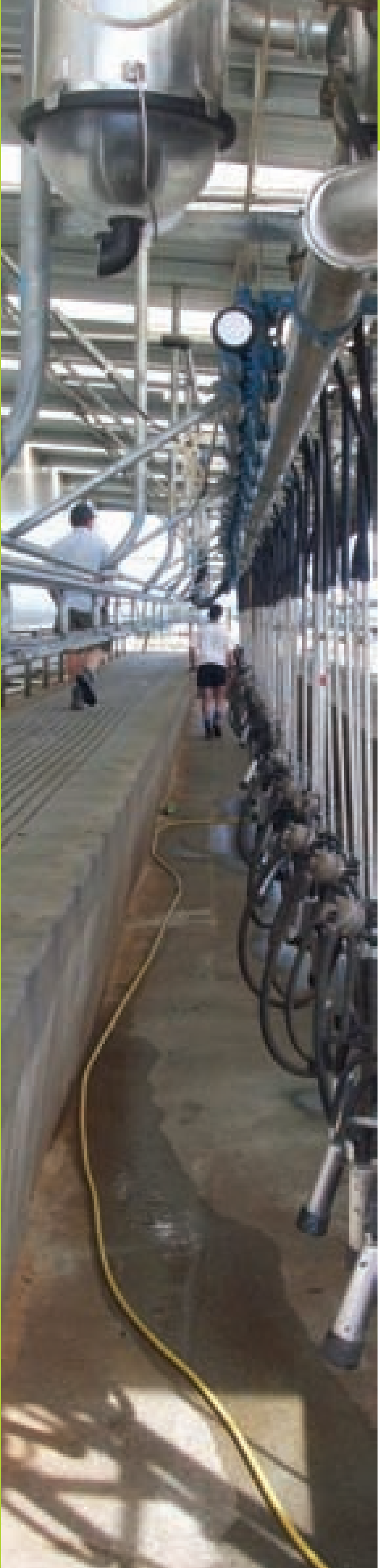


Contents

Introduction to Collaborative Ventures

Put simply, farmer collaboration consists of two or more farm businesses getting together, sharing resources to reduce cost and or increase profitability. They are relatively common throughout other sectors of UK agriculture, however they are relatively new to dairying.

There are a number of reasons for collaboration, these include:

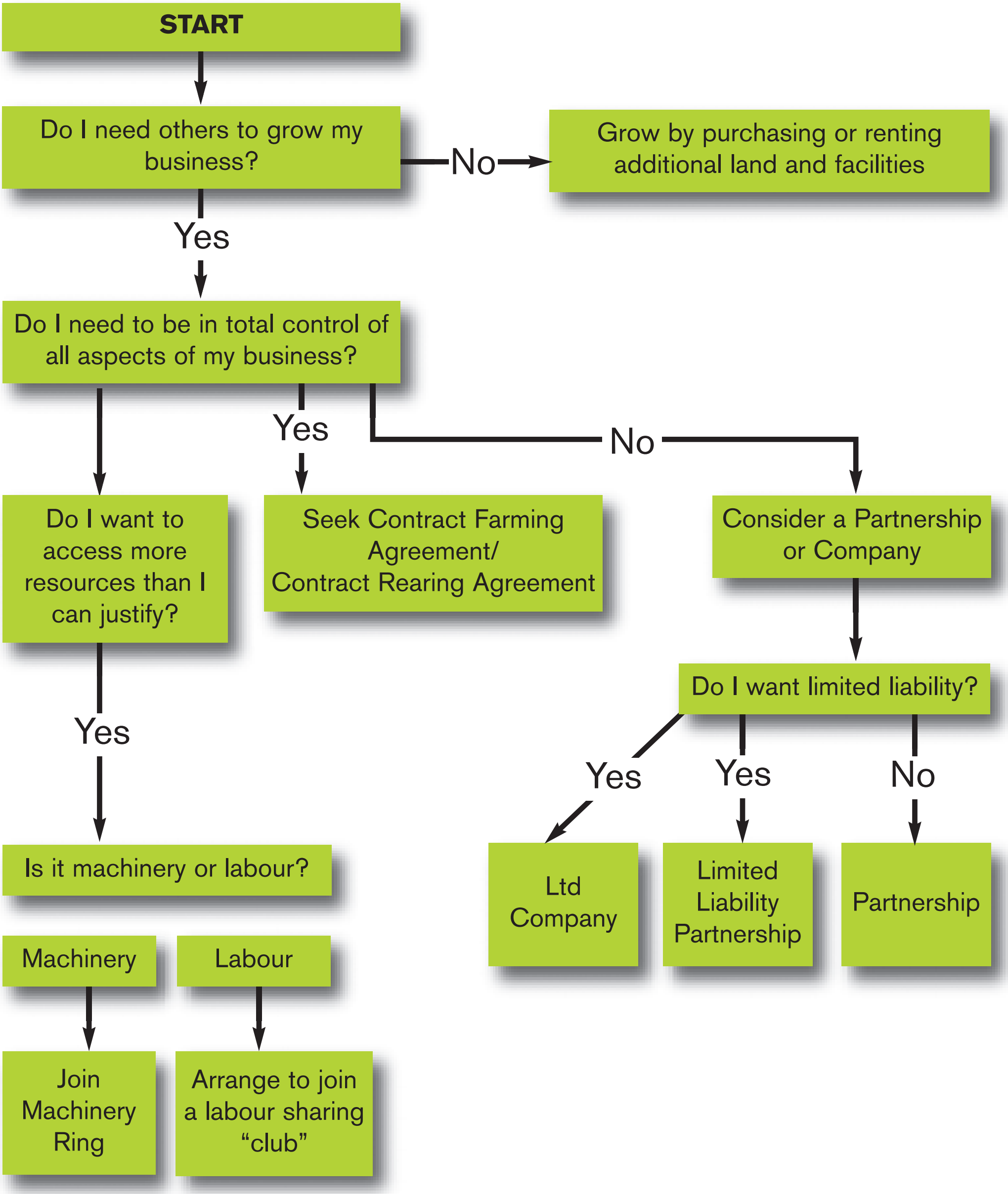
- Improving profitability
- Economies of scale and synergies – cost control
- Personal benefits – quality of life
- Allows succession
- Efficient use of capital

It is essential that a budget is always considered before the agreement commences to ensure viability and delivery of all parties' expectations. It is important though that each individual business that is considering a collaborative venture seeks professional advice from a knowledgeable business and legal advisor. However, there is a shortage of such persons who have adequate knowledge of the subject. Consequently, a farming business could suffer unnecessary delay and cost in the establishment of their agreement, hence the use of checklists and templates provided via the Dairy Development Centre (DDC).

The following information can be used by farming businesses and/or their professional advisors to assist in highlighting potential solutions and provide guidance regarding the points to consider in preparation of the agreed venture being entered into.

This is one booklet in a series and is specific to one type of collaborative venture. To view the Collaborative Ventures report or the other information booklets go to the website www.ddc-wales.co.uk or contact the DDC. For a copy of DairyCo's Joint Venture templates that provide guidance to dairy farmers who are considering a joint venture with other dairy businesses, or bringing others into the business structure, contact DairyCo publications on 02476 478702.

Collaborative Farm Ventures Decision Tree



Background

A partnership in simple terms is a relationship of two or more entities conducting business for mutual benefit. However, care must be taken when defining your business relationship with someone as a 'partnership' (see section on liability).

The partnership concept has evolved from the family partnership structure, to include partnerships between separate businesses with common objectives. This has developed into 'equity partnerships' which in principle is two or more people combining their equity (capital) and skills. These can involve capital being invested in land and property, or simply working capital (cows and machinery).

Dairy farming in Wales is dominated by family partnerships either between two generations (e.g. father, mother, son and daughter in law or between two partners of the same generation e.g. brothers). The establishment of a formal Partnership Agreement is essential to provide operational guidelines and a secure legal framework that brings longevity and reward for all involved.

What is it?

- A landowner or tenant, either existing or new, enters into a partnership with a third party farmer or non-farmer (e.g. herdsman) or another family member.
- All resources including management, labour and power are shared (possibly excluding land and houses if they have been acquired separately).
- Farming system agreed to by both parties in advance.
- Financial surplus shared by both parties in previously agreed proportion, generally reflecting the share of capital investment as well as labour and management input.
- If the land is not included in the partnership there is a need for a rent to be paid to justify the business relationship between the land ownership and working capital.

Objectives

- Opportunity to join separate skill sets and assets together (e.g. cows/machinery/business/management).
- Provides tax efficiency for all partners.
- Both parties profit from improvements in business performance and a more efficient use of capital.

Suitability in the Welsh Dairy Industry

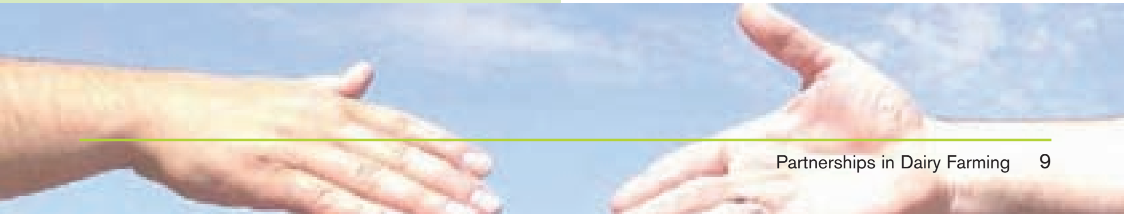
- Both partners retain 'working farmer status' for both trading and capital tax purposes.
- Economies of scale could be gained by two farming families combining capital and resources.
- Good opportunity for young people to enter the dairy industry but at the same time have the benefits of scale from day one (e.g. 30% share of a more efficient 200 cow herd instead of milking 60 cows on their own).
- Farmers with multi site operations can have people on the ground with ownership in the business. This can provide for improved motivation, retention and also can ensure a sense of ownership of the operation without the need for the farmer to be on-site each day.

Strengths

- Achieve optimum performance with economies of scale.
- Partners 'tap in' to the strengths and motivation of others.
- Gives clarity of roles, responsibilities and rewards.
- Useful new business vehicle for new business acquisition between farmer and partner and existing family members.
- Can be a good opportunity for inclusion of the Wales Young Entrant Support Scheme (YESS).
- Could improve the likelihood of securing external finance.
- Achieve business and personal goals that could not be achieved alone.
- Establishes longevity for family businesses.

Weaknesses

- Decision making can be bureaucratic and become poor unless responsibilities are clearly defined. Trust and respect must be commonplace.
- If one partner's personal financial circumstances change and capital is required out of the business then this could put a strain on the other partners.



Reasons for success

- Synergy of the partners, providing cover for the perceived weaknesses of others.
- Time and effort put into the agreement/operation with all potential issues recognised and addressed at the outset, including exit strategies (using sound professional advice to help facilitate this process).
- Successful partner selection - matching desire for growth/profit reward (this does not mean age has to be the same).
- Optimum use of capital.
- Clearly defined, logical and agreed principles of reward:

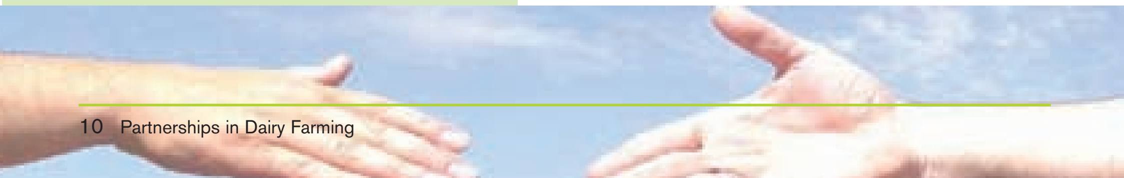
  Salaries paid to working partners.

  Return On Capital (ROC) payments made to each party (e.g. 10% on all capital employed) to reflect the cost of borrowing and opportunity cost of investment.

  Appropriate profit shares to reflect input.
- Fun and enjoyment (not working on your own).

Reasons for failure

- Poor decision making.
- Partners change their objectives which no longer provide synergy.
- Insufficient profit.



Liability & Structure

In a partnership you are responsible for the other partners' decisions. The same applies to any debts incurred by the partnership, as all partners are joint and severally liable (i.e. each partner can be solely liable for all of the debts).

You can choose to become a Limited Liability Partnership (LLP) or form a Limited Company in order to obtain Limited Liability and therefore restrict the financial risk to either party.

A Limited Company is a different structure to a LLP and can involve additional accounting costs. Accounts of an LLP and Limited Company have to be made public each year.

Tax

In a partnership the share of the profits are transferred to each partners' individual tax returns. In a Limited Company the company is its own entity and pays its own corporation tax and then dividends are drawn down by the shareholders who then pay income tax depending on their current tax band. The Limited Company can employ directors and pay them a salary which is taxable at usual income tax rates.

There are tax benefits for all types of business structure depending on the total personal income of partners/shareholders/directors. Advice from an accountant should be sought when considering the business structure of a new venture.

Case Study - Partnership

Farmer owns:

400 acres (dairy and arable)
milk quota
dairy herd and youngstock
machinery and facilities for 230 cows

The farmer wishes to retire (do less) but still have some involvement in the business. The farm employs a family member who is on PAYE.

Options for the future were discussed and because the family member (who had been employed by the farmer for almost 10 years) and the farmer trusted and respected each other they entered into a partnership.

The partnership owns:

dairy cows
dairy heifers
machinery

The partnership rents from the owner:

land
milk quota
buildings and facilities

Farmer initially owns all partnership assets of the business:

dairy herd
youngstock
machinery
current account

Profit/reward is split as follows:

	Farmer	Family Member
Partnership:		
Rent Received:	Yes	No
Salary:	No	Yes
Return on Capital Received	Yes at 10%	None
Surplus Profit:	Small % to the non-working partner	Higher % to the working partner

As the Partnership progresses the new family member starts to invest the unspent profit surplus into replacement capital owned by the original farmer or as additional capital to grow the business and becomes entitled to a return on capital (10% in this case study).

Family Partnership Structure
(This could represent a typical situation in the Welsh Dairy Industry)

Example: 300 acre farm, 180 cows at 7000 litres per cow (i.e. 1.26 million litres sold annually).

Life expectancy is increasing and many farmers have limited 'pension' provisions as either all or a large proportion of their capital is employed in their farm business rather than off farm investments such as private pension investments or equities in stocks and shares etc. There should however have been sufficient investment in the state pension scheme to provide a return on reaching the age of retirement. The farmer's accountant may also advise continued involvement in the partnership for tax benefits and the opportunity to minimise tax payments but without sufficient advanced planning and action the partnership may find it difficult to generate sufficient income to sustain an increased number of partners.

The following schedule indicates the level of return that each partner should receive.

Family Member	Age	Income generation justification	Annual Partnership Reward
Grandparents They own the assets	75	300 x £120 per acre	£36,000*
Son / Daughter They have worked in the business and generated the working capital	50	ROC £400,000 x 10% livestock, plant and machinery	£40,000
Grandson/Granddaughter Are now actively working in the business fulltime and are likely to be milking the cows	25	Salary for Labour fulltime active involvement	£26,000

** some of this figure may be reinvested*

In the above example business the annual financial demand for the family partnership (this could also apply for any business partnership) is £102,000. This equates to approximately 8 pence per litre profit. The generation of this level of profit is both essential and necessary for the continued success of the business partnership and will allow through cash surpluses (after taxation) for growth and reward.

The generation of 8 pence per litre is achievable in many businesses but continual discussion and business development is essential as well as motivating and rewarding for all generations.

Heads of Terms

Please find below the minimum requirements that should be included in an agreement.

PARTNERSHIP AGREEMENT

1. First Partner Details

1.1 Name of First Partner ____

	Please tick
Sole Trader	☐
Partnership	☐
Limited Liability Partnership	☐
Company	☐

1.2 Address of First Partner ____

____

____

2. Second Partner Details

2.1 Name of Second Partner ____

2.2 Address of Second Partner ____

____

____

3. If more than two partners are involved
Please provide details on separate sheet

4. Farm Details

4.1 Address of Farm to be Partnership farmed (if different to 1.2 above)

____

____

____

4.2 Farmable area of land to be Partnership farmed ____________________

4.3 Please provide field schedule on separate sheet

5. Agreement Length

5.1 Date of commencement of agreement ____________________

5.2 Year end of agreement ____________________

5.3 Length of agreement and/or termination date ____________________

5.4 Will compensation be available to the Partners for early determination? ______

If so how much and at what interval ____________________

____

6. Farming Details

6.1 Farming System – please provide a brief description ____________________

____

____

6.2 Single Farm Payment – please provide schedule of entitlements to be made available and copy of most recent SFP application form.

6.3 Is the farm in either an Environmental Scheme? ☐ Yes ☐ No

Are the payments to be included in the Partnership Account?

☐ Yes ☐ No

6.4 Will any Partner provide any : Please tick if yes

☐ Fixed equipment ☐ Capital ☐ Animals ☐ Improvements

If yes please specify: ______________________________

____

7. Payment Details

7.1 Provide outline budget

	£/ha	£/ac
Output:		
Variable Costs:		
Gross Margin:		
Overheads:		
Rent and Finance:		
Partners Net Profit:		

7.2 What rate will divisible surplus be divided between parties?

☐ 50 : 50 ☐ 60 : 40 ☐ 40 : 60 Other – please state ______________

8. Other Information

8.1 Name of Partnership Bank ______________________________