AVOIDING COMMON SUCCESSION PITFALLS

There is no silver bullet to ensure problems do not arise throughout your family farm succession journey. What may work well for one family will not work at all for another! However, there are some common pitfalls that you can avoid.

The experts we interviewed in the development of the Succession Toolkit shared with us the common issues they have witnessed in working with dozens of families.

What can go wrong?

1 Attitude of young people entering the process

Sometimes young people underestimate the need for respect and do not understand the key aim of succession planning is to develop a good and fair arrangement: one that's both good for them, and good for their parents.

We must not forget the older generation has a wealth of knowledge and experience. Ben Chartres of Peppin Planners advised other young people to "approach succession with a sense of appreciation, not entitlement."

2 Putting it off

Don't put it in the too hard basket! The choice to not plan early will mean succession will be triggered by an event over which you may have no control over (e.g. death, divorce). This will mean change happens at the back end - when someone is leaving the business - and emotions are running extremely high and decisions may have to be made very quickly.

Putting it off is also demotivating for the incoming generation, who will feel uncertainty around their future compounding as the year's roll on.

> *"There is nothing scarier for farm families who are trying to gain control over their lives than to have no clue about what the future holds."*
>
> - Elaine Froese

3 Unprofitability of farming business

Succession transition is difficult if the business is not profitable. There's a trap of not considering early enough, how big does the business need to be in order to service the long-term needs and financial commitments to family members.

ANZ note that this is becoming more of an issue because the outgoing generation is likely to live longer and require more income for retirement, and therefore needs to take more capital out of the business. They continue, "If a business isn't profitable, the question has to be asked, 'what is being achieved from succession?' In particular, farm assets have shown strong appreciation in recent years, which is not necessarily linked to cashflow performance. How to balance the equity between capital value and cashflow value across a range of interested parties is particularly complex (Succession Matters, ANZ)."

4

Underestimating parents emotions

Younger people underestimating the need to understand the emotions that succession planning might bring up in their parents can be detrimental to the process. Be conscious and considerate as the following may be circling around in your parents minds:

- a fear of getting old
- fear of failing because your passing on debt
- fear of next generation divorce
- fear of being bossed around
- fear of losing assets that you've worked your backside off to build.

And if you underestimate those thoughts and emotions (or don't look for them) you can easily find that your parents are saying yes, but meaning no, explained Ben Chartres of Peppin Planners. This may cause unnecessary frustration and delays in moving forward.

5

Lack of communication

Chapman and Eastway reported that anecdotally at least most of the issues relating to succession appear to stem from a failure to communicate which leads to tension, uncertainty, and conflict. Respondents to their survey stated the following reasons for lack of communication:

- fear that doing so will open a 'can of worms' and disrupt family harmony
- fear they will not be able to develop a workable plan
- family culture or habit of non-communication
- mistrust of daughters-in-law and siblings-in-law, particularly in the case of divorce
- reluctance to face reality of ageing, retirement and death
- fear from children of being perceived as greedy or demanding
- doubt that the next generation is ready or capable of managing the farming asset.

6

Poor communication

Getting angry and frustrated is common but it only makes it more difficult to have productive conversations. Poor communication can be the leading factor causing relationship break downs amongst generations, off and on-farm children and with partners.

Is there a secret sauce?

Jason Croker from RSM Australia shared his wealth of experience with the Young Farmer Business Program. He stated that communication from an early stage, usually over many years, contributes highly to success.

The families that do this the best have a couple of things in common:

1. They discuss this from an early stage and take into account all parties:
   - Mum & Dad
   - Farming children
   - Non Farming children
2. The communication is open and honest and based on agreed principles, such as:
   - All members of the family have a stake
   - Treat each other with respect
   - Act with honesty & integrity
3. They document the outcomes for all parties to see.
4. Follow through on promised actions.

7

Complacency and assumptions

Don't assume you're all on the same page! Being complacent about the need to address issues you might find trivial but are important to other members of the family is a key risk.

In a similar vein, assumed or expected roles in the business can be damaging and may mean some family members may feel obligated or expected to fulfill a certain role on- or off-farm. No one should make assumptions about anyone else's goals. Rather each family member should be given the time and respect to outline and share his or her vision for their future.

8

Not understanding implications of options

Many succession plans fall apart because of the limited understanding of legal and tax implications of transferring land, income and assets. The maze of implications of capital gains tax, stamp duty, and GST will hinder, or in fact prevent, many options as the costs might well be prohibitive (GRDC).

Assemble a strong team of advisors and expert advice is essential to work through these details before you get too far down a succession option that may be unviable. And do not underestimate the need for robust legals!

9

Aiming for an equal outcome

There are always competing interests and it is very rare to achieve an equal outcome unless for example, no one has contributed without adequate remuneration and all assets are sold and split equally or there are enough assets to split farming assets and off-farm assets equally between family members.

In many cases fairness is achieved when each party has to compromise from their highest and best position and their interests are balanced against the interests of each other party.

10

Underpayment of on-farm children

Many children work on the farm and receive inadequate wages under the assumption that the farm will be theirs in the future.

Patrick Barrett of Walsh & Blair Lawyers explained, "Pay anyone who works in the business correctly or at very least measure their contribution in a measured way with an agreement for proper compensation in future. To pay a family member a reduced amount is a false economy and has been proven to fail. Further, people who are paid correctly either learn how to make their money generate wealth or squander it, which may demonstrate their ability as a future business manager and controller."

As a young person, take responsibility of your own circumstances, rather than making assumptions about what might happen in the future.

How can a young farmer prepare?

Patrick Barrett from Walsh & Blair Lawyers provided some sage guidance for young farmers starting the succession journey:

- Try to treat the farming business as you would any other business that you may have worked in. It must be economically viable to successfully transition between family members.
- If you are entering into the business as an employee, make sure that you are being paid correctly or your contribution is being measured and will be compensated correctly. If the business is not able to maintain viability while paying you correctly then you either need to supplement your wage through other means or the business model needs to change in the short term to generate enough income to accommodate an additional labour unit.
- Establish parameters to prompt discussion about the transition of roles in the business at certain agreed milestones and/or performance indicators. This does not mean that you are entitled to demand to takeover a management role on day one. Management roles must be earnt as in any other business.
- It is imperative that at each stage of transition all parties must consider each factor at play from their own perspective, each other parties' perspective and the business's perspective to try to achieve a compromise between each of the competing interests that weigh into a decision.

How can we avoid these pitfalls?

- Start discussions early
- Approach with appreciation, not entitlement
- Open and communication
- Appreciate degree of parents emotions
- Clear, fair & transparent process
- Communicate with all parties
- Run business like a business
- Pay anyone who work in the business correctly or measure and record their contribution
- Document the process and don't rely on verbal promises or conversations
- Have a strong team of experienced advisors
- Don't underestimate need for robust legals
- Defined roles
- Ensure all members understand the difference between fair and equal.

The following table (Walsh & Blair Lawyers) lists some of the factors that must be considered and the questions that family members must ask themselves throughout the succession planning process. Each party must understand how each factor will affect them, the rest of the family and the business. It is important to also consider the interplay between factors (e.g. exposure to debt versus building off farm assets).

SUCCESSION FACTORS	HOW DOES IT AFFECT **ME?** WHAT IS THE **COMPROMISE?**	HOW DOES IT AFFECT **OTHERS/ BUSINESS?** WHAT IS THE **COMPROMISE?**
Exposure to debt (including as guarantor)		
Farm business assets		
Farm business entity structure		
Farm assets (land, infrastructure, natural resources, value of land)		
Off farm assets		
Superannuation		
Family dynamics (goals, size, make up, marital status, personalities, employment)		
Land ownership		
Seasonal risks/opportunities		
Farm production		
Capital gains tax and income tax		
Transfer and landholder duty		
Estate claim risk, business risk, family law risk		
Death, disability, aged care, lifestyle and retirement requirements		

This factsheet was prepared by Airlie Landale (Farm Table) for the Young Farmer Business Program with the assistance Walsh & Blair Lawyers and Peppin Planners.