Creating economies of scale – while retaining the values of the family farm

John Gladigau, Collaborative Farming Australia (CFA)

John Gladigau and his wife Bronwyn own a 2000 hectare property at Alawoona in the Northern Mallee region of South Australia. They have two children, Jayden (15) and Aimee (11).

In 2006 John was awarded a Nuffield Scholarship, sponsored by ABB Ltd, to study collaborative ventures around the world. During 2007 he travelled to USA, Canada, NZ, Mexico, Brazil, UK and Europe gaining a global perspective on the future of agriculture and visiting many businesses involved in collaborative arrangements which were creating long term benefits for all involved.

Over the past six years John and Bronwyn, along with another local farming family, have been involved in the creation of their first collaborative farming venture. "Bulla Burra" is the merged entity of the two former farming businesses, which in its sixth season in 2014 will plant 8800 hectares to wheat, barley, canola and mustard. John is excited about the future potential of their new farming model as a means to build long term profitability and sustainability for the agricultural sector while retaining the integrity and heritage of family farms, and the fabric of local communities.

In the time I have been involved in agriculture, there have been huge changes in the agricultural industry. We have seen big advances in agronomy, crop varieties, understanding of soils, no till, types of machinery, GPS and precision ag to name a few. So what is the next big advance? I believe it is in the way we structure our businesses.

In the past 20 -30 years there has been significant structural changes to most of the businesses farmers have a relationship with, whether they be machinery dealers, fertiliser companies, grain marketers or banks. These structural changes have been designed to create efficiencies, economies of scale and a greater level of profitability, while attempting to align themselves more firmly with their ever changing market.

But what of family farms themselves? How many family farms have intentionally redesigned themselves to create efficiencies, economies of scale and the level of professionalism needed in an ever changing environment? It actually seems that most family farms still operate structurally in a similar manner today as they did 30 years ago.

But is not necessarily all about getting bigger. We all heard the catch cry of the eighties "Get big or get out". Farmers have always understood the need for scale in order to maximise the potential from their land, machinery and infrastructure. But getting bigger doesn't automatically make you more efficient, more profitable or a more professional farm manager. In fact, statistics show that some of the most profitable farms are actually those in the medium size range, rather than those we see with the huge tracts of land with lots of bright new shiny machinery.

In my Nuffield studies and travels I focussed on how family farms could create economies of scale and a higher level of efficiency, but without losing the integrity and heritage of the family farm. This in turn led to the formation of Collaborative Farming Australia (CFA), and the creation of our first collaborative farm – Bulla Burra.

Who is CFA?

Collaborative Farming Australia Pty Ltd (CFA) is an innovative company bringing the economic strength of corporate business to Australia's family farms, while sustaining the social fabric of rural communities. It is a privately owned company which aims to create solutions for rural businesses to enable their long term profitability and sustainability while retaining the integrity and heritage of the family farm.

CFA has focussed on bringing together farmer groups to create Collaborative Farming Ventures (CFV's). A CFV may be flexible and combine the assets, infrastructure and skills of two or more farming businesses, along with the addition of leased or share farmed land if required. Outside investors can also be utilised in a CFV business structure.

At its core are the development of optimum efficiency cells, and the implementation of a professional business structure with an emphasis on accountability and transparency. While many cooperatives and groups continue to be created to facilitate joint marketing of produce and purchasing of inputs, the CFA collaborative approach focuses on creating efficiencies and synergies in infrastructure, business structures and production. This can then be used as a foundation on which value chain opportunities can be built.

The objective is to create collaborative models which can be measured against existing business structures, taking into account personal financial situations, personalities, attitude to risk, emotional issues and succession planning, along with social and environmental issues.

Principles of successful collaborative businesses

At the core of CFA are seven key principles which we believe are central to the success of any collaborative business. These need to be all considered in the context of the vision for the business, and implemented in order to create a profitable and sustainable enterprise.

1. Differentiate between real estate and operations: Most dryland farmers in Australia struggle to realise that they are actually running two enterprises, a real estate business and and operations business, and both of them need to return a profit in order for long term sustainability to occur. In the case of horticulture we can include additional enterprises such as water allocations and contractual arrangements. It is important to understand that these are all different potential sources of income which are integrated into the one business, and the return on each of these enterprises is relevent to the overall business.

2. Utilise Machinery resources efficiently: One of the great limiting factors in growth in the agricultural sector is the over capitalisation in machinery. Businesses need to understand the true cost of owning machinery, compared with investing that capital in other income producing investments and utilising machinery from other sources. This could include conventional contracting, a joint venture with a machinery contractor or neighbour, or involvement with a machinery ring. There are also many innovative machinery finance

structures which can be created which can add significant benefits to properly structured businesses.

3. Create cells of optimum efficiency and replicate them: This is one of the key principles farming businesses need to comprehend in order to grow their level of efficiency and profitabilty. Basically this involves creating cells of optimum efficiency (sometimes called scaleable units) by matching the machinery, labour and infrastructure required to most efficiently farm a given area of land, and replicating those cells in order to grow the business. As an example, an efficiency cell in dryland farming in the SA Mallee may be deemed to be 4000 hectares, which can be cropped with a 42ft seeder, 300 HP tractor, 42ft harvestor, 120 ft sprayer, a Mother Bin, a 4x4 ute and two labour units at maximum efficiency. In order to grow the business and retain the efficiencies it would be necessary to expand in 4000 hectare cells.

   In the case of horticulture the land area, machinery and labour units would be different (and with the added dimension of water rights and contracts) but the concept remains the same. Understanding this is vitally important as in some cases business expansion can in fact make the business less efficient, and therefore less profitable, while in others a small expansion can make a significant positive influence to the bottom line.

4. Create an environment of win-win: We deal with many people within our businesses. Neighbours, share farmers, lessors and lessees, contractors, wholesalers, retailers, marketers and employees. Unfortunately a lot of our dealings are based on having a win at someone else's expense. However, if we want to create long term relationships within our businesses, and with those we deal with we need to create an environment where all parties have something to gain, no matter the circumstances.

5. Utilise specialist services: You do not have to know everything about every intricate aspect of your business. These days you cannot be 'jack of all trades and master of none'. But, if you have the ability to source or collaborate with people who have expertise in areas you are lacking, have the ability to manage those people, keep them focussed on a common goal, and generously reward them both financially and mentally, then your business will grow and prosper. Though this may sound simple and logical, most would admit that it can be very difficult to recognise areas in which their business may be lacking, and acknowledge their own personal weaknesses, which could be built up by more highly skilled outside sources

6. A level of independence is needed: Every successful business talks about the need for professionalism, accountability and transparency in order for it to survive and thrive. Within a collaborative venture, these traits are even more important – especially in regard to the differences in personalities and any emotional issues which may be involved. In fact, emotions and personality differences are one of the biggest threats to the success of any collaborative business.

   Having an independent person or group involved in a collaborative venture, who sit outside of the emotion, have no conflicts of interest, and has the ability to keep the business focussed on its strategic plan can assist a business to grow to a new level. The right person will keep all parties accountable, ensure the business maintains a high level of professionalism, will insist on transparency and will see potential conflict and emotional issues before they are even on others radars.

7. Be strategic: While this seems obvious, the reality is that most businesses focus on the daily operations of the business, rather than the business itself. Regularly scheduled time needs to be dedicated to determining what you wish the business to look like in the future, and what steps, structures and practicalities need to be put in place to make this happen.

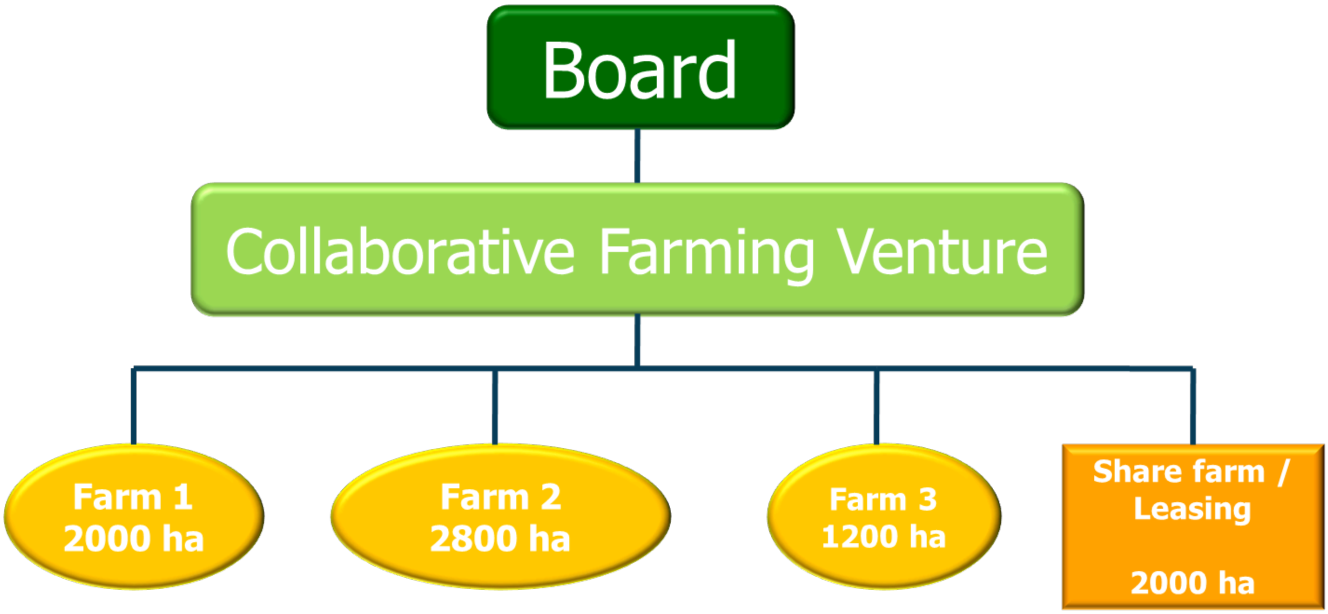
What is the best model?

It is our firm belief that there is no one singular model which suits all businesses. Rather a strategic approach needs to be taken to create a bespoke model which takes into account a range of factors. In many ways we might say 'there is no model' and 'there are no rules' as we believe there are always opportunities to create efficiencies and economies of scale, but these may vary significantly from business to business.

But while there is no set model, for a collaborative business venture to work it does need to be based on core values such as professionalism, efficiency, accountability and transparency in order to be the profitable, sustainable and enjoyable business most would like it to be.

Example Model

An example of a working model which CFA have designed for use within dry land agriculture is as follows:



This scenario involves three dry land farmers, one with 2000 ha, one with 2800 ha and one with 1200 ha. They have recognised that an optimum efficiency cell for their region is 4000 ha. They have agreed to come together and form a collaborative farming venture involving two efficiency cells of 4000 ha for a total of 8000 ha. In order to do this the following will occur.

- A new company is formed
- The three shareholders lease their land to the new company
- They source the additional land required to get to their efficiency cell (s) required through leasing and share farming.
- They sell all of their existing machinery (either privately or to the CFV if its required) and source the machinery required to operate their new venture efficiently
- They ascertain the level of capital input required to effectively operate the venture (including overdraft limits if required) and agree on individual shareholdings. These shareholdings may not be at the same levels as land value contributed, which is accounted for through leasing, share farming or land units.
- They agree on the appropriate skills and labour required to operate the CFV efficiently, and involve themselves in the business in the areas where they add the most value.
- They agree to contract in areas in which they do not have the skills, which may include financial, agronomy, marketing etc.
- They have an independent chairman to maintain a high level of accountability, transparency and professionalism.

The seven principles discussed earlier are addressed as follows:

1. Differentiate between real estate and operations: All landholders either receive a lease payment or land unit distributions which are separate to income derived from operations in order to recognise and value the different enterprises.

2. Utilise machinery resources efficiently: The machinery purchased will be that which can most efficiently farm the area using the labour available. A machinery finance structure will be determined which best fits the requirements of the business.

3. Create cells and replicate them: The optimum efficiency cell has been determined as 4000 hectares and replicated by two to create the CFV.

4. Create an environment of win-win: All shareholders, landholders and stakeholders would be involved in discussions to ensure that all believe they benefit from the venture.

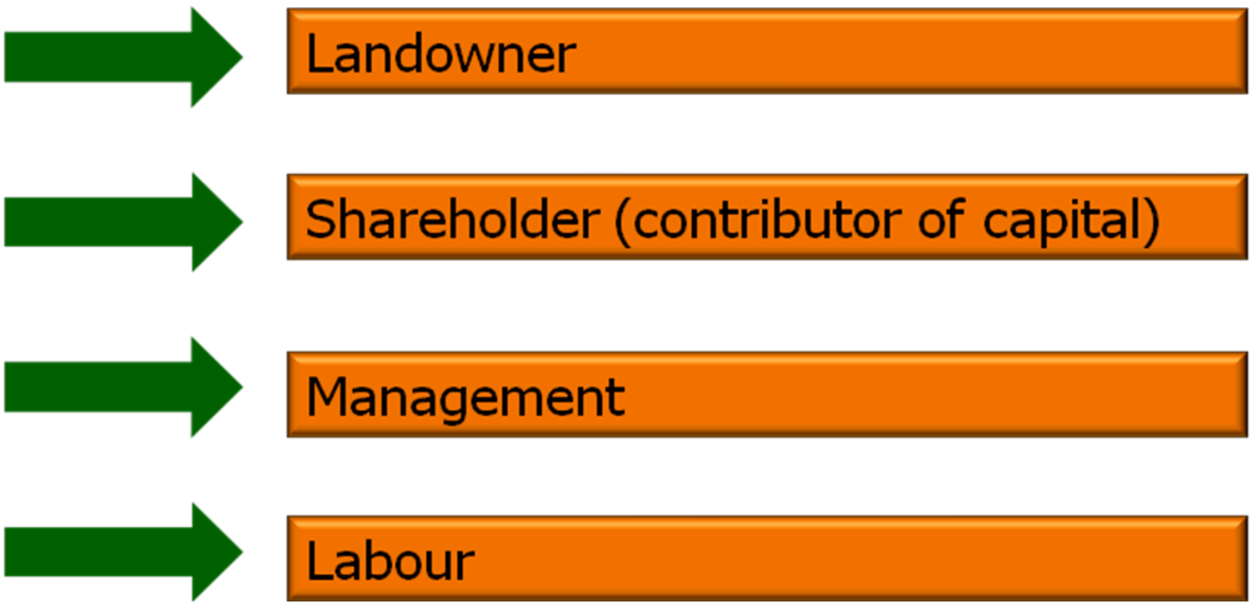
5. Utilise specialist services: All are involved in the business in areas in which they are most passionate and add the most value. In areas in which the business may be lacking specialist services would be contracted in. This may include agronomy and grain marketing services.

6. A level of independence is needed: The involvement of a company like CFA in the development process would assist with the creation of efficiency cells, shareholder discussions and due diligence to ensure everyone's needs and expectations are met. An independent chairman would be appointed to sit on the CFV board to ensure a level of professionalism, accountability and transparency, and to ensure the business focuses on it strategic objectives. The independent party would also ensure that a comprehensive business plan and policy documents are drawn up, with input from all shareholders and stakeholders in the business, in order to mitigate any emotion or personality issues which may arise.

7. Be Strategic: The whole model is determined by taking into account the values and goals of the prospective partners – and the long term vision for the business. The business is then designed to meet all the objectives and to be efficient, profitable and sustainable – and then the structures and steps needed to make it happen are put in place.

Ways to contribute to the model

Using the model described above, there would be four ways to contribute to the business and receive income.



In most agricultural businesses the proprietor is all four of these in that he /she owns the land, contributes the capital and provides labour and management. The advantage of this type of model is that there is the opportunity to differentiate between all these areas and have involvement in ways which add the most value to the CFV. For example, someone may only wish to be a landowner and work casually at seeding and harvest, another may not have land but may have capital to invest. There may be a person who has land and capital but does not wish to be actively involved in the business. Another may have capital and management skills. The options are many.

In a horticultural environment we can add water ownership and marketing contracts as additional ways to contribute to a CFV. For example, one person may own land and have a significant amount of water to contribute. Another may have land, a small amount of water and a CCW contract. A third may have capital and management skills. While on their own these may not be enough to constitute an effective business, together they form the components of what could be a highly successful collaborative farming venture.

Development of a collaborative farming venture

The process required to create a successful collaborative farming venture requires a high level of due diligence, including discussions with interested growers, collection of financial data and comprehensive modelling and analysis. It also requires the breaking down of many of the barriers associated with the implementation of a successful venture, including the perceived need for independence, emotional attachments and personality differences.

The issues which are faced by family farms may be complex on a range of levels, but we believe the potential to create structural and production efficiencies through collaboration can create enormous benefits. This can be coupled with opportunities for value adding of produce to create a strong horizontal and vertically integrated business approach.

Advantages of being involved in a collaborative farming venture

We believe there are many advantages in being involved in collaborative farming models, based on the principles listed above, including:

- Maximising profitability of the enterprise through the creation of efficiency cells
- Ability to access latest technology
- Flexibility of involvement
- Integrity and heritage of family farm is retained through land ownership
- Farming and business skills are recognised and valued
- Geographical spread of risk
- Partners can specialise in areas of their passion / skill
- High level of professionalism and accountability
- Succession planning benefits

And most of all – it's still your farm!

The Bulla Burra Model (2009- current)

In 2009 my wife Bronwyn and I joined together with Robin and Rebecca Schaefer to form Bulla Burra based on the collaborative principles listed above. Both the original Gladigau and Schaefer family farms were 2000 ha each, and are leased to Bulla Burra (separating land ownership from operations). We agreed at the time that 4000 ha would be our efficiency cell, and that we had the capacity to operate two cells in our venture. The additional land was sourced into the business through share farming and leasing. Since 2009 we have slightly expanded our cell size to 4400ha (8800 ha total) which is sown to wheat, barley, canola and some legumes. We sold all of our individual machinery at the time and purchased machinery which we believed would most efficiently operate our new cell, some of which we owned previously, but most purchased outside. We then placed ourselves into Bulla Burra where we believed we added the most value, with Robin being responsible for the practical operations and myself the business side of the company. We also put in place a board, with an independent chairman, to ensure that we remained focussed on efficiency and profitability, operated professionally at all times, and had a structure which ensured accountability and transparency.

Bulla Burra is currently a cropping only venture, though some of the landholders whose land we share farm run livestock in the pasture phase. We strongly focus on the principles mentioned above, and implement them in the business wherever possible. It certainly has not been an easy ride, with many challenges along the way. However, we believe the benefits we have attained and the opportunities which now present themselves through this type of model will provide us with a future which is profitable and sustainable, while still preserving the integrity of the family farm.

The Bulla Burra Model – lessons learned

Bulla Burra has just completed its fifth harvest, and has gone through an enormous period of growth and development since its embryonic days. All those involved in Bulla Burra as shareholders and stakeholders would agree that taking a step back from our individual businesses and starting off with a blank sheet of paper to create a new structure focused on efficiency and profitability has provided some enormous benefits. Through CFA, we have also worked with many individual farmers and industry groups with an interest in farm collaboration, and personally assisted others in the formation of their own collaborative businesses.

With this in mind, the opportunity of hindsight, much research and five years of collaborative experience behind us, these are some of the significant lessons we have learned.

1. <u>Collaboration was the catalyst, not the cure</u>: While initially our main focus with the creation of Bulla Burra was to create a higher level of efficiency and profitability through collaboration, the real benefits have really been outside of this. By setting up a purpose built, corporate type structure in order to allow effective collaboration to occur, some of the biggest positive impacts have been through creating a business which is professional in its approach, has an effective decision making process, is focussed on building business relationships – and has a high level of accountability and transparency.

2. Emotion does not go away: One of the collaborative principles was the need to have an independent voice in the business in order to maintain a high level of professionalism, accountability and transparency. While we recognised early that emotions and personality differences were one of the biggest threats to a collaborative business, this certainly does not diminish over time. If there is a silver bullet to the success of a collaborative farm, it is the need to maintain the independent voice to ensure the business practically and strategically continues on its agreed path.

3. You cannot be half pregnant: You are either in a fully developed collaborative business or you are not. To maximise the benefits, create the highest levels of efficiency, profitability and equality it needs to involve the creation of a whole new business rather than the merging of two old ones. The emotional hurdles which need to be overcome through bringing in assets, labour and infrastructure from previous businesses need to be managed well.

4. The value of relationships cannot be underestimated: As a brand new entity, Bulla Burra set out to build positive and open relationships with its suppliers, end users, landowners, employees, financiers and all other stakeholders in the business. These relationships have led to a greater understanding of each others needs, which has led to options and opportunites which we did not envisage five years ago – along with a stronger company culture and brand.

5. There is a cost to being a mini corporate: At Bulla Burra, we pride ourselves on being a professional, safe and compliant farm business in which we highly value our staff and the relationships we have with our stakeholders. We also have a high level of pride in how we showcase our business. All of this comes at a cost, including providing uniforms, a safe work environment, chemical and OH&S compliance etc. There is also some significant financial and opportunity cost in being cutting edge in terms of technology, structure and research and development. It is certainly our observation that the social and community expectations of a corporately structured business are higher than those of others in the farming community.

6. Scale and corporatisation can easily create more inefficiencies: While we might want to pat ourselves on the back because of the efficiencies we have created, the technology we are using and the structures we have in place – we need to constantly be aware of other inefficiencies we may potentially create. These can include inefficiencies in management, creating too much ‘fat’ within the business and not ensuring full accountability for spending. Machinery purchase decisions based on efficiency and timeliness need to be constantly monitored to ensure value for dollars spent. The role of an independent chairman or advisor within the business is very important to ensure complacency does not set in allowing unintended inefficiencies to begin to occur.

7. The unexpected opportunites and challenges of creating a brand: All businesses have a brand, whether intended or not. As a newly formed business we set policies on how we wished to present ourselves, our willingness to share ideas, availability to the media and our desire to present a positive image for agriculture. With these objectives we have also become active on Facebook, Twitter and YouTube in order to share our stories and vision. This 'branding' of Bulla Burra has opened many doors socially, commercially and politically - providing many opportunities. But it has also made us very aware of the responsibility we now hold to speak for our industry, and to present a positive image of agriculture to the wider community.

The development of Bulla Burra has been a very positive experience for our two farming families, and hopefully for all of those who are associated with our farm. We believe there are many opportunities for Australian farming businesses to create additional efficiencies, and raise their own level of professionalism, accountability and profitability by taking a step back and looking strategically to the future.

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