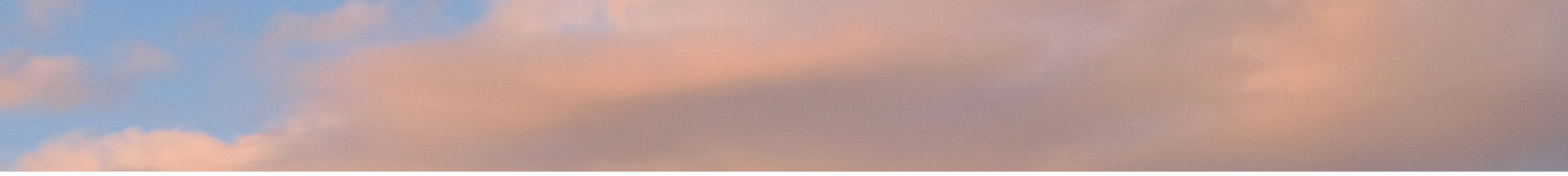

Strategies for family-run farms and estates

CLA

STRUTT & PARKER

The opportunities and challenges of growth and succession in family businesses

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Contents

A version of this report was produced as part of the build-up to the CLA Rural Business Conference 2018 *Inspiring Investors* held on 29 November 2018. It is one of three reports produced for the Master Class events that were held in summer and autumn 2018. Ideas and thoughts from these reports and Master Classes helped set the agenda for the CLA's national conference.

Introduction

Businesses controlled by families – from the smallest to largest – are key to the UK economy. They produce around a quarter of our Gross Domestic Product, which is the value of the goods and services produced in the UK, and employ over 12 million people. The majority of farms, estates and rural businesses are family businesses.

Family businesses are different to other types of business, and this is reflected in them performing well compared with other ownership types. The cashflow returns generated by large family businesses that are listed on stock exchanges have consistently been higher than those in the wider listed sector[1]. McKinsey has identified a number of factors that could explain this high level of performance[2]:

Family businesses have distinct advantages. They tend to:

1 Have long time horizons, which enables them to be more patient in terms of investment.

2 Have a sense of mission and identity, that creates a sense of belonging among employees that can lift the business to better performance.[3]

3 Have a deep understanding of their markets, where they operate and their customers.

4 Be nimble so they can get things done quickly and react to markets faster than other types of organisation.

This report explores the two challenges of growth and succession and looks at some examples of successful family businesses. We hope you find it useful and that it sparks ideas for your family business. Please call our team for their expertise on growing and helping family businesses succeed.

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1. Credit Suisse and EY, *Family businesses: Sustaining performance.* 2012.
2. McKinsey & Company, *Perspectives on Founder- and Family-Owned Businesses.* 2014.
3. McKinsey's survey of more than 1,200 respondents from family firms around the world found that 90% of non-family managers said that family values were present in the organisation, and 70% said that these values were part of day-to-day operations.

Challenges

As well as advantages, family-run businesses do face their own challenges.

One challenge is how to deal with the desire to grow quickly by some family members when others want a slower path. Having the right structures in place both to allow growth but protect wealth, for both the business and the family, is important.

A second challenge is succession. Many family businesses do not survive the transition from the first founding generation to the second, and only 13% of businesses that reach a second generation survive to the third generation, and only 3% to the fourth generation and beyond. Many of those that reach the fourth generation and beyond will be landowning rural businesses with a multi-generational vision.

A large part of this is about having suitable, willing successors. A study of the succession intentions of more than 34,000 next-generation family business members found that just 20% of potential successors are open to the prospect of one day taking over their family firm[4].

Even if willing successors are identified, it can be challenging to incorporate them well into a business. Many will have new ideas about business – influenced by growing up in a digital, more connected age – which may be different to those of the previous generations.

New ways of doing business can be both an opportunity and a threat, and failure to listen to and seriously incorporate this new thinking can turn many potential successors off joining the family firm; the younger generation and their ideas need to be added to the business carefully.

Current context

The UK economy is continuing to recover from the recession that started in 2008. It has not fully recovered in many places.

The decision to leave the European Union will affect many land-based, rural businesses as direct support for farming will fall and the current Basic Payments, which are vital for many farmers, could be reduced to zero. The payments will be replaced – partially – by *'public money for public goods'*, but both the levels of and management requirements to receive these payments remain unclear. Stronger environmental principles underlying policy – stronger *'polluter pays'* and *'precautionary'* principles – are likely to increase compliance costs for many businesses as they have to absorb some of the external costs of their activities.

Brexit also means the replacement of government support, for example through the Rural Development Programme for England and Scottish and Welsh equivalents with a new UK-designed policy. The UK Industrial Strategy suggests that major elements of the policy will be the new Shared Prosperity Fund and a greater role for Local Enterprise Partnerships (LEPs) in delivering Local Investment Plans (LIPs). It is very unclear how this will work in rural areas and how the disadvantages for family businesses operating in rural areas – such as poor communication, higher costs of doing business, challenges to recruit and retain staff who need to travel further to work – will be addressed.

Growth

As already stated, family-controlled businesses have a number of advantages over other types of business. While these all sound like factors that could apply to corporate businesses, family businesses seem to combine them to their advantage[5].

Long time horizons
Family businesses can make decisions with a longer-term view compared with more corporate organisations which have to consider short-term shareholders' interests. Often called 'patient capital', because it can wait a little longer for a return on investment, this allows the family business to invest differently, often with the aim of long-term capital generation as well as shorter-term income.

4 EY and the University of St Gallen Center for Family Business, *Coming home or breaking free?* 2015.
5 It is not just down to the four factors listed. It may also be due to family businesses having what Matthew Syed called, in *Black Box Thinking*, a *'growth mindset'*; this is one in which the culture is open, honest, collaborative and where organisations support individuals even if they fail, as they learn from it. This type of mindset tends to lead to growth and adaptation. Of course, many family businesses have *'fixed mindsets'*, and perhaps they are the ones that do not survive past the first or second generations.

75% of family businesses have a formal board of directors.
Of these, over 50% have non-family members on the board and a third have non-executive directors from outside the family[6].

A sense of mission
It is easier to be motivated when your work produces a value that your family and family business can keep. Due to this, managers can engage staff in this collective, more tangible effort. McKinsey & Co put it as: *'Family ownership can confer a strong competitive advantage through the creation of value-driven organisational cultures that inspire identity, trust, and a sense of belonging among employees.'*[7] This is not to say that family businesses should exclude external influences; indeed, the most successful family businesses value the challenge from non-family members, professional advisers and non-executive directors.

Deep understanding of their core markets
The most successful family enterprises tend to concentrate on their core business – that is what they know and what they are best at – so most rarely diversify outside of this core business.

An ability to react to opportunities quickly
However, family businesses are often agile and innovative within their core business. An article for the Institute for Family Business described them as more like the fast-moving, nimble speed boat compared with the lumbering, slow-turning oil tanker that is a stock exchange listed rival.

If a family business spots a gap in their core market they want to exploit, they can make an almost on-the-spot decision to pursue it, as the family can make decisions about investment and can often discuss matters quickly[8]. A listed company may need management sign-off and to wait for the next budget to allocate time or funds to the opportunity.

Succession

A quarter of family businesses say that challenges with the next generation are the most difficult issue they have to confront[9] – that is, identifying successors, attracting them into the business and then creating the right structures for them and the business to thrive.

Some of the key elements to making succession, or transition, successful are set out below.

What do the current generation of leaders want from succession?
The current generation of leaders can start by documenting precisely and clearly what they want from succession.

Questions to consider

- What are their personal considerations, including retirement income?
- What are their business priorities? What would they like to happen to the business – will it be passed on to family or will it be passed to its professional managers or even sold?
- Over what period do they want the succession to happen?
- Do they want to fairly divide the family wealth in the business between those who will be active in the business and those who are not?

Only one-third of family businesses have a succession or exit plan in place[10].

> *'I still believe in the philosophy –* FORTUNE *quoted me saying this 20 years ago – that a very rich person should leave his kids enough to do anything but not enough to do nothing.'* **Warren Buffett**

6 Family Business Place research with Charles Russell Speechleys, 2016.
7 McKinsey & Company, *Perspectives on Founder- and Family-Owned Businesses*. 2014.
8 This is sometimes referred to as an *'informal communication network'*, which is one that takes place outside the formal, communication structures of meetings and memos.
9 Family Business Place, *The Annual Family Business Survey 2016*. 2016.
10 Family Business Place, *The Annual Family Business Survey 2016*. 2016.

What can be done to equip the next generation with the skills they will require?
It is usually never too early to start introducing the next generation to a family business – to show them what the business does, its culture and its ambitions, and to start discussing whether the next generation sees themselves working within the business. This can be a systematic approach to making them 'part of the team'.

However, millennials[11] and Generation Z[12] may have different values to the previous generations. They may want to gather a range of different experiences and join the business when they are older – if they want to join at all. Forcing or requiring them to join before they are ready is usually counter-productive.

90% of family business members have experience from working elsewhere[13].

Approaches that can help the next generation join smoothly include offering them a task or section of the business to start work on, and to learn the business from the ground upwards. Some family businesses set up 'shadow' boards, which receive the same papers as the main board and share some members, so that the business benefits from the different perspective that a new generation can bring.

Questions to consider

- Have the potential successors got the required skills and experience?
- What needs to be done to help them realise their potential?
- Should they get experience with another organisation before joining the family business?
- How can a two-way discussion be had about the business' values and culture, so that both generations understand each other better?

How can a business be passed on smoothly?
Experience and research have identified some simple 'guides' on making succession successful.

Firstly, make succession collaborative and open. A collaborative partnership between generations often works well. Current generation leaders can find passing on a management role difficult so a transition period rather than a sudden break is often more realistic.

Questions to consider

- What is the best way to pass on the management of the business, without giving up management completely but without interfering?
- What controls are needed to get general agreement from the family or a board before making significant changes?

11. The generation now aged 20-40.
12. The generation aged up to 20ish.
13. Family Business Place research with Charles Russell Speechleys, 2016.

Secondly, create a framework to introduce the next generation and manage any legal and emotional issues. Having a structure, in terms of rules, policies and procedures – so it is transparent why and how things happen – often helps. These often create a separation between business issues and family issues.

- **A business constitution**
- **Articles of association** – on what the business is for and its values. Writing this can be a very cathartic process.
- **A shareholders' agreement** – on how shares can be transferred, how to resolve disputes and how to avoid hostile takeovers.

- **Family issues governance**
- **A family charter** – to cover the principles the family wants to follow, including the vision for the business, its ownership strategy, a family education programme, criteria for joining the business, such as experience elsewhere and qualifications, a defined succession plan, how tax, wills and advisers will be dealt with, and communicating information to family members.
- **A family council** – a group of family members, including those not involved in running the business, to discuss and agree long-term plans, including ownership and management.

How can the business and family be sensibly protected, in case things go wrong – because they can?
Many family businesses get damaged because they have not made plans for when things go wrong. In the worst cases, businesses or assets have been sold, and lack of communication can often lead to bad feeling between family members. It is good to talk – and to plan.

Questions to consider

- How do we protect the business and family assets in case of death, divorce or a series of unfortunate events?
- Is it clear how the business' shares can be transferred – can they go to non-blood family members?
- What is Plan B in case the original plans don't work?
- Is there a realistic, credible plan for running the business if the current generation leaders are not around?

Strategies that businesses can use

Approach 1

Mercer Farming: growth through ambition and willingness to take managed risks, through a professional business structure

Roger Mercer presented a picture of his family business at the 2017 CLA Rural Business Conference. It is a food and farming business with a turnover of £40m.

Although his two key messages were about the importance of marketing and the business being run by a younger generation, he focused heavily on having the right principles underlying the business, knowing how the business is performing and making introducing the next generation as successful as possible.

Business principles and structure

1 Have an appropriate business structure to give ownership and accountability to directors. As the business grows it may become more complex but this can be necessary.

2 There must be clear, impartial oversight of the business. To do this, it has a board structure, plus two non-executive directors (an accountant and a food company executive), and a non-executive chairman. The structure means that any call from the business for capital is fully challenged.

3 Be flexible – don't be afraid to try things and to get out of businesses.

4 The people in the business must be excellent and managed excellently, through appraisals, training and delegation.

5 Collaborate with like-minded people.

Knowing how the business is performing

6 Separate property ownership from farming, as there are lots of uses for the land, and farming may not be the most profitable one.

7 Always monitor performance, using cashflows, benchmarking and end-of-year valuation of assets, with the aim of 10% compound growth, after tax and private drawings.

8 Know the return on capital employed on all of your assets, so you can make informed decisions and structure the business so some assets produce a high return.

9 Decide how much the business should borrow (i.e., its gearing level), what the target rate of return on that borrowing is and how much risk the business will accept.

10 Keep separate accounts for Basic Payments and agri-environment scheme payments, so that their 'profitability' can be properly understood.

Smoothing succession

11 A key element is clear, honest, regular communication – use a facilitator if necessary.

12 Passing on a business does not necessarily require a transfer of assets if the right business structures are used.

13 Trying to treat everyone equally is not essential and can actually hamper the business. A key is to enable individuals to develop to their potential.

14 Regularly review your plans as it is a changing scenario with children and their situations.

15 A good way to think about bringing new people into the business is helping them 'grow their own circle'. If a circle (or business) grows at 7% in real terms each year, in 25 years there will be four circles of the same size as the original ones.

Approach 2

Will Gemmill, head of farming at Strutt & Parker: preparing farms and estates for a future without Basic Payments

There are broad principles that businesses should consider in order to ready themselves. themselves for when direct payments are phased out:

1 People make the difference. Ensure that managers and staff have agreed a strategy for the business, based on critical reviews of how it is performing now and what the opportunities for improvement are. There is a clear link between successful businesses and highly skilled people; not all businesses have the right people, skills, drive and vision, in which case they should explore options to invest in training to inspire the current team or bring in the right staff.

2 Farm as efficiently as possible. The top 25% of businesses are less reliant on direct payments and more resilient to volatility. Farmers should continue to look for ways to improve their farming systems, in terms of outputs and markets for their products, variable and fixed costs. This includes benchmarking; the best farming businesses critically evaluate their costs against industry standards and continually look at ways of improving. A key differentiator between average and top performing businesses are fixed costs (labour, power, administration and property).

3 Take your approach to environmental management as seriously as your approach to crop and livestock management. This will prepare you for the new generation of UK agri-environment schemes (which is likely to be called the Environmental Land Management Scheme - ELMS - and payments for public goods).

4 Understand what valuable public goods your land produces. Review Biodiversity Action Plans, Landscape Character Areas, flood risk maps, water risk maps and air quality maps.

5 Collaboration. This is not just about scale, but about using the best skills of the group, sharing labour and machinery, group buying and selling, sharing risk, cutting capital investment, and producing landscape-scale public goods, such as pollination.

6 Grow profits from diversification and environmental management to reduce the impact of the cut in Direct Payments and spread the business' risk.

Approach 3

Peter Wiggins-Davies, Revesby Estate, Lincolnshire: Lessons learned on growing an estate business from a Nuffield Scholarship tour

Peter Wiggins-Davies found that the most successful businesses that he came across on his world tour as a Nuffield Scholar had a *'golden thread'*, which is a sense of identity or purpose that they use to direct them. For some it is about producing a service to a desired standard and for some a product. Identifying the *'golden thread'*, being able to describe it and then embedding it into the business' strategy and operations can be challenging but Peter is trying to do it for the estate.

Growth

One of the key points he learned was that he was wrong to view growth as solely about bolt-on projects. The most common ways in which businesses were growing were:

- Scale and replication
- Driven by subsidy
- Cross selling and vertical integration
- Diversification

Business principles and structure

He also found that many estates' objective - of leaving it in a better condition for the next generation - is not just about finances; it is also about the understanding (and probably writing down) of the relative importance of the following *'building blocks'*:

- Custodianship
- Environmental objectives
- Visual and historic objectives
- Complicated family involvement
- Social objectives
- Diversified income streams

Once the building blocks have been discussed and agreed, they form the basis of a strategy, which can be structured using the following objectives:

- Succession
- Non-financial objectives
- Keeping the family together
- Financial objectives

Since returning to the estate, he has made a number of changes. He, his family and his team have:

- created strategy documents – and *'we enjoyed doing it!'*;
- been working to build a strong foundation;
- taken on two business mentors to aid development as a leader and meet them monthly;
- started having an all-team monthly meeting, which includes using external trainers;
- began, as a team, to identify and correct the estate's culture where necessary;
- ensured the culture is underpinned by an Estate Values Statement;
- created a board structure with the aim of meeting quarterly;
- worked to truly define their *'golden thread'*;
- worked hard and invested heavily into their brand.

How the government can help

As we have seen, family businesses are already successful in general and there are some exceptional businesses. However, there is potential for them to do even better if some key barriers or blockers can be overcome.

People
People can make the biggest difference to the performance of a business but, especially for family businesses, can be one of the most different elements to change. It is hard to discuss, let alone change family members if their performance is restricting growth.

There is also a lack of formal training and skills development in rural businesses. CLA research found that only 12% of its members had had any formal business training in the past two years. Many family businesses would benefit from training and developing their skills. There are private sector providers but there is a role for the Government to stimulate training; currently, there is an over-centralised skills system which is struggling to train and upskill people, especially in more rural settings, and failing to meet the needs of businesses[14].

Investment
The amount of investment and risk that a business is willing to take on varies greatly. Many family businesses that are focused on growing have written down criteria for the amount of gearing they want in their business, what categories their new investments should be in so it is not piecemeal and the level of return wanted.

While the most common source of funding for growth comes from a business' own reserves, grants from the Government can be important in enabling investment that might otherwise not reach a business' target rates of return. The Rural Development Programme for England (RDPE), and its equivalents in Scotland and Wales, has stimulated lots of rural businesses to either start or grow; over 450 grants have been awarded under the RDPE's Growth Programme and Countryside Productivity schemes since 2014. There should be equivalent funding post-Brexit, including through the Shared Prosperity Fund.

The planning system
Many investments in rural businesses are frustrated by the planning system, which is often unnecessarily costly, time-consuming and bureaucratic and results in some planning applications which would have clear economic benefits not even being submitted. It has a disproportionate effect on rural businesses who want to invest as, due to their small size, they often do not have the resources required to take an application through the planning system compared with larger businesses.

1 in 3 rural landowners wanted to invest in some sort of property or buildings such as housing but have been unable to – with 50% saying the planning system prevented them making the investments they wanted to.
CLA Rural Business Conference 2016 – *Unlocking investment, unlocking potential*

Communications
Poor and unreliable mobile and broadband connectivity is excluding family businesses, especially rural ones, from the opportunities of growth. Satisfaction with internet coverage is lowest amongst businesses located in remote rural areas[15].

Having better communications and 'going digital' will enable rural family businesses to improve business efficiency. UK Gross Value Added could increase by at least £12 billion per year if digital constraints in rural areas were overcome[16].

14 Local Government Association, *The future of non-metropolitan England. Moving the conversation on.* Interim report of the Post-Brexit England Commission, 2018.
15 Ofcom, *Connected Nations 2017*, 2017.
16 Rural England and SRUC, March 2018. Gross Value Added or GVA is the value of goods and services produced minus the value of materials and inputs used in their production.

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