case study 2.3 solution

New Zealand Farming and its Form of Business Ownership

Tenders for the Crafar family farms have closed with the receivers reporting ‘significant’ interest, but just how strong the buyer competition was, is for now anyone’s guess.

The only two certainties at the 4 pm deadline were state-owned enterprise Landcorp, which today announced its bid would be a joint venture with its Wairakei Pastoral farming partners, businessmen Trevor Farmer, Mark Wyborn and Ross Green, and Chinese company Natural Dairy.

The Hong Kong-registered company had a purchase agreement for the 16, mainly dairy, farms conditional on getting Overseas Investment Office consent, and providing the receivers got no offer that suited them better.

Receivers Brendan Gibson and Michael Stiassny said in a statement today they expected ‘a number’ of other tenders before 4 pm. Assessing the offers would take some time and no further comment would be made until a decision had been made.

The Crafar farms, totalling 8,000 ha in the southern and central North Island, were put into receivership in October by their financiers, owed $200 million. Family spokesman Allan Crafar was reported today as saying he hoped to raise $200 million to settle the debts by 4pm. He declined to comment a short time ago.

Natural Dairy only applied for OIO consent yesterday after a drawn-out process that has included court action to try to get around the OIO obligation, and return of the company’s first application for want of detail and the correct fee. The company has lodged an appeal over a High Court dismissal of its case to circumvent OIO approval.

Landcorp chief executive Chris Kelly said the joint venture bid with the Wairakei partners was for ‘all 16 farms or nothing’.

The Wairakei farming partnership was formed six years ago after the three businessmen bought the former 25,000 ha Fletcher Forests. Landcorp has developed 9,000 ha into dairy farms and leases them from the partnership under a 40-year agreement, Mr Kelly said.

He said Landcorp’s prospective partners in the Crafar farms bid were ‘New Zealanders and long-term farm owners and investors’.

A new 50:50 company would be formed if the bid was successful.

‘This would be a long-term partnership. We are no strangers to one another, and they are sound reputable businessmen.’

The new company could sell some of the Crafar farms on, but that was a decision for later, Mr Kelly said.

The joint venture offer would be conditional on vacant possession of three farm houses the Crafar family has so far resisted leaving.

SOURCE: Andrea Fox, ‘Tenders Close for Crafar Farms’, 7 July 2010, *Business Day*. Last accessed, 27 August 2010: http://www.stuff.co.nz/business/farming/3893313/Tenders-close-for-Crafar-farms.

Questions

1 Provide a brief synopsis of the article, outlining the key parties involved.

A family-owned farming enterprise, Crafar Farms, has been placed into receivership by its financiers, owing $200 million debt. The receivers have placed a tender for the 8000 hectares of land.

A leading bid has been placed by a joint venture between Landcorp, Wairakei Pastoral farming partners and a Chinese company, Natural Dairy. The tender being placed is for all 16 farms and is conditional on the vacation of the Crafar family from all residential lodging.

If the bid were successful it is planned to form a new company in which to control the newly acquired assets.

2 What is meant by the term ‘tender’?

A tender is an open offer or invitation to the public (usually announced in a newspaper advertisement) to tender a purchase price for a business for sale by a specified time. In this case a tender was put out by the receivers of Crafar Farms to settle prior debt.

3 Landcorp announced its bid for the Crafar Farms would be a joint venture with its Wairakei Pastoral farming partners. What is meant by the term ‘joint venture’?

A joint venture is defined by ‘NZ IAS 31: Interests in Joint Ventures’ as:

A *joint venture* is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.

Joint ventures take many different forms and structures. This Standard identifies three broad types – jointly controlled operations, jointly controlled assets, and jointly controlled entities – that are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:

(a) two or more venturers are bound by a contractual arrangement; and

(b) the contractual arrangement establishes joint control.

In this case the joint venture is in the form of a jointly controlled entity bearing a contractual arrangement (in the form of a company as per the end of the article) between Landcorp, Wairakei Pastoral farming partners and a Chinese company, Natural Dairy, to take over the operations of the farms.

4 The Wairakei farming partnership constitutes three partners and was established in 2004 after a land purchase of 25 000 hectares of Fletcher Forests. Explain what is meant by ‘mutual agency’ and how this would affect these partners.

‘Mutual agency’ essentially means that partners will be responsible jointly and separately for the actions of other partners in relation to the business operations.

In this case, if one of the partners misappropriated funds, all other partners could be held jointly liable.

5 Landcorp states that it developed 9000 hectares of land into dairy farms and leases them back from the partnership. Outline the advantages and disadvantages for Landcorp in this arrangement.

Potential advantages of leasing

• Leasing is less capital-intensive than purchasing, so if a business has constraints on its capital, it can grow more rapidly by leasing property than it could by purchasing the property outright.

• Capital assets may fluctuate in value. Leasing shifts risks to the lessor, but if the property market has shown steady growth over time, a business that depends on leased property is sacrificing capital gains.

• Leasing may provide more flexibility to a business, which expects to grow or move in the relatively short term, because a lessee is not usually obliged to renew a lease at the end of its term.

• In some cases a lease may be the only practical option.

• Depreciation of capital assets has different tax and financial reporting treatment from ordinary business expenses. Lease payments are considered expenses, which can be set off against revenue when calculating taxable profit at the end of the relevant tax accounting period.

Potential disadvantages of leasing

• A lease may shift some or all of the maintenance costs onto the lessee.

• If circumstances dictate that a business must change its operations significantly, it may be expensive or otherwise difficult to terminate a lease before the end of the term. In some cases, a business may be able to sublet property no longer required, but this may not recoup the costs of the original lease, and, in any event, usually requires the consent of the original lessor. Tactical legal considerations usually make it expedient for lessees to default on their leases.

• If the business is successful, lessors may demand higher rental payments when leases come up for renewal. If the value of the business is tied to the use of that particular property, the lessor has a significant advantage over the lessee in negotiations.

6 If this bid were successful a new company would be formed. Outline the potential advantages for the owners in forming a new company. What are the potential disadvantages to the company’s suppliers and how can they minimise their risk?

Possible benefits to the owner:

• limited liability

• unlimited life

• possible taxation benefits (lower maximum tax rate)

• possible access to funds from additional owners

• potentially the ability to transfer or sell part of the ownership interest without selling the entire business

• possible separation of ownership and management.

Possible disadvantages to the suppliers:

The major disadvantage to suppliers is that of the limited liability of the owners in relation to business debts.

Obviously not all suppliers of goods and services are protected, as we read regularly that they lose all or part of what is owed to them when companies are liquidated (for example, Ansett, Feltex, Enron, HIH insurance, and so on). However, a number of factors, requirements or actions are designed to provide protection including:

• the legal requirement for companies to prepare financial reports in conformity with statutory accounting standards

• suppliers require payments to be made in advance

• creditors require personal guarantees by the owners or management

• lenders take out a specific claim against tangible assets of the company (mortgage, bill of sale)

• creditors will rank before the shareholders in the distribution of assets in the event of liquidation of the company

• lending agreements restrict the financial practices

• maximum level of debt to assets

• minimum required return on assets

• limitations on profit distributions

• restrictions on asset sales

• specification of accounting methods that can be used.

7 Landcorp chief executive Chris Kelly states that if the bid were successful a new company would be formed. He then comments, ‘This would be a long-term partnership’. Critically discuss what is meant by this phrase.

Landcorp chief executive Chris Kelly stated in the article that if the bid was successful it is likely that a joint venture will proceed in the form of a jointly controlled entity in the establishment of a new company. This company would constitute the legal entity and can consume and provide assets just like an individual.

He has then commented that this would be a ‘long-term partnership. We are no strangers to one another, and they are sound reputable businessmen.’ The context in which this phrase is used is within the everyday use of the word partnership in terms of the businessmen working together. It is not meant in the context of a legal form of ownership.