Ed McMillan, an agribusiness consultant and mergers and acquisitions specialist, told the Association of Agricultural Production Executives members that due to increasing global competition, shrinking margins and emerging technologies, if commercial farmers and ranchers want to remain competitive, growth will be a necessity...not a luxury. In terms of management strategy he encouraged them to consider three options:

• **Lead**...proactively develop a future direction that's right for your business, e.g. increase productivity and output; increase value added of current products; expand the size of the current operation; or leverage skills and assets into a new operation.

• **Follow**...find someone who knows where to head and get on board, i.e. merge or align with another business.

• **Get Out of the Way**...find a buyer and decide where else to best invest your skills and capital.

While his comments won’t resonate well with many producers, they were directed to a group of producers who are looking at the long term and who want to remain players as full-time operators.

My objective in this article is to address some of the issues that need to be considered by producers who might be considering about a merger, either as the acquirer or the acquiree, as a business growth or sustainability strategy. Although the idea of a merger of equals tends to be the most appealing option, I have yet to see one that worked out that way.

If any merger is to be successful, the first question is would the new entity be greater than the sum of its original parts in terms of competitiveness and performance? This may result from economies of scale, management specialization, complementarity of talents or resources, or access to new input and output markets. One caveat, just getting bigger does not necessarily produce economies of scale. Scale economies usually result from shifting to a new cost or revenue curve, or from moving to a lower point on the industry’s long run cost curve.

Two comments I frequently hear are that too many farmers and ranchers run
their businesses more as producers than as business managers, and that they are resistant to change. From my experience, most farmers don’t see either statement being directly applicable to them personally. First, most believe they are managing their farm as a business. The question should really be if they are using the best business management practices and do they possess the necessary management skills and attributes to compete with the best in the business. In a February, 2003 *Corn and Soybean Digest* article “Is 1000 Acres Part-Time Work,” I referenced several studies documenting the significant differences in financial performance between the average and the top managers. Second, almost every farmer believes he has been making significant changes in his business. The real issue again is, are they moving forward as fast as their leading edge competitors, i.e. the top 10 percent. Let me use an analogy to make my point. Consider two people driving the same direction on an Interstate Highway. Both are clearly changing and both may even be headed in the same direction. However, one is traveling 55 mph and the other 70 mph. That means one is getting further ahead of the other by 15 miles every hour. Based on five 8-hour days a week, at the end of one year he will be 31,200 miles ahead (145,600 - 114,400). That’s a pretty big advantage. But what if the 70 mph operator decided to ramp things up do business 24/7, through round the clock multiple 8-hour shifts, think of modern manufacturing plants or large dairy operations. If the 55 mph driver stayed on his current pace he would now be falling behind by 498,800 miles per year (613,200 - 114,400). Assuming a highway that circumvented the globe, he would be getting lapped about 20 times year. Is the example extreme? - yes. Is it unrealistic? - no. One row-crop operator I know now farms in 15 states so he can diversify production and market risks, in addition to utilizing his labor, management and equipment 9 months a year rather than the normal single site planting and harvesting periods. A Florida specialty crop operator I recently met harvests 364 days a year, they don’t work on Christmas Day, and plants a new crop every 3 days.

The second question may actually be harder to answer and that is an honest and objective assessment of you and your business, as well as your prospective business partner. Essentially, it involves doing a comprehensive S.W.O.T. Analysis of each firm’s strengths, weaknesses, opportunities and threats - both internal and external. This means not just considering the historical and current situation, but also what risks and changes are on the horizon for the industry. This then needs to be followed up with a similar evaluation of what the answers would be for the merged entity. Synergy, compatibility, complementarity and new opportunities are all key things to look for. Some poorly conceived mergers could actually compound both firm’s problems.

It is critical to know what you need out of a merger, what you would gain and
what you would be willing to give up. Part of the rationale behind any successful merger needs to be the ability to compensate for weaknesses and to capitalize on strengths. Some of the possible reasons not previously mentioned might include management succession, the ability to grow without taking on additional debt, the elimination of duplication, the ability to adapt new technology and the ability to more fully utilize existing resources.

Over the past few years, the farm press has profiled several farmers who have merged operating entities in order to capture greater economies of scale and as a way to achieve greater management specialization by pulling together a management team with complementary skills, i.e. where one business’s strengths offset another’s weaknesses and vice versa.

While mergers can offer a great deal of economic potential they also present their own set of risks. This is particularly true on the relationship side of the business. A merger is a business marriage and just like any other marriage, things don’t always work out even when the business rationale appears to make sense. Most of the failures that occur are because they involve people with different backgrounds, personalities, egos, values, personal and business goals, and management/work styles. These are all things that need to be recognized, discussed and never underestimated in terms of their impact on the venture’s potential. Due diligence shouldn’t be limited to just doing the homework on the financial and legal matters.

One of my favorite quotes is from Pita Alexander, New Zealand’s best known and most respected farm business consultant, who says:

“Never forget that with partners or a joint venture of any kind, it is invariably harder to get out of a business arrangement than it was to first get into it. Don’t get personally and financially involved with any business unless the benefits are real, sustainable, bankable and enjoyable. Think about what your exit strategy would be before you enter the business. You will often find that the exit strategy is much more important than the entry strategy and seldom is enough thought given to it.”

Over the past three years I have received calls from several farmers who have been approached by another farmer offering them the opportunity to acquire their farm business, i.e. to acquire their business as an ongoing entity in exchange for continued employment and a minority ownership interest in the combined entity. In all but one case, the firms seeking to be acquired were viable and by most measures successful operations. What all of the firms seeking to be acquired said, however, is that as they looked down the road they could see changes occurring in agriculture that they didn’t feel they had the
ability or expertise to handle. All were top producers and operations managers with strong technical skills. Where they felt lacking was in areas such as executive and strategic management skills, strength of an overall professional management team, access to capital, management information systems, people management skills and/or having access to a strong supply chain relationship.

Obviously, the merger or acquisition approach isn’t and won’t be a viable option for many farmers. In some cases they wouldn’t bring anything to the table that another business wanted or needed other than their assets. Likewise many farmers who are used to running their own business would never be happy working for someone else. This is particularly true if the other business’s management and operating style are significantly different than their own. And more often than not this will be the case, because the reason the business they would benefit most from merging with has been successful is because it is managed differently.

Mergers or acquisitions take a lot of time, effort and commitment if they are going to be done right and for the right reasons. A high level of trust and communication is essential, both parties need to be willing to lay all of their cards on the table and there has to be something in the arrangement for all parties involved. Peter Drucker, often called the father of modern management, has said that 60 percent of all management problems are the result of poor communication.

Whatever the nature of the arrangement, there is one thing that I believe is absolutely essential for any multiple owner business, and that is a written buy-sell agreement signed by all the parties involved, including their spouses. There are three basic types of buy-sell agreements: cross-purchase agreements which are entered into between the individual owners, entity agreements which are between the business entity and the individual owners, and a combination of the two. The purpose of the buy-sell is to reach agreement on how potential events should be handled in a manner that is viewed as fair to all parties involved at a time when everyone is getting along and thinking objectively rather than emotionally. While there are an unlimited number of issues that can be addressed, at a minimum I believe the following are essential:

- The basis for establishing value and any discounts that may apply in specific situations
- Rights of first refusal
- Installment purchase terms
- Permitted transfers
- Voting rights
- Put and call provisions which specify the conditions under which an owner must sell or the company/other owners must buy
• Antidilution provisions
• Take along rights
• Management and board compensation restrictions
• An arbitration or mediation provision

If you do decide to pursue a merger, I can’t stress strongly enough the need to use advisors who know their stuff and have experience working with successful mergers. Tax accountants and attorneys are important, but they often lack expertise to address many of the key management questions. A good mergers and acquisitions specialist to help facilitate the deal and equally important, the implementation, can pay huge dividends and eliminate a lot of the problems that frequently develop.

The structure of agriculture is going to continue to change and many aren’t going to like what occurs. But, I sincerely believe there are several ways to survive and succeed; however, almost all are going to involve a greater level of interdependence.

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