Succession Planning: Successfully Bringing a New Generation into the Operation

Cole Ehmke
Specialist in Ag Entrepreneurship and Personal Finance
Department of Agricultural and Applied Economics

Farm and Ranch Transition Conference 9 March 2018
Land Grant University

Three Functions

Teaching    Research    Service
Iowa State survey of farmers

- 50% had no estate plan
- 71% had no named successor
- 20% HAD spoken to a banker
- 30% HAD spoken to an accountant
- 28% HAD spoken to an attorney
Family/Personal System

Ownership System

Management System

Fun
Security
Nurturing

Productivity, day-to-day operations

Return on investment, transfer of assets
Which path?

- Business
- Assets
- Family Business
- Goals
- Succession Plan
- Retirement Plan
- Transition Plan
- Financial Viability
- Estate Plan
“Ranchers and farmers are telling us their weakest link is not technology nor information. Their weakest link is human relationship management.”

- Robert Fetsch, Colorado State University Cooperative Extension
Farm Transition Planning

• Much more than estate planning!
• Weaving family life cycle with business life cycle.
• Combines
  – Career development plan
  – Professional development
  – Retirement plan
Typical Career Progression

Worker → Manager → Leader
Transferring Power – Create a Plan

• List and categorize all of the work, management and leadership activities on your operation
• List the skills, attributes, experience and training
• Then divide work/management/leadership as dictated by skills/attributes/experience/training
Common Sources of Farm/Ranch Family Conflict

- Control
- Transfer of property/ownership
- Division of income . . . fairness
- Obligations, debts and risks
- In-law relations and competing loyalties
- Coping differences
- Decision making
Succession and Retirement Planning - Roadmap

1. Planning Goals, Discover Expectations
2. Take Stock
3. Risks
4. Planning Tools, Examining Options
5. Financial Health

Planning Goals

- Protect the Family Farm
- Transfer Farm to the Next Generation
- Planning for Retirement
- Minimize Taxes (and other risks)

- Starting point is to determine your goals, and to prioritize the goals
  - This will provide a guide and clarify your path
Goals

Say NO to Secrecy!
"Hey! C'mon! Hold it! Hold it! ... Or someone's gonna get hurt!"
Who are the Family Members?

- Generation 1 – Mom and Dad
- Generation 2 – Children
  - On-Farm
  - Off-Farm – how involved?
- Generation 3?
- Other key players (key employees? inlaws?)

Are these people included in the planning discussion?
What is the “Family Farm?”

**Essential Businesses**
- Livestock
- Grain
- Trucking
- Other?

**Essential Assets**
- Land
- Equipment (tractors, trucks, etc)
- Inventory (livestock, grain)
Risks in Planning

Estate Taxes – Affects estates > $22.4M (married) or $11.2M (single)
  – If this is YOU – Seek professional help (attorney or CPA) immediately! You can afford it and you need it.
  – No Wyoming inheritance tax

Other Risks
  – 5D risks: Divorce, Disability (incl. dementia), Death, Disaster, Disagreement
  – Capital Gains Taxes
  – Emotional roadblocks
Planning Tools

• Sole Ownership
• Limited Liability Company
• C-Corporation
• S-Corporation
• Partnership or Joint Venture
• Trusts

Keep in family:
• Buy-sell agreements
• Gifting
• Trusts

Outright sale:
• Third party
• Liquidation

Internal sale:
• Partners
## Evaluation of Farm Management Skills

### Charles for Charles

- [✓] Dad for Charles

### Tools

<table>
<thead>
<tr>
<th>Skill</th>
<th>Low (1)</th>
<th>Low (2)</th>
<th>Low (3)</th>
<th>Average (4)</th>
<th>Average (5)</th>
<th>Average (6)</th>
<th>Average (7)</th>
<th>Average (8)</th>
<th>Average (9)</th>
<th>Average (10)</th>
<th>High (11)</th>
<th>High (12)</th>
<th>High (13)</th>
<th>High (14)</th>
<th>High (15)</th>
<th>High (16)</th>
<th>High (17)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Crop Management</td>
<td></td>
<td></td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Livestock management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Marketing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Purchasing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Mechanical ability</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 Building construction skills</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 Personnel management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8 Financial management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9 Securing resources</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 Physical endurance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Emotional endurance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 Analytical ability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Decision making</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14 Ability to act and accept risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 Communication skills</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16 Negotiation skills</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17 Leadership skills</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Create a Succession Plan

• Plan for transferring management
• Plan for transferring property
• Contingency plan for managing disruptive events

# Plan Components

<table>
<thead>
<tr>
<th>Year</th>
<th>Labor</th>
<th>Management</th>
<th>Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
How you say it counts more than WHAT you say!

7% Words
38% Tone of Voice
55% Body Language
100% Total Message
Financial Health

Do you have what it takes to keep your operation intact?

– Planning for retirement
  • Conventional retirement accounts (IRA, 401K)
  • Planning for passive farm income (cash rent, or passive owner interest in farm operation)

– Planning for transfer to next generation
  • (Our program today)

– What assets need protected?
– What people need protected?
Effective communication is necessary for the planning system.

To support the incoming generation, 80% of cases expand after implementing a transfer plan.
Typical Parent-Child Business Arrangements on Family Farms

- Spin-off model
- Landlord-tenant model
- The “super-firm” model
If you can’t make a profit with a pencil, you can’t make a profit with a plow.
Economic Considerations

Profitability
  Pointless to talk about transferring a systematically unprofitable farm or ranch

Feasibility
  Can we make the payments on proposed expansion plans?

Size
  Is the business large enough to accomplish goals?
## Financial Feasibility Worksheet

### Farm Size:
- Gross Farm Income (Line 11, Sch. F): $100,000
- Operating Expenses: $85,000

### Farm Profitability
- Net Farm Profit (Line 36, Sch. F): $15,000
- Depreciation (Line 16, Sch. F): $5,000
- Net Farm Income from Operations (Cash Available For Principal, Growth & Family Living): $20,000
- Gross Farm Income (Line 11, Sch. F): $100,000
- % Profit Margin: 20%
### Financial Feasibility Worksheet

**% Profit Margin**

<table>
<thead>
<tr>
<th>Principal Payment</th>
<th>$20,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family Living</td>
<td>$40,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$60,000</strong></td>
</tr>
</tbody>
</table>

What if you increase family living expense to $40,000 & make a term principal payment of $20,000?

How much gross farm income is needed with 20% profit margin?
What if you increase family living expense to $40,000 & make a term principal payment of $20,000?

How much gross farm income is needed with 20% profit margin?

\[
\frac{60,000}{X} = 20\% \\
\text{Or } \frac{60,000}{0.2} = X \\
X = 300,000
\]
The 5-to-1 Ratio for Healthy Relationships

In order to compensate for their disproportionate effect, it is necessary to have a ratio of 5 good interaction elements to compensate for 1 negative one.

- Includes verbal and nonverbal elements
  - E.g., positive expressions, conciliatory gestures, really listening
- If it lowers below 5 to 1, there are problems
Succession and Retirement Planning - Roadmap

1. Planning Goals, Discover Expectations
2. Take Stock
3. Risks
4. Planning Tools, Examining Options
5. Financial Health

• Newsletter
• Learning Materials
• Self-study Modules
• External Links

AgLegacy.org

University of Wyoming | aglegacy.org
For additional information on personal finance or new venture management contact

Cole Ehmke
Department of Agricultural and Applied Economics
University of Wyoming, Laramie, Wyo.
(307) 766-3782
cehmke@uwyo.edu
Succession Plan

- Are parents (business owners) ready for a partner?
- How committed is the child to the business?
- Is the business large enough?
- Do you have a common vision for your future together?
- Can you live and work together?
- How many children are in the business?
- What are the roles of children?
- Are the non-business children supportive?
Challenge Yourself to Good Strategic Planning with SMART Goals

- **Specific** — be clearly defined and stated
- **Measurable** — have objective standards
- **Attainable** — be realistic with effort
- **Rewarding** — Profitable and self-satisfying
- **Timed** — have a deadline
Planning Tools
– Organization of Farm

Parameters for organization
– WHO runs the essential business(es)?
– Will the “business” continue after the current operator?
  • Livestock contracts may be particular to the operator
  • If there are no “on farm” heirs, the “next generation“ may be only interested in cash rent
– HOW will the farm be managed in GEN2?
  • On Farm manager
  • Off-Farm owners/profit shares
The Effect of Leadership Change on a Generic Organization
Common Pitfalls:

- Keeping it a secret
- Underestimating talent
- Narrow minded thinking – too old/young, rough, different
- Focusing exclusively on hard skills
- Not offering training/development opportunities
- Expecting employees to self-identify – help them see what they can be.
- Not holding management accountable for succession planning.
- Considering only upward succession. Lateral?