

UNIVERSITY OF WYOMING EXTENSION

**Succession Planning: Successfully  
 Bringing a New Generation  
 into the Operation**


Cole Ehmke  
 Specialist in Ag Entrepreneurship  
 UW Cooperative Extension Service

3 March 2017  
 Farm and Ranch Transition Conference  
 Laramie, Wyo.



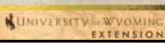
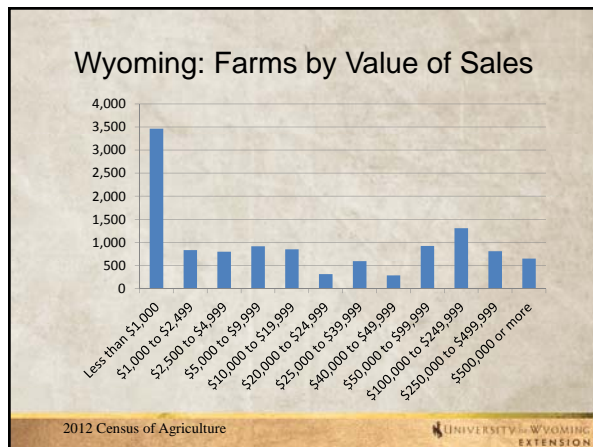

UNIVERSITY OF WYOMING

**Land Grant University**  
Three Functions  
**Teaching    Research    Service**

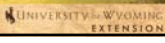
What is a farm?

- U.S. Census - any establishment which produced and sold \$1,000 or more of agricultural products during the year.
- Just over 2.1 million farms in the United States.
- Average farm family exceeds \$47,000 per year needed for basic living.
- Less than 1 in 4 of the farms produce gross revenues in excess of \$50,000.

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



**Succession and Retirement Planning -  
 Roadmap**

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

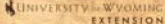


1 **Planning Goals**

- 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



2 **What is the “Family Farm?”**

**Essential Businesses**

- Livestock
- Grain
- Trucking
- Other?

**Essential Assets**

- Land
- Equipment (tractors, trucks, etc)
- Inventory (livestock, grain)



**Who are the Family Members?**

2

- 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?



**Risks in Planning**

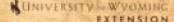
**Estate Taxes – Affects estates > \$10.9M (married) or \$5.45M (single)**

- 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**

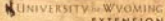
- 5D risks (Divorce, Disability, Death, Disaster, Disagreement)
- Capital Gains Taxes

3

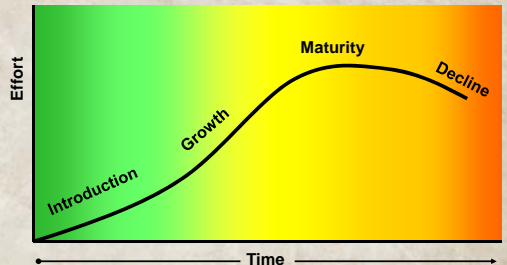


**Why Do Succession Plans Fail?**

- Disagreements about business philosophy
- Inadequate earning capability
- <sup>3</sup>Transfer of work and management decision making
- Emotional roadblocks
- Poor communication
- Death, disease, disability, disaster, divorce (5 Ds)
- Poor estate plans

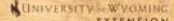


**Business Life Cycle**



The graph shows a bell-shaped curve representing the business life cycle. The vertical axis is labeled 'Effort' and the horizontal axis is labeled 'Time'. The curve starts at the origin and rises through the 'Introduction' and 'Growth' phases, reaches its peak in the 'Maturity' phase, and then falls through the 'Decline' phase. The background of the graph is color-coded: green for Introduction, yellow for Growth, orange for Maturity, and red for Decline.

Source: Wadsworth

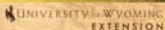




### Planning Tools – Organization of Farm

- 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

4



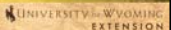
### Planning Tools – Organization of Farm

Organize the Family Farm TODAY to address future expectations and needs

- Divide key businesses into component parts that can be ended or continued separately

4

- Corral liability into one entity to protect the remainder of the farm assets.
- Look for “manageable” and “logical” components



### Planning Tools

• Sole Ownership	Keep in family:
• Limited Liability Company	Buy-sell agreements
• C-Corporation	Gifting
• S-Corporation	Trusts
• Partnership or Joint Venture	Outright sale:
• Trusts	Third party
	Liquidation
	Internal sale:
	Management buy out
	Employees (ESOP or CO-OP)
	Partners

4



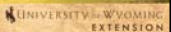
### Choosing the Successor

#### Expectations of a successor?

- Education
- Experience
- Personal characteristics
- Skills required
- Job responsibilities

4

#### Job Description



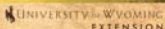
### Grooming the Successor

- Key positions
- Tools needed to succeed
- Management training – skill development
- Career growth
- Regular feedback

4

- Provide time and space. Timetable? (allow 5 years to 15 years)

Are there opportunities for making decisions, taking risks, and developing management skills (finance, marketing, production)?




### Evaluation of Farm Management Skills

	Low	Average	High							
	1	2	3	4	5	6	7	8	9	10
1 Crop Management				✓		•				
2 Livestock management										✓
3 Marketing				✓						
4 Purchasing				•						
5 Mechanical ability					✓					
6 Building construction skills					•					
7 Personnel management				✓						
8 Financial management					•					
9 Securing resources						✓				
10 Physical endurance									✓	•
11 Emotional endurance				•						
12 Analytical ability					•		✓			
13 Decision making							✓			
14 Ability to act and accept risk							•			
15 Communication skills								✓		
16 Negotiation skills									✓	
17 Leadership skills										✓

Charles for Charles ✓

Dad for Charles •

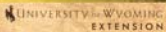


### Create a Succession Plan

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

4

Written. Documented. Goals and timeline followed. Shared.



### Plan Components

	Labor	Management	Ownership
2018			
2019			
2020			
2021			

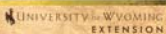


### Financial Health

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

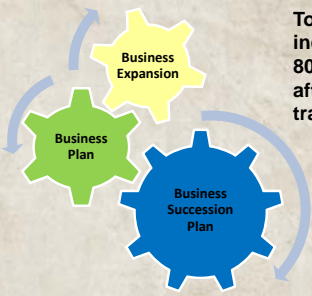
- Planning for retirement
  - Conventional retirement accounts (IRA, 401K)
  - Planning for passive farm income (cash rent, or passive owner interest in farm operation)
- Planning for transfer to next generation
  - (Our program today)
- What assets need protected?
- What people need protected?

5

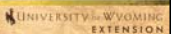


### Planning Links

Effective communication is necessary for the planning system



To support the incoming generation, 80% of cases expand after implementing a transfer plan.



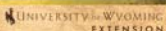
### Financial Feasibility Worksheet

**Farm Size:**

Gross Farm Income (Line 11, Sch. F)	<b>\$100,000</b>
Operating Expenses	<b>\$85,000</b>

**Farm Profitability**

Net Farm Profit (Line 36, Sch. F)	<b>\$15,000</b>
Depreciation (Line 16, Sch. F)	<b>\$6,000</b>
Net Farm Income from Operations (Cash Available For Principal, Growth & Family Living)	<b>\$20,000</b>
Gross Farm Income (Line 11, Sch. F)	<b>\$100,000</b>
% Profit Margin	<b>20%</b>



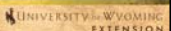
### Financial Feasibility Worksheet

% Profit Margin	<b>20%</b>
-----------------	------------

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

Principal Payment	<b>\$20,000</b>
Family Living	<b>\$40,000</b>
Total	<b>\$60,000</b>

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





### Financial Feasibility Worksheet

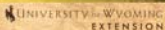
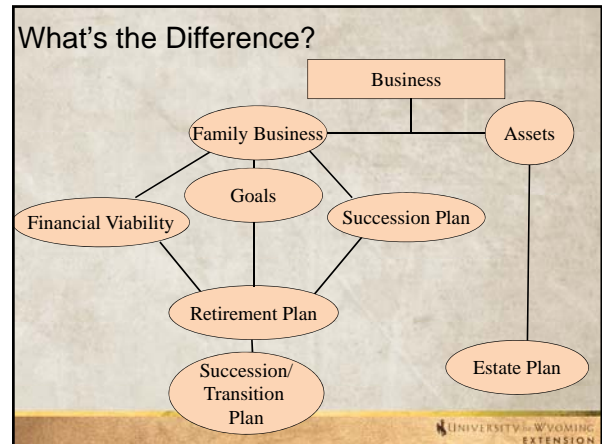
% Profit Margin **20%**

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?

$$\$60,000 / X = 20\%$$

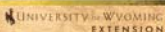
$$\text{Or } \$60,000 / 0.2 = X$$

$$X = \mathbf{\$300,000}$$



### Typical Parent-Child Business Arrangements on Family Farms

- Spin-off model
- Landlord-tenant model
- The “super-firm” model

5



### Financial Viability

#### A. Business Efficiency

Expenses

- Purchases
- Bang for the buck
- Quantity/early pay discounts

Income

- Production, Production, Production
- Marketing
- Quality

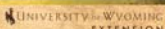
Assets earning their keep



### Financial Viability

#### B. Business Debt Structure

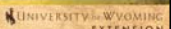
- Long term vs. short term loans
- Interest rate
- Principal payments



### Financial Viability

#### C. Family living costs

- Senior generation
- Junior generation
- Off-farm employment



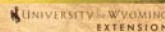
### Succession and Retirement Planning - Destination

- 1 • Planning Goals, Expectations
- 2 • Take Stock
- 3 • Risk Analysis
- 4 • Tools, Options, Plans
- 5 • Financial Health



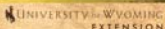

### What Succession Is and Is Not

<p><b>Succession is:</b></p> <ul style="list-style-type: none"> <li>• A process</li> <li>• About family, people and relationships</li> <li>• About ownership, management and estate</li> <li>• About what is fair</li> <li>• Driven by the family values, wants and concerns</li> </ul>	<p><b>Succession is not:</b></p> <ul style="list-style-type: none"> <li>• An event</li> <li>• One person's problem</li> <li>• About minimizing taxes</li> <li>• About equity</li> <li>• Driven by technical issues that are handled by lawyers, accountants, etc.</li> </ul>
---	--



### If you take away only two things ...

1. START NOW!
  - Succession planning is important at every stage of the business.
2. INVOLVE OTHERS...
  - Family
  - Stakeholders
  - Professionals



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

